

**M-VITA/VECTA Instructor Guide**  
**For Use in Preparing Tax Year 2003 Returns**

# VOLUNTEER INSTRUCTOR'S GUIDE



## For Use in IRS Volunteer Programs

- **Military Volunteer Income Tax Assistance (M-VITA)**
- **Volunteer Embassy and Consulate Tax Assistance (VECTA)**

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# *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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**Confidentiality Statement:**

All tax information you receive from taxpayers in your VOLUNTEER capacity is strictly confidential and should not, under any circumstances, be disclosed to unauthorized individuals.

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DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

WAGE AND INVESTMENT DIVISION

NOV 07 2003

## 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 and its partners across the nation and abroad are able to offer free tax help to taxpayers having low-to-moderate income. As a volunteer, you will help prepare tax returns for a taxpayer segment which often includes seniors, disabled persons, people with limited English proficiency, 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.

I urge you 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. As technology changes the face of filing taxes, we recognize that it will impact every aspect of volunteer training. In fact, the 2003 edition of our volunteer training materials employs a new integrated training feature that bridges the gap between paper-based training of the past and web-based training of the future. We are working to make this training as convenient and versatile as possible.

In performing this service to your fellow taxpayers, I appreciate your steps to safeguard the personal and sensitive documents or files that you may encounter. Preserving the privacy of those persons you assist is key to the preservation of the integrity embedded in the VITA/TCE Programs.

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  
SE:W:CAR:SPEC:PPD:E, Stop 45-WI  
401 W. Peachtree Street, NW  
Atlanta, GA 30308

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 Tax Law Changes for 2003

**Exemption amount increased.** The amount each taxpayer can deduct for each exemption has increased from \$3,000 to \$3,050.

**Standard deduction amount increased.** The standard deduction (for taxpayers that do not itemize deductions on Schedule A (Form 1040)) is higher in 2003 than it was in 2002. In addition, the standard deduction for married taxpayers filing jointly is twice the amount for single filing status.

Married filing jointly & Qualifying Widow(er)	\$9,500
Head of Household	\$7,000
Single	\$4,750
Married Filing separately	\$4,750

**Increase in 10% tax bracket.** The 10% tax bracket has been increased from \$6,000 to \$7,000 (\$12,000 to \$14,000) for joint filers.

**Increase in 15% bracket for married filing jointly status.** The 15% tax bracket has been increased to twice that of single filers.

**Marginal tax rates reduced.** The rates are reduced to 25%, 28%, 33%, and 35% retroactively effective January 1, 2003.

**Capital gains rate reduced.** The rate has reduced from 20% to 15% (from 10% to 5% for taxpayers in the 10 and 15 percent brackets) effective on or after May 6, 2003 through December 31, 2008. In 2008, the capital gains rate will drop to 0% for lower-income tax taxpayers. The lower rates will apply to both regular tax and alternative minimum tax.

**Certain dividends taxed at capital gains rates.** The same rates apply to both foreign and domestic companies' dividends. Lower-income taxpayers will pay 5% on dividends paid between January 1, 2003 and December 31, 2007 and 0% in 2008. Taxpayers in tax brackets above 15 % would pay 15 % on dividends paid between January 1, 2003 and December 31, 2008.

**Standard mileage rate.** The standard mileage rate for the cost of operating a car in 2003 is 36 cents a mile for all business miles. The 2003 rate for use of a vehicle for medical care and moving expenses is 12 cents a mile.

**Household employer's income reporting requirement.** In 2003, household employers are required to issue a Form W-2 to employees whose earnings are \$1400 or more.

**Lifetime learning credit.** Beginning in 2003, the amount of the qualified tuition and related expenses you may take into account in figuring your lifetime learning credit increases from \$5,000 to \$10,000. The credit will equal 20% of qualified expenses, with the maximum credit being \$2,000.

**Student loan interest deduction.** Beginning in 2003, the modified adjusted gross income ranges for phasing out the student loan interest deduction may be adjusted annual for inflation.

**Child tax credit increased.** The child tax credit has been increased to \$1,000 for 2003. An early refund of the 2003 Child Tax Credit was issued to eligible taxpayers who claimed the child tax credit on their 2002 tax return and had a qualifying child that was born after 1986. Taxpayers that received the “early refund” Advance Child Tax Credit payment must include the amount received when calculating the 2003 Child Tax Credit.

**Earned Income Credit (EIC) Limits:** For 2003, the investment, earned income, and adjustment gross income for the EIC are:

Investment income is \$2,600 or less.

Total earned income must be at least \$1 but less than:

- \$33,692 (\$34,692 if married filing jointly) and more than one qualifying child.
- \$29,666 (\$30,666 if married filing jointly) and one qualifying child.
- \$11,230 (\$12,230 if married filing jointly) and no qualifying child.

Adjusted gross income less than:

- \$33,692 (\$34,692 if married filing jointly) and more than one qualifying child.
- \$29,666 (\$30,666 if married filing jointly) and one qualifying child.
- \$11,230 (\$12,230 if married filing jointly) and no qualifying child.

**Child and dependent care credit.** Significant changes to the child and dependent care credit take effect in 2003.

The credit amount can be as much as 35% (previously 30%) of qualifying expenses.

The maximum adjusted gross income amount that qualifies for the highest rate increases to \$15,000 (previously \$10,000).

The limit on the amount of qualifying expenses increases to \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals.

The amount of income that is treated as having been earned by a spouse who is either a full-time student or not able to care for himself or herself increases. This amount increases to \$250 a month if there is one qualifying individual and \$500 a month if there are two or more qualifying individuals.

**Tax benefit for adoption.** The adoption credit and the exclusion from income of benefits under an adoption assistance program for the adoption of a child with special needs is \$10,160 regardless of the amount of qualified adoption expenses. The modified adjusted gross income limit will be adjusted annually for inflation.

**Traditional Individual Retirement Account (IRA) income limits.** The amount of income taxpayers can have and not be affected by the deduction phase-out increases. The amounts vary depending on filing status and impacts taxpayers that have a traditional IRA and are covered by a retirement plan at work. For further information go to [www.irs.gov](http://www.irs.gov).

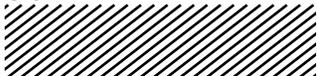
**Deemed IRAs.** For plan years beginning after 2002, a qualified employer plan (retirement plan) can maintain a separate account or annuity under the Plan (a deemed IRA) to receive voluntary employee contributions. An employee’s account can be treated as a **traditional IRA** or a **Roth IRA**.



**The Health Coverage Tax Credit (HCTC).** The HCTC was introduced by the Trade Act of 2002 to assist certain taxpayers. Potentially eligible taxpayers receive a HCTC Program Kit in the mail. This credit is primarily available to workers who have lost their jobs due to the effects of international trade and taxpayers over age 55 who receive benefits from the Pension Benefit Guaranty Corporation. Calculation of the credit is outside of the scope of the volunteer programs. For further information go to [www.irs.gov](http://www.irs.gov)

**Increase in Alternative Minimum Tax Exemption.** Increased to \$40,250 for single and head of household taxpayers; \$58,000 for Married Filing Jointly and Qualified Widow(er)s; and \$29,000 for Married Filing Separately taxpayers.

<b>N-#-#</b>	<b>=</b>	<b>Notes to Instructor</b>
<b>#-#</b>	<b>=</b>	<b>Basic Tax Law</b>
<b>M-#-#</b>	<b>=</b>	<b>Military Module</b>
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<b>CP-#</b>	<b>=</b>	<b>Comprehensive Problem</b>
<b>N-A-#</b>	<b>=</b>	<b>Notes to Instructor Appendix — Integrated Training</b>
<b>A-#</b>	<b>=</b>	<b>Appendix — Integrated Training</b>



# NOTES TO INSTRUCTORS

Welcome to new and returning instructors!! To all our instructors, thank you for volunteering to embark on a very important and rewarding aspect of our taxpayer outreach initiatives. We constantly strive to provide our instructors the best training material possible. This year's instructor guide has a new format which was developed based on feedback from previous instructors and other support staff.

We welcome your comments and suggestions for improving our products and encourage you to respond to the course evaluation survey included in your instructor kit.

This training material is designed to allow you the flexibility you need to teach to your clients' needs. **It is presented in three modules - basic, wage earner and pension. Information specific to military/international taxpayers are presented as segments in the three modules and in four additional lessons.** This year, your kit consists of the following products:

1. Publication 1155M, Instructor Guide (the student guide is embedded)
2. Form 6744, Test
3. Form 6745, Retest
4. Publication 4012, Quick Resource Guide for Paper and Electronic Returns
5. Publication 4189, Test and Retest Answers
6. Publication 1278, Bag
7. Form 12462, Instructor Evaluation
8. Form 12467, Instructor Comments
9. Document 12107, Business Reply Labels for Evaluations

## TAX YEAR 2003 PRODUCT CHANGES

**Complete Student and Instructor Text for Military/International Volunteers.** This year's instructor kit (Publication 1155M) combines the information that was included in Publications 1155, 678IN, and 678M into one kit. Publications 678IN and 1155 are no longer required for military or international volunteer student or instructor training. Publication 678M has also been revamped to be an all-inclusive product for military volunteers.

**Eliminated the "wrap-around instructor" feature.** We hope you like our new 8.5 x 11 inch guide. Instructor notes for each lesson precede the actual student text this year and many of the tax tips and alerts which were formerly "wrapped around" the student text are now within the body of the material.

**Integrated Training “bridges traditional paper and web-based training.”** In response to demands for shorter training, we are offering integrated training. Without sacrificing quality tax law instruction, we have bridged the traditional paper-based training approach and the web-based training of the future. Additional information about this comprehensive training begins on page A-1 of the appendices.

**Class Syllabuses or Suggested Class Schedules.** While every class is unique, we strive for consistency in the training that is presented to the volunteers. The class syllabuses cover a variety of training situations and are divided into three basic categories: New Students, Returning Students and a Combination of New and Returning Students. There is also a suggested Tax Law Refresher schedule. The syllabuses begin on page B-1 of the appendices.

**Draft forms available on-line.** The lessons will refer to a variety of IRS publications and forms that are available on-line. We discontinued publishing the tax forms booklet (Publication 3657) this year. The products referenced at the beginning of each lesson can be downloaded from [www.irs.gov](http://www.irs.gov). The Tax Tables and EITC tables which were included in the publication are in the appendices of the student guide (Publication 678).

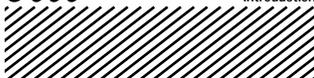
**Reference Guides Combined.** The quick reference guides (Publication 1977 and Publication 4012) have been combined into one product this year. Publication 4012, contains useful training and site information for preparing paper and electronic returns. Publication 1977 is obsolete. Publication 4012 is the only product in the student kit to be used at the actual tax preparation site.

**Separate Test Answer Booklet.** The test answer booklet has been removed from the instructor guide (Publication 1155). The Test and Retest Answers can be found in Publication 4189.

**Products Available on the Internet.** Many of the products in the student and instructor kits are available on-line at [www.irs.gov](http://www.irs.gov) in late October.

## **TAX YEAR 2003 ADMINISTRATIVE CHANGES**

**Site Identification Number (Site IDN).** The Site IDN will be an 8-digit number preceded by the letter ‘P’. This change is discussed in Lesson 6, Finishing the Return.



**Evaluation Process.** The evaluation process has been changed this year. We solicit your support in obtaining this valuable information from your students. We also welcome your comments. Please return the evaluations to IRS using the business reply labels (Document 12107) included in this year's kit. The evaluation process is discussed further in the Introduction and Administrative Guidelines. Mail comments to:

Internal Revenue Service  
Attention: Education & Product Development  
Stop 45WI – 12 Floor  
401 West Peachtree Street, NW  
Atlanta, GA 30308

## ***CUSTOMIZING CURRICULUM***

Volunteers differ in the types of returns they prepare. In order to determine which modules and lessons will best serve the needs of your students, you or the site coordinator will need to know some facts about the students and their plans for volunteering. Here are some points to consider.

- **What** tax knowledge do your students bring to class? Are they law school students who have all had basic tax classes? Are they members of a social club who have no tax knowledge? Do they usually prepare their own return?
- **Where** will they be working? Will students be working at a senior center or a shopping mall? Will they be working at the community center of a low income housing area?
- **Who** will your students serve? Are your students primarily interested in working with senior citizens? Are they primarily going to assist low income single moms?

Answers to these questions will help you determine the types of returns your students will be preparing. This, of course, will help you decide which modules and topics you will need to teach.

## **Organization of Material**

The three separate training modules are comprised of various topics. Included in the first three modules are segments of information that are specific to international and military taxpayers.

**Basic** — Covers issues *all* volunteers need. Topics include:

1. Personal and Dependency Exemptions (including military and international segments)
2. Filing Status (including military and international segments).
3. Who Must File — Who Should File
4. Income (including military and international segments)
5. Adjustments (including a military segment)



6. Standard Deduction and Itemized Deductions (including military and international segments)
7. Tax Computation
8. Miscellaneous Credits (including an international segment)
9. Finishing the Return (including a military segment)

**Wage Earner** — Covers issues working families and individuals might have, including:

1. Child and Dependent Care Credit
2. Education Credits
3. Earned Income Credit
4. Child Tax Credit and Additional Child Tax Credit

**Pension Earner** — Contains more complex issues, those generally encountered by retirees and senior citizens, including:

1. Sale of Stock
2. Sale of Home
3. Pensions (including a military segment)
4. Credit for the Elderly or Disabled

**International and Military taxpayers**—Addresses issues specific to military and international taxpayers in the following areas:

1. Foreign Earned Income Exclusion
2. Tax Options for Combat Zone Participants
3. Aliens
4. Home Leave

## ***CHOOSING MODULES TO TEACH***

Based on the information about the needs of the class, you (and your site coordinator) can determine which modules and topics you will cover in your class. All classes must include the Basic module.

## ***CERTIFICATION AND TESTING***

**Instructors** — *Should* take the test for all modules. (Check with your sponsoring agency to see if the instructor is *required* to take and pass the test.)

**Students** — Must take and pass the test for Basic and Military/International Modules and at least one other module — either Wage Earner or Pension Earner.

**Other Volunteers** — Not required to attend class or take the test if their activity will be limited to reception, clerical or child care duties.

### SECTION OVERVIEW

This section sets the stage for the course by helping volunteers understand and internalize the goal of the Program: **To provide free, top-quality service to eligible taxpayers.** In this section, students learn about the administrative procedures that help ensure that they fulfill their volunteer roles in providing this service. Students also are reassured that they never have to “go it alone” in providing assistance to taxpayers. In particular, they learn how the IRS assists its volunteers with hotline information, training, and quality review procedures. Finally, “What if . . . ?” scenarios help volunteers begin to build a repertoire of responses for taxpayers who have questions related to administrative procedures.

### TEACHING TIPS

1. Stress that students are VOLUNTEERS and that their service to taxpayers is FREE.

Caution students to gracefully decline any token of appreciation offered by a taxpayer while acknowledging the generous intention.

2. Remind volunteers of the importance of comparing FINAL FORMS with those that appear in the materials before helping taxpayers with their returns. Forms that were not in their final version at the time that this publication went to print are identified with the word “DRAFT as of 5/8/03.”
3. You may wish to provide the following study tip to help students remember material. When memorizing material, do not study it carefully for long and continuous periods. It is more efficient to examine the material once, and then let some time pass before looking it over again. Double the amount of time that passed before sitting down to study the material a third time.

This study method is more effective because repeated periods of study help to “anchor” the information to a person’s memory more effectively than one concentrated period of study.

### TEACHING TIP — CONFIDENTIALITY AND INTEGRITY

Convey to your students that the information they receive from taxpayers in their volunteer capacity is confidential and under no circumstances should they discuss or share the information with unauthorized individuals. Volunteers should contact the local IRS coordinator for additional information.

## TEACHING TIPS

You can model the volunteers' roles as "coaches" by sharing your leadership role in the classroom. You will find the Group Activities provided in the instructor edition effective for actively involving students in their learning.

## GUIDED QUESTIONS

Volunteer sites should have a quality review practice in place.

1. Site managers will designate a volunteer to review each return before the taxpayer leaves the site. Where there are not enough volunteers to appoint a reviewer you are encouraged to exchange returns with another volunteer for the review. If you are the only person at the site you should double check your entries on each line of the tax return.
2. **Why is the Volunteer Hotline available only to participants in this program?** (Answers should reflect students' understanding that the hotline is available as part of the IRS's commitment to providing volunteers with ongoing technical assistance. Emphasize that the line is not available to the general public.)

## GROUP ACTIVITY

(3–5 min.)

After students have finished reading the "What If . . . ?" section, ask them to make additional queries if they are unsure about other administrative guidelines. Point out that you encourage their questions at all times. This is a good way to gain their confidence and make sure that they fully understand the lesson.

## GROUP ACTIVITY

(3–5 min.)

Divide the class into groups of five students and write the following statement on a chalkboard or a large piece of paper. Then, have the more experienced volunteers in each group finish the statement:

**"Before I became a volunteer assistor/counselor, I wish I had known . . ."**

Experienced volunteers may also wish to share an amusing story about their past experiences.

## **GROUP ACTIVITY**

*(7–10 min.)*

It is appropriate to go through the students' list of concerns at this time to make sure that all have been addressed. If some concerns deal with material that has not yet been covered in this book, leave them posted in the classroom until they have been answered.

## **TEACHING TIP — TRAINING EVALUATION**

A new procedure is in place for both instructor and student evaluations of the volunteer training and course material. Beginning with training for filing season 2004, new evaluation forms are included in both the instructor and student kits. They are OCR (scannable) forms designed for IRS employees but we believe they provide the information we need to evaluate both the training and our course materials.

Each Publication 1155 and Publication 1155M instructor kit includes the following:

Form 12462	Instructor Evaluation
Form 12467	Instructor Comments
Document 12107	Business Reply Labels (HQ SPEC address)

Each Publication 678 and Publication 678M student kit includes the following:

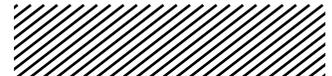
Form 12466	Student Evaluation
Form 12469	Student Comments

Prior to your class, you must obtain a training class number from your local IRS SPEC office. This number must be entered on the top portion of both the student and instructor evaluations. Each IRS SPEC office will be given a list of all volunteer training course numbers for their territory.

Students will complete the student evaluation and student comments. Each instructor will collect the student evaluations and comments, complete an instructor evaluation and comment form, then mail to HQ SPEC using the business reply label included in your instructor kit.

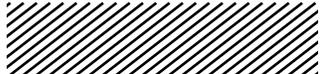
These evaluation forms are scannable so they should not be folded, stapled, or photocopied. Please use an envelope large enough to accommodate the 8 ½ x 11 size.

Instructors and students have the opportunity to complete the evaluation forms on-line directly to the vendor. Ask your local IRS SPEC office for the on-line procedures.



**STUDENT NOTES**

Lined area for student notes.



# INTRODUCTION AND ADMINISTRATIVE GUIDELINES

Welcome to the Internal Revenue Service's (IRS) Military Volunteer Income Tax Assistance (M-VITA) and Volunteer Embassy and Consulate Tax Assistance (VECTA) Programs. 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 the process.

Every year thousands of volunteers nationally and internationally assist millions of taxpayers with their federal income tax return. We've taken great care to improve our products and incorporate changes recommended by our volunteer community. In this section, we explain general training requirements and highlight important administrative requirements and enhancements.

## TAX YEAR 2003 ADMINISTRATIVE ENHANCEMENTS

**Site Identification Number (Site IDN).** Your site IDN is a 8-digit number preceded by the "letter P" that must be entered on all returns (Forms 1040, 1040A, and 1040EZ) you prepare—both paper and electronic. Your site coordinator provides this number along with other necessary guidelines for completing the return.

The Site identification number should appear in the "Paid Preparer's Use Only" section of the return and will be discussed in detail in Lesson 6, Finishing the Return.

**Evaluation Process.** A new procedure is in place for student evaluation of the M-VITA/VECTA training and course material. Beginning with training for filing season 2004, a new evaluation form is included in your training materials. It is a scannable form designed for IRS employees but we believe it provides the questions we need to evaluate both your training and our course materials. Your instructor will give you specific instructions on completing the form. If you are taking this course self-study, please contact your local IRS SPEC office or your site manager for details. Your instructor will also give you information on how to complete this form on the internet and transmit directly to the vendor who will compile the evaluations.

## **IMPORTANT REQUIREMENTS**

**Valid Social Security Number:** 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 and not mailed to the applicable IRS Processing Center. **Exception:** When a return is filed electronically with the IRS and you encounter unworkable rejects.

## **SCOPE AND SEQUENCE**

Most taxpayers are either wage earners or pension earners. Therefore, we have organized this training material in four modules: basic, wage earner, pension earner, military and international specific. 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 and the applicable lesson(s) from the Military and International specific module.

#### Introduction

#### Lesson 1 — Getting Started

##### Military Segments

Dependency Exemptions

Exemption For A Foreign Spouse

Filing Status

##### International Segments

Exemption For Foreign Spouse Or Dependent

Filing Status Issue

#### Lesson 2 — Income

##### Military Segments

Income

Other Income

##### International Segments

Worldwide Income

Self-Employment Tax

Rental Income And Expenses



## Lesson 3 — Adjustments

### Military Segment

#### Moving Expenses

## Lesson 4 — Standard And Itemized Deductions, And Tax Computation

### Military Segments

#### Travel Expenses

#### Miscellaneous Itemized Deductions

### International Segment

#### Business Travel Expenses

## Lesson 5 — Miscellaneous Credits

### International Segment

#### Foreign Tax Credit

## Lesson 6 — Finishing The Return

### Military Segment

#### Finishing and Filing The Return

## **Wage Earner Module**

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

Lesson 7 — Credit For Child And Dependent Care Expenses

Lesson 8 — Education Credits

Lesson 9 — Earned Income Credit

Lesson 10 — Child Tax Credit

## **Pension Earner Module**

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

Lesson 11 — Sale of Stock

Lesson 12 — Sale of Home

Lesson 13 — Pensions

### Military Segment

#### Thrift Savings Plan

Lesson 14 — Credit For The Elderly Or The Disabled

## Military and International Specific Lessons

Volunteers must complete the Military and International specific module if applicable.

Lesson 15 — Foreign Earned Income Exclusion

Lesson 16 — Tax Options For Combat Zone Participants

Lesson 17 — Aliens

Lesson 18 — Home Leave

## Proof Copies of Forms

Forms imprinted with “draft” were current as of the date this publication was sent to print. Final forms may have changes. Be sure to compare the final forms with those in this publication. The Internet ([www.irs.gov](http://www.irs.gov)) provides access to the final form.

## Testing

All volunteers must take the applicable tests 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.

## Exercises and Exhibits

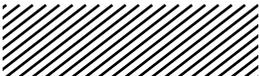
It is important that you take the time to complete the exercises to achieve the objectives in each lesson. Studies have shown that long-term retention of information increases dramatically if you put pencil to paper in responding to questions and problems. The Volunteer Assistor’s Guide is your learning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

Note: Answers to all exercises are available at the end of the lesson.

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 and Objectives

There is a brief **Introduction** to each lesson or segment. 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. There will be a list of **Objectives**, when appropriate, that clearly defines 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 Section, Segment, or Lesson

This boxed feature appears at the end of each lesson/segment. 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. **Potential Pitfalls** point out commonly made errors and indicate ways to avoid these errors. **Alert!** identifies pending legislation, tax law changes, or tax forms changes that were expected, but not enacted.

## **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 M-VITA and VECTA 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.

### **ALERT**



### **CONFIDENTIALITY AND INTEGRITY**

All tax information you receive from taxpayers in your VOLUNTEER capacity is strictly confidential and should not, under any circumstances, be disclosed to unauthorized individuals. See your site coordinator for additional information.

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 OF SERVICE*

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

- Where possible prepare the return using electronic filing software.
- If preparing a paper return, 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 (1-800-829-8482).

## **Volunteer Hotline**

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

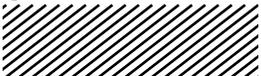
To complete accurate returns, you must ask certain questions about the taxpayers and their families. It is important to set the appropriate climate to obtain this information.

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. Inform the taxpayer about the M-VITA and VECTA 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 if a taxpayer or dependent does not have a social security number?

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.

### 2. 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](http://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)

### 3. 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.)

#### **4. 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.

#### **5. 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.

#### **6. 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.

#### **7. 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 nontaxable 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*.

#### **8. 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 compa-

nies 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.

### **9. 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.

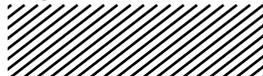
**Innocent Spouse Relief**, Publication 971, addresses how one spouse may request relief from past taxes due solely based on the other spouse's debt. Request for Innocent Spouse Relief, Form 8857, explains various forms of relief and who may qualify.

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](http://www.irs.gov), or by visiting a Tax Assistance Center in your area.

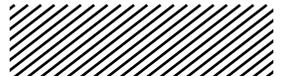
### **10. Your Civil Rights Are Protected**

Publication 4053, explains that under no circumstances will the Internal Revenue Service tolerate discrimination by its employees, grantees, contractors, and/or subcontractors. These provisions extend to VITA and TCE Programs. Publication 4053 or other IRS Civil Rights information should be displayed or made available to all taxpayers.



## *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 2003**

OMB No. 1545-0675

**Label**

(See page 14.)  
**Use the IRS  
label.**  
Otherwise,  
please print  
or type.

**Presidential  
Election  
Campaign  
Campaign**  
(page 14)

L A B E L  H E R E	Your first name and initial	Last name <b>(6)</b>	
	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 14.	Apt. no.	
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 14.		

Your social security number

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? . . . . . ▶

You                      Spouse  
 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.

<b>1</b> Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	<b>(2)</b>	
<b>2</b> Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.	2	<b>(2)</b>	
<b>3</b> Unemployment compensation and Alaska Permanent Fund dividends (see page 16).	3	<b>(2)</b>	
<b>4</b> Add lines 1, 2, and 3. This is your <b>adjusted gross income</b> .	4		
<b>5</b> Can your parents (or someone else) claim you on their return? Yes. Enter amount from                      No. If <b>single</b> , enter \$7,800. <input type="checkbox"/> worksheet on back. <input type="checkbox"/> If <b>married filing jointly</b> , enter \$15,600. See back for explanation.	5	<b>(5)</b>	
<b>6</b> Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your <b>taxable income</b> .	6		

**Payments  
and tax**

<b>7</b> Federal income tax withheld from box 2 of your Form(s) W-2.	7	<b>(6)</b>	
<b>8</b> Earned income credit (EIC).	8	<b>(9)</b>	
<b>9</b> Add lines 7 and 8. These are your <b>total payments</b> .	9	<b>(6)</b>	
<b>10</b> Tax. Use the amount on <b>line 6 above</b> to find your tax in the tax table on pages 25–29 of the booklet. Then, enter the tax from the table on this line.	10	<b>(4)</b>	

**Refund**

Have it directly  
deposited! See  
page 21 and fill  
in 11b, 11c,  
and 11d.

<b>11a</b> If line 9 is larger than line 10, subtract line 10 from line 9. This is your <b>refund</b> .	11a	<b>(6)</b>	
<b>b</b> Routing number	<input type="text"/>	<b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	<b>(6)</b>
<b>d</b> Account number	<input type="text"/>		

**Amount  
you owe**

<b>12</b> If line 10 is larger than line 9, subtract line 9 from line 10. This is the <b>amount you owe</b> . For details on how to pay, see page 22.	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) ▶	<input type="text"/>
-------------------	-----------------	--	----------------------

**Sign  
here**

Joint return?  
See page 13.  
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 <b>(6)</b>	Date	Your occupation	Daytime phone number ( )
Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation	

**Paid  
preparer's  
use only**

Preparer's signature <b>(6)</b>	Date	ENTER SITE IDENTIFICATION NUMBER ▶	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Phone no. ( )	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 24.

Cat. No. 11329W

Form **1040EZ** (2003)

# FORM 1040A

Form 1040A Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return 2003 IRS Use Only—Do not write or staple in this space.

**Label**  
(See page 21.)

**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 22.	Apt. no.
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 22.	

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 22.)

**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**  
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 23.)  
If the qualifying person is a child but not your dependent, enter this child's name here. ▶
- 5  Qualifying widow(er) with dependent child (See page 24.)

**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 25)
				<input type="checkbox"/>

d Total number of exemptions claimed. 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 27.

Enclose, but do not attach, any payment.

7	Wages, salaries, tips, etc. Attach Form(s) W-2.	7	(2)
8a	Taxable interest. Attach Schedule 1 if required.	8a	(2)
b	Tax-exempt interest. Do not include on line 8a.	8b	(2)
9a	Ordinary dividends. Attach Schedule 1 if required.	9a	
b	Qualified dividends (see page XX).	9b	
10a	Capital gain distributions (see page 27).	10a	(2)
b	Post-May 5 capital gain distributions (see page 27).	10b	
11a	IRA distributions.	11a	(13)
11b	Taxable amount (see page 27).	11b	
12a	Pensions and annuities.	12a	(13)
12b	Taxable amount (see page 28).	12b	
13	Unemployment compensation and Alaska Permanent Fund dividends.	13	(2)
14a	Social security benefits.	14a	(13)
14b	Taxable amount (see page 30).	14b	
15	Add lines 7 through 14b (far right column). This is your <b>total income</b> .	15	
16	Educator expenses (see page 30).	16	
17	IRA deduction (see page 30).	17	
18	Student loan interest deduction (see page 33).	18	
19	Tuition and fees deduction (see page 33).	19	
20	Add lines 16 through 19. These are your <b>total adjustments</b> .	20	(3)
21	Subtract line 20 from line 15. This is your <b>adjusted gross income</b> .	21	

# FORM 1040A

Form 1040A (2003)

Page 2

<b>Tax, credits, and payments</b>	<b>22</b> Enter the amount from line 21 (adjusted gross income).	22	
<b>23a</b> Check <input type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind } Total boxes if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind } checked ▶	23a	<input type="checkbox"/>	(4)
	<b>b</b> If you are married filing separately and your spouse itemizes deductions, see page 34 and check here ▶	23b	<input type="checkbox"/>
<b>24</b> Enter your <b>standard deduction</b> (see left margin).	24		
<b>25</b> Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25		
<b>26</b> Multiply \$3,050 by the total number of exemptions claimed on line 6d.	26		
<b>27</b> Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your <b>taxable income</b> .	▶ 27		
<b>28</b> Tax, including any alternative minimum tax (see page 35).	28		(4)
<b>29</b> Credit for child and dependent care expenses. Attach Schedule 2.	29	(7)	
<b>30</b> Credit for the elderly or the disabled. Attach Schedule 3.	30	(14)	
<b>31</b> Education credits. Attach Form 8863.	31	(8)	
<b>32</b> Retirement savings contributions credit. Attach Form 8880.	32	(5)	
<b>33</b> Child tax credit (see page 38).	33	(10)	
<b>34</b> Adoption credit. Attach Form 8839.	34	(5)	
<b>35</b> Add lines 29 through 34. These are your <b>total credits</b> .	35		
<b>36</b> Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36		
<b>37</b> Advance earned income credit payments from Form(s) W-2.	37		(9)
<b>38</b> Add lines 36 and 37. This is your <b>total tax</b> .	▶ 38		
<b>39</b> Federal income tax withheld from Forms W-2 and 1099.	39	(6)	
<b>40</b> 2003 estimated tax payments and amount applied from 2002 return.	40	(6)	
<b>41</b> <b>Earned income credit (EIC)</b> .	41	(9)	
<b>42</b> Additional child tax credit. Attach Form 8812.	42	(10)	
<b>43</b> Add lines 39 through 42. These are your <b>total payments</b> .	▶ 43		(6)
<b>Refund</b>	<b>44</b> If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> .	44	(6)
<b>45a</b> Amount of line 44 you want <b>refunded to you</b> .	▶ 45a		(6)
<b>b</b> Routing number <input type="text"/>	<b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
<b>d</b> Account number <input type="text"/>			(6)
<b>46</b> Amount of line 44 you want <b>applied to your 2004 estimated tax</b> .	46	(6)	
<b>Amount you owe</b>	<b>47</b> <b>Amount you owe.</b> Subtract line 43 from line 38. For details on how to pay, see page 53.	▶ 47	(6)
<b>48</b> Estimated tax penalty (see page 53).	48		

**Third party designee** Do you want to allow another person to discuss this return with the IRS (see page 54)?  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 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 (6)	Date	Your occupation	Daytime phone number ( )
Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation	

**Paid preparer's use only**

Preparer's signature (6) Date ENTER SITE IDENTIFICATION NUMBER ▶ 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 2003** IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2003, or other tax year beginning \_\_\_\_\_, 2003, ending \_\_\_\_\_, 20

OMB No. 1545-0074

**Label** (See instructions on page 21.) **Use the IRS label.** Otherwise, please print or type.

**Label Here**

Your first name and initial \_\_\_\_\_ Last name **6**

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 21. \_\_\_\_\_ Apt. no. \_\_\_\_\_

City, town or post office, state, and ZIP code. If you have a foreign address, see page 21. \_\_\_\_\_

**Your social security number** \_\_\_\_\_

**Spouse's social security number** \_\_\_\_\_

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

**Presidential Election Campaign** (See page 21.) **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** (See page 21.) 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. (See page 21.)

**Exemptions** **1** **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. **6b**  Spouse. **6c 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 22)
				<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 22) \_\_\_\_\_

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

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	<b>2</b>
8a	Taxable interest. Attach Schedule B if required	8a	<b>2</b>
8b	Tax-exempt interest. Do not include on line 8a	8b	
9a	Ordinary dividends. Attach Schedule B if required	9a	<b>2</b>
9b	Qualified dividends (see page 25)	9b	<b>2</b>
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 25)	10	<b>2</b>
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	<b>2</b>
13a	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13a	
13b	If box on 13a is checked, enter post-May 5 capital gain distributions	13b	
14	Other gains or (losses). Attach Form 4797	14	
15a	IRA distributions	15a	<b>13</b>
15b	Taxable amount (see page 25)	15b	
16a	Pensions and annuities	16a	
16b	Taxable amount (see page 25)	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	<b>2</b>
20a	Social security benefits	20a	<b>13</b>
20b	Taxable amount (see page 27)	20b	
21	Other income. List type and amount (see page 29)	21	<b>2</b>
22	Add the amounts in the far right column for lines 7 through 21. This is your total income <b>▶</b>	22	

**Adjusted Gross Income**

23	Educator expenses (see page 29)	23	<b>3</b>
24	IRA deduction (see page 29)	24	<b>3</b>
25	Student loan interest deduction (see page 31)	25	<b>3</b>
26	Tuition and fees deduction (see page 32)	26	
27	Moving expenses. Attach Form 3903	27	<b>3</b>
28	One-half of self-employment tax. Attach Schedule SE	28	
29	Self-employed health insurance deduction (see page 33)	29	
30	Self-employed SEP, SIMPLE, and qualified plans	30	
31	Penalty on early withdrawal of savings	31	
32a	Alimony paid	32a	
32b	Recipient's SSN	32b	
33	Add lines 23 through 32a	33	
34	Subtract line 33 from line 22. This is your adjusted gross income <b>▶</b>	34	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 76. Cat. No. 11320B Form **1040** (2003)

# FORM 1040

## Tax and Credits

### Standard Deduction for—

• People who checked any box on line 36a or 36b or who can be claimed as a dependent, see page 34.

• All others:

Single or Married filing separately, \$4,750

Married filing jointly or Qualifying widow(er), \$9,500

Head of household, \$7,000

<b>35</b>	Amount from line 34 (adjusted gross income)	<b>35</b>	
<b>36a</b>	Check <input type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind. <b>Total boxes</b> <input type="checkbox"/> if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind. <b>checked</b> ▶ <b>36a</b> <input type="checkbox"/>		
<b>b</b>	If you are married filing separately and your spouse itemizes deductions, or you were a dual-status alien, see page 34 and check here ▶ <b>36b</b> <input type="checkbox"/>		<b>4</b>
<b>37</b>	<b>Itemized deductions</b> (from Schedule A) or your <b>standard deduction</b> (see left margin)	<b>37</b>	
<b>38</b>	Subtract line 37 from line 35	<b>38</b>	
<b>39</b>	If line 35 is \$104,625 or less, multiply \$3,050 by the total number of exemptions claimed on line 6d. If line 35 is over \$104,625, see the worksheet on page 35	<b>39</b>	
<b>40</b>	<b>Taxable income.</b> Subtract line 39 from line 38. If line 39 is more than line 38, enter -0-	<b>40</b>	<b>4</b>
<b>41</b>	<b>Tax</b> (see page 36). Check if any tax is from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972	<b>41</b>	<b>4</b>
<b>42</b>	<b>Alternative minimum tax</b> (see page 37). Attach Form 6251	<b>42</b>	
<b>43</b>	Add lines 41 and 42	<b>43</b>	
<b>44</b>	Foreign tax credit. Attach Form 1116 if required	<b>44</b>	<b>5</b>
<b>45</b>	Credit for child and dependent care expenses. Attach Form 2441	<b>45</b>	<b>7</b>
<b>46</b>	Credit for the elderly or the disabled. Attach Schedule R	<b>46</b>	<b>14</b>
<b>47</b>	Education credits. Attach Form 8863	<b>47</b>	<b>8</b>
<b>48</b>	Retirement savings contributions credit. Attach Form 8880	<b>48</b>	<b>5</b>
<b>49</b>	Child tax credit (see page 39)	<b>49</b>	<b>10</b>
<b>50</b>	Adoption credit. Attach Form 8839	<b>50</b>	
<b>51</b>	Credits from: <b>a</b> <input type="checkbox"/> Form 8396 <b>b</b> <input type="checkbox"/> Form 8859	<b>51</b>	
<b>52</b>	Other credits. Check applicable box(es): <b>a</b> <input type="checkbox"/> Form 3800 <b>b</b> <input type="checkbox"/> Form 8801 <b>c</b> <input type="checkbox"/> Specify	<b>52</b>	
<b>53</b>	Add lines 44 through 52. These are your <b>total credits</b>	<b>53</b>	
<b>54</b>	Subtract line 53 from line 43. If line 53 is more than line 43, enter -0-	<b>54</b>	
<b>55</b>	Self-employment tax. Attach Schedule SE	<b>55</b>	<b>2</b>
<b>56</b>	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137	<b>56</b>	
<b>57</b>	Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required	<b>57</b>	<b>13</b>
<b>58</b>	Advance earned income credit payments from Form(s) W-2	<b>58</b>	
<b>59</b>	Household employment taxes. Attach Schedule H	<b>59</b>	
<b>60</b>	Add lines 54 through 59. This is your <b>total tax</b>	<b>60</b>	
<b>61</b>	Federal income tax withheld from Forms W-2 and 1099	<b>61</b>	<b>6</b>
<b>62</b>	2003 estimated tax payments and amount applied from 2002 return	<b>62</b>	<b>6</b>
<b>63</b>	<b>Earned income credit (EIC)</b>	<b>63</b>	<b>9</b>
<b>64</b>	Excess social security and tier 1 RRTA tax withheld (see page 56)	<b>64</b>	
<b>65</b>	Additional child tax credit. Attach Form 8812	<b>65</b>	<b>10</b>
<b>66</b>	Amount paid with request for extension to file (see page 56)	<b>66</b>	
<b>67</b>	Other payments from: <b>a</b> <input type="checkbox"/> Form 2439 <b>b</b> <input type="checkbox"/> Form 4136 <b>c</b> <input type="checkbox"/> Form 8885	<b>67</b>	
<b>68</b>	Add lines 61 through 67. These are your <b>total payments</b>	<b>68</b>	
<b>69</b>	If line 68 is more than line 60, subtract line 60 from line 68. This is the amount you <b>overpaid</b>	<b>69</b>	
<b>70a</b>	Amount of line 69 you want <b>refunded to you</b>	<b>70a</b>	<b>6</b>
<b>b</b>	Routing number	<b>c</b>	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
<b>d</b>	Account number		<b>6</b>
<b>71</b>	Amount of line 69 you want <b>applied to your 2004 estimated tax</b>	<b>71</b>	
<b>72</b>	<b>Amount you owe.</b> Subtract line 68 from line 60. For details on how to pay, see page 57	<b>72</b>	
<b>73</b>	Estimated tax penalty (see page 57)	<b>73</b>	

## Other Taxes

## Payments

If you have a qualifying child, attach Schedule EIC.

## Refund

Direct deposit? See page 56 and fill in 70b, 70c, and 70d.

## Amount You Owe

## Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see page 58)?  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 21. Keep a copy for your records.

Your signature <b>6</b>	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 **6** Date \_\_\_\_\_ Preparer's SSN or PTIN \_\_\_\_\_

Firm's name (or yours if self-employed), address, and ZIP code \_\_\_\_\_ EIN \_\_\_\_\_ Phone no. ( ) \_\_\_\_\_

Each year the Internal Revenue Service contracts with a tax preparation software vendor to provide free software to our volunteers. You will find TAXWISE hints integrated throughout the text. They are located just before “Summing Up This Lesson” or “Summing Up This Segment”. They are also located, when appropriate, in the Military/International segments.

▶▶ **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



### LESSON OVERVIEW AND OBJECTIVES

This lesson will explain what is needed to begin to prepare an individual federal income tax return. Emphasis is placed on the importance of insuring that the taxpayer's (or dependent's) name and social security number matches IRS 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.
- Determine which taxpayers need an Individual Taxpayer Identification Number (ITIN).
- Use the 5 tests for a qualifying dependent.
- Apply the requirements for each of the five filing status.
- Determine who must file.
- Determine who should file.
- Select the appropriate tax form to use.

### MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the publications or forms, you can download the files from [www.irs.gov](http://www.irs.gov).

- Form 1040A and Form 1040, *Exemptions* section
- Form 1040A and Form 1040, *Filing Status* section

### TEACHING TIP

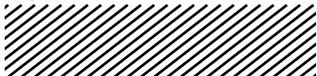
**Note:** This note is not in the text but is something that you as the instructor, should mention during this lesson. It is important to stress to students that they must explain the reason for asking a taxpayer questions of a personal nature. The loss of a child, even if that child was stillborn or only lived briefly, can still be painful for a taxpayer. Similarly, other deaths in the household can remind taxpayers of painful experiences.

## GUIDED QUESTION - DEPENDENCY TEST

1. **Define the term *dependent*.** (A dependent is a person, other than the taxpayer or spouse, who entitles the taxpayer to claim a dependency exemption.)
2. **How does the relationship or member of household test apply to adopted children?** (An adopted child meets the relationship test. If a child is adopted and begins living with the taxpayer in the middle of the year, the taxpayer may claim an exemption for the child even though the child did not live with the taxpayer for the entire year.)
3. **Name the different ways that a person can meet the citizen or resident test.** (A person can meet this test if he or she, for some part of the tax year, is either a U.S. citizen or resident, or a resident of Canada or Mexico.)
4. **Generally, how does someone meet the joint return test?** (A person generally meets this test by being married and not filing a joint return or married filing jointly only to claim a refund.)
5. **To what types of income does the term *gross income* refer?** (Gross income refers to all taxable income in the form of money, property, and services, including all unemployment compensation and certain scholarships.)
6. **What are the two exceptions to the gross income test?** (The test does not apply to the taxpayer's children under the age of 19 or to the taxpayer's children under the age of 24 who are full-time students.)

## GUIDED QUESTIONS - SUPPORT TEST

1. **How much of a person's support must a taxpayer provide in order to claim that person as a dependent?** (In general, a taxpayer must provide more than half of a person's total support for the entire year.)
2. **What are the two exceptions to the support test?** (Multiple support and children of divorced or separated parents are the two exceptions to the support test.)
3. **When can capital items, like cars, be included as support?** (When they are solely for the dependent's own use.)
4. **How does the amount used to decide whether a person meets the support test differ from that used for the gross income test?** (The gross income test considers taxable income only, whereas the support test considers all of the dependent's income—both taxable and nontaxable.)



## ***GUIDED QUESTIONS - DIVORCE OR SEPARATED PARENTS***

- 1. In the case of separated or divorced parents who, together, provide over half of a child's support, which parent can claim the dependency exemption?** (The parent who has custody of the child for the greater part of the year, unless a divorce decree or separation agreement provides otherwise.)
- 2. What is the purpose of Form 8332?** (Form 8332 is signed by the custodial parent in order to allow the non-custodial parent to claim the dependency exemption.)

## ***TEACHING TIP - DEPENDENCY EXEMPTIONS***

1. When determining the number of exemptions, volunteers should not assume that taxpayers will have the same number of exemptions on their current return as they did on last year's return. Information about deaths or births in a taxpayer's household might not be volunteered right away and may require some probing on the part of the assistor/counselor.
2. You may wish to remind students that a taxpayer who can be claimed as a dependent on another person's return cannot claim a personal exemption for himself or herself on his or her own return. This is true even if the other taxpayer does not claim the dependency exemption.

## ***LESSON REVIEW - DEPENDENTS AND SSNs/ITIN***

Emphasize the Tax Tips feature that states that all dependents must have a social security number. Tell students that taxpayers who need to acquire a social security number for a dependent should contact their local social security office.

Volunteers should also tell taxpayers that a certified copy of the dependent's birth certificate will be required in order to get a social security number.

The application process will take a few weeks, in most cases.

**Important Note:** The information on ITINs is being revised. Please check with your IRS contact before covering this topic!

In addition, a resident or nonresident alien who does not have, or cannot get, an SSN should file a Form W-7 with the IRS to apply for an individual tax identification number (ITIN). The ITIN is entered on the return wherever the SSN is requested, and is used *for tax purposes only*. A taxpayer that has an ITIN and later receives a SSN, should no longer use the ITIN on tax returns.

## TEACHING TIPS - ALIENS/COMMUNITY PROPERTY

1. When confronted with a situation in which the taxpayer is a United States resident or citizen who is married to a nonresident alien, volunteers should know that the taxpayer can file a joint return as long as both spouses agree to be taxed on their worldwide income. IRS Publication 519, *Tax Guide For Aliens*, deals with this type of situation.
2. If more information is needed to answer students' questions about community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin) refer to IRS Publication 555, *Community Property*.

## LESSON REVIEW - FILING STATUS

1. Students may wonder when spouses filing separately can achieve a lower tax. If one spouse has high medical or miscellaneous expenses or large casualty losses, for example, separate returns may result in lower taxes because a lower adjusted gross income allows more expenses or losses to be deducted.
2. Students may wonder which absences qualify as “temporary” in determining head of household filing status. Remind them that temporary absences include those that are for school, vacation, illness, business, or military service.

## GUIDED QUESTIONS - FILING STATUS

1. **Is married filing jointly the only status available to spouses?** (No; they can file married filing separately.)
2. **Can a married couple file separate returns even if one spouse had no income?** (Yes)
3. **If a married couple files separately, can only one spouse itemize deductions?** (No; if one itemizes, the other must itemize because he or she cannot take the standard deduction.)
4. **Must the person who qualifies the taxpayer as head of household be claimed as the taxpayer's dependent?** (Yes, unless the person is the taxpayer's child—with some exceptions.)

## TEACHING TIPS - FILING STATUS (HOH)

1. Review with students, from the earlier discussion of the head of household status, which individuals qualify as “child.” Included are a natural child, a grandchild, a stepchild, and an adopted child. Explain that each of these individuals also qualifies as a “child” when determining qualifying widow(er) with dependent child filing status.



2. Remind students that this filing status is only available for 2 years following the year of death of the spouse.
3. The material in this section deals with the surviving spouse's return. However, volunteers should know that a tax return must sometimes be filed on behalf of a deceased person. If the surviving spouse files a joint return with the deceased spouse for the year of death, a separate return is not required for the deceased spouse. A tax return must be filed on behalf of any other deceased taxpayer whose income exceeded the limits outlined in this Lesson. See Publication 559, *Survivors, Executors, and Administrators*, for more information.

### ***GUIDED QUESTIONS - HEAD OF HOUSEHOLD***

1. **For a relative to qualify a taxpayer for the head of household filing status, how long must the taxpayer's home be the main home of the relative?** (More than half the year.)
2. **What happens when the name of the qualifying person is not entered on a head of household return?** (The IRS will delay processing the return and correspond with the taxpayer because the return cannot be processed without this information. See the Tax Tips feature in the student text.)

### ***GUIDED QUESTIONS - FILING STATUS - WIDOW(ER)***

1. **What information must you know in order to determine if a widow or widower can use the qualifying widow(er) with dependent child filing status?** (The year the spouse died; whether or not the taxpayer was entitled to file a joint return for the year that the spouse died; and whether or not the taxpayer has furnished over half the cost for the year of keeping up the main home of a child, foster child, stepchild, or adopted child, who qualified as the taxpayer's dependent.)
2. **If a taxpayer has not remarried, is there a limit to the number of years after the death of a spouse that he or she may use the qualifying widow(er) with dependent child filing status?** (Yes; the taxpayer can only use the qualifying widow(er) status for the two years following the year of death; if all other qualifications are met.)

### ***GUIDED QUESTIONS - FILING STATUS***

1. **Why is it important to select the correct filing status?** (Because the filing status factors in how much tax will be due.)
2. **What two filing statuses generally yield the lowest tax due?** (Married filing jointly and qualifying widow(er) with dependent child.)
3. **Do filing statuses vary depending on the tax form?** (No.)

4. **When a taxpayer is eligible for more than one filing status, which status do you select?** (You recommend the taxpayer select the one that yields the lowest tax.)

### ***TEACHING TIPS - RELATED PUBLICATIONS***

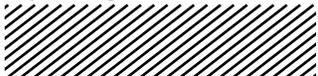
Remind students that Publication 17, Your Federal Income Tax, and Publication 501, Exemptions, Standard Deduction, and Filing Information are excellent tools to assist with determining filing status.

### ***GUIDED QUESTIONS - WHO MUST FILE***

1. **What information must a volunteer have in order to determine if an individual must file a tax return?** (The individual's filing status, age, gross income, and type of income are needed. The volunteer must also determine: if some of the income is excludable, whether the individual can be claimed as a dependent on another tax return, if the individual is blind, and whether the individual received advance earned income credit payments.)
2. **With which group of individuals should volunteers use Chart A—*For Most People*?** (Individuals who cannot be claimed as a dependent on another taxpayer's return.)
3. **What chart should be used with all individuals, regardless of their dependency status?** (*Chart C—Other Situations When You Must File.*)
4. **Direct students' attention to Chart A—*For Most People*, and ask, "How does the information in the right-hand column determine if an individual must file?"** (If the individual's gross income is at least the amount listed in the right-hand column, the individual must file a return.)
5. **What charts and checklists apply specifically to individuals who can be claimed as a dependent on another taxpayer's return?** (*Chart B—For Children and Other Dependents, and Dependents Who Must or Should File a Return.*)

### ***LESSON REVIEW - BLIND DEPENDENTS***

1. Students may ask whether a single individual who is blind (and can be claimed as a dependent) must also be 65 years or older to use the *Standard Deduction Chart for People Age 65 or Older or Blind* in the form instructions. Review Form 1040 (or Form 1040A) and its instructions to help students understand that if a taxpayer is EITHER blind or 65 or older, the *Standard Deduction Chart for People Age 65 or Older or Blind* must



be used. Review also the *Standard Deduction Worksheet for Dependents* (in the instructions) that is used if the taxpayer is a dependent.

2. Point out to students that “blindness” may not be a simple determination. Individuals whose sight is not better than 20/200 in their best eye while wearing contact lenses or glasses, or whose field of vision is 20 degrees or less, might be legally blind. Remind students that determining if an individual is legally blind requires volunteers to use some of their effective interviewing skills.
3. Remind students to appropriately complete the age/blindness boxes on the tax return. Stress to students that quality-review checks revealed that the failure to complete the age/blindness indicator was one of the most frequent errors.

Also stress that if any of these boxes are checked, the *Standard Deduction Chart for People Age 65 or Older or Blind* must be used. If the taxpayer is also a dependent, use the *Standard Deduction Worksheet for Dependents*. The chart and the worksheet are both in the form 1040 instructions.

### **TEACHING TIPS - TAX TERMS AND WHOM MUST FILE**

1. Despite the advice given in the student text, some students will insist that it is important for them to know the meanings of *all* the unfamiliar tax terms NOW.

Explain that, just as taxpayers will have to trust the students' expertise when they assist them, you are asking students to trust you. Assure them that they can accomplish the objectives of this lesson quite successfully without understanding the meaning of the vocabulary in question.

2. As you lead students in using the charts to determine whether an individual **MUST** or **SHOULD** file a return, think of how we interchangeably use the words *must* and *should* in everyday speech. For the purposes of tax assistance situations, it is important that students recognize and respect the different implications of these words for taxpayers. As you conduct in-class discussions, listen carefully to make certain that your students are using the words in the correct context.

### **GUIDED QUESTIONS - FILING REQUIREMENTS**

1. **In what situation should a dependent be required to file a tax return, although Chart B may indicate that he or she does not have to file?** (A married dependent with at least \$5 of income whose spouse itemizes deductions on a separate return; a dependent with at least \$400 of net self-employment income; and a dependent who is not required to file but had income tax withheld.)



2. **What is *self-employment income*?** (Earned income from farming or a trade, business, or other profession that is not paid by an employer.)
3. **What chart should you use as a last step in determining who must file?** (*Chart C—Other Situations When You Must File.*)
4. **In what three instances should an individual file a return, even if the charts noted in this lesson indicate that filing is not necessary?** (To claim a refund of withheld taxes, to claim the earned income credit, and to claim the additional child tax credit.)

### ***LESSON REVIEW - FILING REQUIREMENTS***

To review students' understanding of who must file, and who should file, engage students in the following summary activity.

Divide the class into small groups. Assign each group one of the charts or checklist covered in this section. Distribute half sheets of paper to each group and instruct each group to write a scenario based on the reference that it has been assigned.

Collect and shuffle the papers. One at a time, permit individuals to select a scenario that either they or their group can respond to in terms of the questions “**Must** the individual file?” and “**Should** the individual file?”

### ***GUIDED QUESTION – DEPENDENCY EXEMPTIONS – MILITARY SEGMENT***

1. **Can a person in the military ever be claimed as a dependent on another person's return? If yes, when are most likely to see this situation?**

Yes, usually if they were dependents of another person before entering the military and they have been in the military less than 6-months.

All dependency tests, must be applied to determine if individuals that have been in the military for less than 6-months can be claimed as a dependent of someone else.

### ***GUIDED QUESTION – FILING STATUS – MILITARY SEGMENT***

1. **Can a taxpayer ever be considered unmarried even though they are married on December 31?**

Yes, for head of household filing status **only**—if the spouse is a nonresident alien and does not choose to be treated as a resident alien for tax purposes the taxpayer may be considered unmarried. All other head of household qualifications must be met.



### INTRODUCTION AND 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 (SSN) match IRS records.

Every U.S. Federal tax return that is filed must have each person identified by a number. Each person refers to the taxpayer, the taxpayer's spouse if the taxpayer is married, and any dependent claimed on the return. The identifying number will be a social security number for those persons who qualify to be issued one. All others must have an individual taxpayer identification number (ITIN).

After completing this lesson you should be able to:

- Explain the importance of requiring a social security card for the tax preparation.
- Determine which taxpayers need an Individual Taxpayer Identification Number (ITIN)
- Use the 5 tests for a qualifying dependent.
- Apply 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

It is extremely important that each person use the correct social security number. The most accurate information is usually located on the taxpayer's original social security card. 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. If a tax-

#### POTENTIAL PITFALLS



Canadians have a number that is like a social security number, but it is for their old age pension. Do not use this number on a U.S. tax return. Canadians often have both a U.S. and Canadian Social Security Number.

payer does not have a valid SSN, direct them to Form SS-5, Social Security Number Application. This form should be submitted to the nearest Social Security Administration Office. Explain to him/her that they **must** have a number before you can assist them with filing the tax return.

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

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

## ***INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS***

Important Note: ITIN information will be provided as a separate supplement. For additional information see your instructor or IRS coordinator.

## ***SUMMING UP THIS LESSON***

- All taxpayers and dependents listed on a tax return must have an identification number.
- An Identification Number can be either a SSN or an ITIN.
- Use caution when completing the entity section of the tax return.

## ***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** (\$3,050 for 2003) when figuring taxable income.

### 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.

#### ALERT



For 2003 the exemption amount increased to \$3,050.

## 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
2. Citizen or Resident
3. Joint Return
4. Gross Income
5. Support

### 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
- 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 2003 is \$3,050.

*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 fulltime students are not included in total support.

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

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

Alexis 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 Alexis' 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 Alexis' medical expenses and education.

<b>Funds Belonging to the Person You Supported</b>	
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)	\$
<b>Expenses for Entire Household</b> (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	
<b>Expenses for the Person You Supported</b>	
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)	\$
<b>Did You Provide More Than Half?</b>	
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	\$
<p>Is line 21 more than line 22?  <b>Yes.</b> You meet the support test for the person. If the other exemption tests are met, you may claim an exemption for the person.  <b>No.</b> 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.</p>	

## 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 to identify each of the others not claiming the exemption. The person who claims the exemption attaches Form(s) 2120 to his or her current year's tax return and must keep for his records the signed statement from the person agreeing not to claim the exemption.

### Example 2

Henry E. and Harold S. Rust each provide more than 10 percent of the total support of their mother Margaret S. Rust, 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 <b>2120</b> (Rev. December 2002) Department of the Treasury Internal Revenue Service	<b>Multiple Support Declaration</b> ▶ Attach to Form 1040 or Form 1040A.	CMB No. 1545-0071 Attachment Sequence No. <b>114</b>
Name(s) shown on return Henry E. Rust	Your social security number 000 00 4877	
During the calendar year ....., the eligible persons listed below <b>each</b> paid over 10% of the support of: Margaret S. Rust 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.		
Harold S. Rust Eligible person's name 123 Main Street, Springfield, VA 22140 Address (number, street, apt. no., city, state, and ZIP code)		000 00 2780 Social security number
Eligible person's name Address (number, street, apt. no., city, state, and ZIP code)		Social security number
Eligible person's name Address (number, street, apt. no., city, state, and ZIP code)		Social security number
Eligible person's name Address (number, street, apt. no., city, state, and ZIP code)		Social security number

## 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.

### Example 3

Ellen M. and Richard A. Stonehill 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.

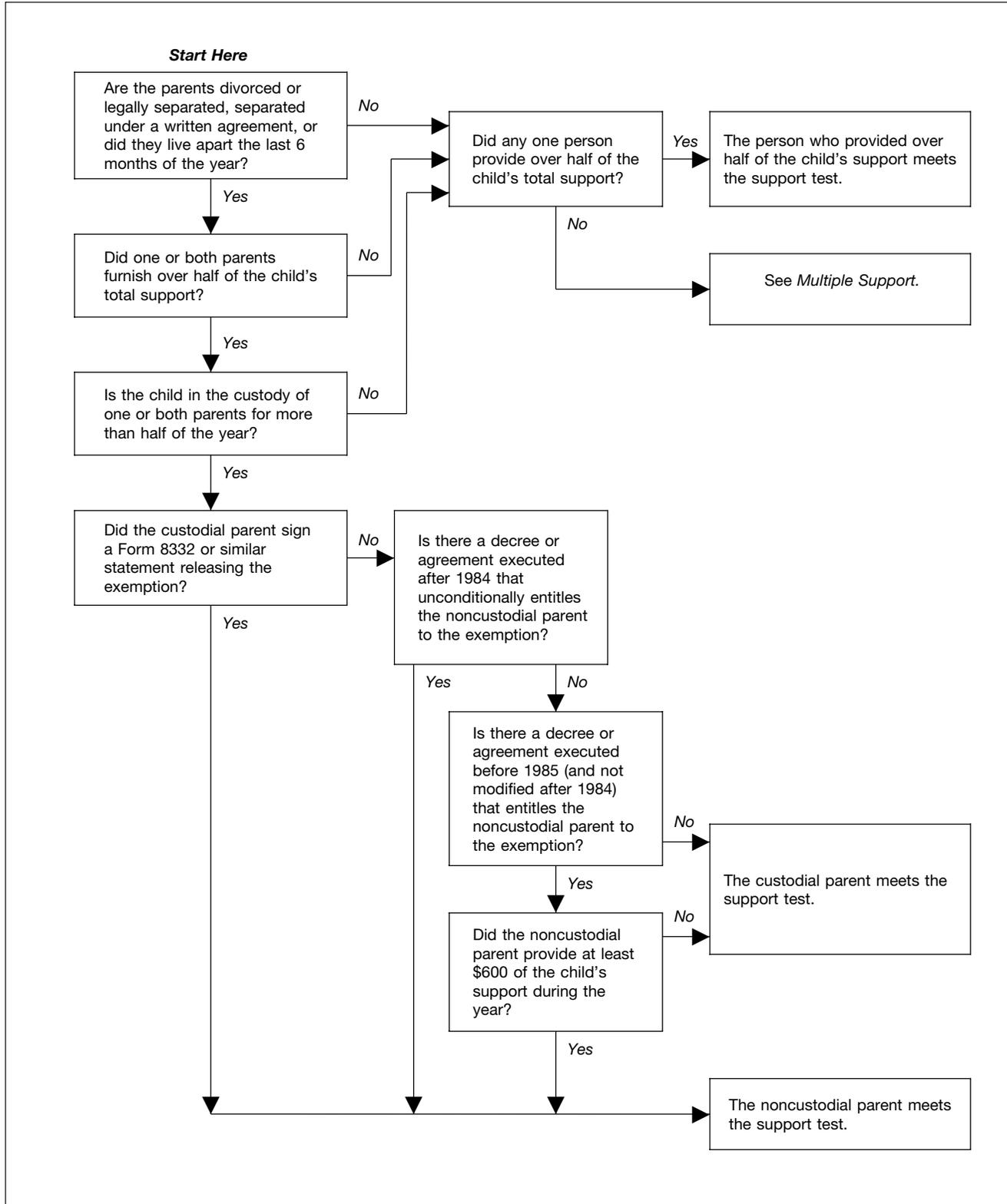
If Ellen had provided only \$500 of support for each child, she could not claim dependency exemptions for the two children. To claim the exemptions, she must provide at least \$600 of support for each child.

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 <b>8332</b> (Rev. December 2000) Department of the Treasury Internal Revenue Service	<b>Release of Claim to Exemption for Child of Divorced or Separated Parents</b> ▶ <b>Attach</b> to noncustodial parent's return <b>each year</b> exemption is claimed. <b>Caution:</b> Do not use this form if you were never married.	CMB No. 1545-0915 Attachment Sequence No. <b>115</b>
Name of noncustodial parent claiming exemption <u>Ellen M. Stonehill</u>	Noncustodial parent's social security number (SSN) ▶	<u>000   00   2338</u>
<b>Part I Release of Claim to Exemption for Current Year</b>		
I agree not to claim an exemption for <u>Alan R. Stonehill and Mary E. Stonehill</u> Name(s) of child (or children)		
for the tax year 20 <u>03</u> .		
<u>Richard A. Stonehill</u> Signature of custodial parent releasing claim to exemption	<u>000   00   3832</u> Custodial parent's SSN	<u>3/26/2004</u> Date
<b>Note:</b> If you choose not to claim an exemption for this child (or children) for future tax years, also complete Part II.		



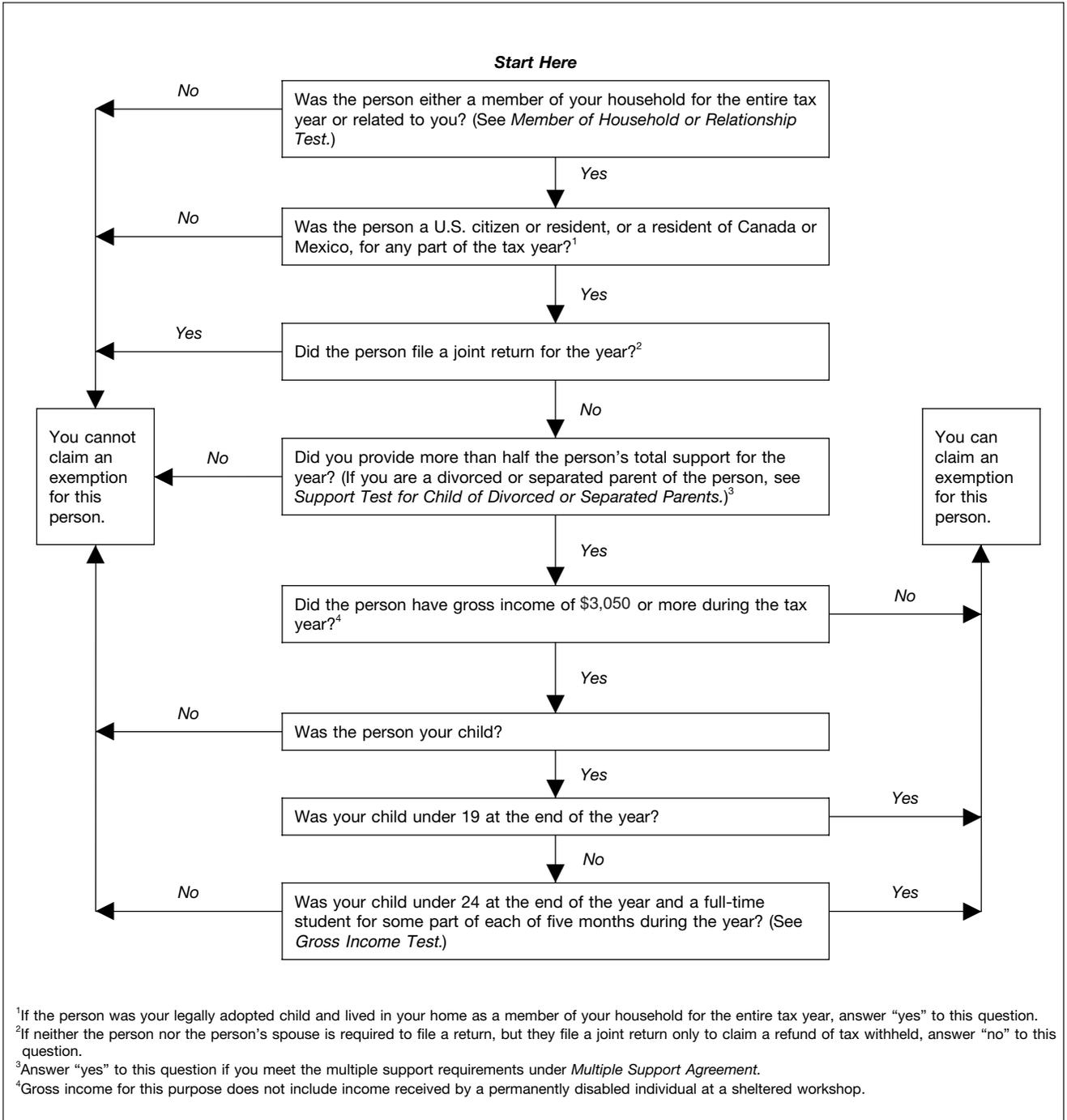
## DETERMINING THE NUMBER OF EXEMPTIONS TO CLAIM

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?



## 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 10). 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).

**Exhibit 6**

Form 1040/1040A, page 1

<b>Exemptions</b>		<b>6a</b> <input checked="" type="checkbox"/> <b>Yourself.</b> If your parent (or someone else) can claim you as a dependent on his or her tax return, <b>do not</b> check box 6a.				No. of boxes checked on 6a and 6b
<b>6b</b> <input checked="" type="checkbox"/> <b>Spouse</b>						No. of children on 6c who:
<b>6c Dependents:</b>		(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 25)	• lived with you	
(1) First name	Last name			• did not live with you due to divorce or separation (see page 26)		
James	Nicholson	000:00:3333	son	<input checked="" type="checkbox"/>	Dependents on 6c not entered above	
				<input type="checkbox"/>	Add numbers on lines above	
				<input type="checkbox"/>	<b>3</b>	
				<input type="checkbox"/>		
<b>d</b> Total number of exemptions claimed.						

If more than six dependents, see page 24.

If you are claiming Child Tax Credit (CTC), Earned Income Credit, and/or Dependent Care (DC), you must enter the date of birth for qualifying children and "X" the EIC and/or DC box(es). CTC is automatically calculated for you.

**▶▶ Summing Up This Section ◀◀**

There are two types of exemptions: personal and dependency. Each exemption reduces taxable income by \$3,050 in 2003.

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 2003, 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 2003. 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. Wiley has three children, Mark, Tim, and Mary. Each child contributes toward Mrs. Wiley'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. Wiley 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. Wiley 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 \$3,050.

**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; she did not pass the Gross Income Test.

**Exercise 7**

- A. Mark or Tim are eligible to claim the exemption. Both provide more than 10 percent of Mrs. Wiley'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.

# FILING STATUS

## 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, 2003, and did not remarry in 2003. 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.

### 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.

## 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 4 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 in the label section or line 6a.

## 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:

- 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 step child	Yes	No
2. Married child, grandchild, or step child	Yes	Yes*
3. Foster child	Yes***	Yes
4. Mother or father	No	Yes
5. Other relatives	Yes**	Yes
<b>Exceptions:</b>		
* 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.		

## 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

<b>Filing status</b>  Check only one box.	1 <input type="checkbox"/> Single	4 <input checked="" type="checkbox"/> Head of household (with qualifying person). (See page 23.)
	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 24.)

## **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 2001 or 2002 and the taxpayer did not remarry before the end of 2003, 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.

Exhibit 9

Filing Status After Death of Spouse		
Tax Year	Filing Status	Exemption for Deceased Spouse?
1. Year of Death	Married (joint)	Yes
	OR	
2. First Year after death	Married (separate)	Yes
	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

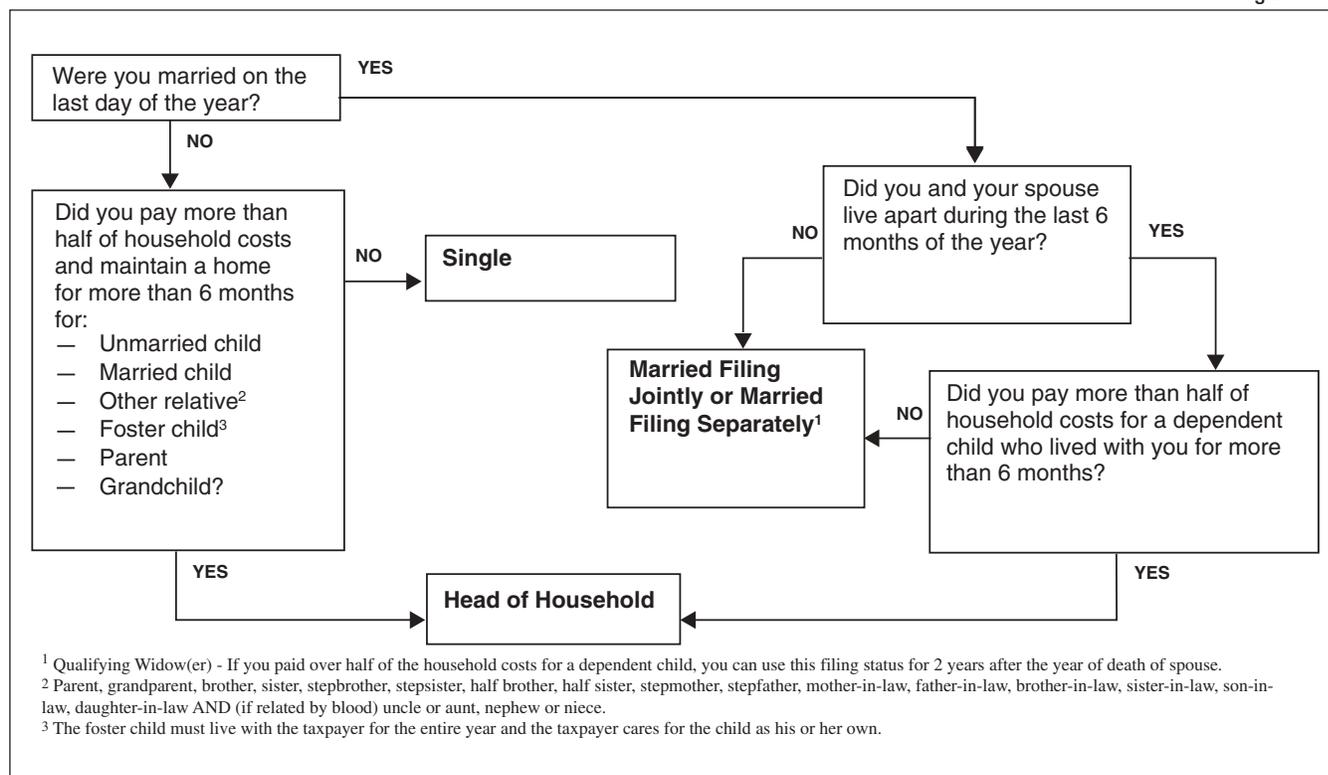
\* With a qualifying dependent.  
 \*\* With a qualifying relative.

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



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 2002. They are not divorced, but lived apart all of 2003. 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. Calvin 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. Calvin 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 2003. She took her children with her. She supported the children during all of 2003 and will claim them as dependents. Lily will not file a joint return with her husband. Which filing status should Lily use in 2003? \_\_\_\_
18. Rose and her husband separated in October 2003, but were still married on December 31, 2003. What filing status can she use?  
\_\_\_\_\_
19. Dick's wife died in 2001. Dick has not remarried. Dick provides all of the support for his two dependent children. What will be Dick's filing status for 2004? \_\_\_\_\_

**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 person.

**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 2003.

**Exercise 18**

Either married filing jointly or married filing separately.

**Exercise 19**

Head of household; he could claim qualifying widower for 2002 and 2003 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.

Chart A—For Most People		
If your filing status is...	AND at the end of 2003 you were*	THEN file a return if your gross income** was at least...
Single	Under 65	\$ 7,800
	65 or older	8,950
Married filing jointly***	under 65 (both spouses)	\$15,600
	65 or older (one spouse)	16,550
	65 or older (both spouses)	17,500
Married filing separately	Any age	\$ 3,050***
Head of household (see page 19)	Under age 65	\$10,050
	65 or older	11,200
Qualifying Widow(er) with dependent child (see page 19)	Under 65	\$12,550
	65 or older	13,500
<p>* If you turned age 65 on January 1, 2003, you are considered to be age 65 at the end of 2003</p> <p>** <b>Gross Income</b> 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). <b>Do not</b> include social security benefits unless you are married filing a separate return and you lived with your spouse at any time in 2003.</p> <p>*** If you did not live with your spouse at the end of 2003 (or on the date your spouse died) and your gross income was at least \$3,050, you must file a return regardless of your age.</p>		

## 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.

### Chart B—For Children and Other Dependents

See the instructions for line 6c that begin on page 21 to find out if someone can claim you as a dependent.

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, ordinary dividends, and capital gain distributions. **Earned income** includes wages, tips, and taxable scholarship and fellowship grants. **Gross income** is the total of your unearned and earned income.



If your gross income was \$3,050 or more, you usually cannot be claimed as a dependent unless you were under age 19 **or** a student and under age 24. For details, see **Test 4—Income** on page 22.

**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 \$4,750.
  - Your **gross income** was more than the **larger** of—
    - \$750 or
    - Your earned income (up to \$4,500) plus \$250.
- Yes.** You must file a return if **any** of the following apply.
  - Your earned income was over \$1,900 (\$3,050 if 65 or older **and** blind).
  - Your earned income was over \$5,900 (\$7,050 if 65 or older **and** blind).
  - Your gross income was more than—

The larger of:	Plus	This amount:
<ul style="list-style-type: none"> <li>• \$750 or</li> <li>• Your earned income (up to \$4,500) plus \$250.</li> </ul>	}	\$1,150 (\$2,300 if 65 or older <b>and</b> 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 unearned income was over \$750.
  - Your earned income was over \$4,750.
  - Your gross income was at least \$5 and your spouse files a separate return and itemizes deductions.
  - Your gross income was more than the **larger** of—
    - \$750 or
    - Your earned income (up to \$4,500) plus \$250.
- Yes.** You must file a return if **any** of the following apply.
  - Your unearned income was over \$1,700 (\$2,650 if 65 or older **and** blind.)
  - Your earned income was over \$5,700 (\$6,650 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—

The larger of:	Plus	This amount:
<ul style="list-style-type: none"> <li>• \$750 or</li> <li>• Your earned income (up to \$4,500) plus \$250.</li> </ul>	}	\$950 (\$1,900 if 65 or older <b>and</b> 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
<ul style="list-style-type: none"><li>■ A married dependent with at least \$5 of income whose spouse itemizes deductions on a separate return on Form 1040 must file a return.</li><li>■ A dependent with at least \$400 of net self-employment income must file a return. (<b>Self-employment income</b> is earned income from a trade, business, farming or profession that is not paid by an employer. For example, seamstresses and lawn-care workers who work for themselves (and not for someone else) are considered self-employed.</li><li>■ A dependent who is not required to file but had income tax withheld should file a return to get a refund.</li><li>■ A dependent who has to pay a tax, such as the alternative minimum tax, must file a return.</li></ul>

## 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

You must file a return if any of the four conditions below apply for 2003.

1. You owe any special taxes, such as:
  - 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,
  - Recapture taxes (see the instructions for lines 41 and 60 that begin on pages 33 and 40), or
  - Tax on a qualified plan, including an individual retirement arrangement (IRA), or other tax-favored account. But if you are filing a return only because you owe this tax, you can file Form 5329 by itself.
2. You received any advance earned income credit (EIC) payments from your employer. These payments are shown in box 9 of your Form W-2.
3. You had net earnings from self-employment of at least \$400.
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.

### ***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 a 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.

### ***TAXWISE HINT***

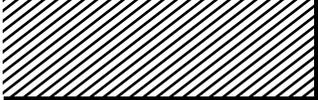
After completing the tax return refer back to the Main Information screen and select the appropriate tax form.

▶▶ 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? \_\_\_\_\_



# *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.

## 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 \$1,500. 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 14. 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 9.

## 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.



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 OBJECTIVE

The basic segment explained the tests that must be met before a person can be claimed as a dependent. In this segment you will find more information about the support and citizen or resident tests to help you assist members of the Armed Forces.

## SUPPORT TEST

### Armed Forces Member as a Dependent

A person who has been in the Armed Forces for the entire year cannot be claimed as a dependent because the support test will not have been met. A person in the Armed Forces for only part of the year can be claimed as a dependent if all the dependency tests are met. All amounts received from the Armed Forces that are used for the person's support must be taken into account.

If a person is appointed to one of the Armed Forces academies and is at the academy all year, he or she cannot be a dependent. An appointee at the academy for only part of the year may qualify as a dependent if all the tests are met.

### Exercise 1

Kathleen Simmons is 18 and single. Kathleen graduated from high school in June 2003 and entered the U.S. Air Force in September 2003. Kathleen provided \$3,400 (wages of \$2,400 and \$1,000 for other items provided by the Air Force) for her own support, and her parents provided \$3,600. Can Kathleen's parents claim a dependency exemption for her for 2003?

Answer \_\_\_\_\_

## Armed Forces Member Claiming a Dependent

If a member of the military has authorized a dependency allotment and the allotment is used to support dependents who did not live with him or her for reasons other than divorce or separation, the member can claim the exemptions if all the dependency tests are met.

### Example

Army Pvt. Gary Fairfield authorized a dependency allotment for his mother. She used the amount received to support herself and Gary's 10-year-old sister. Gary provided no other funds for their support. If the allotment provides more than half of their total support for the year and all other dependency tests are met, Gary can claim exemptions for both his mother and his sister, even though the allotment was authorized for his mother only.

### Exercise 2

Cpl. Jim Mills authorized a dependency allotment for his son, John. The allotment (\$150 a month) was in effect for all of 2003. How much support should Cpl. Mills consider he provided for John in 2003?

Answer \_\_\_\_\_

## *CITIZEN OR RESIDENT TEST*

To meet the citizen or resident test, the taxpayer's dependent must be a U.S. citizen, a U.S. resident, or a resident of Canada or Mexico for some part of the calendar year in which the taxpayer's tax year begins.

### Exercise 3

The wife of Col. William Bates is a Greek citizen. Her sister, Athena, who is also a Greek citizen, lived in the Bates' home in Greece for the entire tax year. Col. Bates provided more than 50% of Athena's total support.

- a. Can Col. Bates claim his sister-in-law as a dependent?

Answer \_\_\_\_\_

- b. What would be your answer to (a) if Athena were a Canadian citizen living in the Bates' home in Greece for the entire year?

Answer \_\_\_\_\_



Children are usually citizens or residents of the country of their parents. If you were a U.S. citizen when your child was born, the child may be a U.S. citizen although the other parent was a non-resident alien and the child was born in a foreign country.

A U.S. citizen who has legally adopted a child who is not a U.S. citizen or resident can claim the child as a dependent if the other dependency tests are met and if, for the entire tax year:

1. The taxpayer's home is the child's main home, and
2. The child is a member of the taxpayer's household.

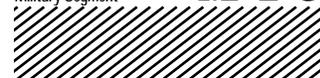
#### Exercise 4

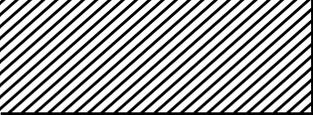
Sgt. John Ranger, a U.S. citizen who has been in the U.S. Army for 13 years, is stationed in Germany. His wife is a German citizen who has never lived in the United States. Their 2-year-old son was born in Germany. Sgt. Ranger's stepdaughter, a German citizen whom Sgt. Ranger has not adopted, also lives with them. The Rangers provide total support for the two children. How many dependency exemptions can Sgt. Ranger claim on a joint return?

Answer \_\_\_\_\_

#### ▶▶ SUMMING UP THIS SEGMENT ◀◀

In this segment you have learned how the support and citizen or resident tests for the dependency exemption apply to some military situations.





# DEPENDENCY EXEMPTIONS

Lesson 1  
Military Segment

*ANSWERS TO EXERCISES*

1. Yes. The support test is met.
2. \$1,800.
3.
  - a. No. His sister-in-law was not a citizen or resident of the United States at any time during the year.
  - b. No. Athena would have to reside in Canada for at least some part of the year to qualify.
4. One. The stepdaughter does not qualify as a U.S. citizen or resident. The son qualifies because his father is a U.S. citizen.

# EXEMPTION FOR A FOREIGN SPOUSE

Lesson 1  
Military Segment

## INTRODUCTION AND OBJECTIVES

There are special tax laws and filing procedures that must be followed in order to prepare to file federal income tax returns accurately for citizens or residents of the United States who have spouses who are nonresident aliens. When we are finished with this segment you will be able to determine if a taxpayer is entitled to claim the personal exemption for a foreign spouse.

## PERSONAL EXEMPTIONS

Each taxpayer is allowed a personal exemption (unless the taxpayer is claimed by someone else). On a Married Filing Separate return a spouse's personal exemption may be claimed by the taxpayer if the spouse had no gross income and is not claimed by anyone else. **Remember: a spouse is never the dependent of the taxpayer.**

If your spouse is a nonresident alien, he or she can choose to file a joint return with you (see Lesson 4, Travel Expenses, for more information). If the nonresident alien spouse makes this choice, they will be treated like a resident alien for tax purposes. This means that they will have to include all of their worldwide income on the joint U.S. tax return. Your spouse does **not** have to be from Canada or Mexico to make this choice.

### Example 1

Pat Simpson, a U.S. citizen, is married to Frank, a nonresident alien. Pat and Frank make the choice to treat Frank as a resident alien by attaching a statement to their joint return. Pat and Frank must report their worldwide income for the year they make the choice and for all later years unless the choice is ended or suspended. Although Pat and Frank must file a joint return for the year they make the choice, they can file either joint or separate returns for later years. If your nonresident alien spouse does not choose to be treated as a resident alien, you may be able to claim an exemption for the spouse on a married filing separate return. The nonresident spouse must not have any gross income for U.S. tax purposes and cannot be the dependent of another U.S. taxpayer. The spouse must have a Taxpayer Identification Number.

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

- ▶ In general, a taxpayer can claim an exemption for a nonresident alien spouse if he or she chooses to file a joint return with them and be taxed as a resident alien.
- ▶ A taxpayer can claim a nonresident alien spouse on his or her married filing separate return if the nonresident alien spouse has no income for U.S. tax purposes and is not the dependent of another U.S. taxpayer.
- ▶ Every person claimed on a return must have a Taxpayer Identification Number.



## INTRODUCTION AND OBJECTIVES

As you have learned, many areas of a tax return are directly tied to the filing status of the taxpayer. After completing this segment you will be able to apply special rules for Head of Household status when the spouse is a nonresident alien.

## HEAD OF HOUSEHOLD (H OF H)

Because of the complexity of this issue errors often occur. In general, in order to claim Head of Household status, the taxpayer must be unmarried or considered unmarried on the last day of the year and pay more than half the cost of keeping up a home, for over six months, that includes the taxpayer and a qualifying individual.

## SPECIAL RULE

For Head of Household purposes, “you are considered unmarried if your spouse was a nonresident alien at any time during the year, and you do not choose to treat your spouse as a resident alien.” All of the other qualifications for Head of Household must also be met.

### Example 1

Raul is in the U.S. Army in Japan. His wife and children live with him and he is able to claim the children as dependents. Raul’s wife (a citizen of Japan) chooses not to be treated as a resident alien. Even though Raul is married, he can claim Head of Household status because of the rule above. If Raul had not passed all of the other qualifications for Head of Household, he would have to file as a married person (either as Married Filing Separate or Married Filing Joint).

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

- ▶ The taxpayer may be considered unmarried if the spouse was a nonresident alien at any time during the year and the taxpayer does not choose to treat the spouse as a resident alien.

**STUDENT NOTES**

Lined area for student notes.



# EXEMPTIONS FOR FOREIGN SPOUSE OR DEPENDENT

Lesson 1

International Segment

## INTRODUCTION AND OBJECTIVES

This lesson will explain the special rules that may affect a taxpayer's ability to claim a foreign spouse and/or dependent on their return.

After completing this lesson, you should be able to:

- Determine whether the taxpayer is a non-resident alien or resident alien
- Differentiate between a resident for tax purposes and a resident for immigration purposes
- Apply the dependency test for taxpayer living overseas

## PERSONAL AND DEPENDENCY EXEMPTIONS

Each taxpayer is allowed a personal exemption (unless the taxpayer is claimed by someone else). On a Married Filing Separate return a spouse's personal exemption may be claimed by the taxpayer if the spouse had no gross income and is not claimed by anyone else. Remember: a spouse is never the dependent of the taxpayer.

The five dependency tests are essentially the same for taxpayers living overseas.

**Citizenship Test.** To meet this test a person must be a U.S. citizen or national, or a resident of the U.S., Canada or Mexico for some part of the tax year. If a U.S. citizen marries a nonresident alien, any child born to them may be entitled to U.S. citizenship. In most instances the U.S. parent will register the child with the U.S. Embassy or Consulate closest to where they live. If the child may claim U.S. citizenship, the child meets the citizenship test for dependency purposes, even though the family is living in a foreign country. Proof of citizenship is not required to be attached to the return. But if the item is questioned by the IRS, the U.S. citizen parent will have to obtain the necessary documentation from the U.S. government.

## Example 2

Betty Glinn, a U.S. citizen, is married to Giovanni Glinn, an Italian citizen. They are currently living in Rome. Their daughter, Patricia, meets the citizenship test for dependency since she is entitled to U.S. citizenship because of her U.S. parent.

Occasionally, you will encounter a situation where a U.S. citizen adopts a child who is not a U.S. citizen. In those circumstances, the adopted child can meet the citizenship test if he or she lives with the U.S. citizen parent for the entire tax year (except for temporary absences).

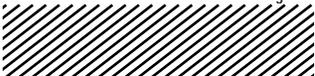
## ***DETERMINING ALIEN STATUS***

Throughout this course material, we refer to U.S. citizens or resident aliens. In order to apply the tax law correctly, you need to determine alien status.

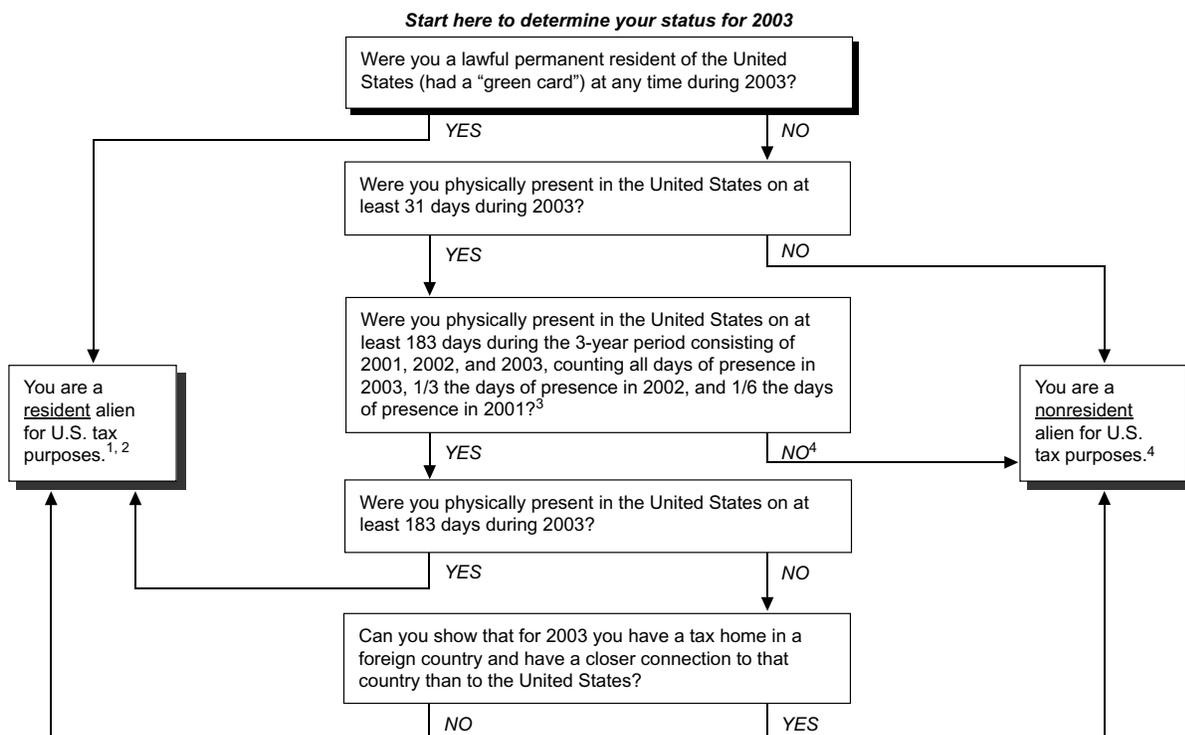
The first issue that must be decided is whether the taxpayer is a nonresident alien. If he/she is a nonresident alien then the taxpayer must be referred to get specialized help. Your training covers only the tax law as it applies to a citizen or a resident alien so this determination is very important. Remember that we are discussing taxes here. A resident for tax purposes is not necessarily a resident for immigration purposes.

The following is an excerpt from Publication 519 (U.S. Tax Guide for Aliens). This section discusses the rules for determining alien status. These issues are complex. In this lesson, we will use examples to review the differences between resident and non-resident aliens.

Glance or read over the following material, especially the flow chart, and get a feel for what is involved.



## Exhibit 1. Nonresident Alien or Resident Alien?



<sup>1</sup> If this is your first or last year of residency, you may have a dual status for the year. See *Dual Status Aliens* in Pub. 519.

<sup>2</sup> In some circumstances you may still be considered a nonresident alien under an income tax treaty between the U.S. and your country. Check the provisions of the treaty carefully.

<sup>3</sup> Do not count the days you were unable to leave the United States because of a medical condition that arose while you were in the United States.

<sup>4</sup> If you meet the substantial presence test for 2004, you may be able to choose treatment as a U.S. resident alien for part of 2003. For details, see *Substantial Presence Test* under *Resident Aliens* and *First-Year Choice* under *Dual-Status Aliens* in Pub 519.

If the taxpayer is an alien (not a U.S. citizen), he or she is considered a nonresident alien unless he or she meets either the green card test or the substantial presence test.

### Green Card Test

You are a resident for tax purposes if you are a lawful permanent resident of the United States at **any time** during the calendar year. (However, see ***Dual Status***, later.) This is known as the “green card” test. You are a lawful permanent resident of the United States at any time if you have been given the privilege, according to the immigration laws, of residing permanently in the United States as an immigrant. You generally have this status if the Bureau of Citizenship and Immigration Services (BCIS) has issued you an alien registration card, also known as a “green card.” You continue to have resident status under this test unless it is taken away from you or is administratively or judicially determined to have been abandoned.

## Substantial Presence Test

You will be considered a U.S. resident for tax purposes if you meet the substantial presence test for the calendar year. To meet this test, you must be physically present in the United States on at least:

1. 31 days during the current year, and
2. 183 days during the 3-year period that includes the current year and the two years immediately before that, counting:
  - a. All the days you were present in the current year (2003) and
  - b. 1/3 of the days you were present in the first year before the current year (2002) and
  - c. 1/6 of the days you were present in the second year before the current year (2001).

### Example 1

You were physically present in the United States on 120 days in each of the years 2001, 2002, and 2003. To determine if you meet the substantial presence test for 2003, count the full 120 days of presence in 2003, 40 days in 2002 (1/3 of 120), and 20 days in 2001 (1/6 of 120). Since the total for the 3-year period is 180 days, you are not considered a resident under the substantial presence test for 2003.

**The term United States** includes the following:

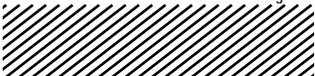
1. All 50 states and the District of Columbia
2. The territorial waters of the United States, and
3. The seabed and subsoil of those submarine areas that are adjacent to the U.S. territorial waters and over which the United States has exclusive rights under international law to explore and exploit natural resources.

The term does not include U.S. possessions and territories or U.S. air space.

## Days of Presence in the United States

You are treated as present in the United States on any day if you are physically present in the country at any time during the day. However, there are exceptions to this rule. Do not count the following as days of presence in the United States for the substantial presence test:

1. Days you regularly commute to work in the United States from a residence in Canada or Mexico.
2. Days you are in the United States for less than 24 hours when you are in transit between two places outside the United States.
3. Days you were unable to leave the United States because of a medical condition that developed while you were in the United States.



4. Days you were an exempt individual.

**Regular commuters from Canada or Mexico.** Do not count the days on which you regularly commute to work in the United States from your residence in Canada or Mexico. You are considered to commute regularly if you commute to work in the United States on *more than* 75 percent of the workdays during your working period.

For this purpose, commute means to travel to work and return to your residence within a 24-hour period. **Workdays** are the days on which you work in the United States or Canada or Mexico.

**Working period** means the period beginning with the first day in 2003 which you are physically present in the United States to work. If your work requires you to be present in the United States only on a seasonal or cyclical basis, your working period begins on the first day of the season or cycle on which you are present in the United States to work and ends on the last day of the season or cycle on which you are in the United States to work. Thus, you may have more than one working period in 2003, and your working period may begin in one calendar year and end in the following calendar year.

**Exempt individual.** For the substantial presence test, do not count days for which you are an exempt individual. The term “exempt individual “ does not refer to someone exempt from U.S. tax, but to anyone in the following categories.

1. An individual temporarily present in the United States as a foreign government-related individual.
2. A teacher or trainee, temporarily present in the United States under a “J” or “Q” visa, who substantially complies with the requirements of the visa.
3. A student, temporarily present in the United States under an “F,” “J,” “M,” or “Q” visa, who substantially complies with the requirements of the visa.
4. A professional athlete temporarily in the United States to compete in a charitable sports event.

After reviewing the rules above, if there are still questions, refer the taxpayer to Publication 519 or to the IRS Information line for alien status determination.

## ***DUAL STATUS***

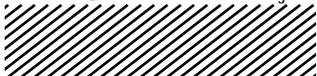
In general, for the first and last year of resident alien status the taxpayer will be considered a “dual status” alien (both resident and nonresident) and special rules apply. Generally, dual status aliens should be referred to the IRS or paid tax professional.



▶▶ **SUMMING UP THIS SEGMENT** ◀◀

**A resident alien is treated the same as a citizen for tax purposes.** The main issues are:

- 1.** Does the taxpayer have a “green card”? If so, then the taxpayer will be considered a resident alien and will meet the citizenship test.
- 2.** Has the taxpayer been here in the U.S. long enough to qualify for the substantial presence test? If so, then the taxpayer is considered a resident alien on a year by year basis (this applies even though the person may be considered “illegal”) and would meet the citizenship test.
- 3.** Remember that certain people are “exempt individuals” and do not count days toward the substantial presence test. They will not be treated as a resident and will not meet the citizenship test for dependency.



## INTRODUCTION AND OBJECTIVES

This lesson will explain additional factors to consider in selecting the married filing joint and head of household filing status for taxpayers who are U.S. citizens or resident aliens. The criteria for selecting the married filing separate, single and head of household filing status are the same as discussed in the basic text.

At the end of this segment, you will be able to:

- Determine the correct filing status for resident aliens.
- Explain how to treat a nonresident alien's spouse as a resident.

## MARRIED NON-RESIDENTS FILING JOINTLY

In order to file Married Filing Jointly, the taxpayers must be married on the last day of the tax year and agree to file a joint return. However, "A joint return generally cannot be made if either spouse is a nonresident alien at any time during the tax year" (Pub 17).

### Treating Non-Resident Spouse as a U.S. Resident

If, at the end of the tax year, the taxpayer is married and one spouse is a U.S. citizen or a resident alien and the other spouse is a nonresident alien, the taxpayer can elect to treat the non-resident spouse as a U.S. resident. This includes situations in which one spouse is a nonresident alien at the beginning of the tax year, but a resident alien at the end of the year, and the other spouse is a nonresident alien at the end of the year.

**If this choice is made, the taxpayer and spouse are treated for income tax purposes as residents for the entire tax year.**

For example, neither the taxpayer nor the spouse can claim tax treaty benefits as a resident of a foreign country for a tax year for which the choice is in effect. Taxpayers must file a joint income tax return for the year the choice is made, but the taxpayer and spouse can file joint or separate returns in later years.

### Example 1

Debra Green, a U.S. citizen for all of tax year 2003, is married to Charles, a nonresident alien. Debra and Charles make the choice to treat Charles as a resident alien by attaching a statement to their joint return for 2003. Debra and Charles must report their world-wide income in 2003 and later years unless the choice is ended or suspended. Although they must file a joint return for 2003, they can file joint or separate returns for later years.

### Example 2

Jim and Judy Adams are married and both are nonresident aliens. In June 2003, Jim became a resident alien and remained a resident for the rest of the year. Jim and Judy both choose to be treated as resident aliens by attaching a statement to the 2003 joint return. Jim and Judy must report their world-wide income in 2003 and later years unless the choice is ended or suspended. They must file a joint return for 2003, but they can file either joint or separate returns for later years.

## ***THE "CHOICE" DECLARATION***

A statement containing the following information must be signed by both spouses and attached to the joint return for the first tax year for which the choice applies.

1. A declaration that one spouse was a nonresident alien and the other spouse a U.S. citizen or resident alien on the last day of the tax year, and that the taxpayer and spouse chose to be treated as U.S. residents for the entire tax year, and
2. The name, address, and social security number or ITIN of each spouse. (If one spouse died, include the name and address of the person making the choice for the deceased spouse.)

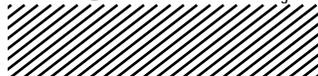
The choice can also be made by filing a joint amended return. Publication 54 contains specifics on this option.

### Suspending the Choice

The choice to be treated as a resident alien does not apply to any later tax year if neither spouse is a U.S. citizen or resident alien at any time during the tax year.

### Example 3

Dick Brown was a resident alien on December 31, 2000, and married to Judy, a nonresident alien. They chose to treat Judy as a resident alien and filed joint returns for tax years 2000 and 2001. On January 10, 2002, Dick became a nonresident alien. Judy had remained a nonresident alien throughout the period. Dick and Judy can file joint or separate returns for 2002. However, since neither Dick nor Judy is a resident alien at any time during 2003, their choice is suspended for that year. If either has U.S. source income or foreign source income effectively connected with a U.S. trade or



business in 2003, they must file separate returns as nonresident aliens. If Dick becomes a resident alien again in 2004, their choice is no longer suspended.

## Ending the Choice

Once made, the choice to be treated as a resident applies to all later years unless suspended or ended in one of the ways shown below. If the choice is ended for any of these reasons, neither spouse can make a choice in any later tax year.

<b>Revocation</b>	<ul style="list-style-type: none"> <li>• Either spouse can revoke the choice for any tax year.</li> <li>• The revocation must be made by the due date for filing the tax return for that year.</li> <li>• The spouse who revokes must attach a signed statement declaring that the choice is being revoked. If the spouse revoking the choice does not have to file a return and does not file a claim for refund, send the statement to the Internal Revenue Service Center where the last joint return was filed.</li> <li>• The statement revoking the choice must include the following:             <ul style="list-style-type: none"> <li>• The name, address, and social security number (or taxpayer identification number) of each spouse.</li> <li>• The name and address of any person who is revoking the choice for a deceased spouse.</li> <li>• A list of any states, foreign countries, and possessions that have community property laws in which either spouse is domiciled or where real property is located from which either spouse receives income.</li> </ul> </li> </ul>
<b>Death</b>	<ul style="list-style-type: none"> <li>• The death of either spouse ends the choice, beginning with the first tax year following the year the spouse died.</li> <li>• If the surviving spouse is a U.S. citizen or resident and is entitled to the joint tax rates as a surviving spouse, the choice will not end until the close of the last year for which these joint rates may be used.</li> <li>• If both spouses die in the same tax year, the choice ends on the first day after the close of the tax year in which the spouses died.</li> </ul>
<b>Divorce or Legal Separation</b>	<ul style="list-style-type: none"> <li>• A divorce or legal separation ends the choice as of the beginning of the tax year in which the legal separation occurs.</li> </ul>
<b>Inadequate records</b>	<ul style="list-style-type: none"> <li>• The Internal Revenue Service can end the choice for any tax year that either spouse has failed to keep adequate books, records, and other information necessary to determine the correct income tax liability, or to provide adequate access to those records.</li> </ul>

## HEAD OF HOUSEHOLD

In general, in order to claim Head of Household status, the taxpayer must:

1. Be unmarried or considered unmarried on the last day of the year and
2. Have paid more than half the cost of keeping up a home for the year and
3. Have a qualifying person in the home for more than half the year.

These general rules for discussed in the basic text and in more detail in Publication 17.

A U.S. citizen or resident alien (for all 12 months of the tax year ) is considered unmarried for if their spouse was a nonresident alien at any time during the year and the taxpayer did not make one of the choices discussed earlier in this segment to treat their spouse as a resident alien for the entire year.



# STUDENT NOTES



### LESSON OVERVIEW AND OBJECTIVES

This lesson gives students practice in using the forms needed to complete the income section of the taxpayer's Form 1040EZ, 1040A, or 1040, as appropriate. Students will practice using Forms W-2, 1099-INT, and 1099-DIV, Schedules B and C-EZ, and others. Approximately 1 1/2 to 3 hours should be devoted to covering the objectives of this lesson.

This lesson will help you achieve the following objectives:

- Determine what is taxable and nontaxable income.
- Determine where to report income on Forms 1040, 1040A, and 1040EZ.
- Identify who can file Schedule C-EZ.
- Identify who must file Schedule SE.

### MATERIALS

This lesson will refer to the following IRS forms and publications. You should provide your students with the most current revision of the forms or publications. You can download the files from [www.irs.gov](http://www.irs.gov).

- Form W-2, *Wage and Tax Statement*
- Form 1099-INT, *Interest Income*
- Form 1099-DIV, *Dividends and Distributions*
- Form 1099-G, *Certain Government Payments*
- Form 1040 EZ and Instructions
- Form 1040A and Instructions
- Schedule 1 (Form 1040A)
- Form 1040 and Instructions
- Schedule B (Form 1040)
- Schedule C-EZ
- Schedule SE
- Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*
- Form 4852, *Substitute for Form W-2 or Form 1099R*

## TEACHING TIPS — TAXABLE AND NONTAXABLE INCOME

If students have difficulty answering the Guided Questions, direct their attention to the lists of taxable and nontaxable income. Point out that the exceptions to taxable interest income are listed under nontaxable income. Review with students questions in Exercise 1. Ask students to use the chart to explain why each form of income named was either included or excluded when computing the total taxable income for each taxpayer.

## TEACHING TIPS — EARNED INCOME

1. Make students aware that if the taxpayer paid cash wages of \$1,400 or more for the year to an employee working in his or her home, the taxpayer must pay the taxes on the employee's wages with Form 1040. Tax-payers in this situation should be advised to seek paid professional tax assistance and refer to Publication 926, *Household Employer's Tax Guide*. This topic is beyond the scope of the VITA/TCE Program.
2. If the taxpayer was a household employee who did not receive a Form W-2 because he or she was paid less than \$1,400, the income must still be included on line 1 (Form 1040EZ), or line 7 (Form 1040A or 1040).
3. In past years, some household employees have reported their wages on Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, when a Form W-2 was not given to them by their employer. Instructors should reinforce that wages of household employees should not be reported on Form 4137.
4. If, after requesting a Form W-2 from the employer, the household employee does not receive a Form W-2, then 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.* Form 4852 is used only to meet the filing deadline. Instructors may want to review the Form 4852 with the students, using an overhead projector. Many students may not know of the use and availability of this form.

## TEACHING TIPS — TAX-EXEMPT INTEREST

1. Remind students that, while tax-exempt interest is not included as part of taxable income, it still must be shown on Form 1040 or 1040A or 1040EZ.
2. Students should refer to a paid professional tax preparer any taxpayer who has OID income under either of these two situations: (1) the taxpayer bought the obligation after its original issue or (2) the taxpayer did not hold the obligation all year. IRS Publication 550, *Investment Income and Expenses*, and



Publication 1212, *List of Original Issue Discount Instruments*, provide useful information about OID income in these situations.

3. Direct students' attention to box 4 on Form 1099-INT. Ask students to name the section (Payments) and the line (61) of Form 1040 on which federal income tax withheld should be reported.
4. Ask students to give examples of tax-exempt interest that can be shown on line 8b of Forms 1040 or 1040A. Check their answers against the list of nontaxable income.

### **TEACHING TIPS — STATE AND LOCAL TAX REFUNDS**

1. Caution students not to assume that because there is an entry in box 2 of a taxpayer's Form 1099-G, they must automatically make an entry on line 10 of Form 1040.
2. Remind students that if a taxpayer did not itemize deductions on his or her 2002 return and received a refund of 2002 state or local tax, the taxpayer does not have to include the refund in taxable income in 2003.

### **TEACHING TIPS — INCOME FROM BUSINESS (OPTIONAL TOPIC)**

1. It is important to stress that taxpayers must keep records of all expenses claimed even though they do not have to be individually listed on Schedule C-EZ.
2. Taxpayers cannot take depreciation and standard mileage at the same time for business use of a car. If they decide to take depreciation instead of standard mileage, the volunteer should refer this taxpayer to a paid professional tax preparer.

### **GUIDED QUESTIONS**

1. **Differentiate between taxable and nontaxable income.** (Taxable income is any income that is subject to tax. It must be reported on a tax return, unless the individual is not required to file a return. 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 subject to tax.)
2. **Although interest is generally considered taxable income, identify some types of interest that are not taxable.** (Interest from state and local bonds and qualified Series EE and/or I savings bonds used to pay for higher education expenses.)
3. **Under what circumstances must a taxpayer complete Schedule B of Form 1040?** (If taxable interest or dividend income is over \$1500, if the

taxpayer claims an exclusion of interest from Series EE or I U.S. savings bonds issued after 1989, or if another situation listed in the Schedule B instructions applies.)

**4. When are long-term obligations considered to be issued at a discount?**

(When they pay no interest before maturity.)

**5. Define Original Issue Discount.**

(Original Issue Discount is the difference between the principal amount [redemption price at maturity] of a long-term debt instrument, such as a bond or note, and its issue price.)

**6. How does a taxpayer report taxable interest income from long-term obligations that pay no interest until maturity?**

(Taxpayers report as interest income the portion of the Original Issue Discount each year until the obligation matures.)

**7. Compare the two forms (sent to the taxpayer and the IRS) that report interest income.**

(Form 1099-INT, *Interest Income*, reports interest income of \$10 or more; Form 1099-OID, *Original Issue Discount*, reports the amount of Original Issue Discount income that a taxpayer should report as interest income for the year.)

**8. What corporate distributions do VITA and TCE cover?**

(Ordinary and qualified dividends and capital gain distributions.)

**9. Which type of dividends can be reported on Form 1040A?**

(Ordinary and qualified dividends.)

**10. On what form is dividend income reported to the taxpayer and to the IRS?**

(Form 1099-DIV.)

**11. Where on Form 1040 or Form 1040A are ordinary dividends reported?**

(If the amount in box 1 of Form 1099-DIV totals \$1500 or less, the total is entered on line 9a. If the amount totals more than \$1500, each amount is listed on Schedule B, Form 1040 or Schedule 1, Form 1040A, Part II.)

**12. Where on Form 1040 or Form 1040A are capital gain distributions reported?**

(Taxpayers who have capital gain distributions can file a Form 1040 or 1040A. Capital gain distributions are reported on line 13a of Form 1040 or line 10a of Form 1040A, if the taxpayer has only capital gain distributions as evidenced by an entry in box 2a of the 1099-DIV. If the taxpayer has gains from the sale of assets or entries in boxes 2b, 2c, 2d, 3 or 6 through 9 the capital gain distribution is reported on line 13a of Schedule D.)



**13. Which taxpayers meet the qualifications to use Schedule C-EZ?**

(Refer to bulleted list under Who Can Use Schedule C-EZ.)

**14. Where can the taxpayer find the Principal Business Code?**

(In the instructions for Schedule C.)

**15. On which line of Form 1040EZ, Form 1040A, or Form 1040 is unemployment compensation reported?**

(Unemployment compensation paid from the Federal Unemployment Trust Fund is reported on 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 reported on line 1 of Form 1040EZ or on line 7 of Form 1040A or 1040.)

**16. What form is sent to recipients of unemployment compensation?**

(Form 1099-G)

***LESSON REVIEW — EARNED INCOME***

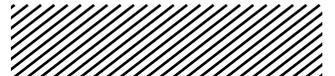
1. Students may wonder what procedure to follow when a Form W-2C is received after the return is filed. Explain that the taxpayer must file an amended return (Form 1040X) and attach Form W-2C to it. Timing is important in filing an amended return, so the taxpayer should contact the IRS with any questions.

***LESSON REVIEW — TIP INCOME***

Since tips may be paid in the form of jewelry, tickets, or meals, students may ask how such tips can be reported as taxable income. Explain that the taxpayer should report the fair market value of the property received as a tip.

***LESSON REVIEW — TAXABLE INTEREST INCOME***

Series I Bonds are inflation-indexed bonds designed to protect the purchasing power of the investment by providing a rate of return over and above the rate of inflation.



## **LESSON REVIEW — INCOME FROM BUSINESS**

1. Remind students that Schedule C-EZ can only be used by a taxpayer who operates one business as a self-employed individual.
2. Individuals who have more than one business must file separate Schedule Cs but combine the income on one Schedule SE. These individuals should be referred to a paid professional tax preparer.
3. Remind students that one-half of the self-employment tax may be claimed as an adjustment to income on line 28 of Form 1040.

## **OPTIONAL GROUP ACTIVITY — A**

*(7–10 min.)*

Divide the class into three groups. Assign each group one of the following sets of interest income to review for the class:

1. Savings accounts and Series EE or I Bonds
2. U.S. Treasury notes and bonds, certificates of deposit, savings accounts, and money-market certificates
3. Life insurance proceeds, life insurance dividends, and insurance dividends left on deposit with the VA

For each type of taxable interest income, the groups should identify when the taxpayer must report the income.

## **OPTIONAL GROUP ACTIVITY — B**

*(7–10 min.)*

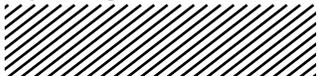
Discuss with the class types of expenses associated with different businesses that might be deductible. Stress the fact that the expense must be ordinary and necessary.

Not all self-employed individuals receive Form 1099-MISC. Discuss situations that apply and expenses that are relevant.

Volunteers need to probe taxpayers for further information relating to their particular situation.

## **OPTIONAL GROUP ACTIVITY — C**

To review students' understanding of income draw on a chalkboard or flip-chart the following graphic organizer. Students should enter each type of income in one of the two columns to show whether or not volunteer assistance can be provided.



Types of Income Reported On Form 1040	
Within Scope of VITA/TCE Program	Refer to Paid Professional Tax Preparer

(Students should list in the first column; wages, salaries, tips, for example; interest income; dividend income (with no entries in boxes 8 or 9 of Form 1099-DIV); state and local tax refunds; alimony received; capital gains and losses; capital gain distributions; unemployment compensation; social security benefits; prizes, awards, and lottery winnings; jury pay.

Students should list in the second column: any amounts reported in boxes 8 or 9 of Form 1099-DIV; the sale or involuntary conversion of business property; royalties, partnerships, estates and/or trusts; farm income; and certain broker and barter exchange transactions.)

### ***GUIDED QUESTIONS – INCOME – MILITARY SEGMENT***

**1. Why do you need to know what military pay is includible and excludible?**

To verify the accuracy of the information conveyed on the W-2.

**2. If you find out that the person’s W-2 is wrong because it includes some income that should have been excluded, what do you do?**

Send the person to their pay office with the pertinent information so that the pay office can send the information in for a W-2C to be issued. The person **MUST** wait for the W-2C to be issued or file an amended return when the W-2C is received.

**3. How is a combat zone determined?**

There must be an Executive Order declaring the area as a combat zone.

**4. If a person is hospitalized while in a combat zone and sent back to the states for continued hospitalization when is the person considered to leave the combat zone?**

He/she is considered to be in the combat zone until they are released from the hospital for the injury/illness that they were hospitalized for from the combat zone.

### ***TEACHING TIP – OTHER INCOME – MILITARY SEGMENT***

*Tax returns that include depreciation are not in the scope of the M-VITA Program.*



## ***GUIDED QUESTIONS – SELF-EMPLOYMENT TAX – INTERNATIONAL SEGMENT***

### **1. Who is responsible for determining how much income has been received when a person is self-employed?**

The self-employed individual is responsible and should keep good permanent records to record the income and expenses.

### **2. Who can file a Schedule C-EZ?**

A self-employed person that meets the following criteria:

- Less than \$2,500 in business expenses
- Uses cash method of accounting
- Has no inventory
- Has a profit
- Has only one business
- Has no employees

### **3. What is the Schedule SE?**

This schedule is used to calculate the self-employment tax on self employment income.

## ***GUIDED QUESTION – RENTAL INCOME AND EXPENSES – INTERNATIONAL SEGMENT***

### **1. How do taxpayers report rental income and expenses?**

Schedule E is used to report the income and expenses from rental property activity. The taxpayer should be referred to the legal assistance office. Depreciation is beyond the Scope of this program.



### 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 on Forms 1040EZ, 1040A, and 1040.

This lesson will help you achieve the following objectives.

- Determine what is taxable and nontaxable income.
- Determine where to report income on Forms 1040, 1040A, and 1040EZ.
- Identify who can file Schedule C-EZ.
- Identify who must file 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
- 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 compensatory 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, interest on certain state and local bonds and on 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

Robert 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 Robert's tax return.

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

### 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. Child Support	_____	_____
5. Credit union dividends	_____	_____
6. Cash bonuses	_____	_____
7. Inheritances	_____	_____
8. Tips	_____	_____
9. Worker's compensation	_____	_____
10. Veteran's life insurance dividends	_____	_____

#### ALERT



New line added to Forms 1040 and 1040A for qualified dividends.

Qualified dividends are eligible for the capital gains rates.

### 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 \$1,500 or less on Form 1040EZ.

In addition to the types of income that can be reported on Form 1040EZ, ordinary and qualified dividends, capital gains distribution, interest income greater than \$1,500, 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

The 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 Forms W-2s from various employers. When the taxpayer and/or spouse receive Forms W-2s from their employers, add the amounts from Box 1 of each Form W-2 and report the total amount on the return.

Generally, if a **household employee** earned less than \$1,400 a year while working in the employer's home, the employer is not required to provide the taxpayer with a Form W-2 but, the income must be included on line 7 (Form 1040A or 1040) or line 1 (Form 1040EZ). However, a Form 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 W-2c, *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.

**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 Forms 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 Forms W-2s)

**ALERT**



In 2003, household employers are required to issue a Form W-2 to employees whose earnings are \$1,400 or more.

Exhibit 1

a Control number		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number		1 Wages, tips, other compensation		2 Federal income tax withheld			
c Employer's name, address, and ZIP code		3 Social security wages		4 Social security tax withheld			
		5 Medicare wages and tips		6 Medicare tax withheld			
		7 Social security tips		8 Allocated tips			
d Employee's social security number		9 Advance EIC payment		10 Dependent care benefits			
e Employee's first name and initial      Last name		11 Nonqualified plans		12a See instructions for box 12			
		13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <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**      **2003**      Department of the Treasury—Internal Revenue Service

**Copy B To Be Filed with Employee's FEDERAL Tax Return.**  
This information is being furnished to the Internal Revenue Service.

**Form 1099-MISC.** Taxpayers with earnings reported on Form 1099-MISC, Miscellaneous Income, 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.

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

<input type="checkbox"/> CORRECTED (if checked)				
PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Rents	OMB No. 1545-0115  <b>2003</b>  Form <b>1099-MISC</b>	<b>Miscellaneous Income</b>
		\$		
		2 Royalties		
		\$	4 Federal income tax withheld	<b>Copy B For Recipient</b>
		3 Other income	\$	
PAYER'S Federal identification number	RECIPIENT'S identification number	5 Fishing boat proceeds	6 Medical and health care payments	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		7 Nonemployee compensation	8 Substitute payments in lieu of dividends or interest	
Street address (including apt. no.)		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>	10 Crop insurance proceeds	
City, state, and ZIP code		11	12	
Account number (optional)		13 Excess golden parachute payments	14 Gross proceeds paid to an attorney	
		\$	\$	
15		16 State tax withheld	17 State/Payer's state no.	18 State income
		\$		\$
		\$		\$
Form <b>1099-MISC</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service

### 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.

**POTENTIAL PITFALLS**

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. (See Pub. 531, Reporting Tip Income).
- 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. Form 4137 should be used to compute and report the additional tax.

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.

### 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. 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).

### 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.

### Exercise 2

- A.** Mike worked two jobs. He was a quality inspector during the week and a bartender on the weekends. He reported all of his tip income (\$3,000) to his employer. His Forms W-2, box 1, showed income of \$21,000 (quality inspector) and \$8,250 (bartender). What amount will Mike report on his Form 1040A, line 7? \_\_\_\_\_
- B.** John 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 John file Form 1040A? \_\_\_\_\_
- C.** Randy had several employers during the tax year. On February 3, 2004, 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 Randy? \_\_\_\_\_

## 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.

## 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.

### 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.

## 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 3

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.

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, see 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 2004. He will receive \$75 in interest income.

Duane will report the interest income on the certificate of deposit on his 2004 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, 2003. It matures on February 29, 2005.

For 2003, Deborah reports the interest income earned from March through December. For 2004, she will report 12 months of interest. For 2005, 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.

### **COVERDELL ESA**

Contributions to a Coverdell ESA are not deductible. Amounts in the ESA grow (tax deferred) until they are distributed. Generally, if the beneficiary has qualified education expenses that are greater than the distribution during the year, then no tax is due.

If the taxpayer received Form 1099-Q, showing a distribution from a Coverdell ESA, ask the taxpayer if the funds were used for qualified education expenses. Coverdell ESA qualified education expenses include elementary, secondary, and postsecondary (higher) education expenses.

If the entire amount of the distribution was spent on qualified elementary and secondary expenses, the distribution is tax-free. Tax-free distributions are not reported. If the taxpayer paid for qualified higher (postsecondary) education expenses, the taxpayer may be eligible for the Hope Credit or Lifetime Learning Credit, which may be more beneficial.

Refer the taxpayer/beneficiary to a paid professional tax preparer and/or Publication 970, *Tax Benefits for Higher Education*, if:

- The funds were not used for qualified education expenses.
- The distribution is more than the amount spent for qualified expenses.

#### **ALERT**



Starting in 2003, Coverdell ESA distributions are no longer reported on Form 1099-R. They are reported on Form 1099-Q.

- Part or all of the distribution is taxable and earnings must be computed.
- The taxpayer/beneficiary received other education benefits such as a distribution from a Qualified Tuition Program, employer provided educational assistance, or a scholarship, or used U.S. Savings Bonds to pay for qualified education expenses.
- If any amount needs to be reported, report it on Form 1040, line 21. Additional tax may be due. Use Part II of Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax Favored Accounts*, to figure any additional tax.

## 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
- Amounts indicated on broker statements as tax-exempt interest or dividends

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 31 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 61.

**Exhibit 4**

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0112		<b>2003</b> <b>Interest Income</b>
PAYER'S name, street address, city, state, ZIP code, and telephone no.		Payer's RTN (optional)		
PAYER'S Federal identification number		RECIPIENT'S identification number		<b>Copy B</b> <b>For Recipient</b> 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		1 Interest income not included in box 3 \$		
Street address (including apt. no.)		2 Early withdrawal penalty \$		
City, state, and ZIP code		3 Interest on U.S. Savings Bonds and Treas. obligations \$		
Account number (optional)		4 <b>Federal income tax withheld</b> \$		
		5 Investment expenses \$		
		6 Foreign tax paid \$		
		7 Foreign country or U.S. possession		
Form <b>1099-INT</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service

**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.

### Example 7

Jennifer received taxable interest income of \$65 and tax-exempt interest income of \$23. She would report her interest income on Form 1040EZ as shown in the exhibit below.

Exhibit 5		Jennifer's 1040EZ	
<b>Income</b> <b>Attach Form(s) W-2 here.</b> Enclose, but do not attach, any payment.  <b>Note.</b> You must check	<b>1</b>	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
	<b>2</b>	Taxable interest. If the total is over \$400, you cannot use Form 1040EZ. <b>TEI=\$23.00</b>	2                    6 5 0 0
	<b>3</b>	Unemployment compensation, qualified state tuition program earnings, and Alaska Permanent Fund dividends (see page 14).	3
	<b>4</b>	Add lines 1, 2, and 3. This is your <b>adjusted gross income</b> .	4
	<b>5</b>	Can your parents (or someone else) claim you on their return? <b>Yes.</b> Enter amount from <b>No.</b> If single, enter 7,450.00.	

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.

### 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 and qualified 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 and qualified 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.
- 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 11, *Sale of Stock*, for more information on capital gains.

### ALERT



In 2003, line 9b is added to Forms 1040 and 1040A for qualified dividends.

- **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 1a of Form 1099-DIV. Add the amounts in box 1a from all the Forms 1099-DIV the taxpayer received. If the total is:

- \$1500 or less, enter the total on line 9a 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 9a 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

### ALERT



In 2003, Line 1 of Form 1099-DIV was changed to Line 1a—Ordinary dividends and Line 1b—Qualified dividends.

or the asset for more than the cost and realizes a capital gain. For more information on capital gains and losses, see Lesson 11, *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 Post-May 5 capital gain distributions (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.

**Exhibit 6**

<input type="checkbox"/> CORRECTED (if checked)				<b>2003</b>	<b>Dividends and Distributions</b>
PAYER'S name, street address, city, state, ZIP code, and telephone no.		<b>1a</b> Total ordinary dividends \$	<b>1b</b> Qualified dividends \$	OMB No. 1545-0110 <b>Form 1099-DIV</b>	
PAYER'S Federal identification number		<b>2a</b> Total capital gain distr. \$	<b>2b</b> Post-May 5 capital gain distr. \$	<b>Copy B For Recipient</b>	
RECIPIENT'S identification number		<b>2c</b> Qualified 5-year gain \$	<b>2d</b> Unrecap. Sec. 1250 gain \$	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		<b>2e</b> Section 1202 gain \$	<b>2f</b> Collectibles (28%) gain \$		
Street address (including apt. no.)		<b>3</b> Nontaxable distributions \$	<b>4</b> Federal income tax withheld \$		
City, state, and ZIP code			<b>5</b> Investment expenses \$		
Account number (optional)		<b>6</b> Foreign tax paid \$	<b>7</b> Foreign country or U.S. possession		
		<b>8</b> Cash liquidation distributions \$	<b>9</b> Noncash liquidation distributions \$		
Form <b>1099-DIV</b> (keep for your records) Department of the Treasury - Internal Revenue Service					

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

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 11 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 61 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 4.)
- Box 6, *Foreign tax paid*. If the taxpayer has an entry in box 6, see Lesson 5 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 or 2c, then that number is reported on line 13 column (g).

## POTENTIAL PITFALLS



If the state or local income tax refund reflects any deductions, credits, or payments for years other than 2002, refer the taxpayer to a paid professional tax preparer.

## 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 2002 return and received a refund of 2002 state or local tax, the taxpayer does not have to include the refund in taxable income for tax year 2003. 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 in 2003. 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.

**Exhibit 7**

<input type="checkbox"/> CORRECTED (if checked)				<b>2003</b>	<b>Certain Government Payments</b>
PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Unemployment compensation \$	2 State or local income tax refunds, credits, or offsets \$	OMB No. 1545-0120 <b>Form 1099-G</b>	
PAYER'S Federal identification number	RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld \$	<b>Copy B For Recipient</b> <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 income is taxable and the IRS determines that it has not been reported.</small>	
RECIPIENT'S name		5	6 Taxable grants \$		
Street address (including apt. no.)		7 Agriculture payments \$	8 Box 2 is trade or business income <input type="checkbox"/>		
City, state, and ZIP code					
Account number (optional)					
Form <b>1099-G</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service	

***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 32a, 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.

***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.

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

**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,

## 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.

- 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 that the Internal Revenue Service supplies to businesses and other professional activities. If the taxpayer does not have one, the space should be left blank. The taxpayer cannot use the taxpayer's social security number.

#### 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 maintenance, 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:

$$\begin{array}{l} \text{Business miles incurred during the year} \times \mathbf{36\text{¢}} \text{ per mile} \\ + \text{ Parking and tolls incurred while on business } \end{array}$$

**Actual Car Expenses.** If the taxpayer chooses to use the actual car expenses, only the business portion of the expenses is 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:

$$\begin{array}{l} (\% \text{ of business use} \times \text{total actual expenses}) \\ + \text{ Parking and tolls incurred while on business } \end{array}$$

**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.

Subtracting line 2 from line 1 and entering the net amount on line 3 determine net profit or loss.

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.

### Part III: Information on Your Vehicle

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

#### ALERT



The 2003 rate for business use of your vehicle is 36 cents a mile.

<b>SCHEDULE C-EZ</b> <b>(Form 1040)</b>  Department of the Treasury Internal Revenue Service	<b>Net Profit From Business</b> (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  <div style="font-size: 2em; font-weight: bold; text-align: center;">2003</div> Attachment Sequence No. <b>09A</b>
Name of proprietor		Social security number (SSN)

**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-4 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.

<b>A</b> Principal business or profession, including product or service	<b>B</b> Enter code from pages C-7, 8, & 9 ▶
<b>C</b> Business name. If no separate business name, leave blank.	<b>D</b> Employer ID number (EIN), if any 
<b>E</b> 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**

<b>1 Gross receipts. Caution.</b> If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <b>Statutory Employees</b> in the instructions for Schedule C, line 1, on page C-3 and check here <input type="checkbox"/>	<b>1</b>		
<b>2 Total expenses</b> (see instructions). If more than \$2,500, you <b>must</b> use Schedule C	<b>2</b>		
<b>3 Net profit.</b> Subtract line 2 from line 1. If less than zero, you <b>must</b> use Schedule C. Enter on <b>Form 1040, line 12</b> , and also on <b>Schedule SE, line 2</b> . (Statutory employees <b>do not</b> report this amount on Schedule SE, line 2. Estates and trusts, enter on Form 1041, line 3.)	<b>3</b>		

**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 2003, 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**

## 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, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, 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 55.

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.

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 55.

### 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 28 as an adjustment to income.

**SCHEDULE SE**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Self-Employment Tax**

▶ **Attach to Form 1040.** ▶ **See Instructions for Schedule SE (Form 1040).**

OMB No. 1545-0074

**2003**

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**

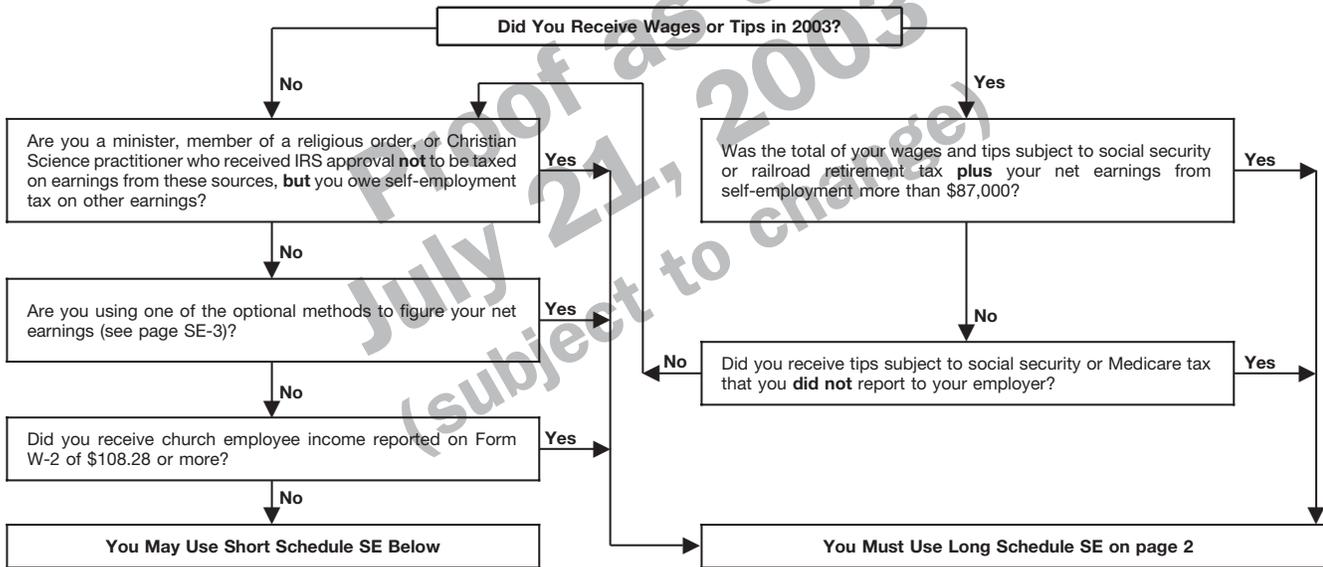
You must file Schedule SE if:

- 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 55.

**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.

<b>1</b>	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a . . . . .	<b>1</b>		
<b>2</b>	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 . . . . .	<b>2</b>		
<b>3</b>	Combine lines 1 and 2 . . . . .	<b>3</b>		
<b>4</b>	<b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax . . . . . ▶	<b>4</b>		
<b>5</b>	<b>Self-employment tax.</b> If the amount on line 4 is: • \$87,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 55.</b> • More than \$87,000, multiply line 4 by 2.9% (.029). Then, add \$10,788.00 to the result. Enter the total here and on <b>Form 1040, line 55.</b>	<b>5</b>		
<b>6</b>	<b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 28</b> . . . . .	<b>6</b>		

## ***CAPITAL GAINS AND LOSSES***

Both the sale of stock and the sale of a home are reported on Form 1040, line 13a. The amount entered on Form 1040, line 13a, is transferred from Schedule D (Form 1040), *Capital Gains and Losses*. See Lessons 11 and 12 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 13, *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.

## ***FARM INCOME***

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

## ***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 (See Exhibit 7) 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.

## **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 13, *Pensions*.

## 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.
- 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. is available and can be completed in TaxWise.

▶▶ 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 31, as an adjustment to income. Do not subtract penalties from interest income.

Report capital gain distributions directly on Form 1040, line 13a 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 of 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. Nontaxable
5. Taxable
6. Taxable
7. Nontaxable
8. Taxable
9. Nontaxable
10. Nontaxable

**Exercise 2**

- (A) Mike will report \$29,250 on line 7. The tip income is included in the \$8,250.
- (B) No; John must file Form 1040 to pay social security and Medicare tax on his tip income.
- (C) Randy 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, Randy should contact the IRS (but not before February 15th).

**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

This segment discusses whether to include specific items in gross income. You should be aware, however, that certain items related to moving or travel expenses generally must be accounted for even if they are not considered income.

This lesson includes information about the combat zone exclusion. For additional tax benefits, see Lesson 16, *Tax Options for Combat Zone Participants*.

This segment will help you to achieve the following objectives:

1. Determine which items received by Armed Forces members are includible in gross income.
2. Determine if an amended return must be filed for a taxpayer who received medical separation pay.
3. Determine who qualifies for exclusion of pay from income because of service in a combat zone.
4. Identify qualifying items of military pay received for service in a combat zone.

## FORM W-2

Includible military income will generally be the amount shown in box 1 of Form W-2, *Wage and Tax Statement*. If this amount differs from the last Leave and Earnings Statement for 2003, advise the person to contact his or her local accounting and finance or payroll office for an explanation.

The wages shown in box 1 of the 2003 Form W-2 should not include military pay excluded from an individual's income under the combat zone exclusion provisions. Tax exempt earned income, basic allowance for subsistence (BAS), basic allowance for housing (BAH), and certain in-kind allowances are no longer reported in box 12 of Form W-2.

Members of the Armed Forces receive many different types of pay and allowances. Some are includible in gross income while others are excludable from gross income. Includible items are subject to tax and must be reported on the taxpayer's tax return. Excludable items are not subject to tax, but may have to be shown on the tax return. The following items are includible in gross income, **unless** the pay is for service in a combat zone declared by an executive order of the President or in a qualified hazardous duty area declared by statute:

Accrued Leave Payment	Aviation Career Incentive Pay
Basic Pay	Continuation Pay
Diving Pay	Enlistment Bonus *
Flight Duty Pay	Foreign Duty Pay
Hostile Fire Pay	Imminent Danger Pay
Medical/Dental Officer Pay	Medical Separation Pay
Nuclear Qualified Officer Pay	Overseas Extension Bonus
Personal Money Allowance	Proficiency Pay
Reenlistment Bonus *	Responsibility Pay
Scholarships (AFHPSP)	Sea Duty Pay
Separation Pay	Student Loan Repayments
Veterinary Officer Pay	

\* Enlistment and reenlistment bonuses fall under the category of taxable income. Income tax will be deducted from these entitlements before they are paid to the service member. Income tax is withheld at a flat rate of 27% as bonuses are treated as supplemental wages. Service members will not need to account for enlistment and reenlistment bonuses separately when preparing their tax returns as the payments and withholdings will be reflected on their Form W-2. If a service member feels this information is incorrect they will need to contact their local accounting and finance or payroll office.

A reenlistment bonus may be tax free if the voluntary extension or reenlistment occurs in a month the service member served in a combat zone.



## ***EXCLUDABLE INCOME***

The following qualified military benefits do not have to be reported as income on Form 1040, 1040A, or 1040EZ. The exclusion applies whether the item is furnished in kind or is a reimbursement or allowance. The personal use of a vehicle cannot be excluded from gross income as a qualified military benefit.

Basic Allowance for Housing (BAH)	Basic Allowance for Subsistence (BAS)
Combat Zone Compensation (including hostile fire pay or imminent danger pay) (limited amount for officers)	Congressional Medal of Honor Pension
Death Allowances	Defense Counseling
Dislocation Allowances	Evacuation Allowance
Family Allowances	Group-term Life Insurance
Interment Allowance	Medical Benefits
Moving and Storage	Other Quarters Allowances
Overseas Housing Allowance (OHA)	Per Diem (Including reservist)
Professional Education	Qualified Hazardous Duty Pay
ROTC Educational and Subsistence Allowances	Survivor and Retirement Protection Plan Premiums Deducted from Military Retired Pay
Trailer Allowance	Veterans' Benefits

**Note:** If the person you are helping is a member of the Armed Forces and was provided a commuter highway vehicle (such as a van) by his or her employer in 2003, refer the taxpayer to Publication 525, Taxable and Nontaxable Income, and to a paid professional preparer.

## ***MEDICAL SEPARATION PAY***

Service members who have been separated from the service for years of service or medical reasons are given severance pay, which are taxable as wages. If any portion of their pay is subject to medical disability, only the Veteran's Affairs (VA) can make that determination and assign what percentage is attributable to medical disability pension due. This process takes several months and sometimes years. The service member will receive the total "pension" which is taxable until the VA makes the determination and sends the discharged service member a letter of determination.



Disability compensation is a monetary benefit paid to veterans who are disabled by injury or disease incurred or aggravated during active military service. The service of the veteran must have been terminated through separation or discharge under conditions that were other than dishonorable. Disability compensation varies with the degree of disability and the number of dependents, and is paid monthly. The benefits are not subject to federal or state income tax.

Once the letter of determination is received, any future pension payments will be off-set by that percentage and paid directly from the VA. The payments received directly from the VA are not taxable and will not be included in the Form W-2. However, the payments received prior to the letter of determination being issued have already been taxed and the letter also exempts that percentage of pay already received from taxes. The service member needs to file an amended return, if a return has already been filed, and attach a copy of the letter of determination to the Form 1040X.

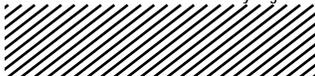
The payment of military retirement pay, disability severance pay and separation incentive payments known as SSB and VSI (Special Separation Benefits and Voluntary Separation Incentives) also affects the amount of VA compensation paid.

### Example

Anita Bennett, an active duty service member, was separated due to a medical condition in February 2002. At the time of her separation she was given medical separation pay or severance pay in the amount of \$10,000.00. She receives a service pension in the amount of \$3000 per month. Her 2002 Form W-2 showed \$48,000 in wages of which \$43,000 ( $\$10,000 + (\$3000 \times 11 \text{ months})$ ) was considered pension. She filed and claimed the full amount on her 2002 tax return. In 2003 the Veteran's Administration (VA) determined that due to her medical condition she was entitled to a VA disability pension of 50% from the date of her discharge. She receives her determination letter from the VA in March 2003, the tax return that includes her severance pay should be amended to exclude the 50% of the pension pay she received in 2002, \$21,500.00 ( $(\$10,000 + 33,000) \times 50\%$ ). She would attach a copy of the letter of determination to the amended return. She also will need to adjust her pension received January thru March 2003 by the 50%, the other months will reflect the correct taxable amount. In 2003 she will also need to attach a copy of the letter to her return to show why the amount is different from the Form W-2. The Form W-2 that she receives in 2004 and forward will show the correct amount of taxable wages.

## **COMBAT ZONE EXCLUSION**

Members of the U.S. Armed Forces who serve in a combat zone (defined later) may exclude certain pay from their income. They do not have to receive the pay while in a combat zone, in a hospital, or in the same year they served in a combat zone. However, the entitlement to the pay must have fully accrued in a month dur-



ing which they served in the combat zone or were hospitalized as a result of wounds, disease, or injury incurred while serving in the combat zone. The following military pay can be excluded from their income.

- Active duty pay earned in any month during which they served in a combat zone.
- Imminent danger/hostile fire pay
- A reenlistment bonus if the voluntary extension or reenlistment occurs in a month during which they served in a combat zone.
- Pay for accrued leave earned in any month during which they served in a combat zone. The Department of Defense must determine that the unused leave was earned during that period.
- Pay received for duties as a member of the Armed Forces in clubs, messes, post and station theaters, and other nonappropriated fund activities. The pay must be earned in a month during which they served in a combat zone.
- Awards for suggestions, inventions, or scientific achievements to which members are entitled to because of a submission they made in a month during which they served in a combat zone.
- Student loan repayments that are attributable to their period of service in a combat zone.

Retirement pay does not qualify for the combat zone exclusion.

**Partial (month) service.** Members of the U.S. Armed Forces who serve in a combat zone for one or more days during a particular month, are entitled to an exclusion for that entire month.

## Combat Zone

A combat zone is any area the President of the United States designates by Executive Order as an area in which the U.S. Armed Forces are engaging or have engaged in combat. An area usually becomes a combat zone and ceases to be a combat zone on the dates the President designates by Executive Order.

**Afghanistan area.** By Executive Order No. 13239, Afghanistan (and airspace above) is designated as a combat zone beginning September 19, 2001.

**Yemen area.** Executive Order No. 13239 was extended to include Yemen as a designated combat zone beginning April 10, 2002.

**The Kosovo area.** By Executive Order No. 13119 and Public Law 106-21, the following locations (including air space above) were designated as a combat zone and a qualified hazardous duty area beginning March 24, 1999.

- Federal Republic of Yugoslavia (Serbia/Montenegro)
- Albania
- The Adriatic Sea



- The Ionian Sea—north of the 39th parallel (including all of the airspace in connection with the Kosovo operation.)

**Persian Gulf area.** By Executive Order No. 12744, the following locations (and airspace above) were designated as a combat zone beginning January 17, 1991.

- The Persian Gulf,
- The Red Sea,
- The Gulf of Oman,
- The part of the Arabian Sea that is north of 10 degrees north latitude and west of 68 degrees east longitude,
- The Gulf of Aden, and
- The total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar, and the United Arab Emirates.

In addition, the Department of Defense has certified these locations for combat zone tax benefits due to their direct support of military operations, beginning on the listed dates:

In support of Operation Enduring Freedom (Afghanistan combat zone):

- Pakistan, Tajikistan and Jordan – September 19, 2001
- Incirlik Air Base, Turkey – September 21, 2001
- Kyrgyzstan and Uzbekistan – October 1, 2001
- Philippines – January 9, 2002
- Yemen – April 10, 2002
- Djibouti – July 1, 2002

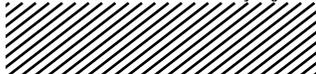
In support of Operation Iraqi Freedom (Arabian Peninsula Areas combat zone):

- Israel and Turkey – January 1, 2003
- The Mediterranean

**Qualified hazardous duty area.** Beginning November 21, 1995, a qualified hazardous duty area in the former Yugoslavia is treated as if it were a combat zone. The qualified hazardous duty area includes:

- Bosnia and Herzegovina,
- Croatia, and
- Macedonia.

Members of the Armed Forces deployed overseas away from their permanent duty station in support of operations in a qualified hazardous duty area, or performing qualifying service outside the qualified hazardous duty area, are treated as if they are in a combat zone solely for the purposes of the extension of deadlines discussed in Lesson 16. These personnel are not entitled to other combat zone tax benefits.



## Serving in a Combat Zone

Service in a combat zone includes any periods that military members are absent from duty because of sickness, wounds, or leave. If, as a result of serving in a combat zone, a person becomes a prisoner of war or is missing in action, that person is considered to be serving in the combat zone so long as he or she keeps that status for military pay purposes.

**Qualifying service outside combat zone.** Military service outside a combat zone is considered to be performed in a combat zone if:

- The service is in direct support of military operations in the combat zone, and
- The service qualifies a member for special military pay for duty subject to hostile fire or imminent danger.

Military pay received for this service will qualify for the combat zone exclusion if the other requirements are met.

**Non-qualifying presence in combat zone.** The following military service does not qualify as service in a combat zone.

- Presence in a combat zone while on leave from a duty station located outside the combat zone,
- Passage over or through a combat zone during a trip between 2 points that are outside a combat zone, and
- Presence in a combat zone solely for a member's personal convenience.

**Note.** Military Members are considered to be serving in a combat zone if they are either assigned on official temporary duty to a combat zone or they qualify for hostile fire/imminent danger pay while in a combat zone.

## Amount of Exclusion

**Enlisted members.** Enlisted members, warrant officers, or commissioned warrant officers who serve in a combat zone during any part of a month, can exclude all of their military pay for that month from their income. They can also exclude military pay earned while they are hospitalized as a result of wounds, disease, or injury incurred in the combat zone. The exclusion of their military pay while they are hospitalized does not apply to any month that begins more than 2 years after the end of combat activities in that combat zone. Their hospitalization does not have to be in the combat zone.

**Officers.** Commissioned officers (including Limited Duty Officers), may exclude their pay according to the rules just discussed. However, the amount of their exclusion is limited to the highest



rate of enlisted pay (plus imminent danger/hostile fire pay they received) for each month during any part of which they served in a combat zone or were hospitalized as a result of their service there.

**Hospitalized while serving in the combat zone.** If a member is hospitalized while serving in the combat zone, the wound, disease, or injury causing the hospitalization will be presumed to have been incurred while serving in the combat zone unless there is clear evidence to the contrary.

### Example

Ron Brady is hospitalized for a specific disease after serving in a combat zone for 3 weeks, and the disease for which he is hospitalized has an incubation period of 2 to 4 weeks. The disease is presumed to have been incurred while he was serving in the combat zone. On the other hand, if the incubation period of the disease were one year, the disease would not have been incurred while he was serving in the combat zone.

**Hospitalized after leaving the combat zone.** In some cases the wound, disease, or injury may have been incurred while serving in the combat zone, even though the member was not hospitalized until after he/she left.

### Example

Martha Marshall was hospitalized for a specific disease 3 weeks after she left the combat zone. The incubation period of the disease is from 2 to 4 weeks. The disease was considered incurred while serving in the combat zone.

## COMMUNITY PROPERTY

The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Special rules apply to married persons who file separate returns or who were divorced during the tax year and were domiciled in a community property state.

For military personnel in community property states, the key word is “domicile.” Domicile describes someone’s legal, permanent residence. It is not always where the person presently lives.

Whether an item is subject to community property laws depends on the nature of the payment.

**Armed Forces pay.** State community property laws apply to active military pay. Generally, the character of the pay as separate to community income is determined by the marital status and domicile of the Armed Forces member and his or her spouse while the member is in active military service.

**Armed Forces retired or retainer pay.** Retired or retainer payments to a member of the Armed Forces may be subject to community property laws.



### Exercise 1

Which of the following should be included in gross income?

- A. Basic Allowance for Subsistence (BAS)
- B. Overseas Housing Allowance
- C. Lump sum for accrued leave, paid on separation
- D. Foreign language proficiency pay
- E. Uniform allowance
- F. Foreign duty pay
- G. Reenlistment Bonus received while a service member was deployed to Qatar
- H. Hazardous duty pay
- I. Family Separation Allowance received while a service member was deployed to Italy

Answer \_\_\_\_\_

### Exercise 2

Sergeant James Wells was medically separated, in November 2002, from active duty military service due to a medical condition that interfered with his ability to perform his military duties. James was entitled to and received \$12,000 in medical separation pay. After taxes he received \$8,640. Prior to his separation he submitted the required documentation to the Veteran's Affairs applying for disability pay. James filed his tax return in March 2003 and received a \$567 refund. In August of 2003 James received his determination letter from VA informing him he was entitled to an \$800 disability pension per month from the date of his discharge.

- A. Does James need to file an amended tax return?

Answer \_\_\_\_\_

- B. What amount of pay will James need to exclude from his pay when he files an amended tax return?

Answer \_\_\_\_\_

- C. When will James start receiving his disability pension?

Answer \_\_\_\_\_



▶▶ SUMMING UP THIS SEGMENT ◀◀

You have learned that certain items received by members of the Armed Forces are included in their gross income. Certain other items are specifically excluded by law. Pay for service in a combat zone is not taxed for an enlisted member of the U.S. military. The amount of income that is not taxed for commissioned officers serving in a combat zone is limited to the highest rate of enlisted pay plus the amount of imminent danger pay per month.



- Exercise 1      C, D, F, and H
- Exercise 2      A — yes  
                    B — \$12,000  
                    C — 15 months or March of 2004

**STUDENT NOTES**

Lined area for student notes.



## INTRODUCTION AND OBJECTIVES

In the first part of this lesson we discussed what the definition of gross income is. Included in this definition was self-employment income and rental income. In this segment we will learn how to handle self-employment income and what is required in order to prepare a tax return with a Schedule C-EZ. Many military members and their spouses may earn additional income as sole proprietors and not be aware of their responsibility to report it. In some cases, income received is reported to those individuals by means of Form 1099-MISC. In many cases no Form 1099-MISC is received, just cash or checks paid to the taxpayer. We will learn about rental income and how to report it.

When this segment is completed, we will be able to:

1. Determine when business income must be reported using Schedule C-EZ.
2. Determine when Schedule SE must be filed.
3. Explain when Schedule E must be filed.

## DETERMINING WHICH TAX YEAR TO REPORT THE BUSINESS INCOME

Under the cash method, a self-employed taxpayer includes in his or her business gross income all items of income actually or constructively received during the tax year. If a taxpayer received property or services, he or she must include the fair market value of those items received in income.

### Example

On December 30, 2002, a customer mailed a check for interior decorating services provided by Kathy (your taxpayer). Kathy received the check on January 2, 2003. Kathy must include the amount of the check in income for 2003.

**Constructive receipt.** You have constructive receipt of income when an amount is credited to your account or made available to you without restriction. You do not need to have possession of it. If you authorize someone to be your agent and receive income for you, you are treated as having received it when your agent received it.

### Example

Interest is credited to your bank account in December 2003. You do not withdraw it or enter it into your passbook until 2004. You must include it in your gross income for 2003.

**Delaying receipt of income.** You cannot hold checks or postpone taking possession of similar property from one tax year to another to avoid paying tax on the income. You must report the income in the year the property is received or made available to you without restriction.

### Example

Frances Jackson, a service contractor, was entitled to received a \$10,000 payment on a contract in December 2003. She was told in December that her payment was available. At her request, she was not paid until January 2004. She must include this payment in her 2003 income because it was constructively received in 2003.

**Checks.** Receipt of a valid check by the end of the tax year is constructive receipt of income in that year, even if you cannot cash or deposit the check until the following year.

### Example

Mrs. Reed received a check for \$500 on December 31, 2003, from a parent in her day care business. She could not deposit the check in her business account until January 2, 2004. She must include this fee in her income for 2003.

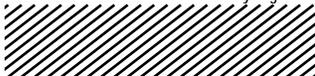
## *INCOME*

Business income may be reported to taxpayers in various ways or even not at all. Some taxpayers receive informational returns such as the Form 1099-MISC other times it may be just a check or cash for services performed. Regardless of how income is received, self-employed taxpayers are responsible for recording the amount of income received, and related expenses, in their permanent books of record. Normally, the easiest record keeping is maintaining a separate business checking account.

From these records the taxpayer should be able to state to you the total gross receipts or sales for the year, any returns and allowances (although normally a cash based taxpayer should not have any of these since income is reported at the end of the year) and the Cost of Goods Sold. We will discuss deductions for expenses later in the lesson.

## *DEDUCTIONS FOR EXPENSES*

In earlier chapters you learned about deductions from gross income. The same concept applies to business gross income. Self-employed taxpayers are allowed to deduct from income those “ordinary and necessary” expenses paid or incurred during the taxable year in carrying out a trade or business.



## Auto Expenses

Business auto expenses can be calculated by either the actual cost method or the standard mileage method. The taxpayer usually makes the choice of which method to use the first year that the vehicle is used for the business. It is permissible to switch from the standard mileage method to the actual expense method; however, taxpayers generally are not permitted to switch from actual method to the standard mileage method.

**The Standard Mileage Method** is available for both owned and leased autos. However, the vehicle must not be used for hire (such as a taxi or shuttle van). The election to use the standard mileage method must generally be made in the year the auto is first used in business. In a later year the taxpayer may switch to the actual expense method but cannot claim any depreciation, if the vehicle is considered fully depreciated. In leased cars the standard mileage method must be for the entire lease period of the auto.

In 2003 the standard mileage rate is 36¢.

Expenses not included in the standard mileage allowance and deductible in addition to the standard mileage allowance are business parking fees and tolls, and interest on auto loan (business portion).

A taxpayer is limited to the actual expense method if any of the following are true:

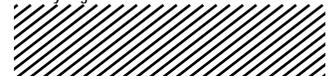
1. ACRS or MACRS Depreciation has previously been claimed on the auto.
2. A section 179 expense has been claimed on the auto.
3. Any method of depreciation on the auto other than straight line over the estimated useful life of the auto.

Under this method the taxpayer determines the actual cost of those items listed under the standard mileage rate and deducts that amount. Both methods should be considered to determine which gives the most beneficial deduction to the taxpayer.

### ***CRITERIA FOR FILING SCHEDULE C-EZ***

In order to file the EZ version of the Schedule C the taxpayer must meet the criteria listed below:

1. Have less than \$2,500 in business expenses
2. Use the Cash method of accounting
3. Have no inventory at any time during the year
4. Have positive net income (not have a net loss)
5. Operate only one business as a sole proprietor during the tax year
6. Have no employees during the year.



## Example

Jerry owns and operates a one-person tax preparation business during the filing season. His income is \$1,500 accounted for via the cash method; this is the only business he operated during the year. He has the following expenses, paper \$400 and ink \$200. Since Jerry's expenses total \$600 Jerry has met all the requirements and therefore can use the Schedule C-EZ for reporting his business income.

### Exercise 1

Jim is the civilian spouse of Lt. Carry Ann. He operates a business (sole proprietorship) as a lawyer. His gross income from business is \$70,000. His total business expenses amount to \$1,800. Can he use the Schedule C-EZ, yes or no?

Answer \_\_\_\_\_

### Exercise 2

Martha is the wife of Stuart, a Marine stationed in California. During the year Martha operates a sole proprietorship called Squared Away Child Care services. She comes to you for help with her return. A review of her records reflect the following:

Income: \$6,700

Expenses:

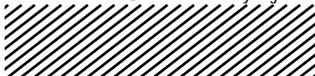
Advertising	\$600
Car & Truck	\$150
Office Expense	\$500
Toys and Games	\$200
Telephone	\$800
Utilities	<u>\$300</u>
Total Expenses	<u>\$2,550</u>
Net Income	\$4,150

Can Martha file a Schedule C-EZ?

Answer \_\_\_\_\_

## **SCHEDULE SE**

If the net income on the Schedule C or Schedule C-EZ is \$400 or more, you will need to file a Schedule SE. The Schedule SE calculates the self-employment tax, which is comprised of the Social Security and Medicare taxes.



For the military, rental income and expenses is a frequent occurrence since many military members are not able to sell their homes when they get orders to relocate. Many homeowners rent out their old home. The income and the expenses from the rental of the property are recorded on Schedule E. This section will provide basic guidance on how to complete the Schedule E.

We will not discuss the calculation of depreciation. Depreciation is a complex subject. If the taxpayer provides you with the depreciation amount, you can enter it on the tax return. If the taxpayer does not know the depreciation amount, you may need to refer them to the military legal assistance office.

In the first year of the rental, you might have to divide the mortgage interest and real estate taxes between Schedule A and Schedule E. You simply divide the total mortgage interest and property taxes by twelve and multiply by the number of months the home was used for each purpose.

### Example

Sgt. Judson lived in his home through September 2003. He received orders and rented his home out in October. Nine months of the mortgage interest and property taxes would go on his Schedule A and the other three months would go on the Schedule E.

Remember, also, that three months of his property insurance is also a deductible item on Schedule E, even though this expense is not deductible when the home is his residence.

Other expenses that are deductible for rental property are: cleaning and maintenance, repairs, utilities that are paid for the tenant, legal and professional fees, management fees you pay a real estate company or individual to care for your property in your absence, auto and travel expense to check on the property, long distance phone calls, etc.

Once you deduct all of the expenses and the depreciation from the rent received, you may come up with a loss. The net income or loss from rental property is usually considered passive. If the taxpayer actively participates in the renting of the property (such as making decisions, determining who can rent the property), the loss is fully deductible.

#### ▶▶ SUMMING UP THIS SEGMENT ◀◀

- ▶ Business income is reported on either a Schedule C or C-EZ.
- ▶ The Schedule C-EZ has limited use.
- ▶ Schedule SE is used to calculate the self-employment tax when the net business income exceeds \$400.
- ▶ Schedule E is used to report rent and royalty income.

**STUDENT NOTES**

Lined writing area for student notes.



## INTRODUCTION AND OBJECTIVES

This lesson will provide insights into the misconception that a U.S. citizen or resident alien only file a U.S. tax return if he or she has income from the United States, especially if taxes are paid to another country.

At the end of this segment, you will be able to:

- Define worldwide income and compute the U.S. dollar value of a foreign currency if given an exchange rate table.
- Determine when to use average annual exchange figures.

## WORLDWIDE INCOME

U.S. citizens and U.S. resident aliens are required to file a U.S. tax return based on their worldwide income. It has been a popular misconception that a person only has to file a U.S. tax return if he or she has income from the United States, especially if he or she pays taxes to another country. While U.S. citizens and U.S. resident aliens living abroad can claim tax benefits such as the foreign earned income exclusion and the foreign tax credit (later lessons), they have the same filing requirements as U.S. citizens living in the United States. This applies whether their income is from within or outside the U.S. Types of income, such as child support, which would not be taxed in the U.S., are generally not taxed if from outside the U.S. But, types of income which would be taxable if from within the U.S. are also taxable if from outside the U.S.

You may wish to refer to the lists of taxable and nontaxable income on the applicable pages of the basic Military Section of the text.

### Example 1

In 2003, Joe Adams earned \$40,000 while working in Austin, Texas, for XYZ Corporation. In September 2003, he transferred to their office in Stuttgart, Germany. While in Germany, he earned \$30,000. His worldwide wages earned in 2003 would be \$70,000. Line 7 of his Form 1040 would show \$70,000.

### Exercise 1

Marta Brener lives in Mussbach, Germany. Her 2003 income included \$22,000 in wages earned in Germany. She earned \$3,000 in interest from her U.S. bank and \$2,000 unemployment compensation from the state of Iowa. What is Marta's worldwide gross income?

### Exercise 2

Mary Carlton lives in Belgium. Her 2003 income included \$10,000 in wages from her Belgian employer. She received \$2,000 interest from her U.S. bank, \$8,000 in alimony payments and \$8,000 in child support payments from her ex-spouse. What is her worldwide gross income?

### Exercise 3

Would Marta Brener (Exercise 1) have to file a U.S. tax return for 2003? Would Mary Carlton (Exercise 2) have to file a U.S. tax return?

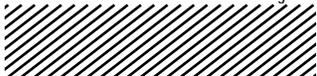
## Exchange Rates

Another question that you will frequently be asked is "What exchange rate do I use?" The exchange rates of foreign currencies to the U.S. tax dollar change on a daily basis. **All amounts on the U.S. tax return must be stated in U.S. dollars.** Since most taxpayers abroad receive some kind of income in foreign currency, you will find situations when you will need to convert foreign income into U.S. dollars in order to put these income amounts on the return. Most countries have a medium of currency compared to which the value of the dollar is larger. Very few countries have mediums compared to which the U.S. dollar is smaller. Exchange rates are stated in two ways: the foreign currency to the U.S. dollar, and the dollar's value in the foreign currency.

When making a conversion, you should make sure that the exchange rate is stated in foreign currency to one U.S. dollar. To convert a sum of money into U.S. dollars, you would divide the foreign currency by the exchange rate.

### Example 2

If you received 3,000 Euros on a day that the exchange rate was 1.7115 Euros to \$1 U.S., you would have \$1,752.85 in equivalent



U.S. dollar value ( $3,000/1.7115 = 1,752.85$ ). To convert a sum of money into U.S. dollars when the currency unit is larger in value, you can use the same process.

### Example 3

Caryn received 200 Euros on a day that the exchange rate was .5514 Euros to one U.S. dollar. In U.S. dollars, she would have \$362.71 ( $200/.5514 = 362.71$ ).

### Exercise 4

Convert the following amounts to U.S. dollars.

- a. 36,000 Euros (1.7115 exchange rate) \_\_\_\_\_
- b. 800 Euros (.5514 exchange rate) \_\_\_\_\_

**When to Convert.** Now that you have information on how to calculate exchange rates, we now need to discuss what exchange rates to use. Actually, what exchange rate to use is determined by the date of the transactions; that is the date on the check or the date money is credited to the taxpayer's account. If the taxpayer has income which was received evenly throughout the year, he or she can use the average annual exchange rate if the foreign exchange rate was relatively stable during the year. The average annual exchange rate is available from IRS offices throughout the world generally starting around January 15.

IRS also distributes information to its worldwide offices concerning the quarterly exchange rates for various currencies.

### Example 4

Edward Pasco worked in Dallas for Megacorp Incorporated from January until September 2003. On September 29, he was transferred to their Mexico City office where he will be working for 3 years. While in the U.S., Edward earned his salary in U.S. dollars. When he moved to Mexico, he was paid in Mexican pesos. Since he did not receive his salary in foreign currency throughout the year, he should not use the annual average exchange rate. He should use the average rates for October, November, and December.

## Where to Obtain Exchange Rates

To obtain exchange rates, you can call the IRS International office at 215-516-2000, or the overseas IRS offices. The phone numbers of these offices are listed in Publication 54. You may also contact banks who provide international currency exchange services. Since a taxpayer "should use the rate that most nearly reflects the value of the foreign currency" (Publication 54) at the time he or she receives the income, the taxpayer may use an exchange rate that is different from the rates posted in our worldwide offices if he finds it to be a truer representation.



### Exercise 5

Deborah Vance lives and works in Manila, Philippines. In 2003, she had the following income: 16,000 Filipino pesos in wages, 1,200 Filipino pesos interest income and \$500 in U.S. interest from her U.S. bank. On June 7, 2003, she sold her car and made a profit of 2,000 Philippine pesos (fully taxable capital gain). Since these items are fully taxable, what is the total income to be reported on her U.S. tax return (in U.S. dollars)?

For this exercise assume that the 2003 average annual exchange rate for the Philippine peso is 40.25 pesos to 1.00

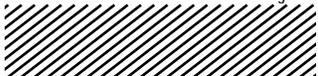
U.S. dollar and the exchange rate for June 7, 2003 was 32.55 pesos to 1.00 U.S. dollar.

Wages \_\_\_\_\_  
Interest \_\_\_\_\_  
Capital Gain \_\_\_\_\_  
Total 2003 Income \_\_\_\_\_

Sometimes, you may get questions on exchanging money when there is “blocked income” or “soft currency”. Questions on these issues should be referred to IRS. “Blocked income” refers to a situation where a taxpayer cannot convert foreign currency to U.S. dollars. This is generally due to local law or local government policy. There are special tax rules that exist when there is blocked income which allows a person to choose to put off reporting part of their income. “Soft currency” refers to a situation where a person can only convert back to U.S. dollars an amount that equals what he brought into that country in U.S. dollars.

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

- ▶ U.S. citizens (and resident aliens) are taxed on worldwide income and must file U.S. tax returns even if all the income is from foreign sources.
- ▶ You have learned how to convert foreign currency to U.S. dollar equivalent values.
- ▶ Exchange rates used should reflect the closest accurate rate.



1. \$27,000
2. \$20,000
3. Yes. Yes.
4. a. \$21,034.18  
b. \$1,450.85
5. Wages  $16,000.00 \div 40.25 = \underline{\$397.52}$   
Interest  $1,200.00 \div 40.25 = \$29.81$  from Philippines plus  $\$500$   
interest from U.S. =  $\underline{\$529.81}$   
Capital Gain  $2,000.00 \div 32.55 = \underline{\$61.44}$   
Total 2003 Income –  $\underline{\$988.77}$

**STUDENT NOTES**

Lined area for student notes.



## INTRODUCTION AND OBJECTIVES

This lesson will explain when a self-employed taxpayer living abroad is subject to U.S. income tax requirements and their filing obligations.

At the end of the segment, you will be able to:

1. Determine who is a self-employed individual.
2. Compute the self-employment tax for a U.S. citizen or resident abroad.
3. Compute the deduction for self-employment tax.

## EMPLOYEE OR SELF-EMPLOYED

A self-employed person is generally one who either:

1. Carries on a trade or business as a sole proprietor or independent contractor.
2. Is a member of a partnership that carries on a trade or business.
3. Otherwise in business for himself or herself.

## SELF-EMPLOYMENT TAX

The self-employment tax is a social security tax for individuals who work for themselves. It is similar to the social security tax withheld from the pay of wage earners.

Social security benefits are available to individuals who are self-employed just as they are to wage earners. Payments of self-employment tax contribute to an individual's coverage under the social security system.

**Income Limits.** You must pay self-employment tax if you have net earnings from self-employment of \$400 or more a year.

Self-employment tax consists of two parts, social security and medicare. For 2003, social security tax is paid on the first \$87,000 of net income. The medicare tax is imposed on the full amount of net earnings.

**Note:** If your self-employment income is \$400 or more, you must file a return even though your income is below the minimum amount for income tax filing purposes.

**Effect of Foreign Earned Income Exclusion.** You must take all of your earned income into account in figuring your self-employment tax, even though the income is exempt from income tax because of the foreign earned income exclusion.

### **Example 1**

You are in business abroad as a consultant and qualify for the foreign earned income exclusion. Your foreign earned income is \$70,000, business expenses \$20,000, resulting in net earnings of \$50,000. You must pay self-employment tax on the net income even though you excluded all of your earned income.

**Exemption from U.S. Self-Employment Tax.** The United States may reach agreements with foreign countries to eliminate dual coverage and dual contributions (taxes) to social security systems for the same work. As a general rule, self-employed persons who are subject to dual taxation will only be covered by the social security system of the country where they reside.

For more information, consult Publication 54, "Tax Guide for U.S. Citizens and Resident Aliens Abroad."

## ***WHICH FORMS TO USE***

Form 1040, U.S. Individual Income Tax Return, is used to report self-employment tax. Both income tax and self-employment tax are due at the same time. Schedule SE, Social Security Self-Employment Tax, is used to figure the tax. Even if the taxpayer is not otherwise required to file an income tax return, he or she must file both Form 1040 and Schedule SE to pay self-employment tax.

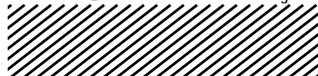
The Schedule SE includes a flowchart to determine if the short or long form is required.

## ***COMPUTING THE SELF-EMPLOYMENT TAX***

Although there are three methods available to compute self-employment tax, VITA volunteers will only use the regular method. Taxpayers who wish to use the other methods should seek paid professional assistance. There are no limits on who may use the regular method. Most taxpayers use this method.

Under the regular method, the net income from your business or profession is generally your net self-employment earnings from Schedules C, C-EZ, F, and K-1 (Form 1065).

If you have more than one trade or business, your net earnings from self-employment are the combined net earnings from each of your businesses. A loss in one business will reduce the income earned in another. You must claim all allowable deductions including depreciation when figuring your net earnings from self-employment.



Even though the income may be exempt from income tax because of foreign earned income exclusion, you must take all of your earned income into account in figuring your self-employment tax. Refer to Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*, regarding the effect of the foreign earned income exclusion on U.S. self-employment tax.

### Example 1

Susan J. Brown is sole proprietor of a dress shop, “Milady Fashions.” Her Schedule C shows a net profit of \$35,100. Susan’s completed Schedule SE is shown at the end of this section.

If Susan were the proprietor of more than one business, she would have combined the profits and losses from all of them and filled out only one Schedule SE. If, in addition to operating her dress shop, Susan had worked for wages totaling \$87,000 or more, she would have already paid the maximum amount of social security tax owed on her wages, but she would still be subject to the medicare portion (2.9%) of self employment tax. In this case, she would use the long Schedule SE.

The line numbers shown below in bold type refer to the line numbers on the sample filled-in Schedule SE on the following page.

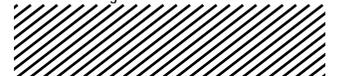
**Line 1.** Since Susan has no earnings from farm self-employment, she leaves line 1 blank.

**Line 2.** Susan enters the net profit from her Schedule C, \$35,100.

**Line 3.** Since Susan has no farm income, she enters the same amount on line 3.

**Line 4.** Multiply the amount of line 3 by .9235 and enter the result.

**Line 5.** Susan determines her self-employment tax by using the first option on Line 5. She multiplies \$32,415 on Line 4 by 15.3%. She enters \$4,959 on Line 5. This is her self-employment tax. She also enters this amount on Line 55 of Form 1040.



**SCHEDULE SE**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Self-Employment Tax**

▶ **Attach to Form 1040.** ▶ **See Instructions for Schedule SE (Form 1040).**

OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **17**

Name of person with <b>self-employment</b> income (as shown on Form 1040)	Social security number of person with <b>self-employment</b> income ▶
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**Who Must File Schedule SE**

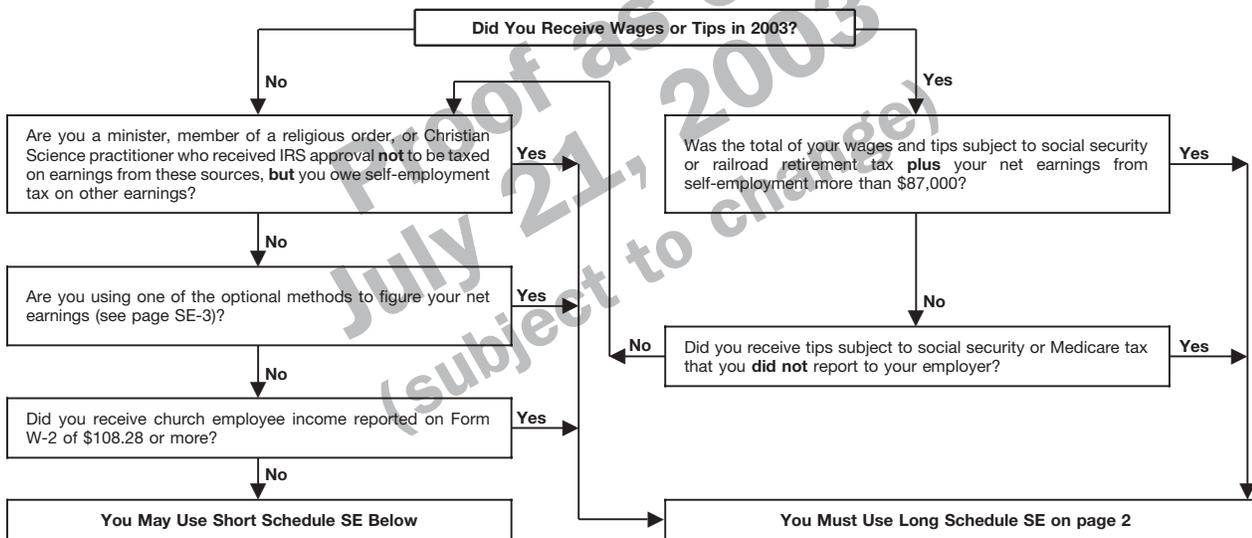
You must file Schedule SE if:

- 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 55.

**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	0	
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	\$35,100	
3 Combine lines 1 and 2 . . . . .	3	\$35,100	
4 <b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax . . . . . ▶	4	\$32,415	
5 <b>Self-employment tax.</b> If the amount on line 4 is: <ul style="list-style-type: none"> <li>• \$87,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 55.</b></li> <li>• More than \$87,000, multiply line 4 by 2.9% (.029). Then, add \$10,788.00 to the result. Enter the total here and on <b>Form 1040, line 55.</b></li> </ul>	5	\$4,959	
6 <b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 28</b> . . . . .	6	\$2,480	

This deduction for one-half of the SE tax will reduce Susan's income subject to income tax. However, if all of Susan's self-employment income qualifies for the foreign earned income exclusion, this deduction is allocable to the excluded income and must be included on line 42 the Form 2555. This prevents the deduction from reducing other taxable income. See the earlier chapter on foreign earned income exclusion for additional information.

▶▶ **SUMMING UP THIS SEGMENT** ◀◀

- ▶ As a volunteer assisting taxpayers abroad, you may be asked questions regarding self-employed tax. In this lesson you have learned how to determine if you are considered a self-employed individual and how to compute the self-employment tax.



## ***SUMMARY EXERCISES***

### **Exercise 1**

You must pay self-employment tax if you have net earnings from self-employment of \$ \_\_\_\_\_ or more a year.

### **Exercise 2**

John has a business abroad in 2003, as a private contractor and his self-employed income qualifies for the foreign earned income exclusion. His foreign earned income is \$64,000, business expenses \$19,000, and net earnings \$45,000. Since his foreign earned income is completely excluded, is he liable for self-employment tax? If yes, what amount of income is subject to self-employment tax?

### **Exercise 3**

The United States may reach agreements with foreign countries to eliminate dual coverage and dual contributions (taxes) to social security systems for the same work. These agreements may be applicable to self-employed persons.

True/False

### **Exercise 4**

Janice Thompson is a self-employed baby-sitter overseas. She is a U.S. citizen living with her husband. He is a U.S. Army officer and also a U.S. citizen. She operates her sole proprietor babysitting service out of their off base apartment. She has no wage income. Her Schedule C shows a net profit of \$9,500 in 2003. She qualifies for the foreign earned income exclusion. She receives no exemption from any agreement to exclude her self-employment tax.

Compute her self-employment tax for 2003 on the blank Schedule SE.



**SCHEDULE SE**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Self-Employment Tax**

▶ **Attach to Form 1040.** ▶ **See Instructions for Schedule SE (Form 1040).**

OMB No. 1545-0074

**2003**

Attachment  
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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**

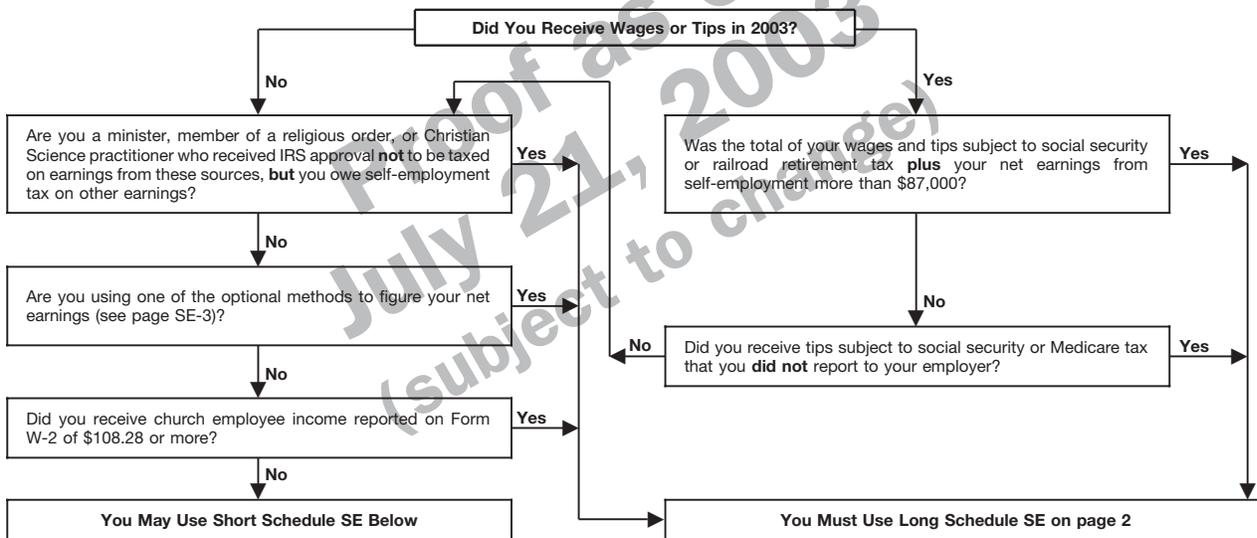
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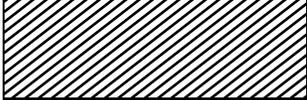
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<b>3</b> Combine lines 1 and 2 . . . . .	<b>3</b>		
<b>4</b> <b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax . . . . . ▶	<b>4</b>		
<b>5</b> <b>Self-employment tax.</b> If the amount on line 4 is: <ul style="list-style-type: none"> <li>• \$87,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 55.</b></li> <li>• More than \$87,000, multiply line 4 by 2.9% (.029). Then, add \$10,788.00 to the result. Enter the total here and on <b>Form 1040, line 55.</b></li> </ul>	<b>5</b>		
<b>6</b> <b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 28</b> . . . . .	<b>6</b>		



# ***SELF-EMPLOYMENT TAX***

Lesson 2

*ANSWERS TO EXERCISES*

International Segment

## **Exercise 1**

\$400

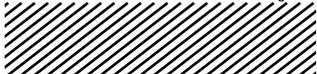
## **Exercise 2**

Yes

John must take all of his earned income into account in figuring his self-employment tax, even though the income is exempt from income tax because of the foreign earned income exclusion. John's \$45,000 net earnings are subject to self-employment tax in 2003.

## **Exercise 3**

True. Agreements may apply to self-employed persons.



**SCHEDULE SE**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Self-Employment Tax**

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OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **17**

Name of person with **self-employment** income (as shown on Form 1040)

Janice Thompson

Social security number of person  
with **self-employment** income ▶

**Who Must File Schedule SE**

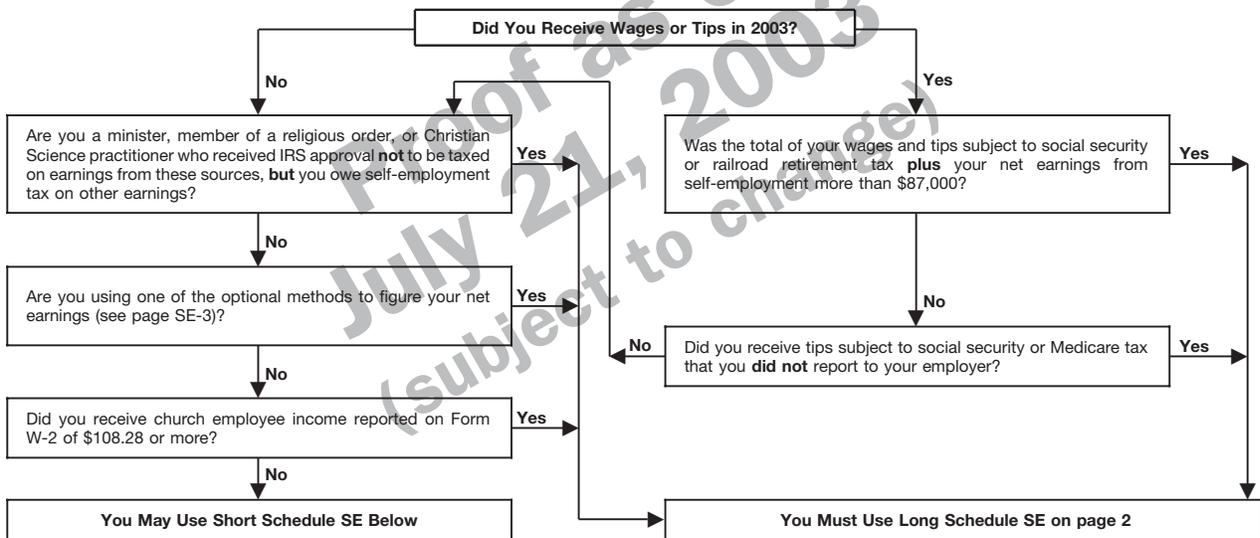
You must file Schedule SE if:

- 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 55.

**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	0
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	\$9,500
3	Combine lines 1 and 2 . . . . .	3	\$9,500
4	<b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax . . . . . ▶	4	\$8,773
5	<b>Self-employment tax.</b> If the amount on line 4 is: <ul style="list-style-type: none"> <li>• \$87,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 55.</b></li> <li>• More than \$87,000, multiply line 4 by 2.9% (.029). Then, add \$10,788.00 to the result. Enter the total here and on <b>Form 1040, line 55.</b></li> </ul>	5	\$1,342
6	<b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 28</b> . . . . .	6	\$671

**STUDENT NOTES**

Lined area for student notes.



# RENTAL INCOME AND EXPENSES

Lesson 2

International Segment

## INTRODUCTION AND OBJECTIVES

This lesson will explain the rental income reporting requirements for U.S. citizens and resident aliens. Generally, you must include in gross income all amounts received from rental properties, including rental receipts received from your former residence. Both United States citizens and resident aliens must report rental income, regardless whether the rental property is located in the United States or in a foreign country.

At the end of the segment, you will be able to:

1. Determine how to report rental income.
2. Determine how to report rental expenses.
3. Determine how to report rental income when property is used for personal purposes either part of the year or during the entire year.
4. Determine how to compute deductible depreciation expense.
5. Identify the application of at-risk and passive activity rules.

**NOTE:** The information and explanation of this issue is beyond the usual scope of Volunteer training. An exception has been made to serve the military and other Volunteers living abroad due to limited access to both resources and the professional preparers.

## WHICH FORMS TO USE

Rental income and expenses are reported on Schedule E (Form 1040), Supplemental Income Schedule, Part 1. Additional information on rental income can be found in Publication 527, "Residential Rental Property," and Publication 946, "How to Depreciate Property."

## RENTAL INCOME

Rental income may include other payments in addition to the normal and ordinary rents received. Include in gross rental income advance rent, security deposits, payments for canceling a lease, expenses paid by the tenant, and the fair market value of property or services received in exchange for rental payments. The security deposit is not included when the taxpayer plans on returning the deposit at the end of the lease. A taxpayer using the cash basis of accounting, reports the income when actually received. Taxpayers using the accrual accounting method report the income in the year they are entitled to receive payments.

# RENTAL EXPENSES

The deductible rental expenses are reported on the Schedule E, Part I, (see Exhibit 1) lines 5 through 18.

Exhibit 1

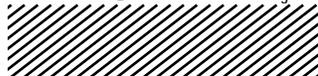
Form 1040 Schedule E

		(See page E-3.)			C
Income:		Properties			Totals (Add columns A, B, and C.)
		A	B	C	
3	Rents received . . . . .	3			3
4	Royalties received . . . . .	4			4
<b>Expenses:</b>					
5	Advertising . . . . .	5			
6	Auto and travel (see page E-4) . . . . .	6			
7	Cleaning and maintenance . . . . .	7			
8	Commissions . . . . .	8			
9	Insurance . . . . .	9			
10	Legal and other professional fees . . . . .	10			
11	Management fees . . . . .	11			
12	Mortgage interest paid to banks, etc. (see page E-4) . . . . .	12			12
13	Other interest . . . . .	13			
14	Repairs . . . . .	14			
15	Supplies . . . . .	15			
16	Taxes . . . . .	16			
17	Utilities . . . . .	17			
18	Other (list) ▶ . . . . .	18			
	. . . . .				
	. . . . .				
	. . . . .				

Deductible expenses include any ordinary and necessary expenses, such as expenses for repairs, maintenance, certain operating expenses and depreciation.

**Repairs vs. Improvements.** The cost of a repair is a current year deduction, however, the cost of an improvement must be depreciated over the useful life of the improvement. The distinction between a repair and an improvement is that a repair keeps the property in good operating condition, whereas an improvement materially adds to the life or value of the property or adapts it to new uses. The following chart helps illustrate the difference between repairs and improvements.

REPAIRS	IMPROVEMENTS
Painting	Adding a Room
Fixing Gutters	Putting up a Fence
Repairing Driveways	Putting in plumbing or wiring
Replacing Window Glass	Replacing hot water tank
Repairing the Roof	Putting on a new roof



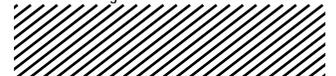
Since an improvement is a capital expenditure and must be depreciated, the total cost including material, labor, and installation increases the basis of the property. Depreciation will be discussed later in this chapter.

**Other Expenses.** Some of the other ordinary expenses that may be deducted from gross rental income include salary and wages, utilities, rental of equipment, insurance premiums, interest expense (mortgage interest), advertising, taxes, and commissions paid for collecting rental income. If any part of the property tax is for local benefits, such as putting in streets and sidewalks, that portion of the property tax is added to the basis of the property rather than deducted as an ordinary expense. Insurance premiums paid in advance must be prorated over the period covered by the policy by both the cash basis and accrual basis taxpayer. If the rental is a condominium or cooperative, the maintenance fee is deductible. See Publication 527, *Residential Rental Property*, for taxes and interest deductions on cooperatives. Generally, mortgage interest expense is fully deductible. However, if the taxpayer has interest expense other than mortgage interest, refer him or her to the Internal Revenue Service or a professional preparer.

Ordinary and necessary travel and transportation expenses attributable to the production of rental income are deductible. If a personal automobile is used, the taxpayer may use the standard mileage rate for business mileage. The standard mileage rate is 36 cents per mile for the year 2003. When using the standard mileage rate, parking fees and tolls may also be deducted. The standard mileage rate method (MACRS) may be selected on a yearly basis. However, if changing to actual expense after using the standard mileage method, accelerated depreciation may not be used. In order to claim depreciation under the actual expense method for transportation expenses, the vehicle must be used more than 50 percent for business, including for the production of rental income. If the travel incurred on behalf of a rental property is into or outside of the United States, the trip may have a dual purpose. Substantiation of the pleasure vs. business purpose and allocation of the expenses may be required. When a tenant does not pay the rent, the cash-basis landlord cannot take a deduction for the unpaid rent, since a deduction can never be taken for a payment that has never been included in income.

### ***SPECIAL ALLOCATION***

Special rules apply when rental property is used for personal purposes, or as a rental without the intent to make a profit. When renting part of the property, certain expenses must be divided between rental use and personal use. When figuring the division of expenses, the taxpayer may use any reasonable method. The most common methods used are based on the number of rooms in the dwelling or on the total area of the dwelling.



## Example 1

Mary Alma rents one room in her house. The total square footage of her house is 1,000 square feet. The rental room measures 10 feet by 10 feet (100 square feet). She may deduct 10% of any allowable expense that benefited the renter. She may deduct 100% of any expenses that relate only to the rental portion of the house, such as painting the rented room.

### Exercise 1

Mary Alma, in the example above, has the following expenses attributable to the entire property:

Taxes	\$ 1,000
Utilities	\$ 600
Mortgage Interest	\$ 800
Depreciation	\$ 500

Also wallpapering expense of \$100 for the tenant's room only.

- a. What are the allowable expense deductions on Schedule E?  
Answer: \_\_\_\_\_
- b. What are the allowable expense deductions on Schedule A?  
Answer: \_\_\_\_\_

For property changed to rental use in the tax year other than the beginning of the year, the allocation of expenses should be made between the number of days in the year for personal use and the number of days for rental use.

## Example 2

John Princeton is transferred overseas and begins renting out his residence on October 1, 2003. For 2003, he may deduct three-twelfths (25 percent) of his yearly expenses such as taxes, interest and utilities as rental expenses.

**Vacation Home and Other Dwelling Units.** Certain limitations apply to rental expenses for vacation homes or other dwellings that are used by the taxpayer for personal use during the year. A dwelling unit for this purpose includes a house, apartment, condominium, mobile home, boat or similar property. However, the limitation does not apply to hotel, motel, inn or similar dwelling unit. The limitation on deductions applies if a dwelling unit is used as a residence during the tax year for personal purposes for greater than:

1. 14 days or
2. 10 percent of the number of days during the tax year the property is rented at fair market value.

See Publication 527 for a discussion of the limitations.



**Use as home before or after renting.** If you use a dwelling unit as your main home before or after renting it, or trying to rent it, you may not have to count the days you use it as your main home as days of personal use.

**12 months or more.** If for 12 or more consecutive months, you rent or try to rent a dwelling unit at a fair rental price, some of the days on which you use the property as your main home are not counted as days of personal use.

Do not count as days of personal use the days you used the property as your main home.

- a) During the year in which you began renting it or offering it for rent, but before you began renting it or offering it for rent, or
- b) During the year in which you stopped renting it or offering it for rent, but after you stopped renting it or offering it for rent.

### Example 3

On February 28, 2001, you moved out of the house you had lived in for 6 years because you accepted a job in another town. You rent your house at a fair rental price from March 15, 2001, to May 14, 2003. On June 1, 2003, you move back to town and move back into your house.

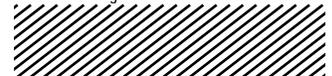
Your use of the house as your main home from January 1 to February 28, 2001, and from June 1 to December 31, 2003, is not counted as personal use.

Since these days are not counted as days of personal use the limitations on deductions discussed above do not apply.

### Depreciation

The cost of property with a useful life of one year or more and used in a trade or business or held for the production of income is recovered by allowing an annual deduction called depreciation. The most common methods for the depreciation are called ACRS (Accelerated Cost Recovery System) for property placed in service after 1980 and before 1987 and MACRS (modified ACRS) for property placed in service after 1986. Both of these depreciation methods have an alternative method that may be chosen that generally increases the number of years the property is depreciated over and therefore decreases the annual deduction. The method used for property placed in service before 1981 is referred to as straight line or declining balance.

Depreciable property includes buildings, machinery, furniture, equipment and vehicles. As discussed earlier any cost for additions or improvements to the rental property must also be depreciated. Depreciation is allowed or allowable. What this means is, if you did not claim depreciation that you were entitled to claim in an earlier year you must still reduce your basis in the property by the amount



of depreciation that you did not deduct. The depreciation deduction is determined by considering several factors. These factors are discussed next in this chapter. When depreciating real property the value of land is not depreciable.

**Basis.** The total of the yearly deductions for depreciation can never total more than the cost or other basis of the property. Generally, the cost (purchase price) of the property including the cost of improvements is the basis for depreciation. However, if the taxpayer acquired the property, other than buying it, the basis may be figured differently than using the original cost. An example is an acquisition through inheritance or gift. For further information on the basis of inherited or gifted property refer to Publication 551, Basis of Assets. When property is converted from personal use to rental use the basis is the lesser of the adjusted basis or fair market value (FMV) at the time of conversion.

#### Example 4

Jen and Tom purchased a house in 1985 for \$85,000. In 2003, they were transferred overseas and decided to rent out their personal residence. The value in 2003 was \$125,000. The basis for depreciation is \$85,000. Assume that the value of land was excluded in determining the cost of the house.

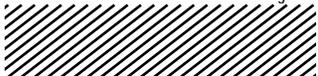
**Adjusted Basis.** The basis of property must be increased or decreased to reflect certain adjustments before the depreciation deduction is computed. For example, to the purchase price of a home add the cost of any improvements, minus any casualty losses or depreciation previously deducted and minus the land value to find the adjusted basis. Since land can never be depreciated, an allocation between land and building must be done based generally on assessed value. Where property is acquired in a purchase along with a trade-in, the basis must be adjusted.

#### Example 5

Neil Bates traded in old appliances used for his rental property with an adjusted basis of \$500 and got new appliances with a fair market value of \$2,000. He paid \$1,000.00 in cash, his basis for depreciation in the new appliances is \$1,500 (the \$500 adjusted basis plus the \$1,000 cash).

**Placed in Service.** For depreciation purpose, property is considered placed in service when it is in a condition or state of readiness and availability for use. However, a depreciation deduction may not be claimed until the property is used in business or for the production of income.

**Property Classes and Recovery Periods.** The Accelerated Cost Recovery System (ACRS) and Modified Accelerated Cost Recovery System (MACRS) use the class life of depreciable property to determine the recovery period. If property is used as a personal residence before 1987 and converted to rental property after 1986, use



the MACRS method to figure depreciation. Under MACRS, tangible property used in a rental activity generally falls into a 5-, 7-, or 27.5-year recovery period.

A home converted in 1998 to a rental property would be depreciated over a recovery period of 27.5 years. A stove also used in this same rental would be assigned a 7 year recovery period. Property, both real and personal, located outside the United States has a longer recovery period. Although the true physical life of the property may be less, under MACRS the recovery period is fixed. MACRS requires that a convention for half-year or mid-quarter be used. Under this special rule, in the year the property is placed in service the depreciation deduction is prorated. Publication 946, How to Depreciate Property, contains tables of depreciation with the conventions already incorporated. Examples of the tables are shown below.

## MACRS charts

**Table A**

**MACRS 5-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	20.00%	35.00%	25.00%	15.00%	5.00%
2	32.00	26.00	30.00	34.00	38.00
3	19.20	15.60	18.00	20.40	22.80
4	11.52	11.01	11.37	12.24	3.68

**Table B**

**MACRS 7-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	14.29%	25.00%	17.85%	10.71	3.57%
2	24.49	21.43	23.47	25.51	27.55
3	17.49	15.31	16.76	18.22	19.68
4	12.49	10.93	11.97	13.02	14.06



## Table I, II

**Table 1**

Residential Rental Property (27.5-year)

Year	Use the column for the month of taxable year placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	3.485%	3.182%	2.879%	2.576%	2.273%	1.970%	1.667%	1.364%	1.061%	0.758%	0.455%	0.152%
2	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%
3	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%
4	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%	3.636%

**Table 2**

Residential Rental Property (31.5-year)

Year	Use the column for the month of taxable year placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	3.042%	2.778%	2.513%	2.249%	1.984%	1.720%	1.455%	1.190%	0.926%	0.661%	0.397%	0.132%
2	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%
3	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%
4	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%	3.175%

For property located outside of the United States, the taxpayer must use an alternative method of depreciation under MACRS. Therefore, residential rental property located in a foreign country would be depreciated over a 40-year recovery period.

### **REPORTING DEPRECIATION**

The depreciation deduction is shown on line 20 of Schedule E (see Exhibit 2). Use Form 4562, Depreciation and Amortization only if you placed an asset in service in the current year, you depreciate listed property or you claim a Section 179 expense.



19	Add lines 5 through 18 . . . . .	19							19	
20	Depreciation expense or depletion (see page E-4) . . . . .	20							20	
21	Total expenses. Add lines 19 and 20	21								
22	Income or (loss) from rental real estate or royalty properties. Subtract line 21 from line 3 (rents) or line 4 (royalties). If the result is a (loss), see page E-5 to find out if you must file <b>Form 6198</b> . . . . .	22								
23	Deductible rental real estate loss. <b>Caution.</b> Your rental real estate loss on line 22 may be limited. See page E-5 to find out if you must file <b>Form 8582</b> . Real estate professionals must complete line 43 on page 2 . . . . .	23	(	)	(	)	(	)		
24	<b>Income.</b> Add positive amounts shown on line 22. <b>Do not</b> include any losses . . . . .	24								
25	<b>Losses.</b> Add royalty losses from line 22 and rental real estate losses from line 23. Enter total losses here	25	(		)					
26	<b>Total rental real estate and royalty income or (loss).</b> Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17. Otherwise, include this amount in the total on line 41 on page 2 . . . . .	26								

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11344L Schedule E (Form 1040) 2003

**AT-RISK AND PASSIVE LOSS**

Very often rental property shows a net loss because the rental expenses are greater than the rental income. In this situation there are two potential restrictions on how much of the loss can offset other sources of income.

The first restriction is the at-risk rule. This rule provides that you can claim a loss for no more than you could actually lose from the activity. That is, you can claim a loss only up to the amount for which you are personally at-risk in the activity. Generally you are considered at-risk for the amount of cash and property contributed to the activity from which you are not protected against personal liability with the exception of casualty insurance.

The Tax Reform Act of 1986 added other limitations to deducting rental losses. Prior to the law, losses from passive activities could offset all other income (for example wages, interest, and dividends) without any restrictions. Rental activities, by definition of the law, are always considered to be a passive activity. The passive activity law states that passive activity losses can only be deducted from passive activity income. A passive activity is a trade or business being conducted without that taxpayer materially participating. Material participation may be defined by the regular continuous and substantial involvement of the taxpayer in the operation of the trade or business, where for rental property active participation does not require regular, continuous and substantial involvement. Active participation requires that the taxpayer participate in making management decisions or arranging for others to provide services in a significant and bona fide sense. Management decisions include approving new tenants, setting rental terms, approving capital or repair expenditures and similar decisions. It is important to understand the difference between active and

material participation as it pertains to rentals, because of a special \$25,000 offset allowed for certain rental losses. Rental losses up to \$25,000 (\$12,500 for married taxpayers filing separate and living apart for the entire year) may be used to offset any and all nonpassive income if the taxpayer actively participates in the residential rental activity. The following list is an example of nonpassive income.

1. Salaries, wages, commissions or tips.
2. Self-Employment income from a trade or business in which the taxpayer materially participates (may be partnership, but not limited partnership income).
3. Distributive shares of income through pass-through entities (such as S corporations) that is not income from a passive activity.
4. Portfolio income (gross income from interest, dividends, annuities, or some royalties).

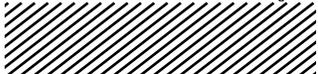
### Example 6

Lynn Ferris, a United States citizen, lives in Europe and has wages paid by the U.S. Government of \$25,000 and interest income of \$100. She rented out her home located in the United States in 2003, and incurred \$1,000 in rental loss. Although her sister collects the rent, Lynn makes all of the bottom line decisions as to whom, and, for what amount, the property will be rented. While Lynn is outside of the United States, she pays her sister to manage the property. The rental loss of \$1,000 may be offset against her gross income of \$25,100 because she is considered to be an active participant in the rental activity.

**Phase-Out of Offset.** The amount allowed to offset nonpassive income is reduced once the taxpayer's adjusted gross income exceeds \$100,000 (\$50,000 for married filing separately). It is completely phased out when AGI exceeds \$150,000 (\$75,000 for married filing separately). Refer taxpayers with an AGI over \$100,000 to the Internal Revenue Service or a professional preparer.

## **REPORTING RENTAL LOSS**

Form 8582, Passive Activity Loss Limitations is filed to summarize losses and income from all passive activities. Check the instructions for Form 1040 to determine if the taxpayer is required to file Form 8582 when he or she has rental losses. Generally, taxpayers who have only one passive loss generated from a rental activity and an adjusted income of less than \$100,000 will not be required to file Form 8582. If any questions arise beyond the scope of this lesson regarding filing Form 8582, refer the taxpayer to the Internal Revenue Service or a professional preparer.



## SELLING RENTAL PROPERTY

The sale of rental property is reported on Form 4797, Sales of Business Property. A gain is the amount realized minus the adjusted basis of the property.

### Example 7

Pat Drake sold her rental property for \$60,000. She had purchased the house for \$30,000 and had claimed \$10,000 for depreciation. Her gain is \$40,000

The gain is figured as follows:

1. Selling price		\$60,000
2. Less selling expenses		<u>0</u>
3. Amount realized		<u>\$60,000</u>
4. Basis	\$30,000	
5. Less depreciation	<u>\$10,000</u>	
6. Adjusted basis	\$20,000	<u>\$20,000</u>
7. Gain (line 3 minus 6)		<u>\$40,000</u>

The gain may be either capital gain or ordinary gain depending on the depreciation claimed. If part of the property was also used for personal uses, the sale is reported as two separate sales. A loss is the adjusted basis of the property minus the amount realized. A loss for any personal use of property cannot be deducted.

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

As a volunteer, you will assist taxpayers who have rental properties. In this lesson you learned what qualified as rental income and rental expenses. You studied how to figure and report the following:

- ▶ The proration needed when the property is used both for personal and rental purposes.
- ▶ Depreciation expense.
- ▶ Rental losses.

## ANSWERS

### Exercise 1

- \$390 (10% of total expenses of \$2,900=\$290 plus \$100 for wall-paper)
- \$1,620 (90% of mortgage interest and taxes)

# STUDENT NOTES



### LESSON OVERVIEW

This lesson will explain the seven adjustments to income covered in the VITA/TCE program. These adjustments are educator expenses; traditional IRA deductions; student loan interest deduction; tuition and fees deduction; penalty on early withdrawal of savings; alimony paid; and jury duty.

The remaining adjustments — moving expenses; self-employment health insurance deduction; and self-employed SEP, SIMPLE, and qualified plans — are beyond the scope of the VITA/TCE training. It is important to reiterate to the volunteers to refer taxpayers with these issues to a paid professional tax preparer.

### MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the publications or forms, you can download the files from [www.irs.gov](http://www.irs.gov).

- Form 8606, *Nondeductible IRAs*
- Publication 590, *Individual Retirement Arrangements (IRAs)*
- *Traditional IRA Deduction Worksheet* (Form 1040 Instructions)
- *Tuition and Fees Deduction Worksheet* (Form 1040 Instructions)
- *Student Loan Interest Deduction Worksheet* (Form 1040 Instructions)

### GUIDED QUESTIONS — GENERAL INFORMATION

1. **Explain the relationship between *adjustments* and *adjusted gross income*.** (Total income minus adjustments results in adjusted gross income.)

### GUIDED QUESTIONS — EDUCATOR EXPENSES

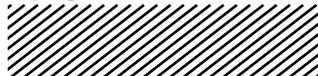
1. **Who is an eligible educator?** (A kindergarten through grade 12 teacher, instructor, counselor, principal, or aide who works at least 900 hours during the school year.)

### TEACHING TIP — EDUCATOR EXPENSES

Many students are confused when the taxpayer and spouse are both eligible educators. Remind them that the deduction can be as high as \$500 when both taxpayers qualify.

## GUIDED QUESTIONS — IRA CONTRIBUTIONS

- 1. What is a traditional IRA?** (A traditional IRA is any IRA that is not a Roth IRA, a SIMPLE IRA, or an Education IRA. An IRA is an individual retirement arrangement, a tax-sheltered savings plan set up by the taxpayer.)
- 2. When are earnings on traditional IRA contributions taxed?** (When they are withdrawn from the traditional IRA.)
- 3. Who is eligible to contribute to a traditional IRA?** (Anyone who is under 70 1/2 years of age by the end of the year and who has taxable compensation can contribute to a traditional IRA.)
- 4. For traditional IRA purposes, what constitutes taxable compensation?** (Compensation consists of wages, salaries, commissions, tips, bonuses, professional fees, earnings from self-employment, and alimony or separate maintenance payments that are included in total income.)
- 5. In any one year, what is the maximum contribution a taxpayer can make to all his or her individual traditional IRAs?** (Usually, the taxpayer's traditional IRA contribution cannot exceed the lesser of either the taxpayer's total taxable compensation or \$3,000 (\$3,500 if the taxpayer is age 50 or older).)
- 6. Identify at least two factors that determine whether or not traditional IRA contributions can be deducted from taxable income.** (The taxpayer's modified AGI, filing status, and whether the taxpayer is covered by a retirement plan at work for any part of the year.)
- 7. When would a taxpayer complete Form 8606?** (Each year that non-deductible contributions are made.)
- 8. When are earnings and gains taxed on non-deductible contributions?** (Earnings and gains are not taxed until distributed.)
- 9. How is an employee's traditional IRA deduction affected if the employee is not covered by a retirement plan at work?** (The taxpayer's deduction is not limited by his or her modified AGI.)
- 10. How is an employee's traditional IRA deduction affected if the employee is covered by a retirement plan provided by the employer?** (The deduction may be reduced or eliminated depending on the modified adjusted gross income and the filing status.)



## **TEACHING TIPS — IRA CONTRIBUTIONS**

A taxpayer who was 70 ½ years of age or older at the end of 2003 might ask volunteers to deduct those traditional IRA contributions that they made in 2003 prior to turning 70 ½. Volunteers should be prepared to explain that when a taxpayer is 70 ½ years old or older by the end of the tax year, NO traditional IRA contributions should have been made or can be deducted for the year.

## **TEACHING TIP — STUDENT LOAN INTEREST DEDUCTION**

Remind students that a taxpayer cannot deduct as interest on a student loan any amount he or she can deduct under any other provision of the tax law.

- 1. Define interest as it pertains to the student loan interest deduction.** (Interest, loan origination fees, capitalized interest, interest on revolving lines of credit, interest on refinanced student loans)
- 2. Can a taxpayer filing married filing separately take this deduction?** (No)
- 3. Are there income limitations to this deduction?** (Yes; \$65,000 for single, head of household and qualifying widow; \$130,000 for married filing jointly)

## **GUIDED QUESTIONS — TUITION AND FEES DEDUCTION**

- 1. What is included in qualified fees?** (Course related books, supplies, and equipment and student activity fees when required as a condition of enrollment or attendance.)

## **GUIDED QUESTIONS — PENALTY ON EARLY WITHDRAWAL OF SAVINGS**

- 1. Under what circumstances do depositors suffer penalties for withdrawing funds from a savings account?** (When funds are withdrawn from time deposit before the maturity date.)
- 2. Can the early withdrawal penalty be reported as an adjustment to income on Form 1040EZ or 1040A?** (No; the early withdrawal penalty can only be reported as an adjustment to income on Form 1040.)
- 3. Is the amount of early withdrawal penalty that can be reported on Form 1040 as an adjustment to income limited by either: (1) the amount of interest earned from a time deposit, or (2) a taxpayer's adjusted gross income?** (No; the full amount of early withdrawal penalty can be reported — even if the penalty is more than the interest is earned.)

### ***TEACHING TIP — ALIMONY PAID***

Emphasize to students the importance of entering on Form 1040, line 32b, the social security number of the person to whom the taxpayer paid alimony or separate maintenance payments. Volunteers should explain to taxpayers who wish to omit the recipient's social security number that the penalties for doing so include a disallowance of the deduction and a penalty.

### ***TEACHING TIP — JURY DUTY PAY GIVEN TO EMPLOYER***

Students may question the fairness of requiring a taxpayer to report as income the total amount of jury duty pay he or she has received when that pay has been turned over to the employer. Remind students that the taxpayer will report the total amount of jury pay as an adjustment to income. Since adjustments to income are subtracted from income to yield adjusted gross income, the jury pay will not be included in the taxpayer's adjusted gross income (or taxable income).

### ***LESSON REVIEW***

To review students' understanding of adjustments and adjusted gross income as they pertain to taxpayers filing Form 1040 or Form 1040A, ask students if each of the adjustments listed below is within the scope of VITA/TCE Program. If it is within the scope, ask where on Form 1040 or Form 1040A the adjustment is reported.

- 1. One-half self-employment tax** (Within the scope of the VITA/TCE Program; report on Form 1040, line 28.)
- 2. Jury duty pay given to an employer** (Within the scope of the VITA/TCE Program; report on Form 1040, line 33, and write "jury pay" dotted on line.)
- 3. Contributions to a traditional IRA** (Within the scope of the VITA/TCE Program; report on Form 1040, line 24, or on Form 1040A, line 17.)
- 4. Self-employed SEP, SIMPLE, and qualified plans** (Outside the scope of the VITA/TCE Program.)
- 5. Self-employed health insurance** (Outside the scope of the VITA/TCE Program.)
- 6. Alimony paid** (Within the scope of the VITA/TCE Program; report on Form 1040, line 32a, along with recipient's social security number.)
- 7. Penalty on early withdrawal of savings** (Within the scope of the VITA/TCE Program; report on Form 1040, line, 31.)
- 8. Moving expenses** (outside the scope of the VITA/TCE Program.)



- 9. Student loan interest deduction** (Generally within the scope of the VITA/TCE Program; report on Form 1040, line 25, or on Form 1040A, line 18.)
- 10. Tuition and fees deduction** (Within the scope of the VITA/TCE Program; report on Form 1040, line 26 or on Form 1040A, line 19.)
- 11. Educator expense deduction** (Within the scope of VITA/TCE Program; report on Form 1040, line 23 or on Form 1040A, line 16.)

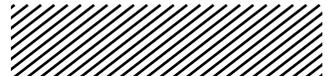
### ***GUIDED QUESTIONS – MOVING EXPENSES – MILITARY SEGMENT***

**1. What form is used to report moving expenses?**

Form 3903, Moving Expenses is used to compute and report moving expenses. The computation is then forward to the adjustment section of the Form 1040.

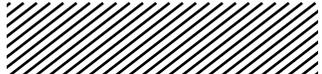
**2. If the Military moves all your goods and pays for everything does the person need to file a Form 3903?**

No, but, they can file Form 3903 if they have allowable unreimbursed expenses to claim.



**STUDENT NOTES**

Lined writing area for student notes.



## INTRODUCTION AND OBJECTIVES

In this lesson you will learn about adjustments to income. There are six adjustments covered in this lesson. They are educators expenses, traditional IRA deductions, student loan interest deduction, tuition and fees deduction, penalty on early withdrawal of savings, and alimony payments. Lesson 2 discusses an additional adjustment to income covered in the VITA/TCE training — one-half of self employment tax.

The remaining adjustments — moving expenses; self-employed health insurance deduction; and self-employed SEP, SIMPLE, and qualified plans — are not covered in traditional VITA/TCE 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.

## 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, contributions 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 2003. If both the taxpayer and spouse are eligible educators and choose to file a joint tax return, they may deduct up to \$500 (\$250 each) of qualified expenses. Prior to 2002 these expenses were deductible only as miscellaneous itemized deductions.

## 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.

### Example 1

Joe and Mary will file a joint return for 2003. Joe is a high school math teacher and incurred \$500 in qualified unreimbursed expenses. Mary is a grade school principal and incurred \$200 in qualified unreimbursed expenses. Both Joe and Mary meet the definition of eligible educators. They will claim \$450 (\$250 for Joe and \$200 for Mary) on Form 1040, line 23.

## 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.

Information on nontraditional IRAs can be found in 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 2

Anna contributed a total of \$2,500 over the last two years to her traditional IRA account. During 2003 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. If both the taxpayer and spouse have compensation and both are under age 70 1/2, each can set up an IRA. However, they cannot participate in the same IRA — they must have separate accounts.

**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, or income you can exclude.

## General Contribution Limits

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 gross 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.

### Example 3

Dan, a college student, working part time earned \$1,500 in 2003. His IRA contributions for 2003 are limited to \$1,500 (the lesser of \$3,000 or compensation includible in income for the year).

### Example 4

George has three traditional IRA accounts. During 2003 he contributed \$1,000 to each. His total IRA contributions for 2003 will be \$3,000.

**ALERT**

Deemed IRAs are new for tax year 2003.

## Deemed IRAs

Beginning in 2003, employers who provide qualified employer retirement plans can maintain a separate account or annuity under the plan to receive voluntary employee contributions. This separate account is referred to as a deemed IRA. A deemed IRA can be a traditional IRA or a Roth IRA, and the same limits apply whether they are deemed or not. If a taxpayer has both a regular IRA and a deemed IRA, the taxpayer can divide contributions between them in any manner, but total contributions to both cannot exceed the \$3,000/\$3,500 limit.

## 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 most that can be contributed for that 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) 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.

### Example 5

Kristen, a full time student with no taxable compensation, marries Jeremy during the year. Neither will be 50 by the end of the year. For the year, Jeremy has taxable compensation of \$30,000. He will contribute \$3,000 to a traditional IRA. If he and Kristen file a joint return, each can contribute \$3,000. This is because Kristen, who has no compensation, can add Jeremy's compensation, reduced by his IRA contribution ( $\$30,000 - \$3,000 = \$27,000$ ) to her own compensation (0) to figure her maximum contribution. In her case, \$3,000 is her contribution limit, because \$3,000 is less than \$27,000 (her compensation for purposes of the figuring the spousal IRA).

### Example 6

Tom and Darcy are married and both are 53. They both work and each has a traditional IRA. Tom earned \$1,800 and Darcy earned \$48,000 in 2003. Because of the spousal IRA limit rule, even though Tom earned less than \$3,500, they can contribute up to \$3,500 in each of their IRAs if they file a joint return. If they file separate returns, the amount that can be contributed to Tom's IRA is limited to \$1,800 (his taxable compensation).

## 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 7

Eldridge is a 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. If Eldridge files a joint return with his spouse who is 68 years old, he can still contribute up to \$3,500 to his spouse's IRA.

### 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).

The actual deductible amount for a traditional IRA depends on the following:

- 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.

### Modified Adjusted Gross Income

Generally, **modified adjusted gross income** is the adjusted gross income without consideration of certain deductions. The modified adjusted gross income (MAGI) can be figured as follows:

AGI (Form 1040 Line 34) plus

- IRA deduction
- Student loan interest deduction
- Tuition and fees deduction
- Foreign earned income exclusion
- Foreign housing exclusion or deduction
- Exclusion of qualified savings bond interest shown on Form 8815

- Exclusion of employer-paid adoption expenses shown on Form 8839.

### 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 8

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. This is true even if the other spouse is covered by an employer retirement 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 both 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.

**NOTE:** If Box 13, Retirement Plan, on Form W-2 is checked, the taxpayer is covered by an employer retirement plan. If taxpayers do not agree with the Form W-2 they must contact their employer. Volunteers cannot make a determination on whether or not a taxpayer is covered by an employer retirement plan. Refer taxpayers with questions on their employer retirement plans to their employer or Publication 590, Individual Retirement Arrangements (IRAs).

**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	\$40,000	\$50,000	\$50,000 or more
Married filing jointly or Qualifying widow(er)	\$60,000	\$70,000	\$70,000 or more
Married filing separately <sup>1</sup>	\$0.01	\$10,000	\$10,000 or more

<sup>1</sup>If the taxpayer did not live with his or her spouse at any time during the year, his or her filing status is considered Single for this purpose.

**ALERT**



For 2003, the MAGI limits increased for taxpayers covered by an employer retirement plan.

**Example 9**

Emily, 36 years old, is single. Her modified AGI was \$49,500. She is covered by a retirement plan at work. Emily's \$3,000 traditional IRA contribution will be reduced or modified on her tax return because her modified AGI is between \$40,000 and \$50,000.

***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**.

**Table 2.**  
**Traditional IRA Deduction Phaseout Chart**  
**(If taxpayer is not covered, but the spouse is)**

Filing Status	Allowable traditional IRA deduction is...		
	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 <sup>1</sup>	\$0.01	\$10,000	\$10,000 or more

<sup>1</sup>The taxpayer is entitled to the full deduction if he or she did not live with their spouse at any time during the year.

**Example 10**

David and Ruth are filing a joint return. David earned \$72,000 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 \$72,000 and their modified AGI is not more than \$150,000 (see Table 2).

**POTENTIAL PITFALLS** 

When determining the allowable deduction, each spouse figures the deduction separately.

## Example 11

Assume still that David earned \$72,000 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 IRS Contributions

Individuals may deduct traditional IRA contributions on their 2003 tax return if the contributions are made in 2003 or by April 15, 2004. Taxpayers may not deduct on their 2003 tax return contributions made in 2003 which were deducted on the 2002 tax return. The contributions do not have to be made before the return is filed. However, if the taxpayer deducts traditional IRA contributions on the 2003 tax return but does not make the traditional IRA contributions by April 15, 2004, for the exact amount deducted, the taxpayer must file an amended tax return.

## 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.

### Example 12

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 (Form 1040, line 22) is \$23,400. Nick and Susan each contributed \$500 to a traditional IRA.

The completed worksheet is shown in Exhibit 1. 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 32a, if they apply to you.
- ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
- ✓ Be sure you have read the list beginning on page 28.



		Your IRA	Spouse's IRA
<p><b>1a.</b> Were you covered by a retirement plan (see page 30)?</p> <p><b>1b.</b> If married filing jointly, was your spouse covered by a retirement plan?</p> <p><b>Next.</b> If you checked "No" on line 1a (and "No" on line 1b if married filing jointly), skip lines 2 through 6; enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7a (and 7b if applicable), and go to line 8. Otherwise, go to line 2.</p> <p><b>2.</b> Enter the amount shown below that applies to you.</p> <ul style="list-style-type: none"> <li>• Single, head of household, or married filing separately and you lived apart from your spouse for all of 2003, enter \$50,000</li> <li>• Qualifying widow(er), enter \$70,000</li> <li>• Married filing jointly, enter \$70,000 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</li> <li>• Married filing separately and you lived with your spouse at any time in 2003, enter \$10,000</li> </ul> <p><b>3.</b> Enter the amount from Form 1040, line 22</p> <p><b>4.</b> Enter the total of the amounts from Form 1040, lines 23, 27 through 32a, plus any amount you entered on the dotted line next to line 33</p> <p><b>5.</b> Subtract line 4 from line 3. Enter the result in both columns</p> <p><b>6.</b> Is the amount on line 5 less than the amount on line 2?</p> <p><input type="checkbox"/> <b>No.</b>  None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.</p> <p><input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 5 from line 2 in each column. <b>If the result is \$10,000 or more, enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7 for that column and go to line 8. Otherwise, go to line 7.</b></p> <p><b>7.</b> Multiply lines 6a and 6b by 30% (.30) (or by 35% (.35) in the column for the IRA of an individual who is age 50 or older at the end of 2003). 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</p> <p><b>8.</b> Enter your wages, and your spouse's if filing jointly, and other earned income from Form 1040, minus any deductions on Form 1040, lines 28 and 30. Do not reduce wages by any loss from self-employment.</p>		<p><b>1a.</b> <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> <p><b>2a.</b> 70,000</p> <p><b>3.</b> 23,400</p> <p><b>4.</b> 0</p> <p><b>5a.</b> 23,400</p> <p><b>6a.</b> 46,600</p> <p><b>7a.</b> 3,000</p> <p><b>8.</b> 23,400</p>	<p><b>1b.</b> <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p><b>2b.</b> 160,000</p> <p><b>5b.</b> 23,400</p> <p><b>6b.</b> 136,600</p> <p><b>7b.</b> 3,000</p>
		<p><b>9a.</b> 500</p> <p><b>10a.</b> 500</p>	<p><b>9b.</b> 500</p> <p><b>10b.</b> 500</p>



If married filing jointly and line 8 is less than \$6,000 (\$6,500 if one spouse is age 50 or older at the end of 2003; \$7,000 if both spouses are age 50 or older at the end of 2003), **stop here** and see Pub. 590 to figure your IRA deduction.

## 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 13

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 \$41,000. Her total basis in traditional IRAs from line 14 of her 2002 Form 8606 is \$10,000. The completed IRA Deduction Worksheet and Form 8606 are shown in Exhibits 2 and 3.

**IRA Deduction Worksheet—Line 24**

Keep for Your Records

**Before you begin:**

- ✓ Complete Form 1040, lines 27 through 32a, if they apply to you.
- ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
- ✓ Be sure you have read the list beginning on page 28.



		Your IRA	Spouse's IRA
<p><b>1a.</b> Were you covered by a retirement plan (see page 30)?</p> <p><b>1b.</b> If married filing jointly, was your spouse covered by a retirement plan?</p> <p><b>Next.</b> If you checked "No" on line 1a (and "No" on line 1b if married filing jointly), skip lines 2 through 6; enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7a (and 7b if applicable), and go to line 8. Otherwise, go to line 2.</p> <p><b>2.</b> Enter the amount shown below that applies to you.</p> <ul style="list-style-type: none"> <li>• Single, head of household, or married filing separately and you lived apart from your spouse for all of 2003, enter \$50,000</li> <li>• Qualifying widow(er), enter \$70,000</li> <li>• Married filing jointly, enter \$70,000 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</li> <li>• Married filing separately and you lived with your spouse at any time in 2003, enter \$10,000</li> </ul> <p><b>3.</b> Enter the amount from Form 1040, line 22</p> <p><b>4.</b> Enter the total of the amounts from Form 1040, lines 23, 27 through 32a, plus any amount you entered on the dotted line next to line 33</p> <p><b>5.</b> Subtract line 4 from line 3. Enter the result in both columns</p> <p><b>6.</b> Is the amount on line 5 less than the amount on line 2?</p> <p><input type="checkbox"/> <b>No.</b>  None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.</p> <p><input type="checkbox"/> <b>Yes.</b> Subtract line 5 from line 2 in each column. <b>If the result is \$10,000 or more, enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7 for that column and go to line 8. Otherwise, go to line 7.</b></p> <p><b>7.</b> Multiply lines 6a and 6b by 30% (.30) (or by 35% (.35) in the column for the IRA of an individual who is age 50 or older at the end of 2003). 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</p> <p><b>8.</b> Enter your wages, and your spouse's if filing jointly, and other earned income from Form 1040, minus any deductions on Form 1040, lines 28 and 30. Do not reduce wages by any loss from self-employment.</p>	<p><b>1a.</b> <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> <p><b>1b.</b> <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p><b>2a.</b> 50,000</p> <p><b>2b.</b></p> <p><b>3.</b> 41,000</p> <p><b>4.</b> 0</p> <p><b>5a.</b> 41,000</p> <p><b>5b.</b></p> <p><b>6a.</b> 9,000</p> <p><b>6b.</b></p> <p><b>7a.</b> 2,700</p> <p><b>7b.</b></p> <p><b>8.</b> 41,000</p>		
<p> <b>CAUTION</b> If married filing jointly and line 8 is less than \$6,000 (\$6,500 if one spouse is age 50 or older at the end of 2003; \$7,000 if both spouses are age 50 or older at the end of 2003), <b>stop here</b> and see Pub. 590 to figure your IRA deduction.</p>			
<p><b>9.</b> Enter traditional IRA contributions made, or that will be made by April 15, 2004, for 2003 to your IRA on line 9a and to your spouse's IRA on line 9b</p> <p><b>10.</b> On line 10a, enter the <b>smallest</b> of line 7a, 8, or 9a. On line 10b, enter the <b>smallest</b> 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)</p>	<p><b>9a.</b> 3,000</p> <p><b>9b.</b></p> <p><b>10a.</b> 2,700</p> <p><b>10b.</b></p>		

Form <b>8606</b> Department of the Treasury Internal Revenue Service	<b>Nondeductible IRAs</b> ▶ See separate instructions. ▶ Attach to Form 1040, Form 1040A, or Form 1040NR.	OMB No. 1545-1007 <b>2003</b> Attachment Sequence No. <b>48</b>
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Name. If married, file a separate form for each spouse required to file Form 8606. See page 5 of the instructions.  
**Rachel Green**

Your social security number  
 000 : 00 : 6220

<b>Fill in Your Address Only if You Are Filing This Form by Itself and Not With Your Tax Return</b>	Home address (number and street, or P.O. box if mail is not delivered to your home)	Apt. no.
	City, town or post office, state, and ZIP code	

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

- Complete this part only if:
- You made nondeductible contributions to a traditional IRA for 2003,
  - You took distributions from a traditional, SEP, or SIMPLE IRA in 2003 (other than a rollover, conversion, recharacterization, or return of certain contributions) **and** you made nondeductible contributions to a traditional IRA in 2003 or an earlier year, **or**
  - You converted part, but not all, of your traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2003 (excluding any portion you recharacterized) **and** you made nondeductible contributions to a traditional IRA in 2003 or an earlier year.

1 Enter your nondeductible contributions to traditional IRAs for 2003, including those made for 2003 from January 1, 2004, through April 15, 2004 (see page 5 of the instructions) . . . . .	1	300	
2 Enter your total basis in traditional IRAs (see page 6 of the instructions) . . . . .	2	10,000	
3 Add lines 1 and 2 . . . . .	3	10,300	
In 2003, 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.	
4 Enter those contributions included on line 1 that were made from January 1, 2004, through April 15, 2004 . . . . .	4		
5 Subtract line 4 from line 3 . . . . .	5		
6 Enter the value of <b>all</b> your traditional, SEP, and SIMPLE IRAs as of December 31, 2003, plus any outstanding rollovers (see page 6 of the instructions) . . . . .	6		
7 Enter your distributions from traditional, SEP, and SIMPLE IRAs in 2003. <b>Do not</b> include rollovers, conversions to a Roth IRA, certain returned contributions, or recharacterizations of traditional IRA contributions (see page 6 of the instructions) . . . . .	7		
8 Enter the net amount you converted from traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2003. <b>Do not</b> include amounts converted that you later recharacterized (see page 7 of the instructions). Also enter this amount on line 16 . . . . .	8		
9 Add lines 6, 7, and 8 . . . . .	9		
10 Divide line 5 by line 9. Enter the result as a decimal rounded to at least 3 places. If the result is 1.000 or more, enter "1.000" . . . . .	10	×	
11 Multiply line 8 by line 10. This is the nontaxable portion of the amount you converted to Roth IRAs. Also enter this amount on line 17 . . . . .	11		
12 Multiply line 7 by line 10. This is the nontaxable portion of your distributions that you did not convert to a Roth IRA . . . . .	12		
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 <b>your total basis in traditional IRAs for 2003 and earlier years</b> . . . . .	14	10,300	
15 <b>Taxable amount.</b> 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 7 of the instructions).

### Exercise 3

Bill and Kathy are both employed and each earned \$15,000 in 2003. Both Bill and Kathy are age 32. Bill was covered by an employer retirement plan but Kathy was not. In July 2003, Bill contributed \$1,200 to his 2003 traditional IRA. In February 2004, he contributed \$800 to his 2003 traditional IRA. Kathy contributed \$400 to her 2003 traditional IRA. They file a joint return. Their total income on line 22 is \$30,000. They have no other adjustments to income.

Complete their IRA deduction worksheet (Exhibit 4).

### 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
- Prohibited transactions, such as borrowing money from one's own IRA or selling property to it.

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

### Credit for Qualified Retirement Savings Contribution

Refer to Lesson 5 to determine if a taxpayer is also eligible to receive the credit for qualified retirement savings contributions based on their contributions to an IRA.

IRA Deduction Worksheet—Line 24

Keep for Your Records

**Before you begin:**

- ✓ Complete Form 1040, lines 27 through 32a, if they apply to you.
- ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
- ✓ Be sure you have read the list beginning on page 28.



	Your IRA	Spouse's IRA
1a. Were you covered by a retirement plan (see page 30)?	1a. <input 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
<p><b>Next.</b> If you checked "No" on line 1a (and "No" on line 1b if married filing jointly), skip lines 2 through 6; enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7a (and 7b if applicable), and go to line 8. Otherwise, go to line 2.</p>		
2. Enter the amount shown below that applies to you.		
<ul style="list-style-type: none"> <li>• Single, head of household, or married filing separately and you lived <b>apart</b> from your spouse for all of 2003, enter \$50,000</li> <li>• Qualifying widow(er), enter \$70,000</li> <li>• Married filing jointly, enter \$70,000 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</li> <li>• Married filing separately and you lived with your spouse at any time in 2003, enter \$10,000</li> </ul>	2a. _____	2b. _____
3. Enter the amount from Form 1040, line 22.	3. _____	
4. Enter the total of the amounts from Form 1040, lines 23, 27 through 32a, plus any amount you entered on the dotted line next to line 33	4. _____	
5. Subtract line 4 from line 3. Enter the result in both columns	5a. _____	5b. _____
6. Is the amount on line 5 less than the amount on line 2?		
<input type="checkbox"/> <b>No.</b> None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.		
<input type="checkbox"/> <b>Yes.</b> Subtract line 5 from line 2 in each column. <b>If the result is \$10,000 or more, enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7 for that column and go to line 8. Otherwise, go to line 7</b>	6a. _____	6b. _____
7. Multiply lines 6a and 6b by 30% (.30) (or by 35% (.35) in the column for the IRA of an individual who is age 50 or older at the end of 2003). 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. _____	7b. _____
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 28 and 30. Do not reduce wages by any loss from self-employment	8. _____	
<div style="border: 1px solid black; padding: 5px; margin: 5px 0;"> <p>If married filing jointly and line 8 is less than \$6,000 (\$6,500 if one spouse is age 50 or older at the end of 2003; \$7,000 if both spouses are age 50 or older at the end of 2003), <b>stop here</b> and see Pub. 590 to figure your IRA deduction.</p> </div>		
9. Enter traditional IRA contributions made, or that will be made by April 15, 2004, for 2003 to your IRA on line 9a and to your spouse's IRA on line 9b	9a. _____	9b. _____
10. On line 10a, enter the <b>smallest</b> of line 7a, 8, or 9a. On line 10b, enter the <b>smallest</b> 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. _____	10b. _____

## ***STUDENT LOAN INTEREST DEDUCTION***

If a taxpayer paid interest on a student loan in 2003, he or she may be able to deduct up to \$2,500 of the interest paid.

If the taxpayer paid \$600 or more in interest to a single lender, the taxpayer should receive a statement from the lender showing the amount of interest paid. This information will assist you in completing the student loan interest deduction.

### **Qualified Student Loan Interest**

Generally, student loan interest is the interest paid during the year on a loan for qualified higher education expenses that were:

1. For the taxpayer, the taxpayer's spouse, or a person who was the taxpayer's dependent when the loan was obtained.
2. Paid within a reasonable period of time before or after obtaining the loan, and
3. For an eligible student.

Interest can be the interest paid during the life of the loan (voluntary and required interest payments), loan origination fees, capitalized interest, interest on revolving lines of credit, and interest on refinanced student loans.

Interest does not include interest on any of the following:

1. A loan from a related person.
2. A loan from a qualified employer plan.
3. A loan for which the taxpayer is not legally liable.

### **Who Can Claim the Deduction**

Generally, a taxpayer can claim the deduction if all the following requirements are met:

1. Taxpayer cannot use married filing separately filing status.
2. Taxpayer cannot be claimed as a dependent on someone else's return.
3. The interest is on a loan to pay tuition and other qualified higher education expenses for the taxpayer, the taxpayer's spouse, or someone whom the taxpayer can claim as a dependent, when the loan was taken out.
4. The education expenses were paid or incurred within a reasonable period of time before or after the loan was taken out.
5. The person for whom the expenses were paid or incurred was an eligible student.

## Qualified Higher Education Expenses

Generally, qualified higher education expenses include tuition and fees; room and board; books, supplies and equipment; and other necessary expenses.

These costs must be reduced by the following:

1. Employer provided educational assistance benefits.
2. Tax-free withdrawals from a Coverdell ESA.
3. Tax-free withdrawals from a qualified tuition program.
4. U.S. savings bond interest excluded from income because it is used to pay qualified higher education expenses.
5. Certain scholarships.
6. Veteran's educational assistance benefits.
7. Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses.

## Eligible educational institution

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. It includes virtually all accredited public, nonprofit, and privately owned profit-making postsecondary institutions.

For the student loan interest deduction only, an eligible educational institution also includes an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, hospital, or health care facility that offers postgraduate training.

If a taxpayer does not know if the educational institution is an eligible institution, the taxpayer should contact the school.

## Eligible student

An eligible student is a student who is enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential.

The standard for what is half the normal full-time work load is determined by each eligible educational institution.

## Deduction Limits

The student loan interest deduction is generally the smaller of \$2,500 or the interest payments paid in 2003.

This amount may be gradually reduced (phased out) or eliminated based on the taxpayer's filing status and modified adjusted gross income (MAGI). Table 3 depicts when the limits apply.

**Table 3**

<b>Limit on Student Loan Interest Deduction</b>		
<b>If your filing status is</b>	<b>AND your modified AGI is</b>	<b>THEN...</b>
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.

**Figuring the Deduction**

Use the Student Loan Interest Deduction worksheet found in the Form 1040 or Form 1040A instructions to figure the deduction.

**Claiming the Deduction**

The student loan interest deduction is entered on Form 1040, line 25, or Form 1040A, line 18.

**Example 14**

During 2003, Rick paid \$2,650 in qualified interest on his student loan. His total income, Form 1040, line 22, is \$35,000. He has no other adjustments to his income. His completed student loan interest deduction worksheet, Exhibit 5, shows Rick is entitled to \$2,500. Although his MAGI falls within the income limits, he is only entitled to a maximum \$2,500 deduction.

**Student Loan Interest Deduction Worksheet—Line 25**

*Keep for Your Records*

- Before you begin:**
- ✓ Complete Form 1040, lines 27 through 32a, if they apply to you.
  - ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32).
  - ✓ See the instructions for line 25 that begin on this page.
  - ✓ Be sure you have read the **Exception** above to see if you can use this worksheet instead of Pub. 970 to figure your deduction.



<p><b>1.</b> Enter the total interest you paid in 2003 on qualified student loans (defined above). <b>Do not</b> enter more than \$2,500</p> <p><b>2.</b> Enter the amount from Form 1040, line 22</p> <p><b>3.</b> Enter the total of the amounts from Form 1040, lines 23, 24, 27 through 32a, plus any amount you entered on the dotted line next to line 33</p> <p><b>4.</b> Subtract line 3 from line 2</p> <p><b>5.</b> Enter the amount shown below for your filing status.</p> <ul style="list-style-type: none"> <li>• Single, head of household, or qualifying widow(er)—\$50,000</li> <li>• Married filing jointly—\$100,000</li> </ul> <p><b>6.</b> Is the amount on line 4 more than the amount on line 5?</p> <p><input type="checkbox"/> <b>No.</b> Skip lines 6 and 7, enter -0- on line 8, and go to line 9.</p> <p><input type="checkbox"/> <b>Yes.</b> Subtract line 5 from line 4</p> <p><b>7.</b> Divide line 6 by \$15,000 (\$30,000 if married filing jointly). Enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000</p> <p><b>8.</b> Multiply line 1 by line 7</p> <p><b>9. Student loan interest deduction.</b> Subtract line 8 from line 1. Enter the result here and on Form 1040, line 25. <b>Do not</b> include this amount in figuring any other deduction on your return (such as on Schedule A, C, E, etc.)</p>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">2,500</td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">35,000</td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">0</td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">35,000</td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">50,000</td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black;"></td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black;"></td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">.</td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">0</td> </tr> <tr> <td style="border-bottom: 1px solid black; width: 50px;"></td> <td style="border-bottom: 1px solid black; text-align: right;">2,500</td> </tr> </table>		2,500		35,000		0		35,000		50,000						.		0		2,500
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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. In addition, the taxpayer must include on the tax return the name and taxpayer identification number of the qualified student.

### 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

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,
- Student activities.
- 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.
- Athletic fees.
- Other expenses unrelated to an individual's academic course of instruction.

### 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).

***Married taxpayers that file as married filing separately 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. It includes virtually all accredited, public, nonprofit, and privately owned profit-making post secondary institutions.

If the taxpayer does not know if the educational institution is an eligible institution, he or she should contact the school.

### Deduction Amount

The deduction amount is determined by the taxpayer's filing status and adjusted gross income. Table 4 depicts when the income limitations apply.

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

**Table 4 Limit on Tuiton and Fees Deduction**

<b>IF your filing status is...</b>	<b>AND your modified AGI is...</b>	<b>THEN...</b>
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

Use the Tuition and Fees Deduction worksheet found in the Form 1040 or Form 1040A instructions to figure the modified adjusted gross income and the resulting deduction amount.

### Example 15

Luis and Priscilla file a joint return for 2003. Their 1040 line 22 total income is \$49,620. In 2003, 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 6.

Exhibit 6

Luis and Priscilla's Tuition and Fees Deduction Worksheet

Tuition and Fees Deduction Worksheet—Line 26		Keep for Your Records
<b>Before you begin:</b>	<ul style="list-style-type: none"><li>✓ Complete Form 1040, lines 27 through 32a, if they apply to you.</li><li>✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32).</li><li>✓ See the instructions for line 26 above.</li><li>✓ Be sure you have read the <b>Exception</b> above to see if you can use this worksheet instead of Pub. 970 to figure your deduction.</li></ul>	
1. Enter amount from Form 1040, line 22	1.	49,620
2. Enter the total of the amounts from Form 1040, lines 23 through 25, 27 through 32a, plus any amount you entered on the dotted line next to line 33	2.	1,500
3. Subtract line 2 from line 1. If the result is more than \$65,000 (\$130,000 if married filing jointly),  You cannot take the deduction for tuition and fees	3.	48,120
4. <b>Tuition and fees deduction.</b> Enter the total qualified tuition and fees (defined above) you paid in 2003. <b>Do not</b> enter more than \$3,000. Also, enter this amount on Form 1040, line 26. <b>Do not</b> include this amount in figuring any other deduction on your return (such as on Schedule A, C, E, etc.)	4.	1,300

## No Double Benefits

A taxpayer cannot:

- Deduct qualified tuition and related expenses if the same expense is deductible on a different line of the return.
- 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 28, the adjustment for one-half of self-employment tax from Schedule SE. This subject was covered in Lesson 2, 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 2, 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 31. The entire penalty is deducted, even if it is greater than the interest income.

### **Example 16**

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. Normally, she would be able to file Form 1040A.

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

## ***ALIMONY PAID***

As you learned in Lesson 2, 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 32a and 32b, 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 2, *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 33, write "jury pay" and the amount. Include jury duty pay with the adjustments claimed on lines 23 through 32a.

## *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 33. Subtract the total adjustments from total income on Form 1040A, line 15, or Form 1040, line 22. Enter the result on Form 1040A, line 21, or Form 1040, line 34. 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.

## *TAXWISE HINTS*

TaxWise will quickly complete any worksheets needed to determine adjustments to income.

There is one worksheet for educator expenses, student loan interest deduction, and tuition and fees deduction. You can link to this form from Form 1040, lines 23, 25, or 26.

Link to the Deductible and Non-deductible IRA Worksheet from Form 1040, line 24. Once the IRA contribution is input for the taxpayer (and spouse if married), TaxWise will complete the Form 8606, if necessary, and input the entry on Form 1040, line 24.

One half the self employment tax will be entered automatically when completing Schedule C or C-EZ.

The penalty on withdrawal from savings should be entered by linking to the Interest Received Worksheet. This worksheet is a link from Schedule B.

TaxWise breaks out the remaining adjustments. Simply input the appropriate amount.

## ▶▶ 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 Schedule 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 only.
- 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 70 1/2.

**Exercise 1**

- (A) Yes; alimony is considered compensation for traditional IRA purposes.
- (B) Yes; But only if they file a joint return.
- (C) No; Carla has no compensation for traditional IRA purposes.
- (D) \$1,250; The lessor of taxable compensation or \$13,500.

**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 \$40,000.
- (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 a portion of her IRA contribution because she is not covered by an employer-sponsored retirement plan and her income is less than \$10,000.

## Exercise 3

## Bill and Kathy's IRA Deductions Worksheet

### IRA Deduction Worksheet—Line 24

Keep for Your Records

**Before you begin:**

- ✓ Complete Form 1040, lines 27 through 32a, if they apply to you.
- ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
- ✓ Be sure you have read the list beginning on page 28.



	Your IRA	Spouse's IRA
1a. Were you covered by a retirement plan (see page 30)?	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
<p><b>Next.</b> If you checked "No" on line 1a (and "No" on line 1b if married filing jointly), skip lines 2 through 6; enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7a (and 7b if applicable), and go to line 8. Otherwise, go to line 2.</p>		
2. Enter the amount shown below that applies to you.		
<ul style="list-style-type: none"> <li>• Single, head of household, or married filing separately and you lived apart from your spouse for all of 2003, enter \$50,000</li> <li>• Qualifying widow(er), enter \$70,000</li> <li>• Married filing jointly, enter \$70,000 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</li> <li>• Married filing separately and you lived with your spouse at any time in 2003, enter \$10,000</li> </ul>	2a. <u>70,000</u>	2b. <u>160,000</u>
3. Enter the amount from Form 1040, line 22.	3. <u>30,000</u>	
4. Enter the total of the amounts from Form 1040, lines 23, 27 through 32a, plus any amount you entered on the dotted line next to line 33.	4. <u>0</u>	
5. Subtract line 4 from line 3. Enter the result in both columns.	5a. <u>30,000</u>	5b. <u>30,000</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 type="checkbox"/> Yes. Subtract line 5 from line 2 in each column. <b>If the result is \$10,000 or more, enter \$3,000 (\$3,500 if age 50 or older at the end of 2003) on line 7 for that column and go to line 8. Otherwise, go to line 7.</b>	6a. <u>40,000</u>	6b. <u>130,000</u>
7. Multiply lines 6a and 6b by 30% (.30) (or by 35% (.35) in the column for the IRA of an individual who is age 50 or older at the end of 2003). 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 28 and 30. Do not reduce wages by any loss from self-employment.	8. <u>30,000</u>	
<div style="border: 1px solid black; padding: 5px; display: inline-block;">  If married filing jointly and line 8 is less than \$6,000 (\$6,500 if one spouse is age 50 or older at the end of 2003; \$7,000 if both spouses are age 50 or older at the end of 2003), <b>stop here</b> and see Pub. 590 to figure your IRA deduction.                 </div>		
9. Enter traditional IRA contributions made, or that will be made by April 15, 2004, for 2003 to your IRA on line 9a and to your spouse's IRA on line 9b.	9a. <u>2,000</u>	9b. <u>400</u>
10. On line 10a, enter the <b>smallest</b> of line 7a, 8, or 9a. On line 10b, enter the <b>smallest</b> 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>2,000</u>	10b. <u>400</u>

**STUDENT NOTES**

Lined area for student notes.

## INTRODUCTION AND OBJECTIVES

This segment covers the moving expenses of military personnel. When a member of the Armed Forces is transferred to a new permanent duty station he or she may deduct certain moving expenses.

In preparing returns for the military, you will need to:

- Identify qualifying moves by assisting in determining if the move qualifies as a permanent change of station (PCS).
- Determine when allowances and reimbursements must be included in income.
- Identify deductible moving expenses.
- Compute the moving expense deduction using Form 3903, Moving Expenses, for moves within and outside the United States.

## PERMANENT CHANGE OF STATION

For military moves, only expenses incurred as a result of a permanent change of station are deductible. A permanent change of station includes:

- A move from home to the area of the first post of duty.
- A move from one permanent post of duty to another.
- A move from the last post of duty to home or to a nearer point in the United States. The member must move within one year of ending active duty or within the period allowed under the Joint Travel Regulations.

**Spouse and dependents.** If a member of the Armed Forces deserts, is imprisoned, or dies, a permanent change of station for the spouse or dependents includes a move to the place of enlistment, the home of record, or any nearer point in the United States.

If the Armed Forces moves a member and his or her spouse or dependents to or from separate locations, the moves are treated as a single move to the member's post of duty. The qualified expenses of both moves are combined and deducted on the same tax return.

### Exercise 1

Which of the following is a permanent change of station?

- A. A move by an Air Force pilot to an airbase for a 6-month detail.
- B. A move by an Army sergeant to his home 2 years after he ended active duty.
- C. A move by a new enlistee from her home to her first post of duty.

Answer \_\_\_\_\_

### **REQUIREMENTS**

The moving expense deduction includes only expenses that are reasonable for the circumstances of the move. For example, the costs of any side trips for sightseeing are not deductible. The cost of lavish and extravagant lodging also is not deductible.

Although civilians must meet a distance test and a time test to deduct moving expenses, members of the military can disregard such tests for moves required by a permanent change of station.

### **PAYMENTS IN KIND, ALLOWANCES, AND REIMBURSEMENTS**

The service member must include in gross income any payments he or she receives from the government for a do-it-yourself (DITY) permanent change of station (PCS) move. A DITY move payment is based on government estimates of the cost to move household goods, not on actual expenses and receipts. The service member will receive a separate Form W-2 for the DITY payment. The amount in box 1 of the Form W-2 must be included on line 7 of Form 1040. He or she must also complete Form 3903 to compute total qualified moving expenses that can be deducted on line 27, Form 1040. These line 7 and line 27 entries on Form 1040 will report the income and applicable related expenses for the move on the Form 1040.

The service member does not include any of the following in his or her gross income.

- Moving or storage services furnished to the member.
- Non-taxable allowances such as:
  - Dislocation allowance
  - Temporary Lodging Allowance
  - Mileage Allowance in Lieu of Transportation
  - Per Diem Allowance



Generally, if total reimbursements or allowances received by the service member are more than his or her qualified moving expenses, the excess will be included with his or her wages in box 1 of Form W-2. However, if reimbursements or allowances (other than nontaxable allowances like the ones listed above) exceed the cost of moving and they are not included in the Form W-2, the service member must still include the excess on line 7 of Form 1040.

Use Form 3903 to deduct qualified expenses that exceed reimbursements and allowances (including nontaxable allowances like the ones listed above).

### Exercise 2

- A.** A member of the Armed Forces must include in gross income all reimbursements, allowances, and the value of moving and storage services that the military organization furnishes. True or false?

Answer \_\_\_\_\_

- B.** If a member of the Armed Forces receives reimbursements or allowances (that are not excludable from gross income) in excess of the actual moving expenses, he or she must include in income only the amount that exceeds actual expenses. True or false?

Answer \_\_\_\_\_

## **DEDUCTIBLE MOVING EXPENSES**

Any qualifying moving expenses that exceed allowances or reimbursements from the government are deductible.

Members of the military will need to determine whether they have excess expenses and, if so, whether the expenses are deductible on their federal tax return.

Qualifying moving expenses are:

- **The cost of moving household goods and personal effects**, including hauling a trailer and packing, storage, and insurance. It does not include the expense of moving furniture or other goods that the taxpayer bought on the way from the old home to the new home.
- **The cost of reasonable travel and lodging expenses** from the old home to the new home, including actual automobile expenses (or 12 cents per mile), airfare, and lodging for the taxpayer and members of his or her household. Members cannot deduct the cost of meals while traveling from the old home to the new home.

**Foreign moves.** A foreign move is one from the United States or its possessions to a foreign country or from one foreign country to another. It is not a move from a foreign country to the United States or its possessions.



### Exercise 3

Which of the following are deductible moving expenses for Major Boone? (Assume the member received no reimbursements from the government.)

- A. Payment to Fulton Construction Company for home improvements made to Major Boone's former home.
- B. Security deposit to Towner Apartments on the Boones new apartment.
- C. Commission to Mercer Real Estate for the sale of the Boones' former home.
- D. Payment to Shelby Transport Company to ship a piano that the Boones bought on the way to their new home.
- E. Cost of transporting Major Boone's second car to the new job location.
- F. Payment for meals while on the way to the new permanent duty station.

Answer \_\_\_\_\_

### **REPORTING MOVING EXPENSES**

Moving expenses are deductible as an adjustment to income on Form 1040, line 27. Only deductible expenses that are more than reimbursements and allowances can be claimed.

If the service member was not reimbursed, he or she can deduct allowable moving expenses either in the year incurred and paid or in the year they were paid.

If the member was reimbursed for expenses, he or she can deduct allowable expenses either in the year incurred or in the year paid

If the member uses the cash method of accounting, which is used by most individuals, he or she can choose to deduct moving expenses in the year of reimbursement if:

- (1) The expenses were paid in a year before the year of reimbursement, or
- (2) The expenses were paid in the year immediately after the year of reimbursement but by the due date, including extensions, for filing his or her return for the reimbursement year.

Moving expenses are reported on Form 3903, *Moving Expenses*. For more information, see Publication 521, *Moving Expenses*.

The following example illustrates applications of the rules discussed in this lesson.



## Example

Capt. Shirley M. Holmes (SSN 000-00-9876) transferred in 2003 from one base to another. The government reimbursed her \$350 for her travel and lodging expenses on the way to her new job location. The travel and lodging reimbursements were not reported as income on Form W-2. The \$5,000 expense for transporting her household goods was furnished in kind by the military. No other reimbursements or allowances were made.

Capt. Holmes incurred the following expenses:

Travel and lodging en route – \$500

The moving expense is computed on Form 3903 as follows:

Exhibit 1

Form 3903

Form <b>3903</b>		<b>Moving Expenses</b>		OMB No. 1545-0092	
Department of the Treasury Internal Revenue Service		▶ Attach to Form 1040.		<b>2003</b> Attachment Sequence No. <b>62</b>	
Name(s) shown on Form 1040 <b>Shirley M Holmes</b>			Your social security number <b>000 00 9876</b>		
<b>Before you begin:</b> ✓ See the <b>Distance Test</b> and <b>Time Test</b> in the instructions to find out if you can deduct your moving expenses. ✓ If you are a member of the armed forces, see the instructions to find out how to complete this form.					
<b>1</b>	Enter the amount you paid for transportation and storage of household goods and personal effects (see instructions) . . . . .	<b>1</b>			
<b>2</b>	Enter the amount you paid for travel and lodging in moving from your old home to your new home (see instructions). <b>Do not</b> include the cost of meals . . . . .	<b>2</b>		500	00
<b>3</b>	Add lines 1 and 2 . . . . .	<b>3</b>		500	00
<b>4</b>	Enter the total amount your employer paid you for the expenses listed on lines 1 and 2 that is <b>not</b> included in the wages box (box 1) of your Form W-2. This amount should be identified with code <b>P</b> in box 12 of your Form W-2 . . . . .	<b>4</b>		350	00
<b>5</b>	Is line 3 more than line 4? <input type="checkbox"/> <b>No.</b> You <b>cannot</b> deduct your moving expenses. If line 3 is less than line 4, subtract line 3 from line 4 and include the result on line 7 of Form 1040. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 4 from line 3. Enter the result here and on line 27 of Form 1040. This is your <b>moving expense deduction</b> . . . . .	<b>5</b>		150	00

**Note:** The \$5,000 expense for transporting her household goods was not included because the Armed Forces paid for this service.

The travel and lodging expenses for moving from the old home to the new home are shown on line 2 of Form 3903.

Reimbursements are shown on line 4.

To figure the moving expense deduction on Form 3903, subtract the total reimbursements on line 4 from the amount on line 3. Check the "Yes" box and enter the result on line 5 and on Form 1040, line 27.

**Exercise 4**

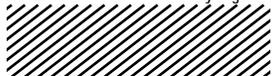
Greg T. (SSN 000-00-4567) and Diane E. Coe are filing a joint return. Greg T. Coe, an airman in the Air Force, was transferred from Maxwell Air Force Base to Scott Air Force Base. The government reimbursed Greg \$400 for travel expenses incurred on the way to his new job location. He also received a \$1,000 dislocation allowance. The travel and lodging reimbursements and the dislocation allowance were not reported as wages on Form W-2. Using the following information furnished by the Coes, complete Form 3903.

Dislocation expenses:	\$ 1,000
Travel and lodging en route:	\$ 575
Meals en route:	\$ 200
Security deposit for new apartment:	\$ 350

Exhibit 2

Form 3903

<p><b>Form 3903</b></p> <p>Department of the Treasury Internal Revenue Service</p>	<p><b>Moving Expenses</b></p> <p>▶ Attach to Form 1040.</p>	<p>CMB No. 1545-0052</p> <p><b>2003</b></p> <p>Attachment Sequence No. 62</p>
Name(s) shown on Form 1040		Your social security number
<p><b>Before you begin:</b> ✓ See the <b>Distance Test</b> and <b>Time Test</b> in the instructions to find out if you can deduct your moving expenses.</p> <p>✓ If you are a member of the armed forces, see the instructions to find out how to complete this form.</p>		
<p>1 Enter the amount you paid for transportation and storage of household goods and personal effects (see instructions) . . . . .</p> <p>2 Enter the amount you paid for travel and lodging in moving from your old home to your new home (see instructions). <b>Do not</b> include the cost of meals . . . . .</p> <p>3 Add lines 1 and 2 . . . . .</p> <p>4 Enter the total amount your employer paid you for the expenses listed on lines 1 and 2 that is <b>not</b> included in the wages box (box 1) of your Form W-2. This amount should be identified with code <b>P</b> in box 12 of your Form W-2 . . . . .</p> <p>5 Is line 3 <b>more than</b> line 4?</p> <p><input type="checkbox"/> <b>No.</b> You <b>cannot</b> deduct your moving expenses. If line 3 is less than line 4, subtract line 3 from line 4 and include the result on line 7 of Form 1040.</p> <p><input type="checkbox"/> <b>Yes.</b> Subtract line 4 from line 3. Enter the result here and on line 27 of Form 1040. This is your <b>moving expense deduction</b> . . . . .</p>	<p>1</p> <p>2</p> <p>3</p> <p>4</p> <p>5</p>	<p></p> <p></p> <p></p> <p></p> <p></p>



1. c.
2. a. False
  - b. True
3. e.
4. See completed Form 3903. The Coes are entitled to a \$175 moving expense deduction. Only the travel and lodging en route can be claimed on Form 3903, line 2. The security deposit and the meals are not deductible expenses. In addition, the dislocation allowance is netted against dislocation expenses. Only if the dislocation expenses exceeded the dislocation allowance would the Coes have reported the difference as an additional moving expense on Form 3903.

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

In this segment you learned what moves qualify for tax benefits, what expenses are deductible, and how to use Form 3903 to compute the moving expense deduction. These expenses are deductible as an adjustment to income on Form 1040, line 27.

Form <b>3903</b> <small>Department of the Treasury Internal Revenue Service</small>	<b>Moving Expenses</b> ▶ Attach to Form 1040.	<small>CMB No. 1545-0062</small> <b>2003</b> <small>Attachment Sequence No. 62</small>
Name(s) shown on Form 1040: <b>Greg T. and Diane E. Coe</b>		Your social security number: <b>000 00 4667</b>
<b>Before you begin:</b> <ul style="list-style-type: none"> <li>✓ See the <b>Distance Test</b> and <b>Time Test</b> in the instructions to find out if you can deduct your moving expenses.</li> <li>✓ If you are a member of the armed forces, see the instructions to find out how to complete this form.</li> </ul>		
1 Enter the amount you paid for transportation and storage of household goods and personal effects (see instructions) . . . . .	1	575 00
2 Enter the amount you paid for travel and lodging in moving from your old home to your new home (see instructions). <b>Do not</b> include the cost of meals . . . . .	2	575 00
3 Add lines 1 and 2 . . . . .	3	575 00
4 Enter the total amount your employer paid you for the expenses listed on lines 1 and 2 that is <b>not</b> included in the wages box (box 1) of your Form W-2. This amount should be identified with code <b>P</b> in box 12 of your Form W-2 . . . . .	4	400 00
5 Is line 3 <b>more than</b> line 4?  <input type="checkbox"/> <b>No.</b> You <b>cannot</b> deduct your moving expenses. If line 3 is less than line 4, subtract line 3 from line 4 and include the result on line 7 of Form 1040.  <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 4 from line 3. Enter the result here and on line 27 of Form 1040. This is your <b>moving expense deduction</b> . . . . .	5	175 00



### LESSON OVERVIEW AND OBJECTIVES

This lesson presents information about reducing adjusted gross income by using the standard deduction or itemizing deductions. Approximately 1 to 2 hours should be devoted to covering the objectives of this lesson.

After completing this lesson you should be able to:

- Identify the correct standard deduction.
- Calculate and accurately report itemized deductions on Schedule A.
- Identify the miscellaneous deductions reported on Schedule A, line 27.
- Review the Qualified Dividends and Capital Gain Tax Worksheet.
- Explain the process to calculate and report tax liability.

### MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the publications or forms, you can download the files from [www.irs.gov](http://www.irs.gov).

- Schedule A (Form 1040)
- Standard deduction, exemption amount, taxable income and tax lines (22-28) of Form 1040A
- *Standard Deduction Chart for People Age 65 or Older or Blind* (Form 1040 Instructions)
- *Standard Deduction Worksheet for Dependents* (Form 1040 Instructions)
- *Tax and Credits section of Form 1040*

### TEACHING TIPS — STANDARD DEDUCTIONS

1. Students should be aware of criteria that apply for blindness.
2. A taxpayer who was totally blind on the last day of 2003 should attach a statement to the tax return describing the blindness.
3. A taxpayer who was partially blind on the last day of 2003 must get a certified statement from an eye physician or registered optometrist, verifying that the taxpayer's vision in the best eye is not better than 20/200 with glasses or contact lenses, or that the field of vision is not more than 20 degrees. If the taxpayer's

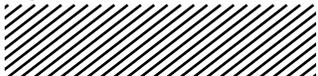
partial vision will never improve beyond one of these two conditions, he or she also must get a statement attesting to this. The taxpayer must keep the statement for his or her records.

### **TEACHING TIPS — ITEMIZED DEDUCTIONS**

1. Review with students that some taxpayers may itemize deductions even if the standard deduction is greater. When this happens, volunteers should enter “IE” next to Form 1040, line 37.
2. Emphasize to students that the only types of points that can be deducted on Schedule A are the points paid for the use of money (as a form of interest), including seller-paid points (deductible by buyer). Any other points paid for a service (such as those paid for the lender’s appraisal fee) are NOT considered interest, and, therefore, are not deductible.
3. Students should be aware that taxpayers cannot deduct as charitable contributions any money spent buying raffle tickets, playing bingo, or playing other games of chance.
4. Taxpayers who have made deductible contributions based on fair market value may ask volunteers if they can deduct the appraisal fees they paid to find the fair market value of the items. Volunteers should explain to taxpayers that appraisal fees are not deductible as contributions, but as miscellaneous expenses on Schedule A, line 22.

### **GUIDED QUESTIONS — STANDARD DEDUCTIONS**

1. **Explain the procedure to follow when you start page 2 of Form 1040A or 1040.**  
(Transfer the adjusted gross income from line 21 or 34 to line 22 or 35, respectively.)
2. **Name at least three factors that determine the taxpayer’s standard deduction amount.**  
(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.)
3. **How is the standard deduction affected when the taxpayer’s filing status is married filing a separate return and the taxpayer’s spouse files Form 1040 and itemizes deductions?**  
(The taxpayer’s standard deduction in this case is zero; if the taxpayer wishes to itemize deductions, he or she should file Form 1040.)
4. **Identify at least two reference tools used to compute taxpayers’ standard deduction.**  
(*Standard Deduction Chart for People Age 65 or Older or Blind, and Standard Deduction Worksheet for Dependents.*)



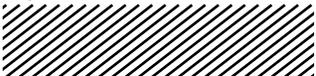
## **GUIDED QUESTIONS — ITEMIZED DEDUCTIONS**

- 1. How do standard deductions and itemized deductions affect adjusted gross income?**  
(They are subtracted from adjusted gross income and result in a smaller taxable income.)
- 2. When might a married taxpayer lose the option to either take the standard deduction or itemize deductions?**  
(If married taxpayers are filing separate returns and one spouse itemizes deductions, the other spouse should also itemize deductions. Otherwise, his or her standard deduction is zero.)
- 3. Should itemized deductions be figured on Schedule A before or after figuring adjusted gross income?**  
Explain. (Itemized deductions should be figured on Schedule A after figuring adjusted gross income. For some itemized deductions, only the portion that exceeds a specific percentage of adjusted gross income is deductible.)
- 4. What three conditions must be met in order for a tax to be deductible?**  
((1) The tax must be imposed on the taxpayer. (2) The tax must be paid by the taxpayer. (3) The tax must be paid during the tax year.)
- 5. Can a taxpayer deduct income taxes and real estate taxes paid to a state, local, or foreign government?** (Yes; a taxpayer can deduct income taxes and real estate taxes that are paid to any of these governments.)
- 6. Are all federal, state, and local taxes, including general sales tax, deductible?**  
(No; many federal, state, and local taxes, such as general sales tax, are not deductible.)
- 7. The amount of mortgage interest that a taxpayer can deduct depends upon what three conditions?**  
(The date of the loan, the amount of the loan, and the use of the proceeds of the loan.)
- 8. After what date do restrictions apply on the deductible amount of a taxpayer's mortgage interest debt?**  
(October 13, 1987.)
- 9. Can taxpayers deduct contributions made directly to needy individuals?**  
(No; in order to be deductible, contributions must be made to a qualified organization, not an individual.)

- 10. How do taxpayers use the fair market value of a charitable contribution?**  
(Taxpayers can deduct the fair market value of clothing, furniture, etc. given to qualifying organizations, and they can deduct the amount of their contribution that was in excess of the fair market value for items such as merchandise and tickets to charity balls or sporting events.)
- 11. Are all deductible contributions reported on Schedule A on the same line?**  
(No; report cash and check contributions on line 15 [the car mileage deduction for charity is treated as a cash contribution]; report all other contributions on line 16.)
- 12. Taxpayers should be referred to a paid professional tax preparer if their non-cash contributions exceed what amount?**  
(\$500)
- 13. What constitutes *Total Itemized Deductions*, reported on line 28 of Schedule A?**  
(*Total Itemized Deductions* is the sum of these deductible amounts: medical and dental expenses (line 4), taxes (line 9), interest (line 14), gifts to charity (line 18), casualty and theft losses (line 19), job expenses and most other miscellaneous deductions (line 26), and other miscellaneous deductions (line 27).)
- 14. How is the amount of *Total Itemized Deductions* used to determine the amount entered on Form 1040, line 37?**  
(The amount of *Total Itemized Deductions* is compared with the standard deduction, and then the larger amount is entered on Form 1040, line 37.)

## LESSON REVIEW

1. Students may ask whether the attorney's fee for drawing up a will qualifies as "tax counsel and assistance" which is deductible on Schedule A as a miscellaneous itemized deduction. Explain to students that the attorney's fee for a will is considered a "personal legal expense," and, therefore, is not a deductible expense. Review with students that in order for a legal expense to qualify as a miscellaneous itemized deduction, the expense must be incurred in one of the following ways: to produce or collect income; to manage, conserve, or maintain property held for producing income; or to determine, contest, pay, or claim a refund of any tax.
2. Tell volunteers that the 2003 exemption amount is \$3,050 for each personal and dependency exemption the taxpayer can take. This information is built into the computation on the return forms (Form 1040, line 39; Form 1040A, line 26; Form 1040EZ, line 5).



## OPTIONAL CLASS ACTIVITY — A

To review students' understanding of the taxable income section of the tax return, ask the following questions:

- 1. Mary is 68 years old and blind. She cannot be claimed as a dependent on another taxpayer's return. What reference will you use to figure her standard deduction?**  
*(Standard Deduction Chart for People Age 65 or Older or Blind.)*
- 2. Consuela is 14 years old and is claimed as a dependent on her father's return. What reference tool will you use to figure her standard deduction?**  
*(You must use the Standard Deduction Worksheet for Dependents.)*
- 3. Louis and Carmella are married filing separate returns. Louis itemized his deductions on Form 1040. Can Carmella take a standard deduction?**  
*(Yes, but her standard deduction amount will be zero.)*
- 4. Lu is blind. Her daughter and son-in-law claim her as a dependent. What reference tool will you use to figure Lu's standard deduction?**  
*(Standard Deduction Worksheet for Dependents.)*

## OPTIONAL CLASS ACTIVITY — B

To review the standard deduction and tax liability, ask the following true/false questions, and have students explain why the false statements are not correct.

- 1. The standard deduction is available to all filers of Form 1040.**  
*(True; a married taxpayer filing separately whose spouse claims itemized deductions, will have a standard deduction of zero.)*
- 2. Although the larger of the standard deduction or itemized deductions usually is entered on Form 1040, line 37, taxpayers might choose to enter the lower amount to gain a benefit from state tax.**  
*(True)*
- 3. There is one reference tool available for determining the standard deduction for filers of Form 1040.**  
*(False; there is one chart, and one worksheet, depending on the taxpayer's age, eyesight, and dependency eligibility, and the standard deduction amount for the appropriate filing status from the appropriate tax form.)*
- 4. The Tax Table is used for all filers of Form 1040.**  
*(False; the Tax Table cannot be used by taxpayers whose taxable income is \$100,000 or more.)*

## ***OPTIONAL CLASS ACTIVITY — C***

To review students' understanding of itemized deductions that can be claimed on Schedule A of Form 1040, ask students to determine which item in each of the following pairs is deductible:

- 1. Taxes paid to the state on property owned by the taxpayer, and on property not owned by the taxpayer.**  
(Taxes paid to the state on property owned by the taxpayer are deductible, but taxes paid on property not owned by the taxpayer are nondeductible to that taxpayer.)
- 2. Interest paid on a qualified mortgage and interest paid on a personal loan.**  
(Interest on a qualified mortgage is deductible, but interest on a personal loan is nondeductible.)
- 3. Contributions to a political candidate, and contributions to a qualified nonprofit volunteer fire company.**  
(Contributions to a political candidate are nondeductible, but those made to a qualified nonprofit volunteer fire company are deductible.)
- 4. Casualty losses due to a car accident, and casualty losses due to mislaid property.**  
(Casualty losses in excess of insurance reimbursement due to a car accident are deductible, but those due to mislaid property are nondeductible.) Remind students that taxpayers with casualty or theft losses should be referred to a paid professional tax preparer.

## ***GUIDED QUESTION — TRAVEL EXPENSES — MILITARY SEGMENT***

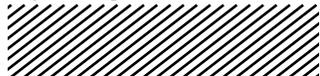
- 1. Can the person elect not to file a travel voucher for reimbursement with their employer and elect to file a Form 2106 with their return?**

No, you cannot file a Form 2106 for any expense that would have been reimbursed by the employer if a claim had been made.

## ***GUIDED QUESTIONS — MISCELLANEOUS ITEMIZED DEDUCTIONS — MILITARY SEGMENT***

- 1. What are the criteria for taking military uniforms and their upkeep as a deduction?**

It must state in the military local policy that the uniform cannot be worn off-duty and the amount must be reduced by the amount of any clothing allowance the military member receives.



**2. What type of educational expenses can be taken as miscellaneous itemized deductions?**

Education expenses that are required by the employer or government entity to maintain the person's current position and not reimbursed by the employer and/or maintains or improves skills required in the person's current position.

**STUDENT NOTES**

Lined area for student notes.



# STANDARD AND ITEMIZED DEDUCTIONS, AND TAX COMPUTATION

Lesson 4

## 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:

- Identify the correct standard deduction.
- Calculate and accurately report itemized deductions on Schedule A.
- Identify the miscellaneous deductions reported on Schedule A, line 27.
- Review the Capital Gain Tax Worksheet.
- Explain the process to 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*.

### ALERT



In 2003, the basic standard deduction for married taxpayers filing jointly and qualifying widow(er)s has increased to \$9,500 (double that of single filers).

The standard deduction for married filing separately has increased to \$4,750 (one half of that for married filing jointly).

### Example 1

Bob is 55 years old and is married to Janice, age 50. If they are filing a joint return and neither is blind, they can enter \$9,500 on either Form 1040 or Form 1040A for their standard deduction amount.

### Example 2

John is 73 years old, blind, and files a single tax return. To find his standard deduction, use the *Standard Deduction Chart for People Age 65 or Older or Blind*. His standard deduction is \$7,050.

## PERSONAL EXEMPTION IN CONNECTION WITH STANDARD DEDUCTION ON FORM 1040EZ

If the taxpayer (or his or her spouse, if married filing a joint return) can be claimed as a dependent on another taxpayer's return, check the *Yes* box on line 5 of the Form 1040EZ. To fill in the amount on line 5 for this taxpayer, you must then turn the form over and complete the worksheet (Exhibit 1 shows a blank worksheet from Form 1040EZ, page 2).

If the taxpayer (or his or her spouse, if filing a joint return) cannot be claimed as a dependent on another taxpayer's return, check the *No* box on line 5. Enter on line 5 the amount shown below that applies to the taxpayer (and spouse, if married filing jointly).

**A.** Single, enter \$7,800. This is the total of the taxpayer's standard deduction (\$4,750) and personal exemption (\$3,050).

#### Exhibit 1

Form 1040EZ, Page 2

#### 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 filing jointly) 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 8).

- |  |          |               |    |          |
|--|----------|---------------|----|----------|
| A. Amount, if any, from line 1 on front  | _____    |               |    |          |
|  | + 250.00 | Enter total ▶ | A. | _____    |
| B. Minimum standard deduction  |          |               | B. | 750.00   |
| C. Enter the <b>larger</b> of line A or line B here  |          |               | C. | _____    |
| D. Maximum standard deduction. If <b>single</b> , enter \$4,750; if <b>married filing jointly</b> , enter \$9,500  |          |               | D. | _____    |
| E. Enter the <b>smaller</b> of line C or line D here. This is your standard deduction  |          |               | E. | _____    |
| F. Exemption amount.   |          |               | }  | F. _____ |
| • If single, enter -0-.  |          |               |    |          |
| • If married filing jointly and—<br>—both you and your spouse can be claimed as dependents, enter -0-.<br>—only one of you can be claimed as a dependent, enter \$3,050. |          |               |    |          |
| 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 filing jointly) as a dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,800. This is the total of your standard deduction (\$4,750) and your exemption (\$3,050).
- Married filing jointly, enter \$15,600. This is the total of your standard deduction (\$9,500), your exemption (\$3,050), and your spouse's exemption (\$3,050).

- B.** Married, enter \$15,600. This is the total of the taxpayer's and spouse's standard deduction (\$9,500), exemption for the taxpayer (\$3,050), and exemption for the taxpayer's spouse (\$3,050).

### 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 2003. 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.

## 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 the 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.

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.

## ALERT



The standard mileage rate for operating a vehicle for medical transportation is 12 cents a mile.

## Medical and Dental Expenses

Claim medical and dental expenses paid in 2003 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 \$3,050 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 Exhibit 2, next page.)
- Prescription eyeglasses, hearing aids, crutches, wheelchairs, braces, and guide dogs
- Transportation for medical care at 12 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**

Exhibit 2

IF the person was, at the end of 2003, age . . .	THEN the most you may deduct is . . .
40 or under	\$250
41-50	\$470
51-60	\$940
61-70	\$2,510
71 or older	\$3,130

These figures should always be checked against the figures in the instructions for the Form 1040, Schedule A.

## Exercise 2

Sam and Paula Ferris 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 doctor's 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 Ferris family.

### Exhibit 3

Schedule A

<b>SCHEDULES A&amp;B</b> (Form 1040)  <small>Department of the Treasury Internal Revenue Service</small>	<b>Schedule A—Itemized Deductions</b> (Schedule B is on back)  ▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).	OMB No. 1545-0074  <b>2003</b> Attachment Sequence No. <b>07</b>
Name(s) shown on Form 1040		Your social security number
<b>Medical and Dental Expenses</b>	<b>Caution.</b> Do not include expenses reimbursed or paid by others.	
1	Medical and dental expenses (see page A-2) . . . . .	1
2	Enter amount from Form 1040, line 35 <b>2</b> . . . . .	2
3	Multiply line 2 by 7.5% (.075) . . . . .	3
4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0- . . . . .	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 2003.

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 tax any of its subdivisions. These taxes include tax withheld, estimated tax payments, and taxes paid in 2003 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 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 reported to them on Form 1098 (all qualified), \$400 in credit card interest, \$300 on installment loan, and \$2,000 on a car loan. Complete the *Interest You Paid* section of Schedule A for John and Shannon.

#### Exhibit 4

Schedule A

<b>Interest You Paid</b> (See page A-3.)	<b>10</b>	Home mortgage interest and points reported to you on Form 1098	<b>10</b>				
	<b>11</b>	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 ▶					
	-----						
	-----						
	<b>Note.</b> Personal interest is not deductible.	<b>12</b>	Points not reported to you on Form 1098. See page A-3 for special rules	<b>12</b>			
	<b>13</b>	Investment interest. Attach Form 4952 if required. (See page A-3.)	<b>13</b>				
	<b>14</b>	Add lines 10 through 13				<b>14</b>	

### 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.

**POTENTIAL  
PITFALLS**



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*.

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.

### 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 5

Schedule A

<b>Gifts to Charity</b>	<b>15</b>	Gifts by cash or check. If you made any gift of \$250 or more, see page A-4 . . . . .	<b>15</b>					
	<b>16</b>	Other than by cash or check. If any gift of \$250 or more, see page A-4. You <b>must</b> attach Form 8283 if over \$500 . . . . .	<b>16</b>					
	<b>17</b>	Carryover from prior year . . . . .	<b>17</b>					
	<b>18</b>	Add lines 15 through 17 . . . . .				<b>18</b>		

### 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.
- Unrecovered after-tax pension contributions (see Lesson 13).

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

Robert is a janitor. His adjusted gross income is \$20,000. He wants to deduct the following items on his tax return:

2003 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, line 20 through 26.

### Exhibit 6

Schedule A

<b>Job Expenses and Most Other Miscellaneous Deductions</b>  (See page A-5 for expenses to deduct here.)	<b>20</b>	Unreimbursed employee expenses—job travel, union dues, job education, etc. You <b>must</b> attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶					
		<b>20</b>					
	<b>21</b>	Tax preparation fees . . . . .					
		<b>21</b>					
	<b>22</b>	Other expenses—investment, safe deposit box, etc. List type and amount ▶					
		<b>22</b>					
	<b>23</b>	Add lines 20 through 22 . . . . .					
	<b>23</b>						
<b>24</b>	Enter amount from Form 1040, line 35 <b>24</b>						
	<b>24</b>						
<b>25</b>	Multiply line 24 by 2% (.02) . . . . .						
	<b>25</b>						
<b>26</b>	Subtract line 25 from line 23. If line 25 is more than line 23, enter -0- . . . . .						
	<b>26</b>						

### 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 a commercial mortgage company holds the mortgage. 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.

### Unreimbursed 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.

**SCHEDULES A&B**  
**(Form 1040)**

**Schedule A—Itemized Deductions**

OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **07**

Department of the Treasury  
Internal Revenue Service

(Schedule B is on back)

▶ **Attach to Form 1040.** ▶ See Instructions for Schedules A and B (Form 1040).

Name(s) shown on Form 1040

Your social security number

**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 35 | **2** | . . . . .
- 3** Multiply line 2 by 7.5% (.075) . . . . .
- 4** Subtract line 3 from line 1. If line 3 is more than line 1, enter -0- . . . . .

**Taxes You Paid**

(See page A-2.)

- 5** State and local income taxes . . . . .
- 6** Real estate taxes (see page A-2) . . . . .
- 7** Personal property taxes . . . . .
- 8** Other taxes. List type and amount ▶ . . . . .
- 9** Add lines 5 through 8 . . . . .

**Interest You Paid**

(See page A-3.)

- 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 ▶ . . . . .

**Note.** Personal interest is not deductible.

- 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 . . . . .

**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 . . . . .
- 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 . . . . .
- 17** Carryover from prior year . . . . .
- 18** Add lines 15 through 17 . . . . .

**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** Tax preparation fees . . . . .
- 22** Other expenses—investment, safe deposit box, etc. List type and amount ▶ . . . . .
- 23** Add lines 20 through 22 . . . . .
- 24** Enter amount from Form 1040, line 35 | **24** | . . . . .
- 25** Multiply line 24 by 2% (.02) . . . . .
- 26** Subtract line 25 from line 23. If line 25 is more than line 23, enter -0- . . . . .

**Other Miscellaneous Deductions**

- 27** Other—from list on page A-6. List type and amount ▶ . . . . .

**Total Itemized Deductions**

- 28** Is Form 1040, line 35, over \$139,500 (over \$69,750 if married filing separately)?
  - 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 37. } ▶
  - Yes.** Your deduction may be limited. See page A-6 for the amount to enter. }

## **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 37. Subtract line 37 from line 35 and enter the result on line 38. Then subtract the exemption deduction (line 39) 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 13a, Form 1040 and
- Use the Capital Gain Tax Worksheet (Exhibit 8) from either the Form 1040A or 1040 instruction booklet to compute tax.

### **Example 3**

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 2003, she received capital gain distributions of \$798 from XYZ Investments. Marjorie pays less tax by using Capital Gain Tax Worksheet (Exhibit 8).

**Qualified Dividends and Capital Gain Tax Worksheet—Line 41**

Keep for Your Records

**Before you begin:** ✓ Be sure you do not have to file Schedule D (see the instructions for Form 1040, line 13a, that begin on page 23).  
 ✓ Be sure you checked the box on line 13a of Form 1040.



1. Enter the amount from Form 1040, line 40 . . . . .	1.	46,250	
2. Enter the amount from Form 1040, line 9b . . . . .	2.	0	
3. Enter the amount from Form 1040, line 13a . . . . .	3.	798	
4. Add lines 2 and 3 . . . . .	4.	798	
5. If you are claiming investment interest expense on Form 4952, enter the amount from line 4g; otherwise enter -0- . . . . .	5.	0	
6. Subtract line 5 from line 4. If zero or less, enter -0- . . . . .	6.	798	
7. Subtract line 6 from line 1. If zero or less, enter -0- . . . . .	7.	45,452	
8. Enter the <b>smaller</b> of: • The amount on line 1 or • \$56,800 if married filing jointly or qualifying widow(er), \$28,400 if single or married filing separately, or \$38,050 if head of household. . . . .	8.	28,400	
9. Is the amount on line 7 equal to or more than the amount on line 8? <input type="checkbox"/> Yes. Skip lines 9 through 15; go to line 16 and check the "No" box. <input type="checkbox"/> No. Enter the amount from line 7 . . . . .	9.		
10. Subtract line 9 from line 8 . . . . .	10.		
11. Add Form 1040, line 13b, and line 2 above . . . . .	11.		
12. Enter the <b>smaller</b> of line 10 or line 11 . . . . .	12.		
13. Multiply line 12 by 5% (.05) . . . . .	13.		
14. Subtract line 12 from line 10. If zero, go to line 16 . . . . .	14.		
15. Multiply line 14 by 10% (.10) . . . . .	15.		
16. Are the amounts on lines 6 and 10 the same? <input type="checkbox"/> Yes. Skip lines 16 through 25; go to line 26. <input type="checkbox"/> No. Enter the <b>smaller</b> of line 1 or line 6 . . . . .	16.	798	
17. Enter the amount from line 10 (if line 10 is blank, enter -0-) . . . . .	17.	0	
18. Subtract line 17 from line 16 . . . . .	18.	798	
19. Add Form 1040, line 13b, and line 2 above . . . . .	19.	0	
20. Enter the amount from line 12 (if line 12 is blank, enter -0-) . . . . .	20.	0	
21. Subtract line 20 from line 19 . . . . .	21.	0	
22. Enter the <b>smaller</b> of line 18 or line 21 . . . . .	22.	0	
23. Multiply line 22 by 15% (.15) . . . . .	23.	0	
24. Subtract line 22 from line 18. If zero, go to line 26 . . . . .	24.	798	
25. Multiply line 24 by 20% (.20) . . . . .	25.	160	
26. Figure the tax on the amount on line 7. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	26.	8,179	
27. Add lines 13, 15, 23, 25, and 26 . . . . .	27.	8,339	
28. Figure the tax on the amount on line 1. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	28.	8,379	
29. <b>Tax on all taxable income.</b> Enter the <b>smaller</b> of line 27 or line 28 here and on Form 1040, line 41 . . . . .	29.	8,339	

## 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 back of this book. 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 40), 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 liability.

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 41.

**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.

## TAXWISE HINT

If a taxpayer wants to determine whether the standard or itemized deduction is best for him or her, input Schedule A information. TaxWise will automatically select the deduction that is more beneficial.

## ▶▶ 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 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 37.

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.

**STUDENT NOTES**

# STANDARD AND ITEMIZED DEDUCTIONS AND TAX COMPUTATION

ANSWERS TO EXERCISES

## Exercise 1

- (A) \$7,000
- (B) \$5,900
- (C) \$10,450
- (D) \$5,700
- (E) \$4,750
- (F) \$1,750

## Exercise 2

Sam and Paula's Schedule A

<b>SCHEDULES A&amp;B</b> <b>(Form 1040)</b>  <small>Department of the Treasury Internal Revenue Service</small>	<b>Schedule A—Itemized Deductions</b> (Schedule B is on back)  <b>▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).</b>	<small>OMB No. 1545-0074</small>  <div style="font-size: 2em; font-weight: bold;">2003</div> <small>Attachment Sequence No. 07</small>																		
Name(s) shown on Form 1040 <p style="text-align: center;">Sam and Paula Fordham</p>		Your social security number 000   00   8612																		
<b>Medical and Dental Expenses</b>	<b>Caution.</b> Do not include expenses reimbursed or paid by others. <b>1</b> Medical and dental expenses (see page A-2) <b>2</b> Enter amount from Form 1040, line 35   <b>2</b>   40,000   <b>3</b> Multiply line 2 by 7.5% (.075). . . . . <b>4</b> 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;"><b>1</b></td> <td style="width: 40%; text-align: center;">3,250</td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> </tr> <tr> <td style="text-align: center;"><b>3</b></td> <td style="text-align: center;">3,000</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;"><b>4</b></td> <td></td> <td></td> <td></td> <td style="text-align: center;">250</td> <td></td> </tr> </table>	<b>1</b>	3,250					<b>3</b>	3,000					<b>4</b>				250	
<b>1</b>	3,250																			
<b>3</b>	3,000																			
<b>4</b>				250																

## Exercise 3

John and Shanon's Schedule A

	<b>9</b>	Add lines 5 through 8 . . . . .		<b>9</b>																																									
<b>Interest You Paid</b> <small>(See page A-3.)</small>  <b>Note.</b> Personal interest is not deductible.	<b>10</b> Home mortgage interest and points reported to you on Form 1098 <b>11</b> 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 ▶ ----- ----- <b>12</b> Points not reported to you on Form 1098. See page A-3 for special rules . . . . . <b>13</b> Investment interest. Attach Form 4952 if required. (See page A-3.) . . . . . <b>14</b> Add lines 10 through 13 . . . . .	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%; text-align: center;"><b>10</b></td> <td style="width: 40%; text-align: center;">2,180</td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> </tr> <tr> <td style="text-align: center;"><b>11</b></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;"><b>12</b></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;"><b>13</b></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;"><b>14</b></td> <td></td> <td></td> <td></td> <td style="text-align: center;">2,180</td> <td></td> </tr> </table>	<b>10</b>	2,180					<b>11</b>						<b>12</b>						<b>13</b>						<b>14</b>				2,180		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%;"></td> <td style="width: 40%;"></td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> <td style="width: 10%;"></td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: center;">2,180</td> <td></td> </tr> </table>											2,180	
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# STANDARD AND ITEMIZED DEDUCTIONS AND TAX COMPUTATION

ANSWERS TO EXERCISES

## Exercise 4

Line 15    \$632

Line 16    \$200

Line 18    \$832

## Exercise 5

Robert's Schedule A

<b>Job Expenses and Most Other Miscellaneous Deductions</b>  (See page A-5 for expenses to deduct here.)	<b>20</b>	Unreimbursed employee expenses—job travel, union dues, job education, etc. You <b>must</b> attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶				
	<b>21</b>	Tax preparation fees . . . . .	100			
	<b>22</b>	Other expenses—investment, safe deposit box, etc. List type and amount ▶	595			
	<b>23</b>	Add lines 20 through 22 . . . . .	695			
	<b>24</b>	Enter amount from Form 1040, line 35   <b>24</b>   20,000				
	<b>25</b>	Multiply line 24 by 2% (.02) . . . . .	400			
	<b>26</b>	Subtract line 25 from line 23. If line 25 is more than line 23, enter -0- . . . . .				295

# STANDARD AND ITEMIZED DEDUCTIONS AND TAX COMPUTATION

## 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 <b>2003</b> Attachment Sequence No. 07	
Department of the Treasury Internal Revenue Service		▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).			Your social security number	
Name(s) shown on Form 1040		Seth and Karen Yale			000 00 1039	
<b>Medical and Dental Expenses</b>	<b>Caution.</b> Do not include expenses reimbursed or paid by others.					
	<b>1</b> Medical and dental expenses (see page A-2)	<b>1</b>	2,320			
	<b>2</b> Enter amount from Form 1040, line 35 <b>2</b> 28,000	<b>2</b>				
	<b>3</b> Multiply line 2 by 7.5% (.075)	<b>3</b>	2,100			
<b>4</b> Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-				<b>4</b>	220	
<b>Taxes You Paid</b> (See page A-2.)	<b>5</b> State and local income taxes	<b>5</b>	1,200			
	<b>6</b> Real estate taxes (see page A-2)	<b>6</b>	780			
	<b>7</b> Personal property taxes	<b>7</b>				
	<b>8</b> Other taxes. List type and amount ▶	<b>8</b>				
<b>9</b> Add lines 5 through 8				<b>9</b>	1,980	
<b>Interest You Paid</b> (See page A-3.)	<b>10</b> Home mortgage interest and points reported to you on Form 1098	<b>10</b>	4,500			
	<b>11</b> 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 ▶	<b>11</b>				
	<b>12</b> Points not reported to you on Form 1098. See page A-3 for special rules	<b>12</b>				
<b>Note.</b> Personal interest is not deductible.	<b>13</b> Investment interest. Attach Form 4952 if required. (See page A-3.)	<b>13</b>				
<b>14</b> Add lines 10 through 13				<b>14</b>	4,500	
<b>Gifts to Charity</b> If you made a gift and got a benefit for it, see page A-4.	<b>15</b> Gifts by cash or check. If you made any gift of \$250 or more, see page A-4	<b>15</b>	980			
	<b>16</b> Other than by cash or check. If any gift of \$250 or more, see page A-4. You <b>must</b> attach Form 8283 if over \$500	<b>16</b>	75			
	<b>17</b> Carryover from prior year	<b>17</b>				
<b>18</b> Add lines 15 through 17				<b>18</b>	1,055	
<b>Casualty and Theft Losses</b>	<b>19</b> Casualty or theft loss(es). Attach Form 4684. (See page A-5.)	<b>19</b>				
<b>Job Expenses and Most Other Miscellaneous Deductions</b> (See page A-5 for expenses to deduct here.)	<b>20</b> Unreimbursed employee expenses—job travel, union dues, job education, etc. You <b>must</b> attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶	<b>20</b>	90			
	<b>21</b> Tax preparation fees	<b>21</b>				
	<b>22</b> Other expenses—investment, safe deposit box, etc. List type and amount ▶	<b>22</b>	30			
	<b>23</b> Add lines 20 through 22	<b>23</b>	120			
	<b>24</b> Enter amount from Form 1040, line 35 <b>24</b> 20,000	<b>24</b>				
	<b>25</b> Multiply line 24 by 2% (.02)	<b>25</b>	560			
<b>26</b> Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-				<b>26</b>	0	
<b>Other Miscellaneous Deductions</b>	<b>27</b> Other—from list on page A-6. List type and amount ▶	<b>27</b>				
<b>Total Itemized Deductions</b>	<b>28</b> Is Form 1040, line 35, over \$139,500 (over \$69,750 if married filing separately)?					
	<input type="checkbox"/> <b>No.</b> 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 37. <input type="checkbox"/> <b>Yes.</b> Your deduction may be limited. See page A-6 for the amount to enter.				<b>28</b>	

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11330X

Schedule A (Form 1040) 2003

**STUDENT NOTES**

## INTRODUCTION AND OBJECTIVES

This segment identifies and explains how to apply the rules concerning travel and transportation expenses for members of the Armed Forces.

When we have concluded this segment you will be able to identify travel and transportation expenses (including meals) deductible by Armed Forces personnel.

## GENERAL INFORMATION

Fully reimbursed employee business expenses, such as travel and transportation expenses, generally are not reported on your tax return if an adequate accounting is made to the employer and any excess reimbursement is required to be returned to the employer.

Armed Forces employees must substantiate their expenses to the federal government and return any excess reimbursement. The records must be adequate and complete. Adequate records include documents such as receipts and checks, account books, diaries, trip sheets, or similar items. To be considered adequate, the records should show the business purpose, time, place, and amount of the expense. If automobile expenses are involved, the records must include the total miles driven and total business miles driven.

## FORM 1040

Deductible employee business expenses are reported generally on Form 2106, *Employee Business Expenses*, and can only be taken as an itemized deduction on Schedule A, Form 1040. Only expenses that exceed 2% of adjusted gross income (AGI) can be deducted.

Excess reimbursements for employee business expenses that are not returned to the employer must be included in income on line 7 of Form 1040. These reimbursements do not include any “qualified military benefit,” such as per diem.

## FORM W-2

If the employee is reimbursed under a plan that requires the employee to adequately account for all business connected expenses and return any funds that are more than the substantiated expenses, the reimbursement should not be included as income in Box 1 of Form W-2. Therefore, the employee cannot deduct these expenses.

Temporary duty (TDY) and temporary additional duty (TAD) allowances for travel and transportation are not reported as income on Form W-2. If there are excess expenses on some trips and the employee wants to claim them as employee business expenses, the employee must report all TAD and TDY trip expenses incurred during the year on Form 2106 and include all TAD and TDY allowances received as reimbursements.

## **FORM 2106**

To claim unreimbursed job related expenses, such as travel or transportation expenses, Armed Forces personnel must complete Form 2106 and attach it to their Form 1040. Form 2106 will not have to be used if the Armed Forces member is claiming only unreimbursed employee business expenses for professional dues, subscriptions to professional journals, educational expenses, and uniform expenses. These expenses are reported on line 20 on Schedule A as miscellaneous itemized deductions subject to the 2% AGI limit.

### **Example 1**

Capt. Glendale traveled from his duty station in California to Washington, DC, for a conference. He was away for 5 days. The Army advanced Capt. Glendale \$700 for the trip. Capt. Glendale's actual expenses were \$625. When he filed his travel voucher with the Army, he returned the excess of \$75. The captain does not have to complete Form 2106.

**Remember, if the Armed Forces member does not claim reimbursement for expenses that he or she is entitled to, no deduction for those expenses is allowed.**

## **MEALS**

The cost of meals can be an employee business expense. This includes meals while on business travel away from home and for business-related entertainment. The deduction for meals is generally limited to 50% of the actual expenses.

The deduction is taken on Form 2106 where the 50% limit is applied before the amount is carried to line 20 on Schedule A where it is subject to the 2% AGI limit.

If the employee is fully reimbursed for the meals under an accountable plan that excludes reimbursement from gross income, there is no amount to deduct and, therefore, no amount subject to the 50% limit. For information on using the standard meal allowance instead of actual expenses, see Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

To be deductible, travel expenses must be ordinary and necessary expenses of traveling away from home temporarily for your job and must be greater than the total of any advances, allowances, and reimbursements you receive for such expenses. “Ordinary” expenses are customary or usual in the employee’s field, trade, business, or profession. “Necessary” expenses are appropriate or helpful in the employee’s job or business. Such expenses include airfares, the costs of operating and maintaining a car, and meals and lodging. For a more complete list, see Publication 463.

Deductible travel expenses are reported on Form 2106 (or Form 2106-EZ, if you qualify) and are deductible as a miscellaneous itemized deduction on Schedule A of Form 1040.

### **Away From Home**

For costs other than local transportation to be deductible, the traveler must be away from home. The term “away from home” has a special meaning for tax purposes.

“Home,” for this purpose, generally is the taxpayer’s main place of business or post of duty. This includes the entire city or general area where his or her business or work is located, regardless of where the taxpayer or his or her family lives. For the military, “home” is the permanent duty station. A naval officer assigned to permanent duty aboard a ship that has regular eating and living facilities has a tax home aboard ship for travel expense purposes.

“Away from home” means away for a period substantially longer than an ordinary day’s work, during which taxpayers need time off for sleep or rest to meet the demands of work.

(For examples, see *Traveling away from home* in Publication 463.) Members of the Armed Forces are away from home if they are away from their permanent duty stations long enough to require significant rest or sleep in order to be able to conduct and complete their duties.

**Note:** Away from home assignments that last, or are realistically expected to last more than one year are not temporary in nature. Therefore, taxpayers cannot deduct travel expenses incurred while on an assignment of more than one year. See Publication 463, for more details.

### **No Deduction for Personal Expenses**

For travel expenses to be deductible, there must be a work-related purpose for the travel. The taxpayer may not deduct expenses for personal travel, such as vacations, sightseeing, entertaining, or family visits.



## Allowable Expenses

Common travel expenses for a member of the Armed Forces include:

- Expenses incurred while on TDY or TAD if away from home (ship, base, or station).
- Expenses of a reservist attending drills away from home overnight.
- Meals and lodging of a reservist temporarily called to active duty.
- Travel expenses, including meals and lodging, incurred in connection with deductible educational activities.
- Travel expenses incurred when carrying on official business while on “No Cost” (to the government) orders.

Mess bills afloat are not deductible by an officer assigned to permanent duty aboard a ship. Bills may be deductible as travel expenses by individuals and members of mobile units in a travel or TAD status while away from their permanent ships or stations.

Travel expense deductions are available to air squadron personnel when away from the squadron’s home base on TAD and to Army personnel when on field duty or maneuvers in a TDY status. Air squadron personnel and members of staffs permanently embarked on ships on extended deployments may not deduct expenses of living aboard ships as travel expenses.

Officers assigned permanent duty afloat may deduct the cost of meals and lodging incurred while on travel or TAD ashore if the ship is not berthed at the temporary duty station, or if the ship is berthed at the temporary duty station but quarters aboard are not available. No deduction is permitted for meals or lodging furnished or available in kind at the place of TAD, even if they are not used.

## **RESERVISTS**

Unreimbursed travel expenses, including meals and lodging, are deductible for military reservists who, under competent orders and with or without compensation, must remain away from their main place of business to perform authorized drills and training duty.

**Temporary active duty.** Reservists temporarily called to active duty may deduct meals and lodging while on active duty if they kept their regular job while on active duty, returned to it after release, and were stationed away from the general area of that job or business. These expenses are deductible only if the reservists pay for meals and lodging at their official military post and only to the extent the expenses exceed BAH and BAS.



## Exercise 1

- A. Sgt. Martin's permanent duty station is in Korea. His wife and children could not accompany him and have remained at their home in the United States. Can he deduct the cost of his meals and lodging?

Answer \_\_\_\_\_

- B. Can Sgt. Martin, in the circumstances above, deduct the cost of meals and lodging for his wife and children?

Answer \_\_\_\_\_

- C. Can Sgt. Martin take a deduction for the cost of returning home to visit his family?

Answer \_\_\_\_\_

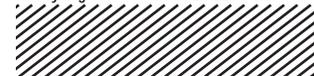
## EDUCATIONAL EXPENSES

In Lesson 8, Education Credits, you will learn about deductions for educational expenses. Taxpayers cannot deduct as a business expense the cost of travel that in itself constitutes a form of education. If educational expenses qualify for a deduction under the rules given in Lesson 8, travel for that education is travel for a business purpose, and the unreimbursed transportation and meals and lodging expenses may be deducted according to the relevant rules discussed in this lesson.

### Example 2

Airman Drake is sent from his permanent duty station to a technical school 500 miles away to learn the latest uses of computers for diagnosing engine performance and maintenance requirements. If his expenses for travel exceed the allowances and reimbursements he receives, he can take the excess as a miscellaneous itemized deduction, subject to the 2% AGI limit.

Lesson 8 will explain which other educational expenses can be deducted.



## Exercise 2

Which of the following can be taken as deductions?

- A. Travel expenses in excess of allowances and reimbursements when the taxpayer is on TAD trips.
- B. Mess bills of an officer permanently assigned to a ship.
- C. Meals that are not lavish or extravagant, but cost more than allowances or reimbursements while the taxpayer attends assigned schooling away from his or her permanent station.
- D. Laundry expenses the taxpayer incurs while traveling on TAD and for which no allowance or reimbursement is received.

Answer \_\_\_\_\_

## **LOCAL TRANSPORTATION EXPENSES**

Local transportation expenses are generally the expenses of getting from one work place to another while not traveling away from home. Such expenses include the costs of operating and maintaining a car, but not meals and lodging. If taxpayers are required during their time on duty to go from one place to another (for example, as a courier or to attend meetings) without being away from home, their unreimbursed transportation expenses are deductible. When they must use their own vehicle, they can deduct transportation expenses. You may be able to use the standard mileage rate to figure the deductible costs of operating your car for business purposes. Beginning January 1, 2003, the standard mileage rate is **36 cents a mile** for all business miles driven on or after that date. This rate is adjusted periodically for inflation. Commuting expenses are usually not deductible. However, you may be able to deduct certain daily transportation expenses, as explained next, under *Temporary Work Location*.

## **TEMPORARY WORK LOCATION**

A taxpayer can deduct local transportation expenses.

Local transportation expenses include the ordinary and necessary costs of all of the following.

- Getting from one workplace to another in the course of the taxpayer's business or profession when he or she is traveling within the city or general area that is his or her tax home.
- Visiting clients or customers.
- Going to a business meeting away from the taxpayer's regular workplace.
- Getting from the taxpayer's home to a temporary workplace when he or she has one or more regular places of work. These temporary workplaces can be either within the area of his or her tax home or outside that area.

Local business transportation does **not** include expenses the taxpayer has while traveling away from home overnight. Those expenses are deductible as travel expenses.

If the taxpayer's employment at a work location is realistically expected to last (and does in fact last) for one year or less, the employment is temporary unless there are facts and circumstances that would indicate otherwise. If the taxpayer's employment at a work location is realistically expected to last for more than one year or if there is no realistic expectation that the employment will last for one year or less, the employment is not temporary, regardless of whether it actually lasts for more than one year. If employment at a work location initially is realistically expected to last for one year or less, but at some later date the employment is expected to last for more than one year, that employment will be treated as temporary (unless there are facts and circumstances that would indicate otherwise) until the taxpayer's expectation changes. It will not be treated as temporary after the date the taxpayer determines it will last for more than one year.

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

In this lesson, you have learned that:

- ▶ Travel and transportation expenses can be taken as miscellaneous itemized deductions on Schedule A, subject to the 2% AGI limit.
- ▶ Travel expenses for meals, lodging, and incidentals must be incurred while temporarily away from home on business to be deductible. Assignments that last, or are realistically expected to last more than one year are not considered temporary.
- ▶ Commuting and other personal expenses are not deductible.
- ▶ Travel costs associated with deductible educational expenses are treated like other business travel costs.
- ▶ Form 2106 and Schedule A (Form 1040) are used to figure and claim the itemized deduction for employee business expenses that exceed reimbursement.



1.
  - a. No.
  - b. No.
  - c. No.
2. a., c., and d.

# MISCELLANEOUS ITEMIZED DEDUCTIONS

Lesson 4  
Military Segment

## INTRODUCTION AND OBJECTIVE

As you learned earlier in this lesson, certain miscellaneous itemized deductions, which includes unreimbursed employee business expenses and investment expenses, are deductible only if the total itemized deductions are more than 2% of the taxpayer's adjusted gross income (AGI). All deductible miscellaneous itemized deductions discussed in this Military segment are subject to the 2% AGI limit. In this segment we will cover additional itemized deductions of special interest to members of the military. To claim these expenses, a taxpayer must itemize using Schedule A (Form 1040), Itemized Deductions.

We will be able to identify miscellaneous itemized deductions, other than travel, of particular interest to the military.

## UNIFORMS

Taxpayers can deduct the cost of buying and maintaining uniforms if the uniforms are specifically required as a condition of employment and they are not adaptable to general use as regular clothing.

Generally, members of the Armed Forces are required to wear uniforms when they are on duty but may be allowed to wear them when they are off duty. Because their uniforms can be worn in place of regular civilian clothing, members of the military cannot claim a deduction for uniform cost and upkeep. However, if military regulations prohibit off-duty wear of certain uniforms, the member can deduct the cost and upkeep of these uniforms. But he or she must reduce any deductible uniform costs incurred by any nontaxable uniform allowances or reimbursements received to pay for these expenses.

### Active Duty Uniforms

Members of the Armed Forces on active duty can deduct amounts spent to buy and maintain required military battle dress uniforms and utility uniforms if local military regulations prohibit their off-duty wear. The member must reduce the expense by any nontaxable uniform allowance or reimbursement received.

## Reservists' Uniforms

A reservist in the Armed Forces can deduct the cost and upkeep of uniforms if military regulations prohibit their wearing the uniform except when performing duties as a reservist. The reservist must, however, reduce the uniform expense by any nontaxable uniform allowance or reimbursement received.

## Articles Not Replacing Regular Clothing

A member of the Armed Forces can deduct the cost of required items that do not replace regular clothing. Such items include insignia of rank, corps devices, epaulets, aiguillettes, and swords.

### Exercise 1

Indicate if the following are deductible or nondeductible by a member of the Armed Forces.

- A. The cost of an Army dress blue uniform (without shoulder boards or gold stripe on pants), including cape. Off-duty wear is not prohibited.

Answer \_\_\_\_\_

- B. The cost of a full Army green uniform (without braid) that can be worn anytime.

Answer \_\_\_\_\_

- C. The cost of gold braid for decoration of a cap and uniform.

Answer \_\_\_\_\_

- D. The cost of battle dress uniforms and utility uniforms that can be worn only while on duty or while traveling to and from duty.

Answer \_\_\_\_\_

## **PROFESSIONAL DUES**

Taxpayers, including members of the Armed Forces, can deduct dues paid to professional societies that are directly related to their trade or business. For example, Lt. Margaret Allen, an electrical engineer at Maxwell Air Force Base, can deduct professional dues paid to the American Society of Electrical Engineers.

However, members of the Armed Forces cannot deduct amounts paid to an officers' club or a noncommissioned officers' club.

## **EDUCATIONAL EXPENSES**

Travel and transportation expenses for educational purposes are discussed in Lesson 8. In this segment, you will learn what educational expenses can be claimed as miscellaneous deductions on Schedule A. Certain rules must be met, however, for the expenses to qualify as a deduction.

## Qualifications

A member of the Armed Forces can deduct expenses for education, even though the education may lead to a degree, if the education:

- Is required by the taxpayer's employer or by law or regulations for the taxpayer to keep salary, status, or job (if these requirements serve a business purpose of his or her employer); or
- Maintains or improves the skills required in the taxpayer's present work.

A taxpayer cannot deduct educational expenses, even though the above requirements are met, if the education:

- Is to meet the minimum educational requirements needed to qualify the taxpayer in his or her trade or business, or
- Is part of a program of study that will qualify the taxpayer for a new trade or business, even if he or she has no plans to enter that trade or business.

Some examples will help illustrate the various rules.

### Example 1

Warrant Officer Newberry, an Army pilot, incurred educational expenses to obtain an accounting degree. He cannot deduct these expenses because they qualify him for a new trade or business.

### Example 2

Lieutenant Commander Morris, who has a degree in financial management, is in charge of base finance at her post of duty. She incurred educational expenses when taking an advanced finance course. She can deduct educational expenses that were more than the educational allowance she received because she had already met the minimum qualifications of her job. By taking the course, she improved skills in her current position. The course did not qualify her for a new trade or business.

## Deductible Expenses

Educational expenses and certain travel and transportation expenses related to education may be claimed on Form 2106, *Employee Business Expenses*. Expenses in excess of reimbursement are deductible only as a miscellaneous itemized deduction on Schedule A, subject to the 2% AGI limit discussed earlier. For more information, see Publication 508, *Tax Benefits for Work-Related Education*, and *Travel Expenses*, in this segment.

Deductible educational expenses include amounts spent for tuition, books, supplies, laboratory fees, correspondence courses, costs of research, and typing as part of an educational program, and travel. Educational expenses of a personal nature are not deductible. For example, a taxpayer cannot deduct the cost of dinner on campus while he or she attends evening classes. Also, deductible educational expenses do not include items of a capital nature, such as computers or desks.

## POTENTIAL PITFALLS



Remind students that qualified educational expenses can be deducted as an adjustment to income, educational credit, or as a miscellaneous itemized deduction.

The volunteer should calculate the various ways and claim these expenses where they are most beneficial.

## Treatment of Allowances and Reimbursements

A member of the Armed Forces must reduce deductible educational expenses by any allowance or reimbursement he or she receives. Any educational services provided in kind are not deductible. For example, base-provided transportation to or from class cannot be claimed.

### Exercise 2

Sgt. Stephen Butler is a mess sergeant. On his own, he takes courses at the local university in early childhood education. Does he have deductible educational expenses? Why?

Answer \_\_\_\_\_

### Exercise 3

Specialist Bates is a qualified X-ray technician. Would he have deductible educational expenses if he took a course required by the Army in new radiology techniques? Assume his expenses exceed reimbursement or allowance received.

Answer \_\_\_\_\_

### Exercise 4

Which of the following can be claimed as miscellaneous itemized deductions by a member of the Armed Forces?

- a. Payment to an officers' club.
- b. Expenses incurred by a flight operations officer to obtain an accounting degree.
- c. Cost of epaulets.
- d. Cost and upkeep of a reservist's uniform when local military regulations prohibit off-duty wear. (No uniform allowance received.)
- e. Expenses incurred by a Navy disbursing clerk to learn television repair.

Answer \_\_\_\_\_

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

In this segment, you learned about some of the more common itemized deductions of special interest to military members. The total of these miscellaneous deductions must be more than 2% of adjusted gross income to be deductible.



# MISCELLANEOUS ITEMIZED DEDUCTIONS

ANSWERS TO EXERCISES

Lesson 4  
Military Segment

1.
  - a. Nondeductible
  - b. Nondeductible
  - c. Deductible
  - d. Deductible
2. No. The courses were not required, do not improve Sgt. Baker's skills as a mess sergeant, and could lead to qualifying him for a new trade or business.
3. Yes. The course is required by Specialist Bates' employer, improves his skills in his present job, is not needed to meet the minimum educational requirements for his job, and will not lead to qualifying him for a new trade or business.
4. c. and d.

**STUDENT NOTES**



## INTRODUCTION AND OBJECTIVES

This lesson will explain how to compute business travel expenses for a U.S. citizen or resident aliens living aboard.

At the end of this segment, you will be able to:

1. Determine when employee business expenses are deductible.
2. Determine what expenses are deductible.
3. Determine how to report the expenses.
4. Complete Form 2106 "Employee Business Expenses".
5. Determine how to complete the expenses when the taxpayer is eligible and elects to take the foreign earned income exclusion.

## TRAVEL EXPENSES

Travel expenses incurred must be ordinary and necessary when carrying out the duties of your employer while away from your home, for your job. Ordinary expenses are those that are customary for the type of travel being done. Necessary expenses are those that are appropriate and helpful to achieving the purpose of the travel. Treatment of the various expenses, allowances, and reimbursements depends on whether allowances and reimbursements were received and whether the expenses were more than allowances and reimbursements, or whether the allowances and reimbursements were more than the expenses. It also depends on whether or not your employer included these allowances and reimbursements as income on Form W-2. These situations will be discussed in this lesson.

**Away from Home Overnight.** For costs other than transportation the taxpayer must be "away from his tax home overnight". "Tax Home" is defined as the taxpayer's main place of business. "Overnight" is defined as a period substantially longer than an ordinary day's work during which the taxpayer would need time off for sleep or rest.

### Example 1

You live with your family in Manchester, England, but work in London where you have lodging and meal expenses during the week. You travel back and forth from London to Manchester on weekends. You may not deduct any of your expenses for travel, meals, and lodging in London because that is your main place of business and the travel on weekends is not for business reasons.

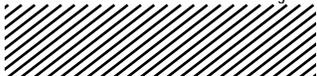
## DEDUCTIBLE EXPENSES

Travel expenses that are ordinary and necessary while traveling away from your home for business purposes include such things as:

1. Air, rail and bus transportation,
2. Operating and maintaining your car,
3. Taxi fares or other costs of transportation between the airport or station and your hotel, from one customer to another, or from one place of business to another.
4. Transportation from the place where you eat and sleep to your temporary work assignment,
5. Baggage and charges and transportation costs for sample and display material,
6. Meals and lodging when you are away from home on business.
7. Cleaning and laundry expenses,
8. Telephone and telegraph expenses,
9. Public stenographer's fees,
10. Operating and maintaining house trailers,
11. Tips that are incidental to any of these expenses, and
12. Other ordinary and necessary expenses related to travel.

**Car Expenses.** If you use your car for business purposes you are entitled to the actual expenses which would include such things as gas, oil, repairs, insurance and depreciation on your car or, you can use the standard mileage rate. The standard mileage rate is .36 cents per mile for 2003. If you use the car for both business and personal mileage you should maintain a log book. You will have to allocate the expenses between business and personal use. If you lease a car to use for qualified business expenses you may have to include an amount called the inclusion amount in your income, depending on the FMV of the vehicle (for more information on deducting actual car expenses see Publication 463).

**Meal Expense.** Expenses for meals claimed on a taxpayer's return are only 50% deductible. When an employee is reimbursed for substantiated meal expenses, the reimbursement will generally be nontaxable and the expenses will not be claimed.



The following discusses how the taxpayer should report his/her allowable expenses for travel, meals & lodging. Self-employed individuals must report their expenses on the appropriate form used to report their business income and expenses by using Schedule C, Form 1040. Employees, including outside sales persons, must complete Form 2106, Employee Business Expenses, and attach it to their Form 1040 to claim these expenses.

Expenses paid by an employee under a “reimbursement or other expense allowance arrangement” with an employer generally do not need to be claimed and the employer will not include the reimbursement as taxable income on the employee’s Form W-2. To qualify as nontaxable reimbursements, the arrangement must require that the employee substantiate the expenses to the employer and return any excess reimbursements. Per Diem or other fixed allowance reimbursements that are similar to allowances specified by the Federal government will also be nontaxable to the extent that the amounts do not exceed government rates.

Form 2106 needs to be completed if:

1. The taxpayer received a reimbursement or an allowance and the employer included the amount on Form W-2, or a Form 1099 as taxable income,
2. The taxpayer seeks to deduct expenses in excess of the amounts paid under a reimbursement allowance arrangement,
3. The taxpayer received no reimbursement for his or her employee business expenses, or,
4. The taxpayer received reimbursement or an allowance and did not account to his or her employer for the expenses.

If the expenses equal the reimbursements and the taxpayer accounted to his or her employer, the taxpayer does not have to complete Form 2106 unless item (1) above applies.

### Example 2

George Grant has incurred qualified employee business expenses. His company’s policy is that all employees must turn in a travel voucher showing all expenses incurred and the company reimburses the employee an amount equal to the expenses. George does not have to file a Form 2106 because he reports directly to his employer and is reimbursed in full.

### Example 3

Judy Coe incurred employee business expenses of \$1,500. Her W-2 shows that her employer reimbursed Judy \$2,000. Judy will have to file Form 2106 and claim \$1,500.00 as an employee business expense on Form 2106 subject to the 50% meals limitation and 2% limitation on Schedule A. The entire \$2,000 reimbursement must be reported as income on line 7, Form 1040.



## Claiming Employee Business Expenses on Form 1040.

The taxpayer can only claim employee business expenses on Form 1040 as a miscellaneous itemized deduction subject to the overall 2% limitation. Exceptions are provided for certain government officials, qualified performing artists, and individuals with a disability. For more information on these exceptions see the instructions for Form 2106.

### Example 4

Frank Falls has a total of \$2,000 of unreimbursed employee business expenses after reducing meals by 50% and no other miscellaneous itemized deductions. His total adjusted gross income is \$52,000. Frank is entitled to a total of \$960 as a miscellaneous itemized deduction.  $(2,000 - [52,000 \times .02] = \$960)$

## COMPLETING FORM 2106

Form 2106 is divided into 2 parts. Part I deals with all the expenses and Part II deals specifically with car expenses. Part II should be completed, if applicable, before entering an amount in Line 1, Part I.

Look at Part II section A. This section deals with general information about the vehicle and is self-explanatory. The taxpayer should have this information from his or her records to assist you in preparing the form.

### Exhibit 1

### Form 2106, Part 2

Form 2106 (2003)

Page 2

#### Part II Vehicle Expenses

**Section A—General Information** (You must complete this section if you are claiming vehicle expenses.)

		(a) Vehicle 1	(b) Vehicle 2
11	Enter the date the vehicle was placed in service . . . . .	/ /	/ /
12	Total miles the vehicle was driven during 2003 . . . . .	miles	miles
13	Business miles included on line 12 . . . . .	miles	miles
14	Percent of business use. Divide line 13 by line 12 . . . . .	%	%
15	Average daily roundtrip commuting distance . . . . .	miles	miles
16	Commuting miles included on line 12 . . . . .	miles	miles
17	Other miles. Add lines 13 and 16 and subtract the total from line 12 . . . . .	miles	miles
18	Do you (or your spouse) have another vehicle available for personal use? . . . . .	<input type="checkbox"/> Yes	<input type="checkbox"/> No
19	Was your vehicle available for personal use during off-duty hours? . . . . .	<input type="checkbox"/> Yes	<input type="checkbox"/> No
20	Do you have evidence to support your deduction? . . . . .	<input type="checkbox"/> Yes	<input type="checkbox"/> No
21	If "Yes," is the evidence written? . . . . .	<input type="checkbox"/> Yes	<input type="checkbox"/> No



Part II, section B. of Form 2106 will be used if the taxpayer owns the vehicle and chooses, or has previously chosen, to use the standard mileage rate for the same vehicle.

**Exhibit 2**

Form 2106, Part II

**Section B—Standard Mileage Rate** (See the instructions for Part II to find out whether to complete this section or Section C.)

**22** Multiply line 13 by 36¢ (.36) . . . . . **22**

<b>Section C—Actual Expenses</b>		<b>(a) Vehicle 1</b>		<b>(b) Vehicle 2</b>	
<b>23</b>	Gasoline, oil, repairs, vehicle insurance, etc. . . . .	<b>23</b>			
<b>24a</b>	Vehicle rentals . . . . .	<b>24a</b>			
<b>b</b>	Inclusion amount (see instructions)	<b>24b</b>			
<b>c</b>	Subtract line 24b from line 24a	<b>24c</b>			
<b>25</b>	Value of employer-provided vehicle (applies only if 100% of annual lease value was included on Form W-2—see instructions)	<b>25</b>			
<b>26</b>	Add lines 23, 24c, and 25 . . . . .	<b>26</b>			
<b>27</b>	Multiply line 26 by the percentage on line 14 . . . . .	<b>27</b>			
<b>28</b>	Depreciation. Enter amount from line 38 below . . . . .	<b>28</b>			
<b>29</b>	Add lines 27 and 28. Enter total here and on line 1 . . . . .	<b>29</b>			

As mentioned previously the taxpayer is entitled to .36¢ per mile for business mileage. The business standard mileage rate may not be used to compute the deductible expenses of vehicles used for hire, such as taxicabs, two or more automobiles used simultaneously (such as fleet operations), or any vehicle that is leased, rather than owned, by the taxpayer. The business standard mileage rate may not be used if the automobile has previously been depreciated using a method other than straight-line for its estimated useful life. The standard rate may not be used if additional first-year depreciation has been claimed, or if the taxpayer used ACRS or MACRS depreciation.

For those taxpayers who are using the actual expense method, vehicles placed in service after September 10, 2001 are eligible for the additional 30% depreciation and an increased first year deduction. Property placed in service outside of the U.S. must be depreciated using the straight-line method.

There is a special first-year depreciation allowance of 50% for qualified property acquired after May 5, 2003 (except for property acquired under a binding written contract in effect before May 6, 2003). Instead of claiming the 50% allowance, taxpayers may elect to claim the 30% allowance or elect not to claim any special allowance. The depreciation limit for vehicles subject to the 50% allowance is increased by \$7,650.

The front side of Form 2106 is divided into 3 steps, Let's look at each step and how it will apply to the taxpayer.

Exhibit 3

Form 2106

Form <b>2106</b> Department of the Treasury Internal Revenue Service (99)	<b>Employee Business Expenses</b> ▶ See separate instructions. ▶ Attach to Form 1040.	OMB No. 1545-0139 <b>2003</b> Attachment Sequence No. <b>54</b>
Your name	Occupation in which you incurred expenses	Social security number

**Part I Employee Business Expenses and Reimbursements**

Step 1 Enter Your Expenses	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.) . . . . .	1	
2 Parking fees, tolls, and transportation, including train, bus, etc., that <b>did not</b> involve overnight travel or commuting to and from work . . . . .	2	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Do not</b> include meals and entertainment. . . . .	3	
4 Business expenses not included on lines 1 through 3. <b>Do not</b> include meals and entertainment . . . . .	4	
5 Meals and entertainment expenses (see instructions) . . . . .		5
6 <b>Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5 . . . . .	6	6

**Note:** If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

Step 1 of Form 2106 is used to summarize the employee business expenses of the taxpayer. Column A is used for all expenses except meals and entertainment. Column B is used only for meals and entertainment expenses. Step 1 must always be filled out. (Note: If the employer did not reimburse the employee for any of the expenses, skip Step 2 and go directly to Step 3 to figure the amount deductible.

Step 2 is filled out only if the taxpayer is reimbursed by the employer and the reimbursement is not shown as income to the taxpayer on a Form W-2 or Form 1099, and the employee seeks a deduction for additional expenses not paid by the employer. On line 7, only include amounts from Box 13 of Form W-2 identified as code "L".

Many overseas employees will receive Forms W-2 reflecting only a portion of their total compensation while others will receive no Form W-2 at all.

Reimbursements received under a reimbursement arrangement described above need not be shown as income on Form 1040 and will be reflected on Form 2106, line 7 only if additional expenses are claimed. Reimbursements for the unsubstantiated travel expenses must be included as income on Form 1040 and will not be included in Step 2 of Form 2106.

Exhibit 4

**Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1**

7 Enter reimbursements received from your employer that were <b>not</b> reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions) . . . . .	7				
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Step 3 is used when the employer did not reimburse the employee in full. This section will show how much the taxpayer is allowed as a miscellaneous itemized deduction on the tax-payer's Schedule A Form 1040. This amount will be reduced by 2% of the taxpayer's adjusted gross income unless the taxpayer is a qualified performing artist.

Exhibit 5

**Step 3 Figure Expenses To Deduct on Schedule A (Form 1040)**

8 Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7 . . . . .	8				
<b>Note:</b> If <b>both columns</b> of line 8 are zero, you cannot deduct employee business expenses. Stop here and attach Form 2106 to your return.					
9 In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses by 65% (.65) instead of 50%. For details, see instructions.) . . . . .	9				
10 Add the amounts on line 9 of both columns and enter the total here. <b>Also, enter the total on Schedule A (Form 1040), line 20.</b> (Fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter the total.) . . . . . ▶			10		

## Example 5

John Scott is a U.S. citizen and an employee for an English company. He normally works out of their London office. However, John was temporarily assigned to the Paris office for the last 7 months of 2003. He had his car sent there so he can carry out his duties. He purchased the car on 6-1-2002, and did incur employee business expenses for that year. He elected in 2002 to use the standard mileage rate on his 2002 tax return. While in France he did some sight-seeing and had recorded personal mileage. John incurred the following expenses during 2003:

Lodging—\$10,640

Meals—\$7,350

Transportation to & from Paris office from London office—\$300

Total mileage on car for 2003—23,720

Average daily roundtrip commute—10 miles

Commuting mileage for 2003—1,530

Business mileage—16,290

Parking fees & tolls—\$586

John is reimbursed \$8,300 for lodging and \$4,000 for meals. The \$4,000 for the meals is shown as income on John's W-2 Form. The \$8,300 is not shown as taxable income on John's Form W-2 because the lodging expenses were properly accounted for. See Exhibit 6 for how the Form 2106 would be filled out.



Form **2106**  
 Department of the Treasury  
 Internal Revenue Service (99)

**Employee Business Expenses**

▶ See separate instructions.  
 ▶ Attach to Form 1040.

OMB No. 1545-0139

**2003**

Attachment  
 Sequence No. **54**

Your name: **John Scott** Occupation in which you incurred expenses: **Sales Manager** Social security number: [Redacted]

**Part I Employee Business Expenses and Reimbursements**

**Step 1 Enter Your Expenses**

	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.) . . . . .	1 5,864.00	[Redacted]
2 Parking fees, tolls, and transportation, including train, bus, etc., that <b>did not</b> involve overnight travel or commuting to and from work . . . . .	2 586.00	[Redacted]
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Do not</b> include meals and entertainment. . . . .	3 10,940.00	[Redacted]
4 Business expenses not included on lines 1 through 3. <b>Do not</b> include meals and entertainment . . . . .	4	[Redacted]
5 Meals and entertainment expenses (see instructions) . . . . .	[Redacted]	7,350.00
6 <b>Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5 . . . . .	6 17,390.00	7,350.00

**Note:** If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

**Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1**

7 Enter reimbursements received from your employer that were <b>not</b> reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions) . . . . .	7	8,300.00	[Redacted]
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**Step 3 Figure Expenses To Deduct on Schedule A (Form 1040)**

8 Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7 . . . . .	8	9,090.00	7,350.00
<b>Note:</b> If <b>both columns</b> of line 8 are zero, you cannot deduct employee business expenses. Stop here and attach Form 2106 to your return.			
9 In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses by 65% (.65) instead of 50%. For details, see instructions.) . . . . .	9	9,090.00	3,675.00
10 Add the amounts on line 9 of both columns and enter the total here. <b>Also, enter the total on Schedule A (Form 1040), line 20.</b> (Fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter the total.) . . . . . ▶	10		12,765.00

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11700N

Form **2106** (2003)

**Part II Vehicle Expenses**

**Section A—General Information** (You must complete this section if you are claiming vehicle expenses.)

		(a) Vehicle 1	(b) Vehicle 2
<b>11</b>	Enter the date the vehicle was placed in service . . . . .	06 / 01 / 2002	/ /
<b>12</b>	Total miles the vehicle was driven during 2003 . . . . .	23,720 miles	miles
<b>13</b>	Business miles included on line 12 . . . . .	16,290 miles	miles
<b>14</b>	Percent of business use. Divide line 13 by line 12 . . . . .	64 %	%
<b>15</b>	Average daily roundtrip commuting distance . . . . .	10 miles	miles
<b>16</b>	Commuting miles included on line 12 . . . . .	1,530 miles	miles
<b>17</b>	Other miles. Add lines 13 and 16 and subtract the total from line 12 . . . . .	5,900 miles	miles
<b>18</b>	Do you (or your spouse) have another vehicle available for personal use? . . . . .	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>19</b>	Was your vehicle available for personal use during off-duty hours? . . . . .	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>20</b>	Do you have evidence to support your deduction? . . . . .	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>21</b>	If "Yes," is the evidence written? . . . . .	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

**Section B—Standard Mileage Rate** (See the instructions for Part II to find out whether to complete this section or Section C.)

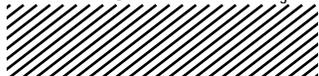
<b>22</b>	Multiply line 13 by 36¢ (.36) . . . . .	<b>22</b>	5,864.00
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**Section C—Actual Expenses**

		(a) Vehicle 1	(b) Vehicle 2
<b>23</b>	Gasoline, oil, repairs, vehicle insurance, etc. . . . .		
<b>24a</b>	Vehicle rentals . . . . .		
<b>24b</b>	Inclusion amount (see instructions)		
<b>24c</b>	Subtract line 24b from line 24a		
<b>25</b>	Value of employer-provided vehicle (applies only if 100% of annual lease value was included on Form W-2—see instructions)		
<b>26</b>	Add lines 23, 24c, and 25 . . . . .		
<b>27</b>	Multiply line 26 by the percentage on line 14 . . . . .		
<b>28</b>	Depreciation. Enter amount from line 38 below . . . . .		
<b>29</b>	Add lines 27 and 28. Enter total here and on line 1 . . . . .		

**Section D—Depreciation of Vehicles** (Use this section only if you owned the vehicle and are completing Section C for the vehicle.)

		(a) Vehicle 1	(b) Vehicle 2
<b>30</b>	Enter cost or other basis (see instructions) . . . . .		
<b>31</b>	Enter section 179 deduction and special allowance (see instructions) . . . . .		
<b>32</b>	Multiply line 30 by line 14 (see instructions if you claimed the section 179 deduction or special allowance) . . . . .		
<b>33</b>	Enter depreciation method and percentage (see instructions) . . . . .		
<b>34</b>	Multiply line 32 by the percentage on line 33 (see instructions) . . . . .		
<b>35</b>	Add lines 31 and 34 . . . . .		
<b>36</b>	Enter the limit from the table in the line 36 instructions . . . . .		
<b>37</b>	Multiply line 36 by the percentage on line 14 . . . . .		
<b>38</b>	Enter the <b>smaller</b> of line 35 or line 37. Also enter this amount on line 28 above . . . . .		



As you can see from the exhibit, the total expenses in Column A are reduced by the \$8,300 reimbursement not included as taxable income on John's W-2. He will be entitled to an itemized miscellaneous deduction of \$12,765. If John's adjusted gross income was \$60,000, John would have to reduce the \$12,765 by \$1,200 ( $\$60,000 \times .02$ ) giving him a total of \$11,565 as a net miscellaneous deduction if John had no other miscellaneous deductions.

### Exercise 1

Susan Troop, social security number 000-00-6789, works in Manila and is temporarily assigned to her company's Tokyo, Japan office. Her round trip air fare is \$375. She also incurred lodging expenses of \$2,760 and meal expenses of \$1,420. She used mass transportation while in Tokyo and spent \$357. Her employer, who is in the retail sales trade, did not reimburse her for any of the expenses. Complete the Form 2106 for Susan Troop.



Form **2106**

**Employee Business Expenses**

OMB No. 1545-0139

Department of the Treasury  
Internal Revenue Service (99)

▶ See separate instructions.

**2003**

Attachment  
Sequence No. **54**

▶ Attach to Form 1040.

Your name	Occupation in which you incurred expenses	Social security number
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**Part I Employee Business Expenses and Reimbursements**

	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
<b>Step 1 Enter Your Expenses</b>		
1 Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.) . . . . .	1	
2 Parking fees, tolls, and transportation, including train, bus, etc., that <b>did not</b> involve overnight travel or commuting to and from work . . . . .	2	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Do not</b> include meals and entertainment . . . . .	3	
4 Business expenses not included on lines 1 through 3. <b>Do not</b> include meals and entertainment . . . . .	4	
5 Meals and entertainment expenses (see instructions) . . . . .		5
6 <b>Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5 . . . . .	6	6

**Note:** If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

**Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1**

7 Enter reimbursements received from your employer that were <b>not</b> reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions) . . . . .	7	
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**Step 3 Figure Expenses To Deduct on Schedule A (Form 1040)**

8 Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7 . . . . .	8	
<b>Note:</b> If <b>both columns</b> of line 8 are zero, you cannot deduct employee business expenses. Stop here and attach Form 2106 to your return.		
9 In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses by 65% (.65) instead of 50%. For details, see instructions.) . . . . .		9
10 Add the amounts on line 9 of both columns and enter the total here. <b>Also, enter the total on Schedule A (Form 1040), line 20.</b> (Fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter the total.) . . . . . ▶	10	10

If the taxpayer is eligible and elects the foreign earned income exclusion he or she must adjust the amount of the business deductions related to the income excluded. The disallowed portion of the expenses is calculated by dividing the excluded foreign earned income by total foreign earned income.

### **Example 6**

Harold Will is a U.S. citizen, employed as a salesperson in a foreign country and is eligible and elects to exclude \$78,000 of his \$98,500 a year salary. His AGI is \$30,000. He had a total of \$2,000 of unreimbursed employee business expenses of which \$500 was for meals; these expenses are deductible only as miscellaneous itemized deductions on Schedule A (Form 1040). First, it is necessary to complete Form 2106. On that form Harold reduces the meal expenses by 50% of the \$500 amount spent, yielding a total of \$1,750 (\$250 & \$1,500).

Harold must reduce the \$1,750 by 79% ( $78,000/98,500$ ) because he excluded 79% of his earned income. Thus \$1,383 of his expenses are not deductible. Harold carries the \$367 ( $\$1,750 - \$1,383$ ) deductible amount to Schedule A.

Harold also has \$500 of other miscellaneous deductions subject to the 2% of AGI limit. He adds the \$367 from Form 2106 plus the \$500 for a total of \$867 miscellaneous expenses. 2% of Harold's AGI is \$600 ( $.02 \times 30,000$ ). Harold's deductible miscellaneous itemized deductions are \$267 ( $\$867 - \$600$ ).

If Harold did not have the other miscellaneous expenses of \$500 he would not have been able to claim any miscellaneous deductions. His remaining expenses (\$367) would have been less than 2% of his AGI (\$600).



## ***SUMMARY EXERCISES***

1. Which of the following taxpayers would be entitled to employee business expenses and if so indicate the type of expense?

Vehicle expenses

Lodging

Meals

Travel

**a.** Joseph Fulton works in London and drives from and to his house every day.

**Answer** \_\_\_\_\_

**b.** Mary Banks works in Paris and had to go to Lyon for the day to conduct business. She returns home to Paris that evening. She used her car.

**Answer** \_\_\_\_\_

**c.** Alice Canton is a nurse working in Rome, Italy. Her employer gives her a temporary assignment for 2 months in Oslo, Norway.

**Answer** \_\_\_\_\_

2. What form do you use to calculate a taxpayer's employee business expenses?

**Answer** \_\_\_\_\_

3. When are employee business expense reimbursements not included in gross income?

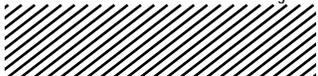
**Answer** \_\_\_\_\_

4. When are the employee business expenses itemized miscellaneous deductions?

**Answer** \_\_\_\_\_

5. How are reimbursements that are more than expenses incurred treated?

**Answer** \_\_\_\_\_

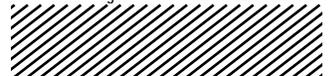


## ▶▶ SUMMING UP THIS SEGMENT ◀◀

Reimbursements from an accountable plan for substantiated employee business expenses are not included as income on the employee's return if the employee is required to return, and does return, any excess reimbursements.

- ▶ If the reimbursements are included as income, deductible expenses are allowed as miscellaneous itemized deductions subject to the 2% limitation.
- ▶ Travel expenses for meals, lodging and incidentals must be incurred while "away from home overnight" to be deductible.
- ▶ Form 2106 is used to calculate the amount of itemized deductions that are in excess of reimbursements.
- ▶ If reimbursements exceed expenses, the excess is income to the employee and must be reported on Form 1040. (If reimbursements exceed the expenses it is probably a nonaccountable plan, and therefore the entire reimbursement is taxable).
- ▶ If it is the company's policy for the employees to account for business expenses to the employer by supplying the employer with documented evidence and the employer reimburses the employee for the amount in full, Form 2106 is not required.

If the taxpayer is eligible for and elects the foreign earned income exclusion, certain adjustments must be made to the gross amount deductible as employee business expenses.



Form **2106**  
 Department of the Treasury  
 Internal Revenue Service (99)

**Employee Business Expenses**

OMB No. 1545-0139

**2003**  
 Attachment  
 Sequence No. **54**

▶ See separate instructions.

▶ Attach to Form 1040.

Your name: **Susan Troop**      Occupation in which you incurred expenses: **Retail Sales**      Social security number: \_\_\_\_\_

**Part I Employee Business Expenses and Reimbursements**

**Step 1 Enter Your Expenses**

	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.) . . . . .	1	
2 Parking fees, tolls, and transportation, including train, bus, etc., that <b>did not</b> involve overnight travel or commuting to and from work . . . . .	2	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Do not</b> include meals and entertainment. . . . .	3 3,492.00	
4 Business expenses not included on lines 1 through 3. <b>Do not</b> include meals and entertainment . . . . .	4	
5 Meals and entertainment expenses (see instructions) . . . . .		5 1,420.00
6 <b>Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5 . . . . .	6 3,492.00	6 1,420.00

**Note:** If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

**Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1**

7 Enter reimbursements received from your employer that were <b>not</b> reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions) . . . . .	7	
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**Step 3 Figure Expenses To Deduct on Schedule A (Form 1040)**

8 Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7 . . . . .	8	3,492.00	1,420.00
<b>Note:</b> If <b>both columns</b> of line 8 are zero, you cannot deduct employee business expenses. Stop here and attach Form 2106 to your return.			
9 In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses by 65% (.65) instead of 50%. For details, see instructions.) . . . . .	9	3,492.00	710.00
10 Add the amounts on line 9 of both columns and enter the total here. <b>Also, enter the total on Schedule A (Form 1040), line 20.</b> (Fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter the total.) . . . . . ▶	10		4,202.00

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11700N

Form **2106** (2003)

# *BUSINESS TRAVEL EXPENSES*

## *ANSWERS TO SUMMARY EXERCISES*

### Lesson 4

#### International Segment

1. a.) No (They are commuting expenses)  
b.) Yes. Vehicle expenses  
c.) Yes. Travel, lodging, meals.
2. Form 2106
3. When the employee is required to substantiate his business expenses under a reimbursement arrangement and return any excess allowance to his employer. Also, Per Diem reimbursements that are similar to allowances specified by the Federal government will be nontaxable to the extent that the amounts do not exceed government rates.
4. When the expenses are more than the amount reimbursed. Itemized deductions are also created in the case of an employee reimbursed under a nonaccountable plan.
5. They are treated as income and shown on line 7 of Form 1040. If reimbursement in excess of expenses exists, the plan is probably a nonaccountable one, and therefore the entire reimbursement is taxable—not just the excess.

**STUDENT NOTES**

Lined area for student notes.



## LESSON OVERVIEW AND OBJECTIVES

In this lesson you will learn about three “miscellaneous credits.” The mortgage interest credit, the foreign tax credit and the credit for qualified retirement savings are covered in this lesson.

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.
- Be aware of the mortgage interest credit.

Important tax terms presented in this lesson appear in boldfaced type in the student text. Emphasize these terms as they are introduced:

- credit rate
- maximum allowable contribution
- eligible contributions
- testing period

## MATERIALS

This lesson refers to a number of IRS publications and forms. If you would like to provide your students with the most current revision of the material referenced, you can download the files from [www.irs.gov](http://www.irs.gov).

## TEACHING TIPS

Some taxpayers may be eligible to take a nonrefundable tax credit for first-time homebuyers if they buy a main home in the District of Columbia. The credit is based on the purchase price and cannot exceed \$5,000. To claim this credit, a taxpayer must file a Form 1040 and complete Form 8859, *District of Columbia First-Time Homebuyer Credit*. For additional information on this credit, see the instructions for Form 8859.

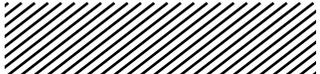
## GUIDED QUESTIONS – FOREIGN TAX CREDIT – INTERNATIONAL SEGMENT

1. **What type of foreign tax qualifies for the foreign tax credit?**

The tax must be a tax imposed on income similar to the income tax imposed by the U.S.

**2. How can a person get the benefit of paying foreign taxes on their return?**

The person can either take a deduction on their Schedule A as an itemized deduction or complete the Form 1116 for the Foreign Tax Credit.



## INTRODUCTION AND OBJECTIVES

In this lesson you will learn about three “miscellaneous credits”. The mortgage interest credit, the foreign tax credit and the credit for qualified retirement savings are covered in this lesson.

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.
- Be aware of the mortgage interest credit.

## 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. All of the credits discussed in this lesson are non-refundable.

## CREDIT FOR QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS

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. The amount of the saver's credit is determined by the taxpayer's filing status, adjusted gross income, and his or her qualified contributions.

The credit is reported on line 48 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 lessor of the:

- Maximum allowable contribution (\$2,000) or
- Eligible contributions.

The credit rate is determined by using the following table.

<b>IF your filing status is...</b>	<b>AND your adjusted gross income is...</b>	<b>THEN your credit rate is...</b>
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 2003. In 2002, Terry withdrew \$500 from his IRA. In 2003, he withdrew \$900 from his IRA. Neither of these withdrawals were rolled over. In 2003, 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 credit is 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 2003. 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

Martha Barnard (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.

Form **8880**

**Credit for Qualified Retirement Savings Contributions**

OMB No. 1545-1805

**2003**

Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040 or Form 1040A.

Attachment  
Sequence No. **129**

Name(s) shown on return

Your social security number



You **cannot** claim this credit if **either** of the following applies.

- The amount on Form 1040, line 35, or Form 1040A, line 22, is more than \$25,000 (\$37,500 if head of household, \$50,000 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral **(a)** was born after January 1, 1986, **(b)** is claimed as a dependent on someone else's 2003 tax return, or **(c)** was a **student** in 2003 (see instructions).

	(a) You	(b) Your spouse
<b>1</b> Traditional and Roth IRA contributions for 2003. <b>Do not</b> include rollover contributions . . . . .		
<b>2</b> Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18) plan contributions for 2003 (see instructions) . . . . .		
<b>3</b> Add lines 1 and 2 . . . . .		
<b>4</b> Certain distributions received <b>after</b> 2000 and <b>before</b> the due date (including extensions) of your 2003 tax return (see instructions). If married filing jointly, include <b>both</b> spouses' amounts in <b>both</b> columns. See instructions for an exception . . . . .		
<b>5</b> Subtract line 4 from line 3. If zero or less, enter -0- . . . . .		
<b>6</b> In each column, enter the <b>smaller</b> of line 5 or \$2,000 . . . . .		
<b>7</b> Add the amounts on line 6. If zero, <b>stop</b> ; you cannot claim the credit . . . . .		
<b>8</b> Enter the amount from Form 1040, line 35*, or Form 1040A, line 22		

**9** Enter the applicable decimal amount shown below:

If line 8 is—		And your filing status is—		
Over—	But not over—	Married filing jointly	Head of household	Single, Married filing separately, or Qualifying widow(er)
<b>Enter on line 9—</b>				
---	\$15,000	.5	.5	.5
\$15,000	\$16,250	.5	.5	.2
\$16,250	\$22,500	.5	.5	.1
\$22,500	\$24,375	.5	.2	.1
\$24,375	\$25,000	.5	.1	.1
\$25,000	\$30,000	.5	.1	.0
\$30,000	\$32,500	.2	.1	.0
\$32,500	\$37,500	.1	.1	.0
\$37,500	\$50,000	.1	.0	.0
\$50,000	---	.0	.0	.0

**Note:** If line 9 is zero, **stop**; you cannot claim the credit.

<b>10</b> Multiply line 7 by line 9 . . . . .		
<b>11</b> Enter the amount from Form 1040, line 43, or Form 1040A, line 28		
<b>12</b> Enter the total of your credits from Form 1040, lines 44 through 47, or Form 1040A, lines 29 through 31 . . . . .		
<b>13</b> Subtract line 12 from line 11. If zero, <b>stop</b> ; you cannot take the credit . . . . .		
<b>14</b> <b>Credit for qualified retirement savings contributions.</b> Enter the <b>smaller</b> of line 10 or line 13 here and on Form 1040, line 48, or Form 1040A, line 32 . . . . .		

## ***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 52 for Form 8396.

Any mortgage interest credit that the taxpayer cannot use in 2003 can be carried forward for up to three tax years. Figure the carry-forward 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*.

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 2003. According to Tabitha she paid no other foreign taxes. She can claim the \$219 on line 44 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?

## 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.

Name(s) shown on return

**MARTHA BARNARD**

Your social security number

**000 00 0088**



You **cannot** claim this credit if **either** of the following applies.

- The amount on Form 1040, line 35, or Form 1040A, line 22, is more than \$25,000 (\$37,500 if head of household, \$50,000 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral **(a)** was born after January 1, 1986, **(b)** is claimed as a dependent on someone else's 2003 tax return, or **(c)** was a **student** in 2003 (see instructions).

	(a) You	(b) Your spouse
<b>1</b> Traditional and Roth IRA contributions for 2003. <b>Do not</b> include rollover contributions . . . . .		
<b>2</b> Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18) plan contributions for 2003 (see instructions) . . . . .	<b>1,000</b>	
<b>3</b> Add lines 1 and 2 . . . . .	<b>1,000</b>	
<b>4</b> Certain distributions received <b>after</b> 2000 and <b>before</b> the due date (including extensions) of your 2003 tax return (see instructions). If married filing jointly, include <b>both</b> spouses' amounts in <b>both</b> columns. See instructions for an exception . . . . .		
<b>5</b> Subtract line 4 from line 3. If zero or less, enter -0- . . . . .	<b>1,000</b>	
<b>6</b> In each column, enter the <b>smaller</b> of line 5 or \$2,000 . . . . .	<b>1,000</b>	
<b>7</b> Add the amounts on line 6. If zero, <b>stop</b> ; you cannot claim the credit . . . . .		<b>1,000</b>
<b>8</b> Enter the amount from Form 1040, line 35*, or Form 1040A, line 22 . . . . .	<b>26,819</b>	

**9** Enter the applicable decimal amount shown below:

If line 8 is—		And your filing status is—		
Over—	But not over—	Married filing jointly	Head of household	Single, Married filing separately, or Qualifying widow(er)
Enter on line 9—				
---	\$15,000	.5	.5	.5
\$15,000	\$16,250	.5	.5	.2
\$16,250	\$22,500	.5	.5	.1
\$22,500	\$24,375	.5	.2	.1
\$24,375	\$25,000	.5	.1	.1
\$25,000	\$30,000	.5	.1	.0
\$30,000	\$32,500	.2	.1	.0
\$32,500	\$37,500	.1	.1	.0
\$37,500	\$50,000	.1	.0	.0
\$50,000	---	.0	.0	.0

**Note:** If line 9 is zero, **stop**; you cannot claim the credit.

<b>10</b> Multiply line 7 by line 9 . . . . .		<b>100</b>
<b>11</b> Enter the amount from Form 1040, line 43, or Form 1040A, line 28 . . . . .		
<b>12</b> Enter the total of your credits from Form 1040, lines 44 through 47, or Form 1040A, lines 29 through 31 . . . . .		
<b>13</b> Subtract line 12 from line 11. If zero, <b>stop</b> ; you cannot take the credit . . . . .		
<b>14</b> <b>Credit for qualified retirement savings contributions.</b> Enter the <b>smaller</b> of line 10 or line 13 here and on Form 1040, line 48, or Form 1040A, line 32 . . . . .		

\*See Pub. 590 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**

Lined area for student notes.

## INTRODUCTION AND OBJECTIVES

This lesson will discuss how to compute the foreign tax credit in situations where a U.S. citizen could pay taxes twice on the same income—once to the government of the foreign country where the income was sourced and once to the U.S. Government. This segment will address the foreign tax credit only as it applies to U.S. citizens and residents.

In the IN segment of the income lesson, the topic of worldwide income was discussed. U.S. citizens and residents compute their U.S. taxes based on their worldwide income. This sometimes leads to a situation when a U.S. citizen may be paying tax twice on the same income. In order to avoid double taxation, a foreign tax credit was created. This allows an individual to take a tax credit for those taxes paid to a foreign government on income from sources in a foreign country.

As explained in Lesson 5, Miscellaneous Tax Credits, like other tax credits, the foreign tax credit is a dollar-for-dollar reduction in the amount of tax. However, in some cases, not all taxes paid to a foreign government can be used in the computation of the foreign tax credit.

After completing this lesson, you should be able to supplement the information you learned in the basic text and:

- Determine which taxes are eligible for the foreign tax credit.
- Apply the criteria for claiming the foreign tax credit
- Accurately compute the foreign tax credit using Form 1116 or tax preparation software
- Assist taxpayer in compiling the documents necessary for a paid professional to complete the return.

## WHAT TAXES QUALIFY FOR THE CREDIT

There are several factors to consider when determining if a tax paid to a foreign government is eligible for the foreign tax credit. They include:

1. Was the income foreign source?
2. What type of tax was paid to the foreign government?
3. Will the taxpayer receive some kind of specific economic benefit from the payment of this tax?

In this part of the lesson, we'll study the criteria for claiming the foreign tax credit.

The taxpayer must have income from a foreign country on which he/she is taxed by a foreign country. The tax imposed on the income must be similar to the income tax imposed in the U.S. This simply means that the income must be from a country other than the U.S. and that the tax paid must be similar to U.S. income tax. Let's look at some examples.

### Example 1

Robb and Betty Grant are U.S. citizens who reside in France. The schedule B on their U.S. tax return contains the following:

\$500, Lee County National Bank (U.S.)

\$600, Banque National de Paris (French)

They paid income taxes on both types of interest to both countries. On their U.S. tax return, they can compute a foreign tax credit against the taxes that they pay to the U.S. on the interest received from the French bank. They would need to check with the French taxing authorities to determine if they can claim a similar tax credit on their French tax return for the interest income from the U.S. bank.

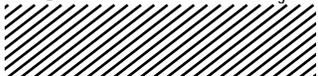
### Example 2

Marie Elliott is a U.S. citizen who lives in Hong Kong. She owns a house in Hong Kong and paid \$2,000 in real estate taxes for her home and \$1,000 in personal property taxes. She also paid \$300 in income taxes to the government of Hong Kong. She is not able to claim a foreign tax credit for either the real estate taxes paid or the personal property taxes paid since these two taxes are not income taxes. She can, however, use the \$300 in income taxes paid to Hong Kong to compute a foreign tax credit. (Note—she can take the real estate taxes that she paid and deduct them as itemized deductions if she itemizes on her U.S. tax return. Foreign personal property taxes are only deductible if they relate to the production of income or a trade/business.)

### Exercise 1

The following is a list of the income on Anne's U.S. income tax return. She is a U.S. citizen living in Canada. She also had to pay taxes on each of these types of income to Canada. Indicate on which of the following a foreign tax credit may be computed.

- \_\_\_\_\_ a. Wages from her job in the U.S.
- \_\_\_\_\_ b. Interest income from a U.S. bank.
- \_\_\_\_\_ c. Interest income from a Canadian bank.
- \_\_\_\_\_ d. Dividend income from a U.S. corporation.
- \_\_\_\_\_ e. Dividend income from a Canadian corporation.



## Exercise 2

Determine if the following taxes paid to a foreign government can be used to compute the foreign tax credit. All taxpayers are U.S. citizens.

- \_\_\_\_\_ a. Martha pays \$1,200 a year in taxes. This tax is based on the number and types of appliances which she owns and uses in her home.
- \_\_\_\_\_ b. Jean pays an inheritance tax to the Spanish government. It is based on an inheritance she received upon the death of an uncle.
- \_\_\_\_\_ c. Dorothy lives in Jamaica. She paid \$1,500 to the Jamaican government for her salaried income which she earned in Jamaica.
- \_\_\_\_\_ d. Henry lives in Haiti. He paid \$100 in taxes to the Haitian government. This tax was based on his type of living accommodations, the location of his residence and the size of this family.

In addition to the requirements that the tax be paid to the foreign country on income derived from a foreign country and the tax be an income tax similar to the income tax as defined under U.S. law, the tax must also not be payment for a specific economic benefit. Simply put, the “tax” cannot actually be a “payment” that results in an individual receiving goods, services or the right to use certain properties which are not available to others who are subject to the income tax that is generally imposed by the foreign country. A taxpayer cannot receive any specific benefit, directly or indirectly from paying a tax.

## Example 3

Bob lives in Country X. He owns and operates his own business in this country. This country has a two tier income tax system. Everyone pays income tax at graduated rates depending upon their income. Bob also pays income tax based upon the profits of his business. This second level of income tax gives Bob the right to reduced fees for telephones, utilities and rents for his business. The government of Country X calls it an income tax because it is based upon the profits of the business. If Bob did not pay this tax, he could not rent a government-owned building and he would pay significantly more for the utilities and his business telephone usage. Since Bob receives a specific economic benefit for the second tier of income tax that he pays, he cannot use those tax payments to compute a foreign tax credit on his U.S. tax return. However, the first tier of income taxes are similar to U.S. income taxes and can be used to figure his foreign tax credit.



**Country Restrictions.** Aside from the restrictions that we have already discussed, there are also certain countries to which a taxpayer may pay foreign income taxes but cannot claim a foreign tax credit. Generally the reason a credit may not be claimed for tax paid to one of these countries is because the Secretary of State has designated the country as one that repeatedly provides support for acts of international terrorism.

The credit can also be denied to countries with which the United States has no diplomatic relations, or countries whose government the United States does not recognize. At the time of this writing, income taxes paid to the following countries are not eligible for the foreign tax credit.

CUBA  
IRAN  
IRAQ  
LIBYA  
NORTH KOREA  
SYRIA  
SUDAN

#### **Example 4**

Ralph is a U.S. citizen who has investments in both Belgium and Iran. On these investments Ralph pays income tax to these two countries by withholding tax from his dividend checks. Ralph can claim the taxes paid to Belgium when computing the foreign tax credit. The income taxes paid to Iran do not qualify for a foreign tax credit.

### ***TYPES OF INCOME***

A separate Form 1116 must be completed for each different type of income. We will only be studying three income categories: passive income, high withholding tax, interest and general limitation income. Remember that you can only check one income category per form and separate Forms 1116 must be submitted for each category. Your tax preparation software will do this for you.



Form <b>1116</b> Department of the Treasury Internal Revenue Service	<b>Foreign Tax Credit</b> (Individual, Estate, or Trust) ▶ Attach to Form 1040, 1040NR, 1041, or 990-T. ▶ See separate instructions.	OMB No. 1545-0121 <div style="font-size: 2em; font-weight: bold; text-align: center;">2003</div> Attachment Sequence No. <b>19</b>												
Name _____		Identifying number as shown on page 1 of your tax return _____												
Use a separate Form 1116 for each category of income listed below. See <b>Categories of Income</b> on page 3 of the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.														
<table style="width: 100%; border: none;"> <tr> <td style="width: 33%;"><b>a</b> <input type="checkbox"/> Passive income</td> <td style="width: 33%;"><b>d</b> <input type="checkbox"/> Shipping income</td> <td style="width: 33%;"><b>g</b> <input type="checkbox"/> Lump-sum distributions</td> </tr> <tr> <td><b>b</b> <input type="checkbox"/> High withholding tax interest</td> <td><b>e</b> <input type="checkbox"/> Dividends from a DISC or former DISC</td> <td><b>h</b> <input type="checkbox"/> Section 901(j) income</td> </tr> <tr> <td><b>c</b> <input type="checkbox"/> Financial services income</td> <td><b>f</b> <input type="checkbox"/> Certain distributions from a foreign sales corporation (FSC) or former FSC</td> <td><b>i</b> <input type="checkbox"/> Certain income re-sourced by treaty</td> </tr> <tr> <td></td> <td></td> <td><b>j</b> <input type="checkbox"/> General limitation income</td> </tr> </table>			<b>a</b> <input type="checkbox"/> Passive income	<b>d</b> <input type="checkbox"/> Shipping income	<b>g</b> <input type="checkbox"/> Lump-sum distributions	<b>b</b> <input type="checkbox"/> High withholding tax interest	<b>e</b> <input type="checkbox"/> Dividends from a DISC or former DISC	<b>h</b> <input type="checkbox"/> Section 901(j) income	<b>c</b> <input type="checkbox"/> Financial services income	<b>f</b> <input type="checkbox"/> Certain distributions from a foreign sales corporation (FSC) or former FSC	<b>i</b> <input type="checkbox"/> Certain income re-sourced by treaty			<b>j</b> <input type="checkbox"/> General limitation income
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		<b>j</b> <input type="checkbox"/> General limitation income												

**Passive Income.** Passive income generally includes the following types of income: dividends, interest, royalties, rents and annuities. If you are assisting a person who has one of these types of passive income from a foreign country, and he or she paid income taxes to a foreign country, you can use your software to compute a foreign tax credit.

### Example 5

Darlene is a U.S. citizen living in Venezuela. She keeps a bank account in the Banco Nacional de Venezuela. In 2003, she received \$380 in interest income from the Venezuelan bank. She also paid Venezuelan income taxes on this interest income. On her U.S. return, she would claim a foreign tax credit for the taxes paid to Venezuela on her interest income. She would check the box for the “Passive income” category on Form 1116.

**High Withholding Tax Interest.** Certain interest income is not included in the passive income category. If the taxpayer you are helping had interest income on which at least 5% foreign gross income tax was withheld, then this income is classified as high withholding tax interest and not passive income.

### Example 6

Michael is a U.S. citizen who lives in the United Kingdom. He maintains a bank account in a London bank. According to local law, the bank withholds a mandatory 27.5% of interest income as income tax. Since the withholding rate is at least 5%, the high withholding tax interest category would be checked on his Form 1116.

### Example 7

Regina lives in Singapore and is a U.S. citizen. She has both dividend income and interest income from countries outside the United States. Her foreign bank withholds 15% of her interest income for income taxes. She also pays foreign income taxes on her dividend income. Regina must complete two Forms 1116. Her foreign dividend income is “passive income” and indicated as such on one Form 1116. Her foreign interest income is in the “high withholding

tax interest” category and is on another Form 1116. The credits on these separate Forms 1116 will eventually be combined. This will be studied later in this lesson.

**General Limitation Income.** The final income category on Form 1116 is the “general limitation income” category. If the person you are helping has foreign income that does not come under any of the other categories on Form 1116, then that foreign income comes under the general limitation income category. Most often, this would be wages earned in a foreign country that an individual does not exclude, or excludes only part of, under the foreign earned income exclusion.

### Example 8

Siegfried lives in Switzerland and is a U.S. citizen. He works in Switzerland and pays income taxes to Switzerland on his earnings. He does not elect to claim a foreign earned income exclusion. He can claim a foreign tax credit for the taxes paid on his earnings to the Swiss government. He checks the box for the general limitation income category on his Form 1116.

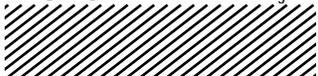
**High Taxed Income.** If the individual you are assisting has passive income which is taxed by a foreign government at a rate that is higher than the highest U.S. income tax rate, then the foreign tax credit for that income would be computed under the general limitation category. (Passive income was discussed earlier in this lesson.) In 2003, the highest U.S. income tax rate is 38.6%. Therefore, if the person pays more than 38.6% on the foreign source passive income for which he or she claimed the credit, then the credit is computed under the “general limitation” category.

### Example 9

Maria lives in Brazil and is a U.S. citizen. She has a bank account in Brazil and pays 45% income tax on her interest income. Even though interest income is normally passive income for purposes of the foreign tax credit, this income would be listed under the “general limitation” category on Form 1116 since the rate of income tax she pays on this passive income is higher than the highest U.S. income tax rate.

### Example 10

Bernard is a resident of Barbados and a U.S. citizen. He keeps a bank account in Barbados. In 2003 he paid 17% income tax on his interest income from his bank account in Barbados. Since 17% (the tax rate he paid) is not more than 38.6% (the highest U.S. income tax rate) and since the 17% that Bernard paid was not paid by withholding, this income fails into the “passive income” category of Form 1116.



## OTHER FOREIGN TAX CREDIT CONCEPTS

We have already discussed the income categories that are listed on separate sections of the Form 1116. In addition, the top of Form 1116 has a line to indicate the name of the country of residence of the taxpayer. This will need to be entered for tax software to correctly figure the tax credit.

**Part I** is used to figure the taxable income from foreign sources in each income category. If the person you are helping has one type of foreign income that comes from several foreign countries, you use one Form 1116. You will note that there is room on Form 1116 for up to 3 countries.

### Example 11

George is both a U.S. citizen and resident. He has interest income from both Canada and Mexico, as well as the U.S. His software will print only one Form 1116 since all the interest income is in the passive income category.

On Line 1, list all foreign income that fits under the category checked at the top of Form 1116. You will list that income separately for each foreign country.

### Example 12

George had \$300 in interest income from his Canadian bank and \$200 in interest income from his Mexican bank. See the completed Form 1116, line 1 for his income in Exhibit 2 which follows.

Exhibit 2

Form 1116, Line 1

<b>Part I Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)</b>				
	Foreign Country or U.S. Possession			Total
	A	B	C	(Add cols. A, B, and C.)
1 Enter the name of the foreign country or U.S. possession . . . . .	Canada	Mexico		
1 Gross income from sources within country shown above and of the type checked above (see page 7 of the instructions): .....				
	300	200		1 500

**Note:** If the taxpayer you are assisting has claimed the foreign earned income exclusion, enter on line 1 of Form 1116 for general limitation income only the amount of earned income not excluded.



### Example 13

Monique lives in France and is a U.S. citizen. She earned \$84,000 in 2002 in France. Monique claimed the foreign earned income exclusion of \$80,000 (discussed in an earlier lesson). As illustrated in Exhibit 3 below, she would only enter \$4,000 on line 1 of her Form 1116 (\$84,000 earned Income – \$80,000 exclusion).

Exhibit 3

Form 1116, Line 1

Part I Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)				
Foreign Country or U.S. Possession				Total
				(Add cols. A, B, and C.)
A	B	C		
1 Enter the name of the foreign country or U.S. possession . . . . .				
France				
1 Gross income from sources within country shown above and of the type checked above (see page 7 of the instructions):				
4,000			1	4,000

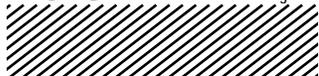
Lines 2–5 are probably the hardest and most confusing lines to complete on the Form 1116. Let’s review the situations that we will not be studying.

- Expenses directly allocable to the income.** If the person you are assisting has expenses that are related directly to the income claimed on line 1 such as employee business expenses, and the income claimed on line 1 was earned income, then you may recommend that this person seek professional assistance or contact the IRS.
- Investment Interest Expense.** If a person borrowed money in order to purchase investment property such as stock, then some special allocations may need to be done. They may wish to contact the IRS or seek a professional preparer.
- Foreign Losses.** If the person you are helping had any type of foreign losses such as net losses from selling capital assets or a net loss from being a limited partner, they may wish to hire a professional preparer or contact the IRS if they wish to prepare their own return.

Now that we have discussed what areas are beyond the scope of VITA, let’s continue with the completion of Part I.

**Line 3.** Your software will complete line 3a if you completed a Schedule A for the person you are assisting to itemize his or her deductions. The total of the itemized deductions not directly related to foreign or U.S. income are medical expenses, real estate taxes and gifts to charity.

If the person you are assisting does not itemize deductions, then the standard deduction claimed on line 37 of the Form 1040 would be entered on line 3a.



## Example 14

Betty is claiming a foreign tax credit. She is single and had itemized deductions of \$6,900 for 2003. Her Schedule A includes \$6,200 of real estate taxes and \$700 of charitable contributions. (See Exhibit 4.)

Exhibit 4

Form 1116, Line 3

<b>3</b> Pro rata share of other deductions <b>not definitely related:</b>				
<b>a</b> Certain itemized deductions or standard deduction (see instructions) . . . . .	6,900			
<b>b</b> Other deductions (attach statement) . . . . .				
<b>c</b> Add lines 3a and 3b . . . . .	6,900			
<b>d</b> Gross foreign source income (see instructions)				
<b>e</b> Gross income from all sources (see instructions)				
<b>f</b> Divide line 3d by line 3e (see instructions) . . . . .				
<b>g</b> Multiply line 3c by line 3f . . . . .				

## Example 15

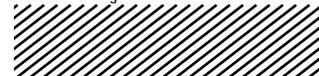
Rebecca wishes to claim a foreign tax credit. She is single and had itemized deductions of \$2,500. Since the standard deduction for a single person for 2003, is \$4,750, it is more advantageous to take the standard deduction. Rebecca's Form 1116 would therefore have a \$4,750 entry on line 3a. (See Exhibit 5.)

All income from foreign sources in the category checked at the top of Form 1116 is listed on line 3d. If the foreign earned income exclusion was claimed on Form 2555 and if the Form 1116 is for the general limitation category, then the amount of the claimed exclusion is included here as well. For example, on line 3d for Monique from one of our prior examples the entry would be \$84,000. That's the sum of \$4,000 from line 1 plus the \$80,000 exclusion she claimed. Under most circumstances, line 3d and line 1 will be the same.

Line 3e is gross income from all sources. Usually, this line will be the same as line 22 of the Form 1040. If a Form 2555 was completed and the Foreign Earned Income Exclusion was claimed, then the amount of the exclusion must be added back to the gross income amount on line 22.

The software's next step is to determine the percentage of foreign source income to total income. This is done by dividing line 3d by line 3e and it will enter the answer on line 3f. Then it takes line 3c and multiplies it by the percentage determined on line 3f and then enters this answer on line 3g. For our purposes line 6 will then be the same as line 3g. This number represents the amount of your deductions allocated to foreign income in the category.

Your software will compute the rest of Part I and has begun to enter figures on Part III.



**Part II. Foreign Taxes Paid or Accrued.** Part II of Form 1116 deals with the amount of foreign taxes paid or that may be owed (accrued). Since the foreign tax credit is allowed when a U.S. taxpayer either pays or accrues taxes to a foreign government, the amount paid or owed to a foreign government must be indicated on the tax return in this section.

Before we can discuss how to complete Part II, we need to discuss cash basis and accrual basis taxpayers. A cash basis taxpayer is one who reports income when actually or constructively received, and expenses when they are paid. The majority of people who file individual income tax returns are cash basis taxpayers. If the person is a cash basis taxpayer, he or she has a choice to take foreign tax credit using the cash or accrual method.

### **Example 16**

Marie is a U.S. citizen who resides in Argentina, where she is currently employed. She is paid every week on Thursday. Her last payday for 2003 is December 30th. She is paid based upon the time she worked in the previous week Sunday through Saturday. Since she is a cash basis taxpayer, she claims on her 2003 tax return the income that she was paid from January 1, 2003 through December 31, 2003 no matter when she earned it or when she may have been entitled to it. She also claims as deductions, expenses for which she actually paid in 2003 even though she may have incurred the debt prior to 2003.

An accrual basis taxpayer computes income and deductions differently. A person who is on the accrual basis computes income when he or she actually earned it or became entitled to it. Therefore, his or her deductions are computed based on when those debts were incurred, but not necessarily paid.

### **Example 17**

If Marie was an accrual basis taxpayer instead of a cash basis taxpayer, then she would declare as her 2003 income the money she had earned from her employer through December 31, even though she would not have been paid for her last week's work until early 2004.

When computing the amount of foreign taxes for Part II of Form 1116, you will need to know if the taxpayer is on a cash basis or an accrual basis. If the person you are helping does not know, then he or she is probably on a cash basis. Taxpayers on the accrual basis should be referred to professional tax preparers for assistance.

A taxpayer on the cash basis may choose to use the accrual method to determine the foreign tax credit. However, once this choice has been made the taxpayer must use the accrual method for the foreign tax credit on all future tax returns.



In the U.S., we have a pay-as-you-go system. That means that we pay taxes on taxable income as we make it. When a wage-earner gets a paycheck, an amount has already been withheld by his or her employer for federal income tax. If there has not been withholding on taxable income, then estimated tax payments must be made.

Many foreign countries have a different system. In some cases, the individual simply reports his or her taxable income and the government involved computes the tax and bills the taxpayer. In other instances, taxpayers make payments in one year for income made the previous year. In these instances, a cash basis taxpayer may wish to use the accrual basis for computing the foreign tax credit since his or her U.S. tax would be based on the income made in 2003 but they would not actually pay the taxes or know the actual tax amount until after the end of the tax year. But remember that once the choice to use the accrual method has been made, it must be used on all future tax returns in computing the foreign tax credit.

On Part II of Form 1116, you must indicate if the credit is being claimed for foreign taxes actually paid in 2003 or if it is being claimed for foreign taxes accrued during 2003. Just as there is space in Part I of the form to claim income from 3 different countries, there is space in Part II for claiming payments to these 3 different countries.

Part II also has two separate sections in which you indicate the amounts withheld, paid, or accrued in the foreign currency and then convert these amounts into U.S. dollars.

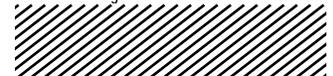
## ***FOREIGN EXCHANGE RATE***

One of the questions that frequently arise is what currency exchange rate should be used. If you are using the cash basis, then the exchange rate that is the most accurate for the date of the payment should be used.

If the person you are helping had tax withheld throughout the year, then you can use the annual average exchange rate. If the person you are assisting is using the accrual method to claim his or her foreign taxes paid, you must generally use the average exchange rate for the tax year.

Column (x) of the Form 1116 Part II is a summary (in U.S. dollars) of all the foreign taxes paid or accrued on income in the category checked at the top of Form 1116.

Line 8 of Part II is the total of foreign taxes paid or accrued to all foreign countries. If the foreign taxes are paid or accrued on foreign income that falls into more than one separate category of income, but the tax is not specifically allocable to any one of the items of income, an allocation of the tax to each separate category must be made. This allocation is made by multiplying the total foreign income by a fraction. The numerator of the fraction is the net income of each of the separate categories. The denominator is total net foreign income.



### Exercise 3

Charles is a U.S. citizen who lives and works in the United Kingdom. He takes the foreign earned income exclusion for his wages. His only other foreign income is interest income from his London bank. British income taxes were withheld at 27.5%. In 2003, his gross interest income from his London bank was £1,200. The average exchange rate for 2003 for purposes of this exercise was £.6 to the U.S. dollar. Charles uses the single filing status on his tax return and claims a standard deduction for 2003. He had earned income of \$60,000 which he excluded. He also had U.S. interest income of \$3,000 and his only other income was a short term capital gain of \$35,000 from a U.S. source. Since 27.5% is also the tax rate for interest income in the United Kingdom, he had no additional income tax due to Great Britain on his interest income. Parts of Charles' Form 1040 are reproduced below. Compute the first page of the Form 1116 for Charles.



		Total number of exemptions claimed		above		
<b>Income</b>	7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	60,000	00	
	8a	Taxable interest. Attach Schedule B if required	8a	5,000	00	
		b Tax-exempt interest. Do not include on line 8a	8b			
	Attach Forms W-2 and W-2G here. Also attach Form(s) 1099-R if tax was withheld.	9a	Ordinary dividends. Attach Schedule B if required	9a		
			b Qualified dividends (see page 25)	9b		
		10	Taxable refunds, credits, or offsets of state and local income taxes (see page 25)	10		
		11	Alimony received	11		
		12	Business income or (loss). Attach Schedule C or C-EZ	12		
		13a	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13a	35,000	00
			b If box on 13a is checked, enter post-May 5 capital gain distributions	13b		
		14	Other gains or (losses). Attach Form 4797	14		
	If you did not get a W-2, see page 23.	15a	IRA distributions	15a		
			b Taxable amount (see page 25)	15b		
		16a	Pensions and annuities	16a		
			b Taxable amount (see page 25)	16b		
	Enclose, but do not attach, any payment. Also, please use Form 1040-V.	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 27)	20b		
		21	Other income. List type and amount (see page 29)	21	(60,000)	00
		22	Add the amounts in the far right column for lines 7 through 21. This is your <b>total income</b>	22	40,000	00
<b>Adjusted Gross Income</b>	23	Educator expenses (see page 29)	23			
	24	IRA deduction (see page 29)	24			
	25	Student loan interest deduction (see page 31)	25			
	26	Tuition and fees deduction (see page 32)	26			
	27	Moving expenses. Attach Form 3903	27			
	28	One-half of self-employment tax. Attach Schedule SE	28			
	29	Self-employed health insurance deduction (see page 33)	29			
	30	Self-employed SEP, SIMPLE, and qualified plans	30			
	31	Penalty on early withdrawal of savings	31			
	32a	Alimony paid	32a			
		b Recipient's SSN				
	33	Add lines 23 through 32a	33			
	34	Subtract line 33 from line 22. This is your <b>adjusted gross income</b>	34	40,000	00	

**For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 76.** Cat. No. 11320B Form **1040** (2003)

Form 1040 (2003) Page **2**

<b>Tax and Credits</b>	35	Amount from line 34 (adjusted gross income)	35	40,000	00
	36a	Check <input type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind. } Total boxes if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind. } checked <input type="checkbox"/> 36a			
		b If you are married filing separately and your spouse itemizes deductions, or you were a dual-status alien, see page 34 and check here <input type="checkbox"/> 36b			
	37	<b>Itemized deductions</b> (from Schedule A) or your <b>standard deduction</b> (see left margin)	37	4,750	00
	38	Subtract line 37 from line 35	38	35,250	00
	39	If line 35 is \$104,625 or less, multiply \$3,050 by the total number of exemptions claimed on line 6d. If line 35 is over \$104,625, see the worksheet on page 35	39	3,050	00
	40	<b>Taxable income.</b> Subtract line 39 from line 38. If line 39 is more than line 38, enter -0-	40	32,200	00
	41	<b>Tax</b> (see page 36). Check if any tax is from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972	41	4,866	00
	42	<b>Alternative minimum tax</b> (see page 37). Attach Form 6251	42		
	43	Add lines 41 and 42	43	4,866	00
	44	Foreign tax credit. Attach Form 1116 if required	44		
	45	Credit for child and dependent care expenses. Attach Form 2441	45		

**Standard Deduction for—**

- People who checked any box on line 36a or 36b or who can be claimed as a dependent, see page 34.
- All others:  
Single or Married filing separately, \$4,750

Form <b>1116</b> Department of the Treasury Internal Revenue Service	<b>Foreign Tax Credit</b> (Individual, Estate, or Trust) ▶ Attach to Form 1040, 1040NR, 1041, or 990-T. ▶ See separate instructions.	OMB No. 1545-0121 <div style="font-size: 2em; font-weight: bold; text-align: center;">2003</div> Attachment Sequence No. <b>19</b>
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Name \_\_\_\_\_ Identifying number as shown on page 1 of your tax return \_\_\_\_\_

Use a separate Form 1116 for each category of income listed below. See **Categories of Income** on page 3 of the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.

- |   |  |   |
|---|--|---|
| <input type="checkbox"/> <b>a</b> Passive income                | <input type="checkbox"/> <b>d</b> Shipping income  | <input type="checkbox"/> <b>g</b> Lump-sum distributions              |
| <input type="checkbox"/> <b>b</b> High withholding tax interest | <input type="checkbox"/> <b>e</b> Dividends from a DISC or former DISC                                       | <input type="checkbox"/> <b>h</b> Section 901(j) income               |
| <input type="checkbox"/> <b>c</b> Financial services income     | <input type="checkbox"/> <b>f</b> Certain distributions from a foreign sales corporation (FSC) or former FSC | <input type="checkbox"/> <b>i</b> Certain income re-sourced by treaty |
|   |  | <input type="checkbox"/> <b>j</b> General limitation income           |

**k** Resident of (name of country) ▶ \_\_\_\_\_

**Note:** If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.

**Part I Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)**

	Foreign Country or U.S. Possession			Total (Add cols. A, B, and C.)
	A	B	C	
<b>1</b> Enter the name of the foreign country or U.S. possession . . . . . ▶				
<b>1</b> Gross income from sources within country shown above and of the type checked above (see page 7 of the instructions):				
				<b>1</b>
<b>Deductions and losses (Caution: See pages 9, 12, and 13 of the instructions):</b>				
<b>2</b> Expenses <b>definitely related</b> to the income on line 1 (attach statement) . . . . .				
<b>3</b> Pro rata share of other deductions <b>not definitely related:</b>				
<b>a</b> Certain itemized deductions or standard deduction (see instructions) . . . . .				
<b>b</b> Other deductions (attach statement) . . . . .				
<b>c</b> Add lines 3a and 3b . . . . .				
<b>d</b> Gross foreign source income (see instructions)				
<b>e</b> Gross income from all sources (see instructions)				
<b>f</b> Divide line 3d by line 3e (see instructions) . . . . .				
<b>g</b> Multiply line 3c by line 3f. . . . .				
<b>4</b> Pro rata share of interest expense (see instructions):				
<b>a</b> Home mortgage interest (use worksheet on page 12 of the instructions) . . . . .				
<b>b</b> Other interest expense . . . . .				
<b>5</b> Losses from foreign sources . . . . .				
<b>6</b> Add lines 2, 3g, 4a, 4b, and 5 . . . . .				<b>6</b>
<b>7</b> Subtract line 6 from line 1. Enter the result here and on line 14, page 2 . . . . . ▶				<b>7</b>

**Part II Foreign Taxes Paid or Accrued (see page 13 of the instructions)**

Country	Foreign taxes paid or accrued										
	Credit is claimed for taxes (you must check one) (m) <input type="checkbox"/> Paid (n) <input type="checkbox"/> Accrued	In foreign currency					In U.S. dollars				
		Taxes withheld at source on:			(s) Other foreign taxes paid or accrued	Taxes withheld at source on:			(w) Other foreign taxes paid or accrued	(x) Total foreign taxes paid or accrued (add cols. (t) through (w))	
(o) Date paid or accrued	(p) Dividends	(q) Rents and royalties	(r) Interest	(t) Dividends		(u) Rents and royalties	(v) Interest				
<b>A</b>											
<b>B</b>											
<b>C</b>											
	<b>8</b> Add lines A through C, column (x). Enter the total here and on line 9, page 2 . . . . . ▶										<b>8</b>



**Part III.** Now that we have completed the front page of the Form 1116, let's go to the back of the form. Part III is the actual computation of the Foreign Tax Credit. This is relatively simple if you just follow the form line by line. If you have utilized tax software and entered all the types of foreign source income and the amounts of tax paid on them to a foreign country, your form is completed at this point, except for three lines, Lines 10, 12 and 15.

**Line 10.** This line deals with carrybacks and carryovers. This occurs when a taxpayer pays more to a foreign government than he or she does to the United States on income attributable to the taxable income in the separate income category. Since the tax credit is limited to the amount of U.S., the surplus tax credit is available as a carryback or carryover. VITA volunteers will not be computing carrybacks or carryovers.

**Line 12.** A reduction to the foreign taxes paid or accrued has to be made under certain circumstances. For our purpose, we will cover the most common situation. This is the reduction for taxes allocable to income excluded under the foreign earned income exclusion. The formula for this reduction is:

$$\frac{\text{Excluded Foreign Earned Income}}{\text{Total Foreign Earned Income}} \times \text{Foreign Tax} = \text{Reduction}$$

For our purposes, if the foreign law taxes foreign earned income and some other income (for example, earned income from U.S. sources or a type of income not subject to U.S. tax), and the taxes cannot be segregated, then the denominator of this fraction is the total amount of income subject to foreign tax.

Let's look at an example.

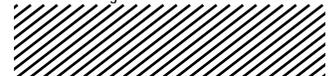
### Example 18

Marsha is a U.S. citizen who resides in Germany for all of 2003. She had wages of \$85,000, and excluded \$80,000 on her U.S. tax return. She also earned \$5,000 interest on a German bank account. She paid \$2,000 income tax to Germany on this income. She will allocate the \$2,000 income tax as follows:

Step 1 — Allocate the tax to Passive and to General Limitation Income.

$$\text{Passive Income: } \frac{\$5,000}{\$90,000} \times \$20,000 = \$1,111$$

$$\text{General Limitation Income: } \frac{\$85,000}{\$90,000} \times \$20,000 = \$18,889$$



Step 2 — Calculate the credit reduction attributable to excluded income.

$$\frac{\$80,000 \text{ (excluded income)}}{\$85,000 \text{ (total foreign income)}} \times \$18,889 = \$17,778$$

Exhibit 9

Form 1116

Form 1116 (2003)		Page <b>2</b>	
<b>Part III Figuring the Credit</b>			
<b>9</b>	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I . . . .	9	18,889
<b>10</b>	Carryback or carryover (attach detailed computation) . . . . .	10	
<b>11</b>	Add lines 9 and 10 . . . . .	11	18,889
<b>12</b>	Reduction in foreign taxes (see page 13 of the instructions) . . . .	12	17,778
<b>13</b>	Subtract line 12 from line 11. This is the total amount of foreign taxes available for credit . . . . .	13	1,111

There are other reductions which can be indicated on line 12. However, they are all beyond the scope of VECTA. These include taxes attributable to boycott operations, or certain mineral income. It is suggested that taxpayers with these types of situations may wish to seek professional assistance.

**Line 15**—These adjustments are beyond the scope of VECTA.

**More Than One Form 1116.** Part IV of the Form 1116 is used as a summary of the foreign tax credit. As you can tell from our discussion thus far, there may be occasions when you will need to complete more than one Form 1116 for the same taxpayer. If this is the case, you would complete Part IV on only one Form 1116. It does not matter which Form 1116 you choose. You would indicate in Part IV of the summary Form 1116 the amount of the credit computed on line 21 of Part III from each Form 1116. Line 30 is then a total of all Forms 1116 and, for our purposes, line 32 should be the same as line 30. Please note that again the reduction of the credit for international boycott operations (line 31) is beyond the scope of this program and will not be discussed.

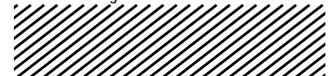


**Part III Figuring the Credit**

<b>9</b>	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I . . . . .	<b>9</b>		
<b>10</b>	Carryback or carryover (attach detailed computation) . . . . .	<b>10</b>		
<b>11</b>	Add lines 9 and 10 . . . . .	<b>11</b>		
<b>12</b>	Reduction in foreign taxes (see page 13 of the instructions) . . . . .	<b>12</b>		
<b>13</b>	Subtract line 12 from line 11. This is the total amount of foreign taxes available for credit . . . . .	<b>13</b>		
<b>14</b>	Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I (see page 14 of the instructions) . . . . .	<b>14</b>		
<b>15</b>	Adjustments to line 14 (see page 14 of the instructions) . . . . .	<b>15</b>		
<b>16</b>	Combine the amounts on lines 14 and 15. This is your net foreign source taxable income. (If the result is zero or less, you have no foreign tax credit for the category of income you checked above Part I. Skip lines 17 through 21. However, if you are filing more than one Form 1116, you must complete line 19.) . . . . .	<b>16</b>		
<b>17</b>	<b>Individuals:</b> Enter the amount from Form 1040, line 38. If you are a nonresident alien, enter the amount from Form 1040NR, line 36. <b>Estates and trusts:</b> Enter your taxable income without the deduction for your exemption . . . . .	<b>17</b>		
	<b>Caution:</b> If you figured your tax using the special rates on qualified dividends or capital gains, see page 15 of the instructions.			
<b>18</b>	Divide line 16 by line 17. If line 16 is more than line 17, enter "1" . . . . .	<b>18</b>		
<b>19</b>	<b>Individuals:</b> Enter the amount from Form 1040, line 41. If you are a nonresident alien, enter the amount from Form 1040NR, line 39. <b>Estates and trusts:</b> Enter the amount from Form 1041, Schedule G, line 1a, or the total of Form 990-T, lines 36 and 37. . . . .	<b>19</b>		
	<b>Caution:</b> If you are completing line 19 for separate category <b>g</b> (lump-sum distributions), see page 15 of the instructions.			
<b>20</b>	Multiply line 19 by line 18 (maximum amount of credit) . . . . .	<b>20</b>		
<b>21</b>	Enter the <b>smaller</b> of line 13 or line 20. If this is the only Form 1116 you are filing, skip lines 22 through 30 and enter this amount on line 31. Otherwise, complete the appropriate line in Part IV (see page 16 of the instructions) . . . . . ▶	<b>21</b>		

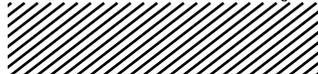
**Part IV Summary of Credits From Separate Parts III (see page 16 of the instructions)**

<b>22</b>	Credit for taxes on passive income . . . . .	<b>22</b>		
<b>23</b>	Credit for taxes on high withholding tax interest . . . . .	<b>23</b>		
<b>24</b>	Credit for taxes on financial services income . . . . .	<b>24</b>		
<b>25</b>	Credit for taxes on shipping income . . . . .	<b>25</b>		
<b>26</b>	Credit for taxes on dividends from a DISC or former DISC and certain distributions from a FSC or former FSC . . . . .	<b>26</b>		
<b>27</b>	Credit for taxes on lump-sum distributions . . . . .	<b>27</b>		
<b>28</b>	Credit for taxes on certain income re-sourced by treaty . . . . .	<b>28</b>		
<b>29</b>	Credit for taxes on general limitation income . . . . .	<b>29</b>		
<b>30</b>	Add lines 22 through 29 . . . . .	<b>30</b>		
<b>31</b>	Enter the <b>smaller</b> of line 19 or line 30 . . . . .	<b>31</b>		
<b>32</b>	Reduction of credit for international boycott operations. See instructions for line 12 on page 13 . . . . .	<b>32</b>		
<b>33</b>	Subtract line 32 from line 31. This is your <b>foreign tax credit</b> . Enter here and on Form 1040, line 44; Form 1040NR, line 42; Form 1041, Schedule G, line 2a; or Form 990-T, line 40a . . . . . ▶	<b>33</b>		



## ▶▶ SUMMING UP THIS LESSON ◀◀

- ▶ In order to qualify for a foreign tax credit, income on which the taxes are paid must be foreign source.
- ▶ The tax being paid must be similar to U.S. income tax.
- ▶ The individual paying the tax cannot derive a specific economic benefit and still claim the foreign tax credit.
- ▶ The foreign tax credit is computed on Form 1116.
- ▶ A separate Form 1116 must be completed for passive income, interest income which is subject to a gross withholding rate of at least 5%, and other income that falls under the general limitation category.
- ▶ If passive income, minus allocations, is subject to tax at a rate that is higher than 35%, then it falls into the general limitation category.
- ▶ If an individual claims the foreign earned income exclusion, the excluded amount is not shown on line 1 of Part I of the Form 1116.
- ▶ A cash basis taxpayer may choose the accrual method to claim the foreign tax credit. Once the choice has been made, the taxpayer must continue to use the accrual method.
- ▶ If the accrual method of claiming the foreign tax credit is used, use the average annual currency exchange rate to convert the foreign money into U.S. dollars.
- ▶ If all or part of the taxes claimed in Part II of Form 1116 are attributable to income excluded under the foreign earned income exclusion, then the taxes available for credit must be reduced by the taxes paid or accrued on the excluded income. The reduction is entered on Part III, line 12.
- ▶ If there is more than one Form 1116 for the same person, Part IV need only be completed on one of the forms.



1. c, e
2. a. no  
b. no  
c. yes  
d. no

Form **1116**

**Foreign Tax Credit**  
(Individual, Estate, or Trust)

OMB No. 1545-0121

**2003**

Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040, 1040NR, 1041, or 990-T.  
▶ See separate instructions.

Attachment  
Sequence No. **19**

Name **Charles Green** Identifying number as shown on page 1 of your tax return **000 - 00 - 6492**

Use a separate Form 1116 for each category of income listed below. See **Categories of Income** on page 3 of the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.

- a  Passive income
- b  High withholding tax interest
- c  Financial services income
- d  Shipping income
- e  Dividends from a DISC or former DISC
- f  Certain distributions from a foreign sales corporation (FSC) or former FSC
- g  Lump-sum distributions
- h  Section 901(j) income
- i  Certain income re-sourced by treaty
- j  General limitation income

k Resident of (name of country) ▶ **United Kingdom**

**Note:** If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.

**Part I Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)**

	Foreign Country or U.S. Possession			Total (Add cols. A, B, and C.)
	A	B	C	
<b>1</b> Enter the name of the foreign country or U.S. possession . . . . .	United Kingdom			
<b>1</b> Gross income from sources within country shown above and of the type checked above (see page 7 of the instructions):				
	2,000			1 2,000
<b>Deductions and losses (Caution: See pages 9, 12, and 13 of the instructions):</b>				
<b>2</b> Expenses definitely related to the income on line 1 (attach statement) . . . . .				
<b>3</b> Pro rata share of other deductions not definitely related:				
a Certain itemized deductions or standard deduction (see instructions) . . . . .	4,750			
b Other deductions (attach statement) . . . . .	4,750			
c Add lines 3a and 3b . . . . .	2,000			
d Gross foreign source income (see instructions)	100,000			
e Gross income from all sources (see instructions)	.0200			
f Divide line 3d by line 3e (see instructions) . . . . .	95			
g Multiply line 3c by line 3f . . . . .				
<b>4</b> Pro rata share of interest expense (see instructions):				
a Home mortgage interest (use worksheet on page 12 of the instructions) . . . . .				
b Other interest expense . . . . .				
<b>5</b> Losses from foreign sources . . . . .				
<b>6</b> Add lines 2, 3g, 4a, 4b, and 5 . . . . .	95			6 95
<b>7</b> Subtract line 6 from line 1. Enter the result here and on line 14, page 2 . . . . . ▶				7 1,905

**Part II Foreign Taxes Paid or Accrued (see page 13 of the instructions)**

Country	Credit is claimed for taxes (you must check one) (m) <input checked="" type="checkbox"/> Paid (n) <input type="checkbox"/> Accrued	Foreign taxes paid or accrued						(w) Other foreign taxes paid or accrued	(x) Total foreign taxes paid or accrued (add cols. (t) through (w))
		In foreign currency			In U.S. dollars				
		(o) Date paid or accrued	(p) Dividends	(q) Rents and royalties	(r) Interest	(s) Other foreign taxes paid or accrued	(t) Dividends		
A	12/31/03			330			550		550
B									
C									

**8** Add lines A through C, column (x). Enter the total here and on line 9, page 2 . . . . . ▶ **8 550**

For Paperwork Reduction Act Notice, see page 16 of the instructions.

Cat. No. 11440U

Form **1116** (2003)

#### LESSON OVERVIEW AND OBJECTIVES

This lesson explains how to figure total federal income tax withheld. The lesson also covers how to figure and report estimated tax. In addition, the material covers how to determine the overpayment or the amount owed.

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 due.
- Determine if estimated taxes should be paid.
- Determine if changes to the taxpayer's W-4 or W-4P should be suggested.

#### MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like the most current revision of the publications or forms, you can download the files from [www.irs.gov](http://www.irs.gov).

- Form W-2, Wage and Tax Statement
- Form W-4, Employee Withholding Allowance Certificate
- Form W-4P, Withholding Certificate for Pension or Annuity Payments
- Form 1040A, US Individual Tax Return
- Form 1040, US Individual Tax Return
- Form 1040ES, Estimated Taxes for Individuals
- Form 1040V, Payment Voucher
- Form 1099DIV, Dividends and Distributions
- Form 1099INT, Interest Income
- Form 1099R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA, Insurance Contracts

#### GUIDED QUESTIONS — TAXES PAID

1. **In what two ways is most federal income tax paid?** (It is either withheld from wages and other types of payments, or it is paid through estimated tax payments.)
2. **In how many installments can estimated tax payments be paid?** (Taxpayers can pay their estimated tax in one payment or they can make up to four quarterly payments. However, additional estimated tax payments may be paid; if necessary).

- 3. Does an amount due and paid with the tax return qualify as an estimated tax payment?** (No; do not include as an estimated tax payment the amount due with the tax return.)

### ***TEACHING TIPS***

Review with students the two most common ways that federal income tax is paid: it is either withheld from wages and other types of payments, or it is paid through estimated tax payments. Remind students that estimated tax payments include part or all of the overpayment from the prior year's return that was applied to 2003 estimated tax and estimated tax payments made after January 15, 2003 and through January 15, 2004. To complete line 62 of Form 1040 or line 39 of Form 1040A, volunteers must know the total federal income tax withheld from Forms W-2, 1099-R, 1099-INT, and 1099-DIV for example. To complete line 63 or line 40, volunteers must know the amounts and payment dates of estimated tax payments, including any refund applied from the taxpayer's 2002 return to his or her 2003 tax.

### ***GUIDED QUESTIONS — ESTIMATED TAXES***

- 1. Under what circumstances do taxpayers make estimated tax payments?** (When income is not subject to withholding or when the tax withheld is expected to be inadequate.)
- 2. Explain the procedure for determining the amount of the total estimated tax payment.** (Figure the expected tax for the coming year and subtract expected credits, deductions, and tax withheld.)

### ***GUIDED QUESTIONS — OVERPAYMENT/ESTIMATED TAXES APPLIED TO NEXT YEAR AND PENALTY***

- 1. Under what circumstances will an amount be entered on line 45a and/or on line 46 of Form 1040A, or line 70a and/or 71 of Form 1040?** (Only if there is an entry on line 44 of Form 1040A or line 69 of Form 1040, the amount of tax that the taxpayer overpaid, can there be an entry on line 45a or line 70a, the amount of line 44 or line 69 that the taxpayer wants to be refunded. There can be an entry on line 46 or line 71, the amount of line 44 or line 69 that the taxpayer wants to be applied to his or her 2004 estimated tax, only if a refund is due.)
- 2. Under what circumstances will an amount be entered on line 48 of Form 1040A or line 73 of Form 1040, estimated tax penalty?** (If line 47 or line 72 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 2003 estimated tax liability, the taxpayer may owe a penalty for underpayment of estimated



tax. If no exceptions apply and a penalty is owed, it should be entered on line 48 or line 73 and included in the amount shown on line 47 or line 72.)

## LESSON REVIEW

1. Students may inquire about the circumstances under which federal income tax is usually withheld from dividend and interest payments. Tell them that tax is usually withheld if the taxpayer does not provide his or her social security number to the payer.
2. If a taxpayer has not rounded the amounts reported on a tax form, it is possible that the amounts overpaid or owed could be less than \$1. Students may wonder if a taxpayer must send a check or money order to the IRS for that amount. The answer is no. Conversely, a taxpayer who has overpaid by less than \$1 will not receive a refund unless the taxpayer sends a written request asking for the refund.

## TEACHING TIPS — ESTIMATED TAXES

1. Many taxpayers who pay estimated tax are self-employed, either on a full-time or a part-time basis. Volunteers should remember that self-employment situations, other than those reported on Schedule C-EZ, are beyond the scope of the VITA/TCE Program and that these taxpayers should be referred to paid professional tax preparers.
2. Explain to volunteers that nonresident aliens are also required to make estimated tax payments. Nonresident aliens who must make estimated tax payments should file Form 1040-ES(NR), *U.S. Estimated Tax for Nonresident Alien Individuals*. These filers should be referred to paid professional tax preparers.
3. To help students figure the estimated tax payment due per quarter, copy the following equation onto a chalkboard or flip-chart:

### PAYMENT CALCULATION

$$\frac{\text{Total Estimated Tax}}{4} = \text{Amount of each equal quarterly payment due}$$

THEN:

Multiply the quarterly payment by the number of quarters due and past due at time of first payment.

4. Students should be aware that a recently retired taxpayer may owe estimated tax for the first time. Retirees may owe tax on pension, interest, or annuity income. Advise volunteers to be careful when determining whether there will be any tax withheld from the taxpayer's payments and to figure the estimated tax accordingly.

## GROUP ACTIVITY — ESTIMATED TAX PAYMENT VOUCHER

(7–10 min.)

In order to have students practice filling out payment vouchers for quarterly estimated tax, get Form 1040-ES packages from the Tax Forms Booklet Appendix. Divide the class into pairs of students. Have one student in each pair play the role of the volunteer and the other student play the role of the taxpayer. Have each “volunteer” complete the four payment vouchers for the year for the “taxpayer” using fictitious information. Remind volunteers to instruct taxpayers about other necessary information required to file quarterly estimated tax. Have students change roles so that each person plays the role of the volunteer. You may wish to bring the class back together to discuss any problems students discovered while completing the vouchers.

## LESSON REVIEW — WITHHOLDING

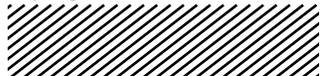
1. Students may wonder what advice to give to taxpayers who had too much tax withheld because they did not claim all the allowances to which they were entitled.

A taxpayer in this situation should submit a new Form W-4 to his or her employer. The employer, however, cannot reimburse the taxpayer for any of the tax withheld under the old Form W-4.

2. Some taxpayers may try to claim more withholding allowances than they are entitled to in order to increase their take-home pay. Explain to students that, as volunteers, they should inform taxpayers that there are penalties for *willfully* supplying false or fraudulent information on Form W-4 or for *willfully* failing to supply information that would increase the amount withheld.

## LESSON REVIEW — NAME CHANGE/ESTIMATED TAX PAYMENT

1. Students may ask how to clear up confusion caused by a taxpayer changing his or her name after making estimated tax payments using another name. A taxpayer in this situation should attach a brief statement to the front of the tax return indicating the following: when payments were made, the amount of each payment, the address(es) to which each payment was sent, the name under which each payment was made, and the taxpayer’s social security number.
2. To review students’ understanding of estimated tax payment and underpayment of estimated tax, tax withheld, and refund or amount owed, divide the class into groups of four or five. Have each group write five questions that review the material covered in this lesson. Allow five to seven minutes for this part of the activity.



When all groups have finished writing their questions, have students from each group read their questions to the class and have the other groups answer the questions. Continue the activity until all groups have asked their questions.

You may wish to take some time to review any points that students found difficult.

### **TEACHING TIPS**

1. Remind students that the *Quality Review Checklist* should be used to verify the completeness and accuracy of every tax return.
2. Volunteers should inform taxpayers who have a substantial overpayment (line 44 of Form 1040A or line 69 of Form 1040) that they might wish to file a new Form W-4, *Employee's Withholding Allowance Certificate*, to reduce the amount of income tax withheld from their pay. Conversely, volunteers should inform taxpayers who owe a substantial amount of tax (line 47 of Form 1040A or line 72 of Form 1040) that they might wish to file a new Form W-4 to increase the amount of tax withheld from their pay.
3. If the taxpayer filed a joint return in 2002 and is filing a joint return for 2003 with the same spouse, the taxpayer should enter his or her name and SSN and that of his or her spouse in the same order as on the 2002 return.
4. Remind students to make certain that taxpayers understand that their decision to contribute \$3 to the Presidential Election Campaign Fund will not increase or decrease the amount owed to the IRS or decrease the amount that they will receive as a refund.

### **LESSON REVIEW — QUALITY REVIEW**

Students sometimes wonder what specific kinds of information the IRS quality review program has yielded.

You may wish to share these statistics with the class. Of all the mistakes made on Form 1040EZ, the most common were math errors—committed, collectively, by the taxpayers, their paid preparers, and VITA volunteers.

### **GUIDED QUESTIONS — FINISHING THE RETURN**

1. **When should the taxpayer identification section be completed?** (After the rest of the return has been completed.)
2. **If there are errors on the taxpayer's pre-addressed label, should the label be discarded?** (No; mark through any errors and print the correct information on the label.)

3. **Is it important to have the taxpayer sign the return?**  
(Yes; an unsigned return is not considered valid and cannot be processed.)
4. **If an amount is owed, how should you end the interview?**  
(Remind the taxpayer not to attach payments to the return. The check or money order should be made payable to the United States Treasury and placed loose in the envelope. The taxpayer can also pay by credit card or by authorizing a direct debit from his or her checking or savings account on the date he/she chooses—by April 15, 2004. If the taxpayer is a Form 1040 filer, he or she should voluntarily send Form 1040-V, *Payment Voucher*, with the payment. Form 1040-V should also be placed loose in the envelope. This will allow the IRS to process the payment more accurately and efficiently. The instructions for completing the voucher appear on the Form 1040-V. The check or money order should include the taxpayer's name, address, social security number, daytime telephone number, and the notation "2003 Form 1040 (or 1040A or 1040EZ, whichever applies)." Tell the taxpayer to mail the return by April 15. If the taxpayer cannot pay the full amount owed on his/her return, he/she may ask permission to make monthly installment payments. The taxpayer should file Form 9465, *Installment Agreement Request*, and pay a nonrefundable processing fee. File Form 9465 with the tax return.)
5. **How does a taxpayer request direct deposit?** (To choose direct deposit, the taxpayer should fill in lines 11b, c, and d of Form 1040EZ, or lines 45b, c, and d of Form 1040A, or lines 70b, c, and d of Form 1040.)

### **LESSON REVIEW — REFUND/BALANCE DUE**

1. **Federal income tax is withheld only from payments that are earned income.** (Disagree; federal income tax can also be withheld from other kinds of payments, including distributions from pensions, annuities, IRAs, interest income, and dividends.)
2. **Taxpayers who have overpaid their tax must receive a complete refund.** (Disagree; taxpayers can opt to apply all or part of the overpayment to next year's estimated tax.)
3. **The method of payment that a taxpayer should follow in paying tax is the same whether the taxpayer uses Form 1040 or Form 1040A except the words "2003 Form 1040" should be written on the payment for filers of Form 1040; whereas the words "2003 Form 1040A" should be written on the payment for filers of Form 1040A.** (Agree)



- 4. If a taxpayer owes a penalty for underpayment of tax, he or she can enter the amount of the penalty on Form 1040, line 73 or leave line 73 blank so that the IRS figures the amount of the penalty, as with Form 1040A, line 48. (Agree)**

***GUIDED QUESTION – FINISHING AND FILING THE RETURN –  
MILITARY SEGMENT***

- 1. If a service member is in a combat zone what is their filing date?**

A service member in a combat zone return is due 180 days from the last day the service member was in the combat zone, or the last day the person's hospitalization due to combat ends PLUS the number of days the individual had left to take any action with the IRS when they entered the combat zone.

**STUDENT NOTES**

Lined writing area for student notes.



# FINISHING THE RETURN

## Lesson 6

### 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.

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.

**Please pay close attention to the section about identifying the returns that you work on. It is critical for you to enter the correct site identification number in the preparer's signature section of the return. The number goes in the designated area on the forms with the pre-printed "P" followed by 8 digits or in the PTIN/SSN field of the return.**

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

#### Withholdings, Payments and Other Credits:

- Add all Federal Income Tax Withholding from Form W-2, box 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 taxpayers 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.

### **Paying Taxes or Adjusting Withholding Taxes if Balance Due:**

- 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 2004.
- Assist the taxpayer with completing form 1040ES for 2004. 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.

### **Advance Earned Income Tax Credit (AEIC):**

- Inform taxpayers about the Advance Earned Income Credit, 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.

## **Name, Address, and Taxpayer Identification Section of Return:**

- 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.

## **Return Assembly and Copy:**

- 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).

## **Site Identification Number on Forms 1040, 1040A, & 1040EZ**

Congress annually asks the IRS to provide the number of returns that were filed by volunteer tax assistance sites. For statistical purposes, the IRS requests that all Federal returns be identified with a Site Identification Number. The Site Identification Number is entered in the Paid Preparer's section of the tax return. The Internal Revenue Service Submission Processing Center will count each return processed using this data.

More about this topic is covered later in this lesson.

### **On Site Quality Review:**

- 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.

### **Signing the Return and Third Party Designation:**

- 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.**)

### **Taxpayer Question:**

- Ask the taxpayer if they have any additional questions.

### **Where to Mail Paper Returns:**

- Tell the taxpayer where to mail the return (if filing by paper). Electronically filed returns are automatically transmitted to the correct IRS Processing Center. Paper tax returns must be mailed in by the taxpayer to the IRS processing Center for the area (state) where the taxpayer resides. Each tax package contains a pre-addressed envelope for a particular area based on the last address filed with the IRS. If the taxpayer has moved or does not have a pre-addressed envelope the address and other mailing information is located in the individual federal tax package and in your Quick Reference Guide, Publication 1977. On-site. Some sites provide unstamped pre-addressed envelope 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.)

## **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 Tier 2
- Form 1099B, Proceeds from Broker and Barter Exchange Transactions

## Example 1

Kamica 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

### Kamica's Form W-2

a Control number		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
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				9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Last name Kamica 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  
 Copy B To Be Filed with Employee's FEDERAL Tax Return.  
 This information is being furnished to the Internal Revenue Service.

**2003**  
(Rev. February 2003)

Department of the Treasury—Internal Revenue Service

## Example 2

Lucas 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

Lucas's Form 1099-INT

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0112		<b>2003</b> <b>Interest Income</b>
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)		
PAYER'S Federal identification number <b>10-4213597</b>	RECIPIENT'S identification number <b>000-00-4213</b>	<b>1</b> Interest income not included in box 3 <b>\$ 935.00</b>		<b>Copy B</b> <b>For Recipient</b> <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 income is taxable and the IRS determines that it has not been reported.</small>
RECIPIENT'S name  Lucas B. George  Street address (including apt. no.) 1360 Shannon Avenue City, state, and ZIP code Denver, CO 86011		<b>2</b> Early withdrawal penalty  \$	<b>3</b> Interest on U.S. Savings Bonds and Treas. obligations  \$	
		<b>4</b> Federal income tax withheld <b>\$ 187.00</b>	<b>5</b> Investment expenses  \$	
Account number (optional)		<b>6</b> Foreign tax paid  \$	<b>7</b> Foreign country or U.S. possession	
Form <b>1099-INT</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service

Exhibit 3

Lucas's Form 1099-R

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0119		<b>2003</b> <b>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</b>
PAYER'S name, street address, city, state, and ZIP code  APEX Triangles 213 Hickory Meadows Denver, CO 86011		<b>1</b> Gross distribution <b>\$ 12,000.00</b>		
PAYER'S Federal identification number <b>10-9753124</b>		<b>2a</b> Taxable amount  \$		<b>Copy B</b> <b>Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.</b>  <small>This information is being furnished to the Internal Revenue Service.</small>
		<b>2b</b> Taxable amount not determined <input type="checkbox"/> Total distribution <input type="checkbox"/>		
RECIPIENT'S identification number <b>000-00-4213</b>	<b>3</b> Capital gain (included in box 2a)  \$	<b>4</b> Federal income tax withheld <b>\$ 960.00</b>		
RECIPIENT'S name  Lucas B. George  Street address (including apt. no.) 1360 Shannon Ave.  City, state, and ZIP code Denver, CO 86011		<b>5</b> Employee contributions or insurance premiums  \$	<b>6</b> Net unrealized appreciation in employer's securities  \$	
Account number (optional)		<b>7</b> Distribution code	IRA/SEP/SIMPLE <input type="checkbox"/>	<b>8</b> Other  \$ %
		<b>9a</b> Your percentage of total distribution %	<b>9b</b> Total employee contributions  \$	
		<b>10</b> State tax withheld \$	<b>11</b> State/Payer's state no.	<b>12</b> State distribution \$
		<b>13</b> Local tax withheld \$	<b>14</b> Name of locality	<b>15</b> Local distribution \$
Form <b>1099-R</b>		Department of the Treasury - Internal Revenue Service		

<input type="checkbox"/> CORRECTED (if checked)			OMB No. 1545-0110		<b>2003</b>	<b>Dividends and Distributions</b>	
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	Form <b>1099-DIV</b>			
		2a Total capital gain distr.	\$				
		2b 28% rate gain	\$				
PAYER'S Federal identification number 10-2846731	RECIPIENT'S identification number 000-00-4213	2c Qualified 5-year gain	\$	2d Unrecap. sec. 1250 gain	<b>Copy B For Recipient</b>  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 Lucas B. George Street address (including apt. no.) 1360 Shannon Avenue City, state, and ZIP code Denver, CO 86011 Account number (optional)		2e Section 1202 gain	\$	3 Nontaxable distributions			\$
		4 Federal income tax withheld	\$ 100.00	5 Investment expenses			\$
		6 Foreign tax paid	\$	7 Foreign country or U.S. possession			
		8 Cash liquidation distr.	\$	9 Noncash liquidation distr.			

Form **1099-DIV** (keep for your records) Department of the Treasury - Internal Revenue Service

### 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.

**ALERT**



You must reduce the 2003 child tax credit by any advance payment that the taxpayer received in 2003.

**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 tax due. His total tax is \$3,491. His total payments are \$5,000. Ron overpaid and wants \$900 to be applied to his 2004 estimated tax. Note that line 45a plus line 46 equals the amount on line 44.

**Exhibit 5**

**Form 1040A, page 2**

<b>28</b>	<b>Tax</b> , including any alternative minimum tax (see page 35).	28	3,491.00
<b>29</b>	Credit for child and dependent care expenses. Attach Schedule 2.	29	
<b>30</b>	Credit for the elderly or the disabled. Attach Schedule 3.	30	
<b>31</b>	Education credits. Attach Form 8863.	31	
<b>32</b>	Retirement savings contributions credit. Attach Form 8880.	32	
<b>33</b>	Child tax credit (see page 38).	33	
<b>34</b>	Adoption credit. Attach Form 8839.	34	
<b>35</b>	Add lines 29 through 34. These are your <b>total credits</b> .	35	0.00
<b>36</b>	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36	3,491.00
<b>37</b>	Advance earned income credit payments from Form(s) W-2.	37	
<b>38</b>	Add lines 36 and 37. This is your <b>total tax</b> .	▶ 38	3,491.00
<b>39</b>	Federal income tax withheld from Forms W-2 and 1099.	39	2,600.00
<b>40</b>	2003 estimated tax payments and amount applied from 2002 return.	40	2,400.00
<b>41</b>	<b>Earned income credit (EIC)</b> .	41	
<b>42</b>	Additional child tax credit. Attach Form 8812.	42	
<b>43</b>	Add lines 39 through 42. These are your <b>total payments</b> .	▶ 43	5,000.00
<b>44</b>	If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> .	44	1,509.00
<b>45a</b>	Amount of line 44 you want <b>refunded to you</b> .	▶ 45a	609.00
<b>▶ b</b>	Routing number <input type="text"/>	<b>▶ c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
<b>▶ d</b>	Account number <input type="text"/>		
<b>46</b>	Amount of line 44 you want <b>applied to your 2004 estimated tax</b> .	46	900.00
<b>47</b>	<b>Amount you owe</b> . Subtract line 43 from line 38. For details on how to pay, see page 53.	▶ 47	0.00
<b>48</b>	Estimated tax penalty (see page 53).	48	

## Refunds

If the taxpayer wants an 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:

- Payor:** LERON BROWN, RENA BROWN, 123 Main Street, Anyplace, CA 10000
- Payee:** PAY TO THE ORDER OF
- Bank:** ANYPLACE BANK, Anyplace, NY 10000
- Amount:** 20 DOLLARS
- Routing number (line 70b):** 250250025
- Account number (line 70d):** 202020 86 1234
- Check number:** 1234
- Microprint:** 15-00000000

Annotations on the diagram:

- A circle around the routing number is labeled "Routing number (line 70b)".
- A circle around the account number is labeled "Account number (line 70d)".
- An oval around the check number is labeled "Do not include the check number".
- A diagonal watermark "SAMPLE" is visible across the center of the check.

## 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, 2004). 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 "2003 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<sup>XX</sup>/<sub>100</sub>”).

## 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, 2004.

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 2003 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, 2004, the IRS will not charge interest on the penalty if the bill is paid by the date specified on the bill.

## 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 2004 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.

### 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 2004 after subtracting federal income tax withheld and credits from taxable income,

**AND**

2. He or she expects the 2004 tax withheld and credits to be less than the smaller of:
  - a) 90 percent of the tax to be shown on his or her 2004 tax return, or
  - b) 100 percent of the tax shown on his or her 2003 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.

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

Jayne is single and retired. She works part time as an usher in a movie theater. She estimates her 2004 income will be \$16,421, which includes \$3,500 of interest income from which there will be no tax withheld. Jayne calculates that she expects to owe \$1,008 (after taking into account her expected tax withheld and credits). Jayne meets condition 1 (mentioned earlier) and may have to pay estimated tax. Further checking tells Jayne that her expected 2004 tax withheld will be less than 100 percent of the tax shown on her 2003 return and less than 90 percent of the tax she will show on her 2004 tax return. Since Jayne 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 2003 tax to figure their 2004 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 2004. All available facts that will affect those items during the year must be taken into account. Use the 2003 tax return as a starting point for estimating 2004 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 2004 Tax Rate Schedules and the 2004 standard deduction and exemption amounts. Be sure to use the 2004 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, 2004	4
April – May 31	June 16, 2004	3
June 1 – August 31	September 15, 2004	2
September 1 – December 31	January 17, 2005	1

### 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-ES instructions for the place where he or she lives. *Do not* use the address shown in the Form 1040 or Form 1040A instructions.

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, 2004. 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 2003 Form 1040 or Form 1040A to the estimated tax for 2004. 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 2004 Form 1040 or Form 1040A by January 31, 2005, 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 18, 2005.

## 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 2003 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 2004 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 2004 is at least one-fourth of the tax shown on the 2003 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 Form 1040-ES instructions.

If the taxpayer paid estimated tax in 2003, he or she should have received a Form 1040-ES package containing preprinted vouchers. These vouchers show the taxpayer's preprinted 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 "2004 Form 1040-ES" on the check or money order (payable to the "United States Treasury") when paying estimated tax.

## **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.

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

The worksheets incorporate the number of allowances, adjustments, deductions, and credits that the employee expects on his or her 2004 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 (from all sources and for both spouses if filing a joint return), 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. **Reminder:** A separate Form W-4 is needed for each job.

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 as 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 pay-

ments 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 2003 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 preaddressed 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 2002 and is filing a joint return for 2003 with the same spouse, *be sure* the taxpayer's and spouse's names and SSNs are entered in the same order as on the 2002 tax return.

## 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

- If taxpayers ask about the site identification number designation at the bottom of the return in the paid preparer's section, explain that this is entered for statistical purposes. Inform the taxpayers that the site identification number 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 site identification number at the bottom of the return in the Paid Preparer Section in the PTIN/SSN field.
- Most sites will have forms preprinted with the site identification number format entered in the Paid Preparer Section of the return. You must enter the number that has been assigned by the Territory Office for that site.
- If you do not have forms with the pre-printed site identification number format, print the appropriate site identification number for that site in the Paid Preparer Section of the return.

## **SITE IDENTIFICATION NUMBER**

The Internal Revenue Service (IRS) will capture statistical 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.

The following procedures must be used when returns are prepared in a VITA or TCE site.

- The site identification number should be entered in the Preparer Section of the return. (See Exhibit 7).
- The following procedures must be followed when returns are prepared in a VITA or TCE site.

### 1. Paper Returns

- All sites will enter the letter P followed by an 8 digit site identification number that is provided by the territory office. Sites should use the overprint form with the bold P format indicated in the Paid Preparer Section. Each of the numbers represent a certain area determined by the territory office. For instance, the fifth digit of the number will be 1 for VITA, 2 for Military VITA, 3 for Co-located site, 4 for TCE and 5 for AARP.
- If you use a return without the bold P format for the number enter the assigned number in the space provided in the Paid Preparer section of the return. Forms 1040EZ, 1040A, and 1040 with the bold “P” format is available from IRS and will be ordered by each site coordinator.

### 2. Electronically Filed Returns

- E-file administrators will set up computers to default to the proper location on the return where the number will already be entered. Ensure the default number has been entered for the site you are working.

Exhibit 7 illustrates a site identification number entered on three tax forms.

<b>Refund</b>	11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your <b>refund</b> . <span style="float:right">▶ 11a</span>		
Have it directly deposited! See page 21 and fill in 11b, 11c, and 11d.	▶ <b>b</b> Routing number	<input style="width:100px; height:20px; border: 1px solid black;" type="text"/>	▶ <b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
	▶ <b>d</b> Account number	<input style="width:150px; height:20px; border: 1px solid black;" type="text"/>	
<b>Amount you owe</b>	12 If line 10 is larger than line 9, subtract line 9 from line 10. This is the <b>amount you owe</b> . For details on how to pay, see page 22. <span style="float:right">▶ 12</span>		
<b>Third party designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 22)? <input type="checkbox"/> <b>Yes</b> . Complete the following. <input type="checkbox"/> <b>No</b>		
	Designee's name ▶	Phone no. ▶ ( )	Personal identification number (PIN) ▶ <input style="width:40px; height:20px; border: 1px solid black;" type="text"/>
<b>Sign here</b>	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.		
Joint return? See page 13. Keep a copy for your records.	Your signature	Date	Your occupation
	Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation
			Daytime phone number ( )
<b>Paid preparer's use only</b>	Preparer's signature ▶	Date	Site Identification Number ▶
	Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Preparer's SSN or PTIN <b>P10-05-1234</b>
		Phone no. ( )	
<b>For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 24.</b>		Cat. No. 11329W	Form <b>1040EZ</b> (2003)

<b>Refund</b>	44 If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> . <span style="float:right">44</span>		
Direct deposit? See page 52 and fill in 45b, 45c, and 45d.	45a Amount of line 44 you want <b>refunded to you</b> . <span style="float:right">▶ 45a</span>		
	▶ <b>b</b> Routing number	<input style="width:100px; height:20px; border: 1px solid black;" type="text"/>	▶ <b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
	▶ <b>d</b> Account number	<input style="width:150px; height:20px; border: 1px solid black;" type="text"/>	
	46 Amount of line 44 you want <b>applied to your 2004 estimated tax</b> . <span style="float:right">46</span>		
<b>Amount you owe</b>	47 <b>Amount you owe</b> . Subtract line 43 from line 38. For details on how to pay, see page 53. <span style="float:right">▶ 47</span>		
	48 Estimated tax penalty (see page 53). <span style="float:right">48</span>		
<b>Third party designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 54)? <input type="checkbox"/> <b>Yes</b> . Complete the following. <input type="checkbox"/> <b>No</b>		
	Designee's name ▶	Phone no. ▶ ( )	Personal identification number (PIN) ▶ <input style="width:40px; height:20px; border: 1px solid black;" type="text"/>
<b>Sign here</b>	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 22. Keep a copy for your records.	Your signature	Date	Your occupation
	Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation
			Daytime phone number ( )
<b>Paid preparer's use only</b>	Preparer's signature ▶	Date	Site Identification Number ▶
	Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Preparer's SSN or PTIN <b>P10-05-1234</b>
		Phone no. ( )	
<b>Printed on recycled paper</b>		Form <b>1040A</b> (2003)	

<b>Refund</b>	<b>69</b>	If line 68 is more than line 60, subtract line 60 from line 68. This is the amount you <b>overpaid</b>	<b>69</b>	
	<b>70a</b>	Amount of line 69 you want <b>refunded to you</b>	<b>70a</b>	
Direct deposit?	<b>b</b>	Routing number	<b>c</b>	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
See page 56 and fill in 70b, 70c, and 70d.	<b>d</b>	Account number		
	<b>71</b>	Amount of line 69 you want <b>applied to your 2004 estimated tax</b>	<b>71</b>	
<b>Amount You Owe</b>	<b>72</b>	<b>Amount you owe.</b> Subtract line 68 from line 60. For details on how to pay, see page 57	<b>72</b>	
	<b>73</b>	Estimated tax penalty (see page 57)	<b>73</b>	
<b>Third Party Designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 58)? <input type="checkbox"/> <b>Yes.</b> Complete the following. <input type="checkbox"/> <b>No</b>			
	Designee's name	Phone no.	Personal identification number (PIN)	
<b>Sign Here</b>	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 21. Keep a copy for your records.	Your signature	Date	Your occupation	Daytime phone number
	Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation	
<b>Paid Preparer's Use Only</b>	Preparer's signature	Date	Site Identification Number	Preparer's SSN or PTIN
	Firm's name (or yours if self-employed), address, and ZIP code	EIN		<b>P10-05-1234</b>
		Phone no.	( )	

Form 1040 (2003)

**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.

## Quality Review Checklist

### Entity

- 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?

### Income

- 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?

### Tax and Credits

- 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?

### Payments

- 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?

**Quality Review Checklist  
(continued)**

**Other**

- 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 site identification number 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 2003, 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 2003 and the taxpayer did not remarry in 2003, the taxpayer can file a joint return. (The taxpayer can also file a joint return if his or her spouse dies in 2004 before filing a 2003 return.) A joint return should show the taxpayer's spouse's 2003 income before death and the taxpayer's income for all of 2003. 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 2003 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 2004 tax return. This is April 15, 2005, for most people.

**As a volunteer preparer you may 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 tax return and records 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 (SPEC) 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 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 this 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 Form 1040A? \_\_\_\_\_  
\_\_\_\_\_
- 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? \_\_\_\_\_  
\_\_\_\_\_

### **Exercise 2**

Look at the completed Form 1040EZ shown in Exhibit 8 and identify at least 3 areas that have not been properly completed.

Form  
**1040EZ**

**Income Tax Return for Single and Joint Filers With No Dependents 2003**

OMB No. 1545-0675

**Label**  
(See page 14.)  
**Use the IRS label.**  
Otherwise, please print or type.

Your first name and initial <b>Jorge</b>	Last name <b>Mendez</b>	Your social security number <b>123 45 6789</b>
If a joint return, spouse's first name and initial <b>Lucinda</b>	Last name <b>Mendez</b>	
Home address (number and street), if you have a P.O. box, see page 14. <b>1040 Main Street</b>		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 14. <b>Anywhere USA 99999</b>		

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

**Presidential Election Campaign** (page 14)

**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.

1 Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	14,900	00
2 Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.	2	2	00
3 Unemployment compensation and Alaska Permanent Fund dividends (see page 16).	3		
4 Add lines 1, 2, and 3. This is your <b>adjusted gross income</b> .	4		
5 Can your parents (or someone else) claim you on their return? <b>Yes.</b> Enter amount from <input type="checkbox"/> worksheet on back. <b>No.</b> If <b>single</b> , enter \$7,800. If <b>married filing jointly</b> , enter \$15,600. 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 <b>taxable income</b> .	6	14,900	00

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

**Payments and tax**

7 Federal income tax withheld from box 2 of your Form(s) W-2.	7	1,700	00
8 <b>Earned income credit (EIC).</b>	8		
9 Add lines 7 and 8. These are your <b>total payments</b> .	9	1,700	00
10 <b>Tax.</b> Use the amount on <b>line 6 above</b> to find your tax in the tax table on pages 25–29 of the booklet. Then, enter the tax from the table on this line.	10	1,490	00

**Refund**

Have it directly deposited! See page 21 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 <b>refund</b> .	11a	2	00
▶ 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 <b>amount you owe</b> . For details on how to pay, see page 22.	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) ▶ <input type="text"/>
-------------------	-----------------	---

**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.

Joint return? See page 13. Keep a copy for your records.

Your signature <b>Lucinda Mendez</b>	Date <b>1/23/04</b>	Your occupation	Daytime phone number ( )
Spouse's signature. If a joint return, <b>both</b> 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. ( )	

## ▶▶ 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 2004 tax withheld and credits to be less than the smaller of: 90 percent of the tax to be shown on his or her 2004 tax return or, generally, 100 percent of the tax shown on his or her 2003 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

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

**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 site identification number in the paid preparer's section.
- ▶ Assemble the return correctly, attaching any Forms W-2 and 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
- The Site Identification Number is missing in the preparer's SSN/PTIN section of the form.
- Line 4 is blank
- Line 5 is blank
- Line 6 is incorrect
- Line 11a is incorrect
- Occupations are missing
- Spouse's signature is missing

**STUDENT NOTES**

# FINISHING AND FILING THE RETURN

Lesson 6  
Military Segment

## INTRODUCTION AND OBJECTIVES

General rules for filing returns may be found in the Basic segment of this lesson. This segment addresses special concerns of members of the Armed Forces and includes information for combat zone participants.

At the end of this lesson you should be able to:

- Determine where and when to file a federal tax return.
- Identify situations in which extensions of time to file are granted and determine the length of these extensions.
- Identify the deadline extension for combat zone participants.

## TAXPAYER IDENTIFICATION

A member of the Armed Forces should include his or her name, social security number, and permanent home address on his or her return. A member who is due a refund and does not want it mailed to his or her permanent home address should enter a current address on the return. If the postal service does not deliver to the member's street address and the member had a post office box, he or she should enter the post office box number on the line for the present home address. A military person living overseas should use an APO or FPO address.

## CHANGE OF ADDRESS

If a taxpayer changes his or her mailing address during the year, the taxpayer should notify the Internal Revenue Service of the change on Form 8822, *Change of Address*. However, if the taxpayer moves after filing a tax return, he or she should fill out and mail Form 8822 to the Internal Revenue Service Center where his or her returns were previously filed. Addresses for the service centers are listed on the back of the form.

## WHERE TO FILE

Taxpayers should send their federal returns to the campus for the place where they reside. For example, Sgt. Keene, who is stationed in Maine but whose permanent home address is in California, should send her federal return to the campus in Maine. The tax form instructions give the addresses for the campuses, including the Philadelphia Campus for APO and FPO addresses.

## WHEN TO FILE

Most individual tax returns cover a calendar year, January through December. Taxpayers who live in the United States or Puerto Rico and who use the calendar-year period should file their individual tax returns by April 15 of the following year. If April 15 falls on a Saturday, Sunday, or legal holiday, the due date is the next business day. (For 2003 tax returns, the due date is April 15, 2004.)

If a taxpayer has a balance due, they can pay by check, money order, direct debit (automatic withdrawal) or credit card. See Form 1040, 1040A, or 1040EZ instructions for complete details.

Taxpayers who cannot pay the tax due with their tax return should attach Form 9465, *Installment Agreement Request*. The Internal Revenue Service will try to arrange an installment payment agreement that reflects the taxpayer's ability to pay the tax owed. However, taxpayers should pay as much as possible with their return to reduce the amount of interest and penalties that will be charged on the unpaid balance.

## EXTENSIONS

Taxpayers can receive extensions of time to file their returns. Different rules apply to taxpayers who live in the United States and those who live outside the United States. Deadline extensions are also available to members of the Armed Forces who served in a combat zone.

IRS will charge interest on taxes not paid by the due date, even if an extension of time to file is granted, unless the combat zone extension is applicable.

### Within the United States

A taxpayer living in the United States can receive an automatic 4-month extension of time to file his or her federal tax return. To get the automatic extension, the taxpayer must file Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*, by the due date for the tax return. Also see *Paying by credit card*, later.

The taxpayer is not required to pay any of the tax due when submitting the form. However, the taxpayer will owe interest on any tax that is owed but not paid by the due date. Interest will be charged from the due date to the date of payment. In addition, the taxpayer may be charged a late-payment penalty if the amount of tax paid before the due date (from withheld taxes or estimated tax payments) is less than 90% of the actual tax owed.

For more details on penalties, refer to filing information in Publication 17 and Lesson 6 in the Volunteer Assistor's Guide.

If Form 4868 is filed late, the request for an extension will be denied. The Internal Revenue Service will inform the taxpayer if the request is denied.



Taxpayers **cannot** use the automatic extension if they:

- Choose to have the IRS figure their tax, or
- Are under a court order to file their returns by the regular due date.

When the tax return is actually filed, any payment made with the application should be entered in line 66, Form 1040; added to the total on line 43, Form 1040A; or added to the total on line 9, Form 1040EZ.

The taxpayer can request an extension beyond this 4-month period by filing Form 2688, *Application for Additional Extension of Time To File U.S. Individual Income Tax Return*, or by letter. Except in undue hardship cases, this additional extension will not be granted unless Form 4868 has been filed first. Form 2688 or the taxpayer's letter will not be considered if filed after the extended due date.

## Outside the United States and Puerto Rico

U.S. citizens and resident aliens who are living outside the United States and Puerto Rico on April 15 and whose main place of business or assigned tour of duty is outside the United States and Puerto Rico are allowed an automatic 2-month extension of time until June 15, 2004, to file a 2003 return. However, interest will be charged from the due date to the date the tax is paid.

**Note:** Traveling outside the United States and Puerto Rico on the due date does not qualify the taxpayer for an automatic 2-month extension.

Taxpayers using this automatic extension must attach a statement to their return stating that they were living outside the United States and Puerto Rico on the due date and that their main place of business or their assigned tour of duty is outside the United States and Puerto Rico.

**Joint returns.** For married persons who file jointly, only one spouse needs to meet the requirements to take advantage of the automatic extension to June 15.

**Separate returns.** For married persons who file separately, only the spouse who meets the requirements qualifies for the automatic extension. If both spouses meet the requirements, each may take advantage of the extension.

As discussed earlier, taxpayers who live outside the United States and Puerto Rico and whose main place of business or assigned tour of duty is outside the United States and Puerto Rico can also request an additional extension by filing Form 4868 by the automatic extension date of June 15 or by paying the tax due by credit card by April 15, 2004. The due date will then be extended to August 16. To obtain the additional extension, the taxpayer must file Form 4868 and write "Taxpayer Abroad" in the top margin of the form. If more time is needed, the taxpayer should file Form 2688.



## Combat Zone Participants

The deadline for filing tax returns, paying taxes, filing claims for refund, and taking other actions with the IRS is automatically extended for members of the Armed Forces who served in a combat zone, qualified hazardous duty area, or began performing qualifying service outside of a combat zone or qualified hazardous duty area. The designation of the combat zone and the combat pay exclusion are described in Lesson 2, Military Segment.

The deadline for taking actions with the IRS is extended for at least 180 days after the later of:

1. The last day a member is in a combat zone, qualified hazardous duty area, or has qualifying service outside of the combat zone/qualified hazardous duty area (or the last day the area qualifies as a combat zone/qualified hazardous duty area), or
2. The last day of any continuous qualified hospitalization (defined in Lesson 2, Military Segment) for injury from service in the combat zone, qualified hazardous duty area, or qualified service outside the combat zone/qualified hazardous duty area.

Time in a missing status (missing in action or prisoner of war) counts as time in a combat zone.

In addition to the 180 days, the deadline is extended by the number of days that were left for the member to take the action with the IRS when he/she entered a combat zone, qualified hazardous duty area (or began performing qualifying service outside of the combat zone/qualified hazardous duty area). If the member entered the combat zone/qualified hazardous duty area (or began performing qualifying service outside of the combat zone/qualified hazardous duty area) before the period of time to take action began, the deadline is extended by the entire time he/she had to take the action. For example, the member has 3 ½ months (Jan. 1–Apr. 15, 2003) to file his/her 2002 tax return.

Any days of the 3 ½ month period that are left when he/she entered a combat zone (or the entire 3 ½ months if the member entered the combat zone before January 1) are added to the 180 days to find the last day allowed for filing the 2002 tax return.



## Example 1

Capt. Margaret Jackson entered Saudi Arabia on December 1, 2001. She remained there through March 31, 2002, when she departed for the United States. She was not injured and did not return to the combat zone. The deadlines for filing Capt. Jackson's 2001, 2002, and 2003 tax returns are figured as follows:

**The 2001 tax return deadline** is January 10, 2004. Capt. Jackson has 285 days (180 plus 105) after her last day in the combat zone (March 31) to file her 2001 tax return. The 105 additional days are the number of days in the 3 ½-month filing period that were left when she entered the combat zone (Jan 1–Apr. 15). There are 105 days in the 2003 filing period.

**The 2002 tax return deadline** is January 10, 2004. Capt. Jackson has 285 days (180 plus 105) after her last day in the combat zone to file her 2002 tax return.

**The 2003 tax return deadline** is not extended. The 180-day extension period after March 31, 2003, ends in September 27, 2003, which is before the start of the filing period for her 2003 return.

## Example 2

Petty Officer Leonard Bishop's ship entered the Persian Gulf on January 5, 2002. On February 15, 2002, Leonard was injured and was flown to a U.S. hospital. He remained in the hospital through April 21, 2003. The deadlines for filing Petty Officer Bishop's 2001, 2002, and 2003 returns are figured as follows:

**The 2001 tax return deadline** is January 27, 2004. Petty Officer Bishop has 281 days (180 plus 101) after his last day in the hospital (April 21, 2003) to file his 2001 return. The 101 additional days are the number of days in the 3 ½-month filing period that were left when he entered the combat zone (Jan. 5–Apr. 15).

**The 2002 tax return deadline** is January 31, 2004. Petty Officer Bishop has 285 days (180 plus 105) after April 21, 2003, to file his 2002 tax return.

**The 2003 tax return deadline** is April 15, 2004. The 180-day period after April 21, 2003, ends October 18, 2003, which is before the start of the filing period for his 2003 return. The due date for his 2003 return is not extended. He has until April 15, 2004 to file his 2003 tax return.

A detailed explanation of the deadline extension provision for filing returns and taking care of other tax matters is included in Lesson 16, *Tax Options for Combat Zone Participants*.

**Interest.** The IRS will pay interest from the regular due date of a return if the return is timely filed (including extensions).

**Identification of combat zone returns.** Taxpayers can choose to file their returns before the end of an extension period. They should file their returns in accordance with procedures provided by the Armed Forces.



**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 2003 tax return with the IRS, the taxpayer should check the “Yes” box in the “Third part designee” area if 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, 2005, for most people.

**Power of Attorney.** Use Form 2848, *Power of Attorney and Declaration of Representative*, to grant authority to an individual to represent you before the IRS and to receive tax information. If an individual is acting on behalf of a taxpayer serving in the combat zone and does not have a power of attorney specifying that he/she can handle federal tax matters, the IRS will accept a general power of attorney or other statement signed by the person for whom the individual is acting. The general power of attorney or statement must authorize the individual to act on the other person’s behalf even though federal tax matters are not specified. A copy must be attached to the tax return.

**Signature.** If it is not possible for the spouse of someone serving in the combat zone to obtain that person’s signature on a joint return, power of attorney, or other signed authorization to act on his or her behalf, the IRS will accept a written statement explaining that the husband or wife is serving in the combat zone.

The statement must be signed by the spouse filing the tax return and attached to the return.



### Exercise 1

Pvt. Franklin, a U.S. citizen, is a calendar-year taxpayer. What would be the due date for him to file a return if his assigned tour of duty were in the following places?

**A. Puerto Rico**

Answer \_\_\_\_\_

**B. Germany**

Answer \_\_\_\_\_

**C. United States**

Answer \_\_\_\_\_

### Exercise 2

Capt. Regis is stationed in England on April 15. He is concerned about when he should file his federal tax return. Answer the following questions for Capt. Regis.

**A. What extensions of time are available to him?**

Answer \_\_\_\_\_

**B. How can he get those extensions?**

Answer \_\_\_\_\_

### Exercise 3

Capt. Mitchell entered the Persian Gulf area combat zone on October 9, 2001, and left the combat zone on May 10, 2003. She was not injured and did not return to the combat zone.

**A. When are her 2001 and 2002 returns due after applying the deadline extension provision?**

Answer \_\_\_\_\_

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

In this lesson you have learned where members of the Armed Forces should file their returns. You learned when the returns are due for taxpayers who live both inside and outside the United States and Puerto Rico and how extensions of time to file can affect the due date. You have also learned that members of the Armed Forces who served in a combat zone are allowed additional time to file their returns.



1.
  - a. April 15
  - b. June 15 if he attached a statement to his return indicating that he was on an assigned tour of duty in Germany on the due date.
  - c. April 15
2.
  - a. An automatic 2-month extension of time to June 15 and an additional 2-month extension to August 15 (for a total of 4 months).
  - b. Captain Regis can obtain the automatic 2-month extension by attaching a statement to his tax return indicating that he was on an assigned tour of duty outside the United States and Puerto Rico on April 15. If Captain Regis needs an additional extension of time, he should file Form 4868 by the automatic extension date of June 15 and write "Taxpayer Abroad" in the top margin of the form. If he still needs additional time, he should request it before the extended due date of August 15 by filing Form 2688, or by letter.
3.
  - a. Capt. Mitchell has 285 days (180 plus 105) after her last day in the combat zone (May 10, 2003) to file her 2001 return. She has 285 days (180 plus 105) after her last day in the combat zone to file her 2002 return. These additional days are the number of days in the 3 ½ month filing period that were left when she entered the Persian Gulf. Her 2001 return and her 2002 return are both due February 19, 2004.

## LESSON OVERVIEW

This lesson covers a very common non-refundable credit — the credit of child and dependent care expenses.

Students should be able to determine who is eligible for credit for child and dependent care expenses and calculate the corresponding credit and exclusion.

## MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the publications and forms, you can download the files from [www.irs.gov](http://www.irs.gov).

- Form 2441, *Child and Dependent Care Expenses*
- Schedule 2, *Child and Dependent Care Expenses for Form 1040A Filers*
- Publication 503, *Child and Dependent Care Expenses*

## GUIDED QUESTIONS

1. **How is the amount of work-related expenses eligible for child and dependent care expenses determined?** (It is the lowest of: the lower-paid spouse's earnings, the single taxpayer's earnings, the actual expenses paid, or the overall limit of \$3,000 a year for one qualifying person or \$6,000 a year for two or more qualifying persons.)
2. **How does dependent care assistance from employers affect the taxpayer's limited eligible expenses?** (The overall limit and qualified expenses incurred are reduced, dollar for dollar, by any reimbursement (benefits) excluded from the taxpayer's income.)
3. **Under what circumstances can married taxpayers claim the child and dependent care credit, even though one spouse is not working?** (If a nonworking 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.)
4. **What form is used in conjunction with Form 1040 or 1040A to claim the credit for child and dependent care expenses?** (Form 2441 or Schedule 2)
5. **Is a spouse who is physically or mentally incapable of self-care considered to be a qualifying person for the credit for child and dependent care expenses?** (Yes)

6. **Is the dollar amount of the child and dependent care credit equal to the qualifying expenses?** (No; the credit is a percentage of qualifying expenses.)
7. **What reference in Schedule 2 or Form 2441 identifies for the taxpayer which percentage to use in figuring the credit?** (The table found below line 8 of Part II.)
8. **For which taxpayers do you complete Part III of Schedule 2 or Form 2441?** (Taxpayers who received benefits under a dependent care benefits program.)

### TEACHING TIPS

On a flip-chart or chalkboard, draw the following graphic organizer that shows the order in which to complete Parts I through III of Schedule 2 or Form 2441. The order is determined by whether the taxpayer received benefits under a dependent care assistance program.

Completing Parts I-III	
Dependent Care Benefits	NO Dependent Care Benefits
1. Part I	1. Part I
2. Part III	2. Part II
3. Part II	

### GROUP ACTIVITY

*3–5 minutes*

Divide the class into two groups. Assign one group the responsibility of identifying qualifying child care expenses associated with schooling and camping. (Care before and after school and day-camp fees are qualifying expenses.) Assign the other group the responsibility of identifying nonqualifying child care expenses associated with schooling and camping. (Expenses for a child to attend first grade or any higher grade, and expenses for an overnight camp are not qualifying child care expenses.)

Caution students to include in Part III all dependent care benefits that were reported in box 10 of Form W-2. However, students should NOT include amounts that were reported as wages in box 1 of Form W-2.

Advise the students to check and recheck that the name and SSN entered agree with the person's social security card. If at the time the return is processed the return and SSN do not agree the credit may be reduced or disallowed. If the qualifying child was born and died in 2003, and did not have an SSN, enter "Died" in column (b) and attach a copy of the person's birth certificate. If the name or SSN on the person's social security card is not correct, the taxpayer will need to contact the Social Security Administration at 1-800-772-1213.



Students may question why Exhibit 1 shows \$2,000 and not \$3,000 as the amount of qualified expenses entered on line 3 of Form 2441, Part II. Point out that Example 7 states that the Fullertons received \$1,000 under a dependent care benefits program. Remind students that for taxpayers like the Fullertons, Part III of Form 2441 must be filled out before Part II.

Review with students Part III of the Fullertons' Form 2441 (see Exhibit 2). Call attention to the amount of excluded benefits entered on line 23 (\$1,000). Make certain that students understand that this amount is not entered on line 3 of Part II.

**STUDENT NOTES**

Lined writing area for student notes.



# CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

Lesson 7

## INTRODUCTION AND OBJECTIVES

In this lesson you will learn about the credit for child and dependent care expenses. This nonrefundable credit is one of the most commonly used credits. The requirements for claiming the credit are the same regardless of the form used. In fact, Form 2441 (used with Form 1040) and Schedule 2 (used with Form 1040A) are virtually identical. In order to qualify for this credit, the taxpayer must satisfy all six tests of eligibility.

Some taxpayers receive employer provided dependent care benefits. Dependent care benefits include amounts the employer paid directly to the taxpayer or to the care provider. These benefits can also include the fair market value of care in a day care facility provided or sponsored by the employer. The taxpayer's salary may have been reduced to pay for these benefits. The employer provided benefits will be reported on Form W-2, Box 10.

After completing this lesson you should be able to:

- Determine who is eligible for the child and dependent care credit.
- Calculate the credit, the exclusion and report the expenses on the correct form.

## QUALIFYING PERSON TEST

The child and dependent care expenses must be for at least one qualifying person.

A qualifying person is:

- A child who was under the age of 13 when the care was provided and for whom a dependency exemption can be claimed. Special rules apply, however, if the parents are divorced or separated. (See next page).
- A dependent who was physically or mentally not able to care for himself or herself and for whom a dependency exemption can be claimed (or could be claimed except the person had \$3,050 or more of gross income).
- A spouse who was physically or mentally not able to care for himself or herself.

### 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 12-year-old daughter, Jill. Both Janet and Jill are qualifying persons for the credit.

### Example 2

Bob and Rhonda paid child care expenses for their son, Ronnie. Ronnie turned 13 on July 15. Ronnie is a qualifying person until he reached the age of 13.

## Children of Divorced or Separated Parents Exception

If the taxpayer is the custodial parent, he or she can treat the child as a qualifying person for the credit even if he or she cannot claim the child's dependency exemption. If the taxpayer **is not** the custodial parent, he or she cannot treat the child as a qualifying person for the credit even if he or she can claim the child's dependency exemption.

This exception applies only if **all** the following are true:

- One or both parents had custody of the child for more than half the year.
- One or both parents provided more than half of the child's support for the year.
- Either
  1. The custodial parent signed Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents, or a similar statement, agreeing not to claim the child's exemption for the year, or
  2. The noncustodial parent provided at least \$600 for the child's support and can claim the child's exemption under a pre-1985 decree of divorce or separate maintenance, or written agreement.

### Example 3

Amanda is divorced and has custody of her 8-year-old daughter, Carrie. Amanda signed Form 8332 to allow her ex-spouse to claim the dependency exemption for Carrie. In order to work, Amanda paid child care expenses for Carrie. Carrie is a qualifying person for the credit. Amanda can claim the credit for child and dependent care expenses. The ex-spouse cannot claim the credit.

## ***KEEPING UP A HOME TEST***

To claim the credit, the taxpayer must pay more than half the cost of keeping up a home for himself or herself and one or more qualifying persons. The cost of keeping up a home normally includes property taxes, mortgage interest, rent, utility charges, home repairs, insurance on the home, and food eaten in the home. Public assistance benefits are funds provided by the state not by the taxpayer.

## ***EARNED INCOME TEST***

The taxpayer (and spouse if married) must have earned income during the year. Earned income includes wages, salaries, tips, other taxable employee compensation, net earnings from self-employment, strike benefits, and disability pay reported as wages.

A spouse is treated as having earned income for any month he or she is a full-time student or physically or mentally not able to care for himself or herself. Only one spouse can be **treated** as having earned income in any one month.

A full-time student is defined as enrolled and attending a school for the number of hours or classes the school considers full-time. The taxpayer (or spouse) must be a student for some part of five calendar months during the year.

## ***WORK-RELATED EXPENSE TEST***

Child and dependent care expenses must be work related to qualify for the credit. Expenses are considered work related only if both of the following are true:

1. The expenses allow the taxpayer (and spouse if married) to work or look for work and
2. The expenses are for a qualifying person's care.

A spouse is treated as working during any month he or she is a full-time student or is physically or mentally not able to care for himself or herself.

To be work related, the expenses must be to provide care for a qualifying person. Expenses are for the care of a qualifying person only if their main purpose is the person's well being and protection.

Expenses for care do not include amounts paid for food, clothing, education, and entertainment. However, small amounts paid for these items can be included if they are incident to and cannot be separated from the cost of care.

**Education.** Expenses to attend first grade or a higher grade are not expenses for care.

**Camp.** The cost of sending a child to an overnight camp is not considered a work-related expense.

**Payments to relatives.** Do not count amounts paid to:

1. A dependent for whom the taxpayer (or spouse if married) can claim as an exemption, or
2. The taxpayer's child who is under age 19 at the end of the year, even if he or she is not the taxpayer's dependent

### ***JOINT RETURN TEST***

Generally, a married couple must file a joint return to take the credit. However, if the taxpayer is legally separated or living apart from his or her spouse, the taxpayer may be able to file a separate return and still take the credit.

If the taxpayer's filing status is married filing separately and all of the following apply, the taxpayer is considered unmarried for purposes of figuring the credit:

1. The taxpayer lived apart from his or her spouse during the last six months of the year, and
2. The qualifying person lived in the taxpayer's home for more than half of the year, and
3. The taxpayer provided over half the cost of keeping up the home, and
4. The taxpayer met the other five tests for eligibility to take the credit.

### ***PROVIDER IDENTIFICATION TEST***

The taxpayer must provide the care provider's name, address, and taxpayer identification number. If the taxpayer is unable to provide this information or if the information is incorrect, he or she must show they used due diligence to obtain the information.

**Due Diligence.** The taxpayer can show due diligence by getting and keeping any of the following documents:

1. Form W-10, Dependent Care Provider's Identification and Certification.
2. Copy of the provider's social security card.
3. Copy of the provider's driver's license if it includes the social security number.
4. A copy of the provider's Form W-4 if the provider is the taxpayer's household employee.
5. A copy of the statement furnished by the taxpayer's employer if the provider is a dependent care plan.
6. A letter or invoice from the provider if it shows the name, address, and taxpayer identification number (EIN or SSN).

**Provider Refusal.** If the care provider refuses to give the taxpayer the identifying information, report whatever information is available, enter “see page 2” for the missing information, and provide a statement at the bottom of page 2 of Form 2441 or Schedule 2.

## 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 \$3,000 for one qualifying person or \$6,000 for two or more qualifying persons.

### 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 (\$3,000).

Some taxpayers receive dependent care benefits from their employers. If so, the overall limit of \$3,000/\$6,000 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 5

Geraldine has one dependent child, Donald, who is 6 years old. She paid \$2,900 in qualified expenses. Box 10 of Geraldine’s Form W-2 shows she received \$1,400 during the year from her employer’s dependent care assistance program. Because she received dependent care benefits, Part III of Form 2441 must be completed before completing Part II.

## 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 not capable of caring for himself or herself for some period during the year, a credit can still 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:

### ALERT



Beginning in 2003, the maximum expenses for the credit increased to \$3,000 for one qualifying person and \$6,000 for two or more qualifying persons.

### ALERT



Beginning in 2003, the amount of earned income for the nonworking spouse increased to \$250 with one qualifying person and \$500 for two or more qualifying persons.

- \$250 with one qualifying person in the home, or
- \$500 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 daycare while Ken attended school. Ken's earned income for the time he attended school is considered to be \$1,250 (5 months  $\times$  \$250).

### Exercise 1

- A. Karen earned \$18,000. She paid \$3,200 for child care expenses for her four-year-old daughter, Crystal. What is the maximum amount of child care expenses Karen can claim? \_\_\_\_\_  
\_\_\_\_\_
- 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 up the home for herself and Charles. Andrea also paid for before-school and after-school child care. Her total child care expenses were \$1,800. Bill left the area 18 months ago. He did not live with Andrea at all during 2003, but he did send \$1,200 in child support. Andrea and Bill will file separate returns. Andrea signed Form 8332 to allow Bill to claim the dependency exemption for Charles. Who can 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 to a two week long overnight camp. Are the camp expenses qualified expenses for the credit for child and dependent care credit? \_\_\_\_\_  
\_\_\_\_\_

The credit is a percentage of qualifying expenses. For taxpayers with adjusted gross incomes of \$15,000 or less, the credit is 35 percent of qualifying expenses. As adjusted gross income increases, the percentage decreases. The lowest percentage is 20 percent for an AGI equal to or greater than \$43,000. There is no upper limitation on income for this credit. The tables on Schedule 2 (Form 1040A) and on Form 2441 show the percentage for each adjusted gross income bracket. After the credit is figured using Form 2441 or Schedule 2, it is reported on Form 1040, line 45, or Form 1040A, line 29.

### Example 7

David A. and Edith B. Fullerton are married and file a joint return. Last year, they paid \$3,500 for the care of their son, Jonathan. The payment was made to Karen's Kiddie Care, 456 Chapman Avenue, Wilmington, DE 19850 (EIN 00-0009101). The \$3,500 payment includes a \$1,000 dependent care benefit Edith received from her employer. Edith earned \$18,979 and David earned \$22,450 last year. Their adjusted gross income is \$39,429 and their tax liability is \$2,492.

Exhibits 1 and 2 show the completed Form 2441 (Form 1040) for David and Edith.

**ALERT**

Beginning in 2003, the credit percentages increased and the maximum AGI amount that qualifies for the highest percentage increased to \$15,000.

Form **2441**  
 Department of the Treasury  
 Internal Revenue Service

**Child and Dependent Care Expenses**

OMB No. 1545-0068  
**2003**  
 Attachment  
 Sequence No. **21**

▶ Attach to Form 1040.  
 ▶ See separate instructions.

Name(s) shown on Form 1040: **David A. and Edith B. Fullerton**  
 Your social security number: **000 00 2935**

**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)
	<b>Karen's Kiddie Car</b>	<b>456 Chapman Ave Wilmington DE 19850</b>	<b>00-0009101</b>	<b>3,500</b>
.....				

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. See the instructions for Form 1040, line 59.

**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 2003 for the person listed in column (a)
First	Last		
<b>Jonathan</b>	<b>Fullerton</b>	<b>000 00 2194</b>	<b>2,500</b>

<b>3</b> Add the amounts in column (c) of line 2. <b>Do not</b> enter more than \$3,000 for one qualifying person or \$6,000 for two or more persons. If you completed Part III, enter the amount from line 26	<b>3</b>		<b>2,000</b>																																																												
<b>4</b> Enter your <b>earned income</b>	<b>4</b>		<b>22,450</b>																																																												
<b>5</b> If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); <b>all others</b> , enter the amount from line 4	<b>5</b>		<b>18,979</b>																																																												
<b>6</b> Enter the <b>smallest</b> of line 3, 4, or 5	<b>6</b>		<b>2,000</b>																																																												
<b>7</b> Enter the amount from Form 1040, line 35	<b>7</b>	<b>39,429</b>																																																													
<b>8</b> Enter on line 8 the decimal amount shown below that applies to the amount on line 7	<b>8</b>		<b>× .22</b>																																																												
<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="3" style="text-align: left;">If line 7 is:</th> <th colspan="3" style="text-align: left;">If line 7 is:</th> </tr> <tr> <th style="text-align: left;">Over</th> <th style="text-align: left;">But not over</th> <th style="text-align: left;">Decimal amount is</th> <th style="text-align: left;">Over</th> <th style="text-align: left;">But not over</th> <th style="text-align: left;">Decimal amount is</th> </tr> </thead> <tbody> <tr> <td>\$0—15,000</td> <td></td> <td>.35</td> <td>\$29,000—31,000</td> <td></td> <td>.27</td> </tr> <tr> <td>15,000—17,000</td> <td></td> <td>.34</td> <td>31,000—33,000</td> <td></td> <td>.26</td> </tr> <tr> <td>17,000—19,000</td> <td></td> <td>.33</td> <td>33,000—35,000</td> <td></td> <td>.25</td> </tr> <tr> <td>19,000—21,000</td> <td></td> <td>.32</td> <td>35,000—37,000</td> <td></td> <td>.24</td> </tr> <tr> <td>21,000—23,000</td> <td></td> <td>.31</td> <td>37,000—39,000</td> <td></td> <td>.23</td> </tr> <tr> <td>23,000—25,000</td> <td></td> <td>.30</td> <td>39,000—41,000</td> <td></td> <td>.22</td> </tr> <tr> <td>25,000—27,000</td> <td></td> <td>.29</td> <td>41,000—43,000</td> <td></td> <td>.21</td> </tr> <tr> <td>27,000—29,000</td> <td></td> <td>.28</td> <td>43,000—No limit</td> <td></td> <td>.20</td> </tr> </tbody> </table>	If line 7 is:			If line 7 is:			Over	But not over	Decimal amount is	Over	But not over	Decimal amount is	\$0—15,000		.35	\$29,000—31,000		.27	15,000—17,000		.34	31,000—33,000		.26	17,000—19,000		.33	33,000—35,000		.25	19,000—21,000		.32	35,000—37,000		.24	21,000—23,000		.31	37,000—39,000		.23	23,000—25,000		.30	39,000—41,000		.22	25,000—27,000		.29	41,000—43,000		.21	27,000—29,000		.28	43,000—No limit		.20			
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<b>9</b> Multiply line 6 by the decimal amount on line 8. If you paid 2002 expenses in 2003, see the instructions	<b>9</b>		<b>440</b>																																																												
<b>10</b> Enter the amount from Form 1040, line 43, minus any amount on Form 1040, line 44	<b>10</b>		<b>2,492</b>																																																												
<b>11</b> <b>Credit for child and dependent care expenses.</b> Enter the <b>smaller</b> of line 9 or line 10 here and on Form 1040, line 45	<b>11</b>		<b>440</b>																																																												

**For Paperwork Reduction Act Notice, see page 3 of the instructions.** Cat. No. 11862M Form **2441** (2003)

**Part III Dependent Care Benefits**

12	Enter the total amount of <b>dependent care benefits</b> you received for 2003. This amount should be shown in box 10 of your W-2 form(s). <b>Do not</b> include amounts that were reported to you as wages in box 1 of Form(s) W-2 . . . . .	12	1,000
13	Enter the amount forfeited, if any (see the instructions) . . . . .	13	0
14	Subtract line 13 from line 12 . . . . .	14	1,000
15	Enter the total amount of <b>qualified expenses</b> incurred in 2003 for the care of the <b>qualifying person(s)</b> . . . . .	15	3,500
16	Enter the <b>smaller</b> of line 14 or 15 . . . . .	16	1,000
17	Enter your <b>earned income</b> . . . . .	17	22,450
18	Enter the amount shown below that applies to you. <ul style="list-style-type: none"> <li>• If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5).</li> <li>• If married filing separately, see the instructions for the amount to enter.</li> <li>• All others, enter the amount from line 17.</li> </ul>	18	18,979
19	Enter the <b>smallest</b> of line 16, 17, or 18 . . . . .	19	1,000
20	<b>Excluded benefits.</b> Enter here the <b>smaller</b> of the following: <ul style="list-style-type: none"> <li>• The amount from line 19 or</li> <li>• \$5,000 (\$2,500 if married filing separately <b>and</b> you were required to enter your spouse's earned income on line 18).</li> </ul>	20	1,000
21	<b>Taxable benefits.</b> 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	0

To claim the child and dependent care credit, complete lines 22–26 below.

22	Enter \$3,000 (\$6,000 if two or more qualifying persons) . . . . .	22	3,000
23	Enter the amount from line 20 . . . . .	23	1,000
24	Subtract line 23 from line 22. If zero or less, <b>stop</b> . You cannot take the credit. <b>Exception.</b> If you paid 2002 expenses in 2003, see the instructions for line 9 . . . . .	24	2,000
25	Complete line 2 on the front of this form. <b>Do not</b> include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here . . . . .	25	2,500
26	Enter the <b>smaller</b> of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11 . . . . .	26	2,000

## Exercise 2

Sam L. (000-00-9832) and Sue D. Windham are married and will file a joint return. They have two dependent children whom they send to day care to allow both parents to work. Sam's earned income is \$18,500 and Sue's earned income is \$19,350. Their AGI (Form 1040, line 35) is \$37,850 and their tax liability (Form 1040, line 43) is \$1,723.

During 2003, they paid The Learning Center day care (496 Irvine Road, Newark, NJ 07102, EIN 11-0007965) \$5,450 to care for their children. The Windhams paid \$2,950 of the total and Sue's employer paid \$2,500 under a dependent care benefits program. The \$2,500 is in Box 10 of Sue's Form W-2.

The children and the amounts paid for day care are as follows:

Doug	SSN 000-00-2387	\$3,000	\$1,250 dependent care benefit
Sally	SSN 000-00-4923	\$2,450	\$1,250 dependent care benefit

Complete their Form 1040, Form 2441 (Exhibits 3 and 4).

## TAXWISE HINTS

Use the flow charts in Publication 4012, VITA/TCE Resource Guide, to determine credit eligibility. For each qualifying child, check the "DC" box on the Main Information Sheet, Dependents/Non-dependents box. TaxWise will add a Form 2441 or Schedule 2 to the forms tree. Complete all entries annotated in red. TaxWise will then calculate any exclusion amounts, calculate the credit, complete the form and insert the credit amount on Form 1040 or Form 1040A.

### ►► SUMMING UP THIS LESSON ◀◀

The Credit for Child and Dependent Care Expenses is a non-refundable credit which allows a taxpayer to reduce their tax liability for a portion of the expenses.

Beginning in 2003, the maximum expense amount increased to \$3,000 for one qualifying person and \$6,000 for two or more qualifying persons.

The maximum credit rate increased from 30% to 35%.

A taxpayer must satisfy the six tests to qualify for the credit. The tests are the qualifying person test; the keeping up a home test; the earned income test; the work-related expense test; the joint return test; and the provider identification test.

The credit is calculated and reported on Form 2441 (Form 1040) or Schedule 2 (Form 1040A).

Form <b>2441</b> Department of the Treasury Internal Revenue Service	<b>Child and Dependent Care Expenses</b> ▶ Attach to Form 1040. ▶ See separate instructions.	OMB No. 1545-0068 <b>2003</b> Attachment Sequence No. <b>21</b>																																																								
Name(s) shown on Form 1040		Your social security number																																																								
<p><b>Before you begin:</b> You need to understand the following terms. See <b>Definitions</b> on page 1 of the instructions.</p> <p>● <b>Dependent Care Benefits</b>      ● <b>Qualifying Person(s)</b>      ● <b>Qualified Expenses</b>      ● <b>Earned Income</b></p>																																																										
<p><b>Part I</b> <b>Persons or Organizations Who Provided the Care</b>—You must complete this part. (If you need more space, use the bottom of page 2.)</p>																																																										
<b>1</b>	(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;"> <tr> <td style="padding: 5px;">Did you receive dependent care benefits?</td> <td style="padding: 5px;">No</td> <td style="padding: 5px;">▶ Complete only Part II below.</td> </tr> <tr> <td style="padding: 5px;"></td> <td style="padding: 5px;">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.																																																
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<p><b>Caution.</b> If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 59.</p>																																																										
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	(a) Qualifying person's name	(b) Qualifying person's social security number	(c) <b>Qualified expenses</b> you incurred and paid in 2003 for the person listed in column (a)																																																							
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<b>3</b>	Add the amounts in column (c) of line 2. <b>Do not</b> enter more than \$3,000 for one qualifying person or \$6,000 for two or more persons. If you completed Part III, enter the amount from line 26			<b>3</b>																																																						
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<b>5</b>	If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); <b>all others</b> , enter the amount from line 4			<b>5</b>																																																						
<b>6</b>	Enter the <b>smallest</b> of line 3, 4, or 5			<b>6</b>																																																						
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<b>8</b>	Enter on line 8 the decimal amount shown below that applies to the amount on line 7			<b>8</b>																																																						
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**Part III** Dependent Care Benefits

<b>12</b>	Enter the total amount of <b>dependent care benefits</b> you received for 2003. This amount should be shown in box 10 of your W-2 form(s). <b>Do not</b> include amounts that were reported to you as wages in box 1 of Form(s) W-2 . . . . .								
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<b>18</b>	Enter the amount shown below that applies to you. <ul style="list-style-type: none"> <li>• If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5).</li> <li>• If married filing separately, see the instructions for the amount to enter.</li> <li>• All others, enter the amount from line 17.</li> </ul>	<b>18</b>							
<b>19</b>	Enter the <b>smallest</b> of line 16, 17, or 18 . . . . .	<b>19</b>							
<b>20</b>	<b>Excluded benefits.</b> Enter here the <b>smaller</b> of the following: <ul style="list-style-type: none"> <li>• The amount from line 19 or</li> <li>• \$5,000 (\$2,500 if married filing separately <b>and</b> you were required to enter your spouse's earned income on line 18).</li> </ul>	<b>20</b>							
<b>21</b>	<b>Taxable benefits.</b> 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" . . . . .	<b>21</b>							

To claim the child and dependent care credit, complete lines 22–26 below.

<b>22</b>	Enter \$3,000 (\$6,000 if two or more qualifying persons) . . . . .	<b>22</b>							
<b>23</b>	Enter the amount from line 20 . . . . .	<b>23</b>							
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<b>25</b>	Complete line 2 on the front of this form. <b>Do not</b> include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here . . . . .	<b>25</b>							
<b>26</b>	Enter the <b>smaller</b> of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11 . . . . .	<b>26</b>							

#### Exercise 1

- (A) \$3,000, which is the lowest of: earned income (\$18,000); the amount actually paid (\$3,200); and the limit of one qualifying person (\$3,000).
- (B) Andrea. Even though she is filing a separate tax return, she is eligible for the credit because she signed a Form 8332 to allow her husband to claim the dependency exemption..
- (C) No.

# CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

## ANSWERS TO EXERCISES

Lesson 7

Exhibit 5 Exercise 2

The Windham's Form 2441, page 1

Form <b>2441</b> Department of the Treasury Internal Revenue Service	<b>Child and Dependent Care Expenses</b> ▶ Attach to Form 1040. ▶ See separate instructions.	OMB No. 1545-0068 <b>2003</b> Attachment Sequence No. <b>21</b>																																																								
Name(s) shown on Form 1040 <b>Sam L. and Sue D. Windham</b>		Your social security number <b>000 00 9832</b>																																																								
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<b>1</b>	(a) Care provider's name <b>The Learning Centre</b>	(b) Address (number, street, apt. no., city, state, and ZIP code) <b>496 Irvine Rd                  Newark NJ 07102</b>	(c) Identifying number (SSN or EIN) <b>11-0007965</b>	(d) Amount paid (see instructions) <b>5,450</b>																																																						
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	<b>Doug Windham</b>	<b>000 00 2387</b>	<b>1,750</b>																																																							
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# CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

## ANSWERS TO EXERCISES

## Lesson 7

### Exhibit 6 Exercise 2

The Windham's Form 2441, page 2

Form 2441 (2003)

Page **2**

#### Part III Dependent Care Benefits

<b>12</b>	Enter the total amount of <b>dependent care benefits</b> you received for 2003. This amount should be shown in box 10 of your W-2 form(s). <b>Do not</b> include amounts that were reported to you as wages in box 1 of Form(s) W-2 . . . . .	<b>12</b>	2,500
<b>13</b>	Enter the amount forfeited, if any (see the instructions) . . . . .	<b>13</b>	0
<b>14</b>	Subtract line 13 from line 12 . . . . .	<b>14</b>	2,500
<b>15</b>	Enter the total amount of <b>qualified expenses</b> incurred in 2003 for the care of the <b>qualifying person(s)</b> . . . . .	<b>15</b>	5,450
<b>16</b>	Enter the <b>smaller</b> of line 14 or 15 . . . . .	<b>16</b>	2,500
<b>17</b>	Enter your <b>earned income</b> . . . . .	<b>17</b>	18,500
<b>18</b>	Enter the amount shown below that applies to you. <ul style="list-style-type: none"> <li>• If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5).</li> <li>• If married filing separately, see the instructions for the amount to enter.</li> <li>• All others, enter the amount from line 17.</li> </ul>	<b>18</b>	19,350
<b>19</b>	Enter the <b>smallest</b> of line 16, 17, or 18 . . . . .	<b>19</b>	2,500
<b>20</b>	<b>Excluded benefits.</b> Enter here the <b>smaller</b> of the following: <ul style="list-style-type: none"> <li>• The amount from line 19 or</li> <li>• \$5,000 (\$2,500 if married filing separately <b>and</b> you were required to enter your spouse's earned income on line 18).</li> </ul>	<b>20</b>	2,500
<b>21</b>	<b>Taxable benefits.</b> 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" . . . . .	<b>21</b>	0

To claim the child and dependent care credit, complete lines 22–26 below.

<b>22</b>	Enter \$3,000 (\$6,000 if two or more qualifying persons) . . . . .	<b>22</b>	6,000
<b>23</b>	Enter the amount from line 20 . . . . .	<b>23</b>	2,500
<b>24</b>	Subtract line 23 from line 22. If zero or less, <b>stop</b> . You cannot take the credit. <b>Exception.</b> If you paid 2002 expenses in 2003, see the instructions for line 9 . . . . .	<b>24</b>	3,500
<b>25</b>	Complete line 2 on the front of this form. <b>Do not</b> include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here . . . . .	<b>25</b>	2,950
<b>26</b>	Enter the <b>smaller</b> of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11 . . . . .	<b>26</b>	2,950

 Printed on recycled paper

Form **2441** (2003)

**STUDENT NOTES**

### LESSON OVERVIEW

This lesson will explain the Hope scholarship credit and the lifetime learning credit. Since tax year 2002, taxpayers have had the option of claiming an above the line deduction for qualified tuition and fees. Depending on the taxpayer's income and corresponding tax bracket, it may be more beneficial to take the adjustment to income. Students may not completely understand this concept.

### MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the publication or form, you can download the files from [www.irs.gov](http://www.irs.gov).

- Form 8863, *Education Credits (Hope and Lifetime Learning Credits)*
- Publication 970, *Tax Benefits for Education*

### GUIDED QUESTIONS

1. **Can a taxpayer claim both the Hope and lifetime learning credit for an eligible student?** (No.)
2. **What form is used to claim the Hope credit or the lifetime learning credit?** (Form 8863)

### TEACHING TIPS

Remind students that if a student is claimed as a dependent by the parent or another taxpayer, the eligible student is not entitled to claim a HOPE credit on his or her tax return.

**STUDENT NOTES**



## INTRODUCTION AND OBJECTIVES

For tax year 2003, there are nine different tax benefits for higher education. Some of these benefits are not taxed (i.e., Coverdell education savings account, qualified tuition program, early IRA withdrawals, employer provided educational assistance and education savings bond program). The student loan interest deduction and tuition and fees deduction were covered in Lesson 3, Adjustments. In this lesson you will learn about the two education credits: Hope credit and the lifetime learning credit.

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 2003 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:

- File using any filing status other than married filing separately,
- 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.

## 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 2003 for qualified tuition for the winter semester that begins in January 2004. He can use the \$1,500 paid in December of 2003 to compute his credit for 2003.

### 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.

## *WHO CAN CLAIM EXPENSES?*

The taxpayer must claim a dependent exemption for the eligible student in order to claim an education credit. Either the taxpayer or the dependent, but not both, can claim an education credit for that dependent's higher education expenses.

<b>If the taxpayer...</b>	<b>Then only...</b>
Claims an exemption on the tax return for a dependent who is an eligible student	The taxpayer can claim the Hope or lifetime learning credit based on that student's expenses. The student cannot claim the credit.
Does not claim an exemption for a dependent who is an eligible student (even if entitled to the exemption)	The student can claim the Hope or lifetime learning credit. The taxpayer cannot claim the student's expenses.

If someone other than the taxpayer, the taxpayer's spouse, or the dependent (such as a relative or former spouse) makes a payment directly to the eligible educational institution to pay for qualified tuition and related expenses, the student is treated as receiving the payment from the other person. The student is considered to have paid the qualified tuition and related expenses to the eligible institution. If the taxpayer claims an exemption for the student, the taxpayer is considered to have paid the expenses. If the taxpayer does not claim a dependent exemption for the student, the student may claim the credit.

## Example 2

Mary Birch paid her grandson, Todd's, tuition for 2003 directly to the university. For purposes of claiming the Hope credit, her grandson is treated as receiving the money as a gift and in turn paying his qualified tuition and related expenses himself. Unless an exemption for Todd is claimed on someone else's return, only Todd can use the payment to claim the Hope credit. If Todd's parents claim his exemption, they may be able to use the expenses to claim the Hope credit. If anyone else claims an exemption for Todd, Todd cannot claim a Hope credit.

## 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.

## 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 \$83,000 if married filing jointly). If a taxpayer's modified AGI is \$51,000 or more (\$103,000 or more if married filing jointly), no credit is allowed. Education credits are not allowed to persons who are married filing separately.

## 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 22 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.

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 3

Sue and Ted paid \$7,000 in qualified tuition and fees for their daughter to attend the local university. They determined it would be more beneficial for 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)**

▶ See instructions.  
▶ Attach to Form 1040 or Form 1040A.

OMB No. 1545-1618

**2003**

Attachment  
Sequence No. **50**

Name(s) shown on return

**Sue and Ted Green**

Your social security number

**000 00 9876**

Caution: You **cannot** take both an education credit and the tuition and fees deduction (Form 1040, line 26, or Form 1040A, line 19) for the **same student** in the same year.

**Part I Hope Credit.** Caution: You cannot take the Hope credit for 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 (see instructions). Do not enter more than \$2,000 for each student.	(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)
	Mary Green	000 00 1234	2,000	1,000	1,000	500
2	Add the amounts in columns (d) and (f)			2	1,000	500
3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit for another student, go to Part II; otherwise, go to Part III ▶			3	1,500	

**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)
<b>Caution:</b> You cannot take the Hope credit and the lifetime learning credit for the same student in the same year.			
5	Add the amounts on line 4, column (c), and enter the total		5
6	Enter the smaller of line 5 or \$10,000		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
9	Enter: \$103,000 if married filing jointly; \$51,000 if single, head of household, or qualifying widow(er)	9	103,000
10	Enter the amount from Form 1040, line 35 *, or Form 1040A, line 22	10	35,000
11	Subtract line 10 from line 9. If zero or less, <b>stop</b> ; you cannot take any education credits	11	68,000
12	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	12	20,000
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
15	Enter the amount from Form 1040, line 43, or Form 1040A, line 28	15	3,349
16	Enter the total, if any, of your credits from Form 1040, lines 44 through 46, or Form 1040A, lines 29 and 30	16	0
17	Subtract line 16 from line 15. If zero or less, <b>stop</b> ; you cannot take any education credits ▶	17	3,349
18	<b>Education credits.</b> Enter the smaller of line 14 or line 17 here and on Form 1040, line 47, or Form 1040A, line 31 ▶	18	1,500

\*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.

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 4**

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 5**

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 \$2,000 per taxpayer for all eligible students. The credit amount is figured by multiplying total qualified educational expenses, up to \$10,000, by 20%.

#### **Example 6**

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.

#### **ALERT**



The maximum lifetime learning credit increased from \$1,000 to \$2,000 for 2003.

Form **8863**  
 Department of the Treasury  
 Internal Revenue Service

**Education Credits**  
**(Hope and Lifetime Learning Credits)**

▶ See instructions.  
 ▶ Attach to Form 1040 or Form 1040A.

OMB No. 1545-1618

**2003**

Attachment  
 Sequence No. **50**

Name(s) shown on return

**Judy Green**

Your social security number

**000 00 2586**

**Caution:** You **cannot** take both an education credit and the tuition and fees deduction (Form 1040, line 26, or Form 1040A, line 19) for the **same student** in the same year.

**Part I Hope Credit. Caution:** You cannot take the Hope credit for 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 (see instructions). <b>Do not</b> enter more than \$2,000 for each student.	(d) Enter the <b>smaller</b> 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)			<b>2</b>			
3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit for another student, go to Part II; otherwise, go to Part III ▶					<b>3</b>	

**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)
	<b>Judy Green</b>	<b>000 00 2586</b>	<b>500</b>
5	Add the amounts on line 4, column (c), and enter the total		<b>5</b> 500
6	Enter the <b>smaller</b> of line 5 or \$10,000		<b>6</b> 500
7	Tentative lifetime learning credit. Multiply line 6 by 20% (.20) and go to Part III ▶		<b>7</b> 100

**Part III Allowable Education Credits**

8	Tentative education credits. Add lines 3 and 7		<b>8</b> 100
9	Enter: \$103,000 if married filing jointly; \$51,000 if single, head of household, or qualifying widow(er)	<b>9</b> 51,000	
10	Enter the amount from Form 1040, line 35 *, or Form 1040A, line 22	<b>10</b> 29,524	
11	Subtract line 10 from line 9. If zero or less, <b>stop</b> ; you cannot take any education credits	<b>11</b> 21,476	
12	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	<b>12</b> 10,000	
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)	<b>13</b> × .	
14	Multiply line 8 by line 13	<b>14</b> 100	
15	Enter the amount from Form 1040, line 43, or Form 1040A, line 28	<b>15</b> 1,701	
16	Enter the total, if any, of your credits from Form 1040, lines 44 through 46, or Form 1040A, lines 29 and 30	<b>16</b> 0	
17	Subtract line 16 from line 15. If zero or less, <b>stop</b> ; you cannot take any education credits	<b>17</b> 1,701	
18	<b>Education credits.</b> Enter the <b>smaller</b> of line 14 or line 17 here and on Form 1040, line 47, or Form 1040A, line 31	<b>18</b> 100	

\*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.

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
\$2,000 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 non-credit 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

**Adjustments to Qualified Expenses**

**Tax-free educational assistance** can include the following:

- Scholarships,
- Pell grants,
- Employer-provided educational assistance,
- Veteran’s educational assistance, and

- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for education expenses.

If the taxpayer paid qualified tuition expenses with these tax-free funds, a credit cannot be claimed for these amounts. Qualified expenses must be reduced by the amount of any tax-free educational assistance received.

### Example 3

In 2003, Jackie paid \$3,000 for tuition and \$5,000 for room and board at her local university. To help pay these costs, she was awarded a \$2,000 scholarship and a \$4,000 student loan.

The scholarship is a qualified scholarship that is excludable from Jackie's income. For purposes of the education credit, she must first use the scholarship to reduce her tuition (her only qualified expense). The student loan is not considered tax-free educational assistance so she does not use it to reduce the qualified expenses. Therefore, Jackie is treated as having paid only \$1,000 in qualified expenses (\$3,000 tuition - \$2,000 scholarship).

**Refunds.** Qualified tuition and related expenses do not include expenses for which the taxpayer received a refund. If the refund or tax-free assistance is received in the same year in which the expenses were paid or in the following year before the tax return is filed, reduce the qualified expenses by the amount received and figure the education credits using the reduced amount of qualified expenses.

If the refund or tax-free assistance is received after the tax return is filed for the year in which the expenses were paid, figure the amount by which the education credits would have been reduced if the refund or tax-free assistance had been received in the year for which the education credits were claimed. Include that amount as an additional tax for the year the refund or tax-free assistance was received. Enter the amount and "ECR" on line 42.

### Example 4

Sally paid \$2,250 tuition on December 26, 2002, for her daughter who began college on January 16, 2003. She filed her 2002 tax return on February 12, 2003, and claimed a Hope credit of \$1,500. After Sally filed her return, her daughter dropped two courses but maintained one-half of a full-time workload. Sally received a refund of \$750. She must refigure her 2002 Hope credit using \$1,500 of qualified expenses instead of \$2,250. The refigured credit is \$1,250. She must include the difference of \$250 on line 41 of her 2003 Form 1040 and annotate next to the line: \$250 ECR.

### Exercise 1

Bruce (SSN 000-00-9541) and Toni Green are married and file a joint tax return. For 2003, their modified AGI (\$65,500) is the same as their AGI. They completed Form 1040 through line 44. Their tax amount on Line 43 is \$6,203. Toni is attending the local community college part time to earn credits toward an associate degree in nursing. She paid \$2,500 in tuition and fees. Their son, Ben, is a full time freshman at the state university. Bruce and Toni paid \$8,000 in tuition and fees for Ben in 2003. They choose to take the lifetime learning credit for Toni and the Hope credit for Ben. They will claim no other credits. Toni's SSN is 000-00-4651. Ben's SSN is 000-00-3945. 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 maximum credit amount for the lifetime learning credit for tax year 2003 increased to \$2,000.

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.



### Exercise 1

Bruce and Toni's Form 8863

Form <b>8863</b> Department of the Treasury Internal Revenue Service	<b>Education Credits</b> <b>(Hope and Lifetime Learning Credits)</b> ▶ See instructions. ▶ Attach to Form 1040 or Form 1040A.	OMB No. 1545-1618 <b>2003</b> Attachment Sequence No. <b>50</b>				
Name(s) shown on return <b>Bruce and Toni Green</b>		Your social security number <b>000 00 9541</b>				
<b>Caution:</b> You <i>cannot</i> take both an education credit and the tuition and fees deduction (Form 1040, line 26, or Form 1040A, line 19) for the <b>same student</b> in the same year.						
<b>Part I Hope Credit.</b> <b>Caution:</b> You <i>cannot</i> take the Hope credit for more than <b>2</b> tax years for the <b>same student</b> .						
<b>1</b>	<b>(a) Student's name</b> (as shown on page 1 of your tax return) First name Last name	<b>(b) Student's social security number</b> (as shown on page 1 of your tax return)	<b>(c) Qualified expenses</b> (see instructions). <b>Do not</b> enter more than \$2,000 for each student.	<b>(d) Enter the smaller of the amount</b> in column (c) or \$1,000	<b>(e) Subtract column (d) from column (c)</b>	<b>(f) Enter one-half of the amount</b> in column (e)
	<b>Ben Green</b>	000 00 3945	2,000	1,000	1,000	500
<b>2</b>	Add the amounts in columns (d) and (f)		<b>2</b>	1,000		500
<b>3</b>	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit for another student, go to Part II; otherwise, go to Part III ▶				<b>3</b>	1,500
<b>Part II Lifetime Learning Credit</b>						
<b>4</b>	<b>(a) Student's name</b> (as shown on page 1 of your tax return) First name Last name	<b>(b) Student's social security number</b> (as shown on page 1 of your tax return)	<b>(c) Qualified expenses</b> (see instructions)			
	<b>Toni Green</b>	000 00 4651	2,500			
<b>5</b>	Add the amounts on line 4, column (c), and enter the total		<b>5</b>	2,500		
<b>6</b>	Enter the <b>smaller</b> of line 5 or \$10,000		<b>6</b>	2,500		
<b>7</b>	Tentative lifetime learning credit. Multiply line 6 by 20% (.20) and go to Part III ▶		<b>7</b>	500		
<b>Part III Allowable Education Credits</b>						
<b>8</b>	Tentative education credits. Add lines 3 and 7		<b>8</b>	2,000		
<b>9</b>	Enter: \$103,000 if married filing jointly; \$51,000 if single, head of household, or qualifying widow(er)		<b>9</b>	103,000		
<b>10</b>	Enter the amount from Form 1040, line 35 *, or Form 1040A, line 22		<b>10</b>	65,500		
<b>11</b>	Subtract line 10 from line 9. If zero or less, <b>stop</b> ; you cannot take any education credits		<b>11</b>	37,500		
<b>12</b>	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)		<b>12</b>	20,000		
<b>13</b>	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)		<b>13</b>	× .		
<b>14</b>	Multiply line 8 by line 13 ▶		<b>14</b>	2,000		
<b>15</b>	Enter the amount from Form 1040, line 43, or Form 1040A, line 28		<b>15</b>	6,203		
<b>16</b>	Enter the total, if any, of your credits from Form 1040, lines 44 through 46, or Form 1040A, lines 29 and 30		<b>16</b>	0		
<b>17</b>	Subtract line 16 from line 15. If zero or less, <b>stop</b> ; you cannot take any education credits ▶		<b>17</b>	6,203		
<b>18</b>	<b>Education credits.</b> Enter the <b>smaller</b> of line 14 or line 17 here and on Form 1040, line 47, or Form 1040A, line 31 ▶		<b>18</b>	2,000		
*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 <b>8863</b> (2003)	

**STUDENT NOTES**

### LESSON OVERVIEW 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. After completing this lesson you should be able to:

- Use the EITC rules to determine which taxpayers are eligible for the earned income tax 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.

Important tax terms presented in this lesson appear in boldfaced type in the student text. Emphasize these terms as they are introduced:

- identification numbers
- qualifying child
- earned income

### MATERIALS

- EIC Worksheet (Form 1040)
- EIC Eligibility Questions (Form 1040, 1040A and Form 1040EZ)
- Publication 596, Earned Income Tax Credit

### GUIDED QUESTIONS

1. **For purposes of the earned income credit, when can a person age 19 or older be a qualifying child?** (Both full-time students under age 24 and permanently and totally disabled individuals of any age can be qualifying children.)

### TEACHING TIPS

You may wish to use question C of Exercise 1 to reinforce the requirements that an individual must meet in order to be considered a qualifying child for purposes of the earned income credit. Ask students to determine whether Jimmy and Anna are qualifying children for Randy and/or Cara.

After students determine that both are qualifying children of each parent, remind students that although an individual may be a qualifying child of more than one taxpayer, only one taxpayer can claim the credit on the basis of that child.

## ***GUIDED QUESTIONS***

- 1. On which worksheet is the earned income credit figured?** (EIC Worksheet. Remind students that there are two versions for 1040 filers and that the instructions at the top of those worksheets indicate which worksheet to use for the taxpayer that they are assisting. Additionally, remind students that the eligibility questions should be completed before figuring the earned income credit on the EIC worksheet.)
- 2. What is the function of the earned income credit table?** (The EIC Table is used to determine the amount of the earned income credit.)
- 3. Is the earned income credit adjusted for the number of qualifying children?** (Yes)

## ***GUIDED QUESTIONS***

- 1. How many qualifying children can a taxpayer list on line 1 of Schedule EIC?** (Only two qualifying children can be listed.)
- 2. Explain the income limits for the earned income credit.** The taxpayer cannot take the EIC if his or her earned income and adjusted gross income is more than:
  - \$33,178 (\$34,178 if married filing jointly) if you have more than one qualifying child,
  - \$29,201 (\$30,201 if married filing jointly) if you have one qualifying child, or
  - \$11,060 (\$12,060 if married filing jointly) if you do not have a qualifying child.

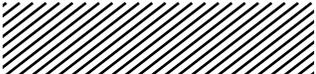
## ***TEACHING TIPS***

Remind students that the earned income credit depends on the taxpayer's earned, adjusted gross income, filing status, income and number of qualifying children. Caution students that they should not count children who are not qualifying children. Also, remind students to use the correct column in the EIC Table for the number of qualifying children and filing status.

## ***TEACHING TIPS***

Direct students' attention to line 4(a) of Schedule EIC.

A child qualifies as a student if he or she was enrolled as a student at a school during any five months of 2002 or took a full-time, on-farm training course during any five months of 2002. For purposes of the earned income credit, "school" includes technical, trade, and mechanical schools, but does not include on-the-job training courses or correspondence schools.



## TEACHING TIPS

If students are uncertain about the requirements that a child must meet in order to be a *qualifying* child for the purpose of the earned income credit, review the related information presented earlier in this lesson.

Remind the students to complete the eligibility questions in the Instructions for Form 1040A (line 39.)

## COMMON QUERIES

Students may ask what procedure to follow when taxpayers have not obtained a social security number for a qualifying child. Students should advise the taxpayer to apply for one by filing Form SS-5 with the Social Security Administration.

They also should advise the taxpayer that in the meantime, he or she has two choices.

1. Request an automatic extension of time to file (see the instructions for Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*).
2. File the return on time, and after receiving the SSN, amend the return to claim the EIC. Use Form 1040X, *Amended U.S. Individual Income Tax Return* to amend the return.

## GROUP ACTIVITY

(7–10 min.)

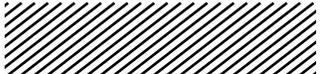
Divide the class into pairs and assign each pair the responsibility of writing one “What if . . .” question related to the requirements to claim the earned income credit. To credit each “What if . . .” question, students should change one piece of information about the taxpayers described. Students can change information about the taxpayers’ filing status, adjusted gross income, taxable and nontaxable earned income, or qualifying child.

After the writing of the questions, have the pairs exchange papers and explain to the class how, if at all, the “What if . . .” situation affects whether the Bells (Exercise 3) can claim the earned income credit.

- What if Sam and Robin file separate returns? (Neither would be eligible for the earned income credit.)
- What if the Bells’ adjusted gross and earned income was \$32,187? (The taxpayers could not claim the earned income credit since their adjusted gross income is not less than \$30,201.)

## COMMON QUERIES

Taxpayers who qualify for the earned income credit may ask volunteers how to receive advance earned income credit payments. Taxpayers must fill out Form W-5, *Earned Income Credit Advance Payment Certificate*. Individuals who have more than one employer must give the form to only one employer. If a taxpayer has a spouse who works, the spouse can also give a form to one employer. Caution students that a new Form W-5 must be completed each year. If a taxpayer's status changes during the year, making him or her ineligible to receive the advance earned income credit payments, he or she is required to complete a new Form W-5. Also, should a taxpayer receive advance earned income credit payments and later discovers that he or she does not qualify for the credit, the taxpayer will have to pay it back when filing Form 1040 or Form 1040A.



## 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.

After completing this lesson you should be able to:

- Use the EITC rules to determine which taxpayers are eligible for the earned income tax 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).

Generally, to claim the earned income tax credit, a taxpayer must:

- Have earned income during the year,
- Not have investment income of more than \$2,600.  
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.

## POTENTIAL PITFALLS



If the taxpayer's filing status is married filing separately, the taxpayer cannot claim the earned income credit.

Table 9-1. Earned Income Credit in a Nutshell

<b>Part A Rules for Everyone</b>	<b>Part B Rules If You Have a Qualifying Child</b>	<b>Part C Rules If You Do Not Have a Qualifying Child</b>
<b>Rule 1.</b> You must have a valid social security number.	<b>Rule 7.</b> Your child must meet the relationship, age, and residency tests.	<b>Rule 10.</b> You must be at least age 25 but under age 65.
<b>Rule 2.</b> Your filing status cannot be “Married filing separately.”	<b>Rule 8.</b> Your qualifying child cannot be used by more than one person to claim the EIC.	<b>Rule 11.</b> You cannot be the dependent of another person.
<b>Rule 3.</b> You must be a U.S. citizen or resident alien all year.	<b>Rule 9.</b> You cannot be a qualifying child of another person.	<b>Rule 12.</b> You cannot be a qualifying child of another person.
<b>Rule 4.</b> You cannot file Form 2555 or Form 2555–EZ (relating to foreign earned income).		<b>Rule 13.</b> You must have lived in the United States more than half the year.
<b>Rule 5.</b> Your investment income must be \$2,600 or less.		
<b>Rule 6.</b> You must have earned income.		
<b>Part D</b>		
<b>Figuring and Claiming the EIC</b>		
<p><b>Rule 14.</b> Your earned income must be less than:</p> <ul style="list-style-type: none"> <li>• \$33,692 (\$34,692 for married filing jointly) if you have more than one qualifying child,</li> <li>• \$29,666 (\$30,666 for married filing jointly) if you have one qualifying child, or</li> <li>• \$11,230 (\$12,230 for married filing jointly) if you do not have a qualifying child</li> </ul>		
<p><b>Rule 15.</b> Your AGI must be less than:</p> <ul style="list-style-type: none"> <li>• \$33,692 (\$34,692 for married filing jointly) if you have more than one qualifying child,</li> <li>• \$29,666 (\$30,666 for married filing jointly) if you have one qualifying child, or</li> <li>• \$11,230 (\$12,230 for married filing jointly) if you do not have a qualifying child</li> </ul>		

## 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:
  - a) \$29,666 (\$30,666 if married filing jointly) if he or she has one qualifying child, or
  - b) \$33,692 (\$34,692 if married filing jointly) if he or she has more than one qualifying child,
- 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 \$11,230 (\$12,230 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 9-2. Examples of Earned Income for the Earned Income Credit**

<b>Earned Income</b>	
<b>Includes</b>	<b>Does not include</b>
<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>

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 or a descendant of the taxpayer's brother, sister, stepbrother or 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. 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.

### 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.

## Qualifying Child of More Than One Taxpayer

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 2003, 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 the other two 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 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.
- The taxpayer with the higher AGI, if neither is a parent of the child.

### Example 2

John (age 26) is unmarried. In 2003, 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 \$33,692.

#### 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 \$29,666.

#### ***DISALLOWED EARNED INCOME CREDIT***

If a taxpayer's earned income credit was disallowed in for any year after 1996 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.

#### ***CERTIFICATION — EARNED INCOME CREDIT***

The Internal Revenue Service will execute a pilot initiative during the 2004 Filing Season with the balanced goal of providing better service and improving the integrity of the administration of the Earned Income Tax Credit. A part of this initiative was an EITC certification component. The twin objectives of the certification process are to 1) reduce overpayments and 2) improve participation of eligible EITC customers

If a taxpayer has received correspondence regarding EITC certification, offer to review the information with the customer. If the taxpayer has received a determination letter, please complete the return, relative to the EITC, as directed. Please note if the customer's situation has altered since receiving a determination letter the qualifying rules still apply. The customer interview is a critical part of completing a correct return.

## 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 2003. 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 is computed on the Earned Income Credit (EIC) Worksheet. Before completing the EIC Worksheet, **you must** complete the steps in the EIC instructions line 63 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 but appears to be based on income limitations, write “No” next to line 8 of 1040EZ; line 41 of 1040A; or line 63 of 1040. **The steps and the EIC Worksheets are included in the 1040, 1040A, and 1040EZ instructions.**

There are two versions (A and B) of the EIC Worksheet for Form 1040 filers. 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. 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 \$3,026.

## 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? \_\_\_\_\_

## 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.

## 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.

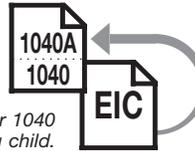
### Example 6

Ronald Evans (SSN 000-00-9840) is single. His son, Harry (SSN 000-00-9849), was born in 1981. Harry lived with Ronald during all of 2003. 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.

**SCHEDULE EIC**  
**(Form 1040A or 1040)**

**Earned Income Credit**  
**Qualifying Child Information**



OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **43**

Department of the Treasury  
Internal Revenue Service

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.

Name(s) shown on return

RONALD EVANS

Your social security number

000 : 00 : 9840

**Before you begin:** See the instructions for Form 1040A, line 41, or Form 1040, line 63, 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 <b>Child's name</b> 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
		HARRY	EVANS	
2 <b>Child's SSN</b> The child must have an SSN as defined on page 44 of the Form 1040A instructions or page 46 of the Form 1040 instructions unless the child was born and died in 2003. If your child was born and died in 2003 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.	000	00	9849	

Next, if the child was born after 1984, go to line 4. Otherwise, continue.

3 <b>If the child was born before 1985—</b> <b>a</b> Was the child under age 24 at the end of 2003 and a student?	<input checked="" type="checkbox"/> <b>Yes.</b> <i>Go to line 4.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue</i>	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 4.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue</i>
	<input type="checkbox"/> <b>Yes.</b> <i>Continue</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.	<input type="checkbox"/> <b>Yes.</b> <i>Continue</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.
4 <b>Child's relationship to you</b> (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)	SON			
5 <b>Number of months child lived with you in the United States during 2003</b> • If the child lived with you for more than half of 2003 but less than 7 months, enter "7". • If the child was born or died in 2003 and your home was the child's home for the entire time he or she was alive during 2003, enter "12".	12 months <i>Do not enter more than 12 months.</i>		_____ months <i>Do not enter more than 12 months.</i>	



You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2003, (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 65 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2003

### 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 1040A, line 7 shows that the Bells had wages of \$21,211, line 8a shows \$39 of taxable interest income, and line 21 shows the Bells' adjusted gross income of \$21,250.

Complete the EIC Worksheet and Schedule EIC.

### 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.

## 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 attached 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 2003:
  - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,692 (\$34,692 if married filing jointly)?
  - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,666 (\$30,666 if married filing jointly)?
  - No children live with you, is the amount on Form 1040A, line 22, less than \$11,230 (\$12,230 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 42)?
 

**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 2003?
 

**Yes.** *See Nonresident aliens on page 42.*

**No.** *Go to Step 2.*

### Step 2 Investment Income

- Add the amounts from Form 1040A:

Line 8a \_\_\_\_\_  
 Line 8b + \_\_\_\_\_  
 Line 9a + \_\_\_\_\_  
 Line 10a + \_\_\_\_\_

**Investment Income** =

- Is your investment income more than \$2,600?
 

**Yes.** You cannot take the credit.

**No.** *Continue*
- Did a child live with you in 2003?
 

**Yes.** *Go to Step 3 on page 40.*

**No.** *Go to Step 4 on page 40.*

(Continued on page 40)

**Step 3 Qualifying Child**

A qualifying child is a child who is your...

Son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild)

or

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as you would your own child

or

Foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child)

**AND**

was at the end of 2003...

Under age 19

or

Under age 24 and a student (see page 42)

or

Any age and permanently and totally disabled (see page 42)

**AND**

who...

Lived with you in the United States for more than half of 2003. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 41.

**Note.** If the child was married, see page 42.

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 2003?

**Yes.**   **No.** *Continue* ↘  
You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Do you have at least one child who meets the above conditions to be your qualifying child?

**Yes.** *Go to question 3.*  **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 2003?

**Yes.** *See Qualifying Child of More Than One Person on page 42.*  **No.** This child is your qualifying child. The child must have a valid social security number as defined on page 42 unless the child was born and died in 2003. *Skip Step 4; go to Step 5 on page 41.*

**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 2003?

**Yes.**   **No.** *Continue* ↘  
You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2003 tax return?

**Yes.**   **No.** *Continue* ↘  
You cannot take the credit.

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2003?

**Yes.** *Continue* ↘  **No.**  You cannot take the credit.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 42 before you answer.

**Yes.** *Go to Step 5 on page 41.*  **No.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

**Step 5 Earned Income**

1. Figure earned income:

Form 1040, line 7 \_\_\_\_\_

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- 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 Form W-2. 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 =

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,692 (\$34,692 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,666 (\$30,666 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,230 (\$12,230 if married filing jointly)?

**Yes.** Go to Step 6.       **No.** **STOP**

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 43.

**Definitions and Special Rules**

(listed in alphabetical order)

**Adopted Child.** An adopted child is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

**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, below.

**Exception to "Time Lived With You" Condition.** A child is considered to have lived with you for all of 2003 if the child was born or died in 2003 and your home was this child's home for the entire time he or she was alive in 2003. 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 7. If you were in the military stationed outside the United States, see Members of the Military on page 42.

**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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
- You are taking the EIC without a qualifying child and the only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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 42)

**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**

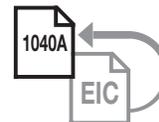
5. If you have:  
 • No qualifying children, is the amount on line 3 less than \$6,250 (\$7,250 if married filing jointly)?  
 • 1 or more qualifying children, is the amount on line 3 less than \$13,750 (\$14,750 if married filing jointly)?  
 **Yes.** Leave line 5 blank; enter the amount from line 2 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 43 to find out if you must file Form 8862 to take the credit for 2003.

Complete this Form

Exhibit 6

Form 1040A (2003)

Page 2

<b>Tax, credits, and payments</b>	<b>22</b>	Enter the amount from line 21 (adjusted gross income).	22	
<b>Standard Deduction for—</b> • People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 34. • All others: Single or Married filing separately, \$4,750 Married filing jointly or Qualifying widow(er), \$9,500 Head of household, \$7,000	<b>23a</b>	Check <input type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind } <b>Total boxes</b> if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind } <b>checked ▶</b> 23a <input type="checkbox"/>		
	<b>b</b>	If you are married filing separately and your spouse itemizes deductions, see page 34 and check here ▶ 23b <input type="checkbox"/>		
	<b>24</b>	Enter your <b>standard deduction</b> (see left margin).	24	
	<b>25</b>	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25	
	<b>26</b>	Multiply \$3,050 by the total number of exemptions claimed on line 6d.	26	
	<b>27</b>	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your <b>taxable income</b> . ▶ 27	27	
	<b>28</b>	<b>Tax, including any alternative minimum tax</b> (see page 35).	28	
	<b>29</b>	Credit for child and dependent care expenses. Attach Schedule 2.	29	
	<b>30</b>	Credit for the elderly or the disabled. Attach Schedule 3.	30	
	<b>31</b>	Education credits. Attach Form 8863.	31	
<b>32</b>	Retirement savings contributions credit. Attach Form 8880.	32		
<b>33</b>	Child tax credit (see page 38).	33		
<b>34</b>	Adoption credit. Attach Form 8839.	34		
<b>35</b>	Add lines 29 through 34. These are your <b>total credits</b> .	35		
<b>36</b>	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36		
<b>37</b>	Advance earned income credit payments from Form(s) W-2.	37		
<b>38</b>	Add lines 36 and 37. This is your <b>total tax</b> . ▶ 38	38		
<b>39</b>	Federal income tax withheld from Forms W-2 and 1099.	39		
<b>40</b>	2003 estimated tax payments and amount applied from 2002 return.	40		
<b>41</b>	<b>Earned income credit (EIC)</b> .	41		
<b>42</b>	Additional child tax credit. Attach Form 8812.	42		
<b>43</b>	Add lines 39 through 42. These are your <b>total payments</b> . ▶ 43	43		
If you have a qualifying child, attach Schedule EIC.	<b>44</b>	If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> .	44	
	<b>45a</b>	Amount of line 44 you want <b>refunded to you</b> . ▶ 45a		
	<b>b</b>	Routing number <input type="text"/> ▶ <b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
<b>d</b>	Account number <input type="text"/>			
<b>46</b>	Amount of line 44 you want <b>applied to your 2004 estimated tax</b> .	46		
Direct deposit? See page 52 and fill in 45b, 45c, and 45d.	<b>47</b>	<b>Amount you owe.</b> Subtract line 43 from line 38. For details on how to pay, see page 53. ▶ 47	47	
	<b>48</b>	Estimated tax penalty (see page 53).	48	
<b>Third party designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 54)? <input type="checkbox"/> <b>Yes.</b> Complete the following. <input type="checkbox"/> <b>No</b>			
	Designee's name ▶	Phone no. ▶ ( )	Personal identification number (PIN) ▶	<input type="text"/>
<b>Sign here</b> Joint return? See page 22. 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 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, <b>both</b> must sign.		Date	Spouse's occupation	<input style="background-color: #cccccc;" type="text"/>
<b>Paid preparer's use only</b>	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. ( )	

Printed on recycled paper

Form 1040A (2003)

Complete this Form

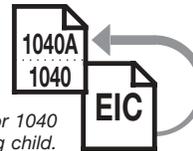
Exhibit 7

**SCHEDULE EIC**  
(Form 1040A or 1040)

Department of the Treasury  
Internal Revenue Service

**Earned Income Credit**  
Qualifying Child Information

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.



OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **43**

Name(s) shown on return

Your social security number

**Before you begin:** See the instructions for Form 1040A, line 41, or Form 1040, line 63, 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 <b>Child's name</b> 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
2 <b>Child's SSN</b> The child must have an SSN as defined on page 44 of the Form 1040A instructions or page 46 of the Form 1040 instructions unless the child was born and died in 2003. If your child was born and died in 2003 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.				
<b>Next, if the child was born after 1984, go to line 4. Otherwise, continue.</b>				
3 <b>If the child was born before 1985—</b>				
a Was the child under age 24 at the end of 2003 and a student?	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 4.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue</i>	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 4.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue</i>
b Was the child permanently and totally disabled during any part of 2003?	<input type="checkbox"/> <b>Yes.</b> <i>Continue</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.	<input type="checkbox"/> <b>Yes.</b> <i>Continue</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.
4 <b>Child's relationship to you</b> (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)				
5 <b>Number of months child lived with you in the United States during 2003</b>				
• If the child lived with you for more than half of 2003 but less than 7 months, enter "7".				
• If the child was born or died in 2003 and your home was the child's home for the entire time he or she was alive during 2003, enter "12".	_____ months <i>Do not enter more than 12 months.</i>		_____ months <i>Do not enter more than 12 months.</i>	



You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2003, (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 65 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2003

## 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 2004 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 58.

### 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 attached 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 2003:
  - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,692 (\$34,692 if married filing jointly)?
  - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,666 (\$30,666 if married filing jointly)?
  - No children live with you, is the amount on Form 1040A, line 22, less than \$11,230 (\$12,230 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 42)?
 

**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 2003?
 

**Yes.** *See Nonresident aliens on page 42.*  **No.** *Go to Step 2.*

### Step 2 Investment Income

- Add the amounts from Form 1040A:

Line 8a \_\_\_\_\_  
 Line 8b + \_\_\_\_\_  
 Line 9a + \_\_\_\_\_  
 Line 10a + \_\_\_\_\_

**Investment Income =**

- Is your investment income more than \$2,600?
 

**Yes.** You cannot take the credit.  **No.** *Continue*
- Did a child live with you in 2003?
 

**Yes.** *Go to Step 3 on page 40.*  **No.** *Go to Step 4 on page 40.*

(Continued on page 40)

**Step 3 Qualifying Child**

A qualifying child is a child who is your...

Son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild)

or

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as you would your own child

or

Foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child)

**AND**

was at the end of 2003...

Under age 19

or

Under age 24 and a student (see page 42)

or

Any age and permanently and totally disabled (see page 42)

**AND**

who...

Lived with you in the United States for more than half of 2003. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 41.

**Note.** If the child was married, see page 42.

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 2003?

- Yes.**   **No.** *Continue* →

You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Do you have at least one child who meets the above conditions to be your qualifying child?

- Yes.** *Go to question 3.*  **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 2003?

- Yes.** *See Qualifying Child of More Than One Person on page 42.*  **No.** This child is your qualifying child. The child must have a valid social security number as defined on page 42 unless the child was born and died in 2003. *Skip Step 4; go to Step 5 on page 41.*

**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 2003?

- Yes.**   **No.** *Continue* →  
You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2003 tax return?

- Yes.**   **No.** *Continue* →  
You cannot take the credit.

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2003?

- Yes.** *Continue* →  **No.**   
You cannot take the credit.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 42 before you answer.

- Yes.** *Go to Step 5 on page 41.*  **No.**   
You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

Need more information or forms? See page 7.

**Step 5 Earned Income**

1. Figure earned income:

Form 1040, line 7 \_\_\_\_\_

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- 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 Form W-2. 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 =**

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,692 (\$34,692 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,666 (\$30,666 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,230 (\$12,230 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 43.

**Definitions and Special Rules**

(listed in alphabetical order)

**Adopted Child.** An adopted child is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

**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, below.

**Exception to “Time Lived With You” Condition.** A child is considered to have lived with you for all of 2003 if the child was born or died in 2003 and your home was this child’s home for the entire time he or she was alive in 2003. 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 7. If you were in the military stationed outside the United States, see Members of the Military on page 42.

**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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
- You are taking the EIC without a qualifying child and the only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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 42)

**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 \$6,250 (\$7,250 if married filing jointly)?  
 • 1 or more qualifying children, is the amount on line 3 less than \$13,750 (\$14,750 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**

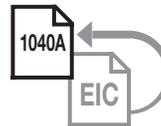
6. **This is your earned income credit.**

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 43 to find out if you must file Form 8862 to take the credit for 2003.

Complete this Form

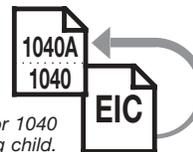
Exhibit 12

**SCHEDULE EIC**  
(Form 1040A or 1040)

Department of the Treasury  
Internal Revenue Service

**Earned Income Credit**  
Qualifying Child Information

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.



OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **43**

Name(s) shown on return

Your social security number

**Before you begin:** See the instructions for Form 1040A, line 41, or Form 1040, line 63, 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

**2 Child's SSN**

The child must have an SSN as defined on page 44 of the Form 1040A instructions or page 46 of the Form 1040 instructions unless the child was born and died in 2003. If your child was born and died in 2003 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.

Next, if the child was born after 1984, go to line 4. Otherwise, continue.

**3 If the child was born before 1985**

**a** Was the child under age 24 at the end of 2003 and a student?

Yes.

No.

Go to line 4.

Continue

Yes.

No.

Go to line 4.

Continue

**b** Was the child permanently and totally disabled during any part of 2003?

Yes.

No.

Continue

The child is not a qualifying child.

Yes.

No.

Continue

The child is not a qualifying child.

**4 Child's relationship to you**

(for example, son, daughter, grandchild, niece, nephew, foster child, etc.)

**5 Number of months child lived with you in the United States during 2003**

- If the child lived with you for more than half of 2003 but less than 7 months, enter "7".
- If the child was born or died in 2003 and your home was the child's home for the entire time he or she was alive during 2003, enter "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 2003, (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 65 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2003

▶▶ **SUMMING UP THIS LESSON** ◀◀

- ▶ The earned income credit can be claimed on Form 1040EZ, Form 1040A or Form 1040.

### Exercise 1

- (A) No; to be a qualifying child, the child must live with the taxpayer 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 \$11,230; 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) \$3,120
- (B) \$1,900

# EARNED INCOME CREDIT

## Lesson 9

## ANSWERS TO EXERCISES

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	1,509
---	-------

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 \$6,250 (\$7,250 if married filing jointly)?
- 1 or more qualifying children, is the amount on line 3 less than \$13,750 (\$14,750 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	\$1,501
---	---------

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

#### Part 3

#### Your Earned Income Credit

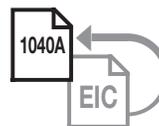
6. This is your earned income credit.

6	\$1,501
---	---------

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 43 to find out if you must file Form 8862 to take the credit for 2003.

### 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 attached 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 2003:
  - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,692 (\$34,692 if married filing jointly)?
  - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,666 (\$30,666 if married filing jointly)?
  - No children live with you, is the amount on Form 1040A, line 22, less than \$11,230 (\$12,230 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 42)?

**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.**       **No.** *Continue* →  
You cannot take the credit.
4. Were you a nonresident alien for any part of 2003?

**Yes.** See *Nonresident aliens* on page 42.       **No.** Go to Step 2.

#### Step 2 Investment Income

1. Add the amounts from Form 1040A:

Line 8a		\$39
Line 8b	+	0
Line 9a	+	0
Line 10a	+	0

Investment Income = **\$39**

2. Is your investment income more than \$2,600?

**Yes.** You cannot take the credit.       **No.** *Continue* →
3. Did a child live with you in 2003?

**Yes.** Go to Step 3 on page 40.       **No.** Go to Step 4 on page 40.

# EARNED INCOME CREDIT

## Lesson 9

## ANSWERS TO EXERCISES

### Exercise 3

Bell's Eligibility Questions, page 2

Form 1040A—Line 41

#### Step 3 Qualifying Child

A qualifying child is a child who is your...

Son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild)

or

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as you would your own child

or

Foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child)

AND

was at the end of 2003...

Under age 19

or

Under age 24 and a student (see page 42)

or

Any age and permanently and totally disabled (see page 42)

AND

who...

Lived with you in the United States for more than half of 2003. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 41.

**Note.** If the child was married, see page 42.

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 2003?

**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.** Go to question 3.

**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 2003?

**Yes.** See *Qualifying Child of More Than One Person* on page 42.

**No.** This child is your qualifying child. The child must have a valid social security number as defined on page 42 unless the child was born and died in 2003. Skip Step 4; go to Step 5 on page 41.

#### 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 2003?

**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 2003 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 2003?

**Yes.** Continue →

**No.** 

You cannot take the credit.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 42 before you answer.

**Yes.** Go to Step 5 on page 41.

**No.** 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

### Exercise 3

Bell's Eligibility Questions, page 3

Form 1040A—Line 41

#### Step 5 Earned Income

1. Figure earned income:

Form 1040, line 7 21,211

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- 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 Form W-2. 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 = 21,211

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,692 (\$34,692 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,666 (\$30,666 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,230 (\$12,230 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 43.

#### Definitions and Special Rules

(listed in alphabetical order)

**Adopted Child.** An adopted child is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

**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, below.

**Exception to "Time Lived With You" Condition.** A child is considered to have lived with you for all of 2003 if the child was born or died in 2003 and your home was this child's home for the entire time he or she was alive in 2003. 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 7. If you were in the military stationed outside the United States, see Members of the Military on page 42.

**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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

- You are taking the EIC without a qualifying child and the only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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 42)

# EARNED INCOME CREDIT

## Lesson 9

## ANSWERS TO EXERCISES

### Exercise 3

Bell's Schedule EIC, page 1

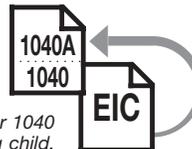
#### SCHEDULE EIC (Form 1040A or 1040)

Department of the Treasury  
Internal Revenue Service

### Earned Income Credit

#### Qualifying Child Information

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.



OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **43**

Name(s) shown on return

Sam U. and Robin O. Bell

Your social security number

000 00 4797

**Before you begin:** See the instructions for Form 1040A, line 41, or Form 1040, line 63, 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

	First name	Last name	First name	Last name
<b>1 Child's name</b> If you have more than two qualifying children, you only have to list two to get the maximum credit.	Jennifer	Bell		
<b>2 Child's SSN</b> The child must have an SSN as defined on page 44 of the Form 1040A instructions or page 46 of the Form 1040 instructions unless the child was born and died in 2003. If your child was born and died in 2003 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.	000	00	1987	
<b>Next</b> , if the child was born after 1984, go to line 4. Otherwise, continue.				
<b>3 If the child was born before 1985—</b> <b>a</b> Was the child under age 24 at the end of 2003 and a student?	<input type="checkbox"/> Yes. <i>Go to line 4.</i>	<input type="checkbox"/> No. <i>Continue</i>	<input type="checkbox"/> Yes. <i>Go to line 4.</i>	<input type="checkbox"/> No. <i>Continue</i>
<b>b</b> Was the child permanently and totally disabled during any part of 2003?	<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>	<input type="checkbox"/> No. The child is not a qualifying child.
<b>4 Child's relationship to you</b> (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)	Daughter			
<b>5 Number of months child lived with you in the United States during 2003</b> • If the child lived with you for more than half of 2003 but less than 7 months, enter "7". • If the child was born or died in 2003 and your home was the child's home for the entire time he or she was alive during 2003, enter "12".	12 months <i>Do not enter more than 12 months.</i>		_____ months <i>Do not enter more than 12 months.</i>	



You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2003, (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 65 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2003

# EARNED INCOME CREDIT

## ANSWERS TO EXERCISES

## Lesson 9

### Exercise 3

Bell's Schedule EIC, page 2

claimed as a dependent, see page 34. • All others: Single or Married filing separately, \$4,750 Married filing jointly or Qualifying widow(er), \$9,500 Head of household, \$7,000	<b>28</b>	<b>Tax, including any alternative minimum tax (see page 35).</b>	28		
	<b>29</b>	Credit for child and dependent care expenses. Attach Schedule 2.	29		
	<b>30</b>	Credit for the elderly or the disabled. Attach Schedule 3.	30		
	<b>31</b>	Education credits. Attach Form 8863.	31		
	<b>32</b>	Retirement savings contributions credit. Attach Form 8880.	32		
	<b>33</b>	Child tax credit (see page 38).	33		
	<b>34</b>	Adoption credit. Attach Form 8839.	34		
	<b>35</b>	Add lines 29 through 34. These are your <b>total credits</b> .	35	0	00
	<b>36</b>	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36	0	00
	<b>37</b>	Advance earned income credit payments from Form(s) W-2.	37		
	<b>38</b>	Add lines 36 and 37. This is your <b>total tax</b> .	▶ 38	0	00
	<b>39</b>	Federal income tax withheld from Forms W-2 and 1099.	39		
	<b>40</b>	2003 estimated tax payments and amount applied from 2002 return.	40		
If you have a qualifying child, attach Schedule EIC.	<b>41</b>	<b>Earned income credit (EIC).</b>	41	1,501	00
	<b>42</b>	Additional child tax credit. Attach Form 8812.	42		
	<b>43</b>	Add lines 39 through 42. These are your <b>total payments</b> .	▶ 43	1,501	00

### Exercise 4

- (A) See Kyle's completed steps and the EIC worksheet.  
 (B) See Kyle's Schedule EIC.

# EARNED INCOME CREDIT

## Lesson 9

## ANSWERS TO EXERCISES

Exercise 4(D)

Kyle's EIC Eligibility Questions, page 1

Form 1040A—Line 41

### 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 attached 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 2003:

- 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,692 (\$34,692 if married filing jointly)?
- 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,666 (\$30,666 if married filing jointly)?
- No children live with you, is the amount on Form 1040A, line 22, less than \$11,230 (\$12,230 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 42)?

**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 2003?

**Yes.** *See Nonresident aliens on page 42.*  **No.** *Go to Step 2.*

#### Step 2 Investment Income

1. Add the amounts from Form 1040A:

Line 8a		0
Line 8b	+	0
Line 9a	+	0
Line 10a	+	0

Investment Income =

2. Is your investment income more than \$2,600?

**Yes.**   **No.** *Continue* →

You cannot take the credit.

3. Did a child live with you in 2003?

**Yes.** *Go to Step 3 on page 40.*  **No.** *Go to Step 4 on page 40.*

### Exercise 4(D)

### Kyle's EIC Eligibility Questions, page 2

Form 1040A—Line 41

#### Step 3 Qualifying Child

A qualifying child is a child who is your...

Son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild)

or

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as you would your own child

or

Foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child)

AND

was at the end of 2003...

Under age 19

or

Under age 24 and a student (see page 42)

or

Any age and permanently and totally disabled (see page 42)

AND

who...

Lived with you in the United States for more than half of 2003. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 41.

**Note.** If the child was married, see page 42.

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 2003?

**Yes.** 

**No. Continue** 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Do you have at least one child who meets the above conditions to be your qualifying child?

**Yes.** Go to question 3.  **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 2003?

**Yes.** See *Qualifying Child of More Than One Person* on page 42.

**No.** This child is your qualifying child. The child must have a valid social security number as defined on page 42 unless the child was born and died in 2003. Skip Step 4; go to Step 5 on page 41.

#### 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 2003?

**Yes.** 

**No. Continue** 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2003 tax return?

**Yes.** 

**No. Continue** 

You cannot take the credit.

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2003?

**Yes. Continue** 

**No.** 

You cannot take the credit.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 42 before you answer.

**Yes.** Go to Step 5 on page 41.  **No.** 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

# EARNED INCOME CREDIT

## Lesson 9

## ANSWERS TO EXERCISES

### Exercise 4(D)

Kyle's EIC Eligibility Questions, page 3

Form 1040A—Line 41

#### Step 5 Earned Income

1. Figure earned income:

Form 1040, line 7 18,751

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- 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 Form W-2. 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 = 18,751

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,692 (\$34,692 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,666 (\$30,666 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,230 (\$12,230 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 43.

#### Definitions and Special Rules

(listed in alphabetical order)

**Adopted Child.** An adopted child is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

**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, below.

**Exception to "Time Lived With You" Condition.** A child is considered to have lived with you for all of 2003 if the child was born or died in 2003 and your home was this child's home for the entire time he or she was alive in 2003. 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 7. If you were in the military stationed outside the United States, see Members of the Military on page 42.

**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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
- You are taking the EIC without a qualifying child and the only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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 42)

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	1,740
---	-------

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 \$6,250 (\$7,250 if married filing jointly)?

• 1 or more qualifying children, is the amount on line 3 less than \$13,750 (\$14,750 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	1,668
---	-------

#### Part 3

#### Your Earned Income Credit

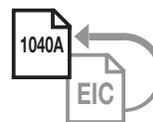
6. This is your earned income credit.

6	1,668
---	-------

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 43 to find out if you must file Form 8862 to take the credit for 2003.

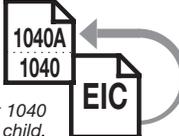
# EARNED INCOME CREDIT

Lesson 9

ANSWERS TO EXERCISES

Exercise 4(D)

Evan's Schedule EIC

<p><b>SCHEDULE EIC</b> (Form 1040A or 1040)</p> <p>Department of the Treasury Internal Revenue Service</p>	<p><b>Earned Income Credit</b> 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 style="font-size: 2em; font-weight: bold;">2003</p> <p>Attachment Sequence No. <b>43</b></p>																																													
Name(s) shown on return <b>Kyle B. Evans</b>		Your social security number <b>000 00 2442</b>																																														
<p><b>Before you begin:</b> See the instructions for Form 1040A, line 41, or Form 1040, line 63, to make sure that (a) you can take the EIC and (b) you have a qualifying child.</p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> </ul>																																																
																																																
<p><b>Qualifying Child Information</b></p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 40%;"></th> <th style="width: 20%; text-align: center;">Child 1</th> <th style="width: 20%;"></th> <th style="width: 20%; text-align: center;">Child 2</th> </tr> <tr> <td></td> <td style="text-align: center;">First name</td> <td style="text-align: center;">Last name</td> <td style="text-align: center;">First name</td> </tr> </thead> <tbody> <tr> <td><b>1 Child's name</b> <small>If you have more than two qualifying children, you only have to list two to get the maximum credit.</small></td> <td style="text-align: center;"><b>Julie</b></td> <td style="text-align: center;"><b>Evans</b></td> <td></td> </tr> <tr> <td><b>2 Child's SSN</b> <small>The child must have an SSN as defined on page 44 of the Form 1040A instructions or page 46 of the Form 1040 instructions unless the child was born and died in 2003. If your child was born and died in 2003 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.</small></td> <td style="text-align: center;">000 00 4104</td> <td></td> <td></td> </tr> <tr> <td colspan="4"><b>Next, if the child was born after 1984, go to line 4. Otherwise, continue.</b></td> </tr> <tr> <td><b>3 If the child was born before 1985—</b></td> <td colspan="2"></td> <td colspan="2"></td> </tr> <tr> <td><b>a</b> Was the child under age 24 at the end of 2003 and a student?</td> <td style="text-align: center;"><input type="checkbox"/> Yes. <i>Go to line 4.</i></td> <td style="text-align: center;"><input type="checkbox"/> No. <i>Continue</i></td> <td style="text-align: center;"><input type="checkbox"/> Yes. <i>Go to line 4.</i></td> <td style="text-align: center;"><input type="checkbox"/> No. <i>Continue</i></td> </tr> <tr> <td><b>b</b> Was the child permanently and totally disabled during any part of 2003?</td> <td style="text-align: center;"><input type="checkbox"/> Yes. <i>Continue</i></td> <td style="text-align: center;"><input type="checkbox"/> No. The child is not a qualifying child.</td> <td style="text-align: center;"><input type="checkbox"/> Yes. <i>Continue</i></td> <td style="text-align: center;"><input type="checkbox"/> No. The child is not a qualifying child.</td> </tr> <tr> <td><b>4 Child's relationship to you</b> <small>(for example, son, daughter, grandchild, niece, nephew, foster child, etc.)</small></td> <td colspan="2" style="text-align: center;"><b>Daughter</b></td> <td colspan="2"></td> </tr> <tr> <td><b>5 Number of months child lived with you in the United States during 2003</b> <ul style="list-style-type: none"> <li>• If the child lived with you for more than half of 2003 but less than 7 months, enter "7".</li> <li>• If the child was born or died in 2003 and your home was the child's home for the entire time he or she was alive during 2003, enter "12".</li> </ul></td> <td colspan="2" style="text-align: center;"><u>12</u> months <i>Do not enter more than 12 months.</i></td> <td colspan="2" style="text-align: center;">_____ months <i>Do not enter more than 12 months.</i></td> </tr> </tbody> </table>					Child 1		Child 2		First name	Last name	First name	<b>1 Child's name</b> <small>If you have more than two qualifying children, you only have to list two to get the maximum credit.</small>	<b>Julie</b>	<b>Evans</b>		<b>2 Child's SSN</b> <small>The child must have an SSN as defined on page 44 of the Form 1040A instructions or page 46 of the Form 1040 instructions unless the child was born and died in 2003. 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<p><b>TIP</b> You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2003, (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 65 of Form 1040.</p>																																																
For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.		Cat. No. 13339M	Schedule EIC (Form 1040A or 1040) 2003																																													

## LESSON OVERVIEW AND OBJECTIVES

In this lesson you will explain how to compute child tax credit, additional child tax credit and complete Form 8812. Approximately 1 to 1 1/2 hours should be devoted to covering the objectives of this lesson.

After completing this lesson you should be able to:

Explain the advance child tax credit and determine who received the advance payment.

Calculate the child tax credit using the child tax credit worksheet.

Calculate the additional child tax credit by using Form 8812.

## MATERIALS

This lesson will refer to the following IRS forms and worksheets. If you would like to provide your students with the most current revision of the forms and worksheets, you can download the files from [www.irs.gov](http://www.irs.gov).

- Publication 972, Child Tax Credit
- Child Tax Credit Worksheet (1040 and 1040A Instructions and Publication 972)
- Form 8812

## TEACHING TIPS

1. 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.
2. To check withholding allowances for 2004, the taxpayer should fill out a 2004 Form W-4.
3. 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.
4. 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.
5. Taxpayers who can claim the additional child tax credit should file a tax return even if they are not otherwise required to file because additional child tax credit may give the taxpayer a refund, even if he or she does not owe any tax.
6. The child tax credit must be figured before the additional child tax credit can be figured.

## GUIDED QUESTIONS

1. **Where does a taxpayer figure the child tax credit?** (Child Tax Credit Worksheet)
2. **What 2 factors affect the amount of a taxpayer's child tax credit?** (The taxpayer's modified AGI and filing status)

## OPTIONAL CLASS ACTIVITY

With an overhead projector and transparencies of the child tax credit questions for Form 1040 filers and the *Child Tax Credit Worksheet* from Publication 972, and the class's assistance, compute the allowable amount of the child tax credit for Susan Smythe.

Susan is a single taxpayer, with two dependent children under age 17. The children are qualifying children for the purpose of the child tax credit. She received an \$800 Advance Child Tax Credit payment in July. Susan's modified AGI is \$77,500, her filing status is head of household, her taxable income is \$61,600, and her tax is \$11,645.

Susan's allowable credit is \$1,050. Draw the students' attention to line 6 of the Child Tax Credit Worksheet from Publication 972. Note to class that the amount in block 6 **must** be a multiple of \$1,000.



## 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:

- Explain the advance child tax credit and determine who received the advance payment.
- Calculate the child tax credit using the child tax credit worksheet.
- Calculate the additional child tax credit by using form 8812.

## ADVANCE CHILD TAX CREDIT PAYMENTS

The Jobs and Growth Tax Relief Reconciliation Act of 2003 raised the Child Tax Credit to a maximum of \$1,000 per child from \$600 per child, beginning in 2003. The Act also provided for immediate tax relief by directing the Treasury to send this increase to taxpayers last summer. Eligible taxpayers could receive up to \$400 for each child claimed on their 2002 returns as an advance payment of their 2003 Child Tax Credit.

The IRS used 2002 tax year data to determine who was issued the advance payment. Generally:

- Taxpayers must have claimed the Child Tax Credit on the 2002 tax return.
- Taxpayers must have used Form 1040 or Form 1040A, or filed electronically.
- The child must have been born after 1986.

There were no actions required of the Taxpayers to receive the advance payment. The IRS automatically sent notices to eligible taxpayers. The IRS notice was followed a few days later by the advance payment check. Both the notice and the check were mailed to the address listed on the taxpayer's 2002 tax return. Anyone who had moved since the filing of the 2002 return should have notified the U.S. Postal Service of the new address, and the notice and check were forwarded.

### ALERT



Beginning in 2003, the Child Tax Credit increased to \$1,000 per qualifying child.

The advance payment checks were mailed July 25th, August 1st, and August 8th to taxpayers who filed their returns by April 15th. The checks were issued based on the last two digits of the Social Security number listed first on the 2002 tax return. Taxpayers whose last two digits are the lowest received their checks first.

Taxpayers who received filing extensions still got the advance payment checks if they were eligible. They were mailed between four to six weeks after the IRS received their 2002 tax return.

If the taxpayer received the advance Child Tax Credit payment, he or she must include the amount received on the Child Tax Credit Worksheet when calculating the 2003 Child Tax Credit.

The IRS established a new service at *www.irs.gov: Where's My Advance Child Tax Credit?* This new service provides on-line advance child tax credit payment information. The information includes the amount of a taxpayer's advance payment, the check mailing date, and any offsets to outstanding liabilities.

Since the taxpayers must figure their advance payments into their calculations for their 2003 child tax credit, *Where's My Advance Child Tax Credit?* information will be available through April 15, 2004.

## ALERT



Beginning in 2003, the Child Tax Credit increased to \$1,000 per child.

## 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 \$1000 per child for 2003. 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 2003,
- 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 2003, AGI is shown on line 21 of Form 1040A and on line 34 of Form 1040.

Table 1: <i>Child Tax Credit</i> 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. They received an \$800 advance child tax credit payment last summer. Their tax on line 43 for 2003 is \$4,503. 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, after considering the advance child tax credit payment. Their modified AGI is less than the phaseout amount for their filing status (\$110,000).

Form 1040—Line 49

## Line 49—Child Tax Credit

### What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined below. It is in addition to the credit for child and dependent care expenses on Form 1040, line 45, and the earned income credit on Form 1040, line 63.

### Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit. See **Qualifying Child for Child Tax Credit** below.
- Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040 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.

### Qualifying Child for Child Tax Credit

A qualifying child for purposes of the child tax credit is a child who:

- Is claimed as your dependent on line 6c, **and**
- Was **under age 17** at the end of 2003, **and**
- Is your (a) son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild); (b) brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew), whom you cared for as you would your own child; or (c) foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child), **and**
- Is a U.S. citizen or resident alien.

**Note.** The above requirements are not the same as the requirements to be a qualifying child for the earned income credit.

An **adopted child** is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

A **grandchild** is any descendant of your son, daughter, adopted child, or stepchild and includes your great-grandchild, great-great-grandchild, etc.

### Questions

### Who Must Use Pub. 972



1. Are you excluding income from Puerto Rico **or** are you filing any of the following forms?
  - Form 2555 or 2555-EZ (relating to foreign earned income)
  - Form 4563 (exclusion of income for residents of American Samoa)

**No.** *Continue*  **Yes.** You must use Pub. 972 to figure your credit.

---

2. Is the amount on Form 1040, line 35, 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.

---

3. Are you claiming any of the following credits?
  - Adoption credit, Form 8839 (see the instructions for Form 1040, line 50, on page 40)
  - Mortgage interest credit, Form 8396 (see the instructions for Form 1040, line 51, on page 40)
  - District of Columbia first-time homebuyer credit, Form 8859

**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 the form(s) listed above for any credit(s) you are claiming.

Need more information or forms? See page 7.

### Child Tax Credit Worksheet—Line 49

Keep for Your Records

#### Before you begin:

✓ If you received (before offset) an advance payment of the child tax credit and you filed a joint return for 2002, you and your spouse are each considered to have received one-half of the payment.



- To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2003 and meet the other requirements listed on page 38.
- **Do not** use this worksheet if you answered “Yes” to question 1, 2, or 3 on page 38. Instead, use Pub. 972.

1. Number of qualifying children: 2 X \$1,000. Enter the result. 1 | \$2,000

2. Enter the amount, if any, of your advance child tax credit (before offset). 2 | \$800

3. Is line 1 less than or equal to line 2?  
 Yes. You cannot take this credit. If line 2 is more than line 1, you do not have to pay back the difference.  
 No. Subtract line 2 from line 1. 3 | \$1,200

4. Enter the amount from Form 1040, line 43. 4 | \$4,503

5. Enter the total of the amounts from Form 1040, lines 44 through 48. 5 | \$0

6. Are the amounts on lines 4 and 5 the same?  
 Yes. You cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit**. See the **TIP** below.  
 No. Subtract line 5 from line 4. 6 | \$4,503

7. Is the amount on line 3 more than the amount on line 6?  
 Yes. Enter the amount from line 6. Also, you may be able to take the **additional child tax credit**. See the **TIP** below.  
 No. Enter the amount from line 3. 7 | \$1,200

} **This is your child tax credit.**  
*Enter this amount on Form 1040, line 49.*



You may be able to take the **additional child tax credit** on Form 1040, line 65, if you answered “Yes” on line 6 or line 7 above.

- First, complete your Form 1040 through line 64.
- Then, use Form 8812 to figure any additional child tax credit.

Draft as of 08/27/2003

## ADDITIONAL CHILD TAX CREDIT

The child tax credit is a nonrefundable credit that gives eligible taxpayers \$1000 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**.

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 \$10,500.

**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 \$10,500.

### Example 2

Maureen Langston is filing Form 1040. Her filing status is head of household for 2003. She has five dependent children, all of whom are qualifying children for purposes of the child tax credit. Maureen received a \$2,000 advance child tax credit payment check in August 2003. 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 \$1,588. 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).

Form 1040—Line 49

## Line 49—Child Tax Credit

### What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined below. It is in addition to the credit for child and dependent care expenses on Form 1040, line 45, and the earned income credit on Form 1040, line 63.

### Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit. See **Qualifying Child for Child Tax Credit** below.
- Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040 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.

### Qualifying Child for Child Tax Credit

A qualifying child for purposes of the child tax credit is a child who:

- Is claimed as your dependent on line 6c, **and**
- Was **under age 17** at the end of 2003, **and**
- Is your **(a)** son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild); **(b)** brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew), whom you cared for as you would your own child; or **(c)** foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child), **and**
- Is a U.S. citizen or resident alien.

**Note.** The above requirements are not the same as the requirements to be a qualifying child for the earned income credit.

An **adopted child** is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

A **grandchild** is any descendant of your son, daughter, adopted child, or stepchild and includes your great-grandchild, great-great-grandchild, etc.

### Questions

### Who Must Use Pub. 972



1. Are you excluding income from Puerto Rico **or** are you filing any of the following forms?
  - Form 2555 or 2555-EZ (relating to foreign earned income)
  - Form 4563 (exclusion of income for residents of American Samoa)

**No.** *Continue*

**Yes.** You must use Pub. 972 to figure your credit.

---

2. Is the amount on Form 1040, line 35, 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.

---

3. Are you claiming any of the following credits?
  - Adoption credit, Form 8839 (see the instructions for Form 1040, line 50, on page 40)
  - Mortgage interest credit, Form 8396 (see the instructions for Form 1040, line 51, on page 40)
  - District of Columbia first-time homebuyer credit, Form 8859

**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 the form(s) listed above for any credit(s) you are claiming.

Need more information or forms? See page 7.

**Child Tax Credit Worksheet—Line 49**

Keep for Your Records

**Before you begin:**

✓ If you received (before offset) an advance payment of the child tax credit and you filed a joint return for 2002, you and your spouse are each considered to have received one-half of the payment.



- To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2003 and meet the other requirements listed on page 38.
- **Do not** use this worksheet if you answered “Yes” to question 1, 2, or 3 on page 38. Instead, use Pub. 972.

1. Number of qualifying children: 5 X \$1,000. Enter the result. 

1	\$5,000
---	---------

2. Enter the amount, if any, of your advance child tax credit (before offset). 

2	\$2,000
---	---------

3. Is line 1 less than or equal to line 2?  
 Yes. You cannot take this credit. If line 2 is more than line 1, you do not have to pay back the difference.  
 No. Subtract line 2 from line 1. 

3	\$3,000
---	---------

4. Enter the amount from Form 1040, line 43. 

4	\$149
---	-------

5. Enter the total of the amounts from Form 1040, lines 44 through 48. 

5	\$0
---	-----

6. Are the amounts on lines 4 and 5 the same?  
 Yes. You cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit**. See the **TIP** below.  
 No. Subtract line 5 from line 4. 

6	\$149
---	-------

7. Is the amount on line 3 more than the amount on line 6?  
 Yes. Enter the amount from line 6. Also, you may be able to take the **additional child tax credit**. See the **TIP** below.  
 No. Enter the amount from line 3. 

7	\$149
---	-------

  
*Enter this amount on Form 1040, line 49.*



You may be able to take the **additional child tax credit** on Form 1040, line 65, if you answered “Yes” on line 6 or line 7 above.

- First, complete your Form 1040 through line 64.
- Then, use Form 8812 to figure any additional child tax credit.

Draft as of 08/27/2003

Form <b>8812</b> 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;">2003</h1> Attachment Sequence No. <b>47</b>
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Name(s) shown on return Maureen Langston Your social security number  
000 : 00 : 9999

**Part I All Filers**

<b>1</b> Enter the amount from line 3 of your Child Tax Credit Worksheet on page 40 of the Form 1040 instructions or page 39 of the Form 1040A instructions. If you used Pub. 972, enter the amount from line 10 of the worksheet on page 3 of the publication . . . . .	1	\$3,000	
<b>2</b> Enter the amount from Form 1040, line 49, or Form 1040A, line 33 . . . . .	2	\$149	
<b>3</b> Subtract line 2 from line 1. If zero, <b>stop</b> ; you cannot take this credit . . . . .	3	\$2,851	
<b>4</b> Enter your total taxable earned income. See the instructions on back . . . . .	4	\$26,375	
<b>5</b> Is the amount on line 4 more than \$10,500? <input type="checkbox"/> <b>No.</b> Leave line 5 blank and enter -0- on line 6. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract \$10,500 from the amount on line 4. Enter the result . . . . .	5	\$15,875	
<b>6</b> Multiply the amount on line 5 by 10% (.10) and enter the result . . . . . <b>Next.</b> Do you have three or more qualifying children? <input type="checkbox"/> <b>No.</b> If line 6 is zero, <b>stop</b> ; you cannot take this credit. Otherwise, skip Part II and enter the <b>smaller</b> of line 3 or line 6 on line 13. <input checked="" type="checkbox"/> <b>Yes.</b> 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	\$1,588	

**Part II Certain Filers Who Have Three or More Qualifying Children**

<b>7</b> 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	
<b>8 1040 filers:</b> Enter the total of the amounts from Form 1040, lines 28 and 56, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 60. <b>1040A filers:</b> Enter -0-.	8	\$0	
<b>9</b> Add lines 7 and 8 . . . . .	9	\$2,018	
<b>10 1040 filers:</b> Enter the total of the amounts from Form 1040, lines 63 and 64. <b>1040A filers:</b> 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	
<b>11</b> Subtract line 10 from line 9. If zero or less, enter -0- . . . . .	11	\$585	
<b>12</b> Enter the <b>larger</b> of line 6 or line 11 here . . . . . <b>Next,</b> enter the <b>smaller</b> of line 3 or line 12 on line 13.	12	\$1,588	

**Part III Your Additional Child Tax Credit**

<b>13 This is your additional child tax credit</b> . . . . .	13	\$1,588	
--	----	---------	--

Enter this amount on Form 1040, line 65, or Form 1040A, line 42.

## 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 49, 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 63, 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 48 of your 1040 instructions	Worksheet B, line 4b.*
	Step 5 on page 45 of your 1040 instructions (but not Worksheet B)	Step 5, Earned Income
1040A	Step 5 on page 43 of your 1040A instructions	Step 5, Earned Income

\* If you were a member of the clergy, 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 were a member of the clergy or 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?

- Taxable 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 2003.

### 1040A Filers

If you, or your spouse if filing a joint return, had more than one employer for 2003 and total wages of over \$87,000, figure any excess social security and tier 1 railroad retirement (RTA) 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 2003 on Form 1040A. All of their children are qualifying for purposes of the child tax credit. The Howards received a \$1,600 advance child tax credit payment in August 2003. Their adjusted gross income is \$31,467, of which \$18,467 is taxable earned income and \$13,000 is unemployment compensation. The Howards' taxable income is \$3,667, Social Security/Medicare taxes are \$1,413, and the earned income credit is \$569. They have no other credits entered in lines 29-32. 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 below. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 29, and the earned income credit on Form 1040A, line 41.

#### Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit. See **Qualifying Child for Child Tax Credit** below.
- 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 37 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 7.

**Qualifying Child for Child Tax Credit.** A qualifying child for purposes of the child tax credit is a child who:

- Is claimed as your dependent on line 6c, **and**
- Was **under age 17** at the end of 2003, **and**
- Is your **(a)** son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild); **(b)** brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew), whom you cared for as you would your own child; or **(c)** a foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child), **and**
- Is a U.S. citizen or resident alien.

**Note.** The above requirements are not the same as the requirements to be a qualifying child for the earned income credit.

An **adopted child** is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

A **grandchild** is any descendant of your son, daughter, adopted child, or stepchild and includes your great-grandchild, great-great-grandchild, etc.

#### 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 38)?
  - No.** Use the worksheet on page 37 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

**Before you begin:** ✓ If you received (before offset) an advance payment of the child tax credit and you filed a joint return for 2002, you and your spouse are each considered to have received one-half of the payment.



If you received Notice 1319, have it available. The notice shows the amount of your advance payment (before offset). If you do not have Notice 1319, you can check the amount of your advance payment (before offset) on the IRS website at [www.irs.gov](http://www.irs.gov). You will need to enter your SSN, your 2002 filing status, and the total number of exemptions you claimed on line 6d of your 2002 Form 1040 or Form 1040A.



- To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2003 and meet the other requirements listed on page 38.
- **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: \_\_\_\_\_ × \$1,000. **1**

Enter the result.

2. Enter the amount, if any, of your advance child tax credit (before offset). **2**

3. Is line 1 less than or equal to line 2?

**Yes.** You cannot take this credit. If line 2 is more than line 1, you do not have to pay back the difference. **3**

**No.** Subtract line 2 from line 1.

4. Enter the amount from Form 1040A, line 28. **4**

5. Add the amounts from Form 1040A, lines 29 through 32. **5**

6. Are the amounts on lines 4 and 5 the same?

**Yes.** You cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit**. See the **TIP** below. **6**

**No.** Subtract line 5 from line 4.

7. Is the amount on line 3 more than the amount on line 6?

**Yes.** Enter the amount from line 6. Also, you may be able to take the **additional child tax credit**. See the **TIP** below. **7**

**No.** Enter the amount from line 3. } **This is your child tax credit.**

Enter this amount on Form 1040A, line 33.



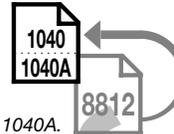
You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered “Yes” on line 6 or line 7 above.



- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

Form **8812**

# Additional Child Tax Credit



OMB No. 1545-1620

**2003**

Attachment Sequence No. **47**

Department of the Treasury  
Internal Revenue Service

Complete and attach to Form 1040 or Form 1040A.

Name(s) shown on return

Your social security number

## Part I All Filers

**1** Enter the amount from line 3 of your Child Tax Credit Worksheet on page 40 of the Form 1040 instructions or page 39 of the Form 1040A instructions. If you used Pub. 972, enter the amount from line 10 of the worksheet on page 3 of the publication

**1**

**2** Enter the amount from Form 1040, line 49, 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 \$10,500?

**No.** Leave line 5 blank and enter -0- on line 6.

**Yes.** Subtract \$10,500 from the amount on line 4. Enter the result

**5**

**6** Multiply the amount on line 5 by 10% (.10) and enter the result

**6**

**Next.** Do you have three or more qualifying children?

**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.

**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.

## 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 28 and 56, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 60.

**8**

**1040A filers:** Enter -0-.

**9** Add lines 7 and 8

**9**

**10 1040 filers:** Enter the total of the amounts from Form 1040, lines 63 and 64.

**10**

**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).

**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

**12**

**Next,** enter the **smaller** of line 3 or line 12 on line 13.

## Part III Your Additional Child Tax Credit

**13** This is your additional child tax credit

**13**



Enter this amount on Form 1040, line 65, or Form 1040A, line 42.

For Paperwork Reduction Act Notice, see back of form.

Cat. No. 10644E

Form **8812** (2003)

## 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 49, 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 63, 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 48 of your 1040 instructions	Worksheet B, line 4b.*
	Step 5 on page 45 of your 1040 instructions (but not Worksheet B)	Step 5, Earned Income
1040A	Step 5 on page 43 of your 1040A instructions	Step 5, Earned Income

\* If you were a member of the clergy, 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 were a member of the clergy or 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?

- Taxable 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 2003.

### 1040A Filers

If you, or your spouse if filing a joint return, had more than one employer for 2003 and total wages of over \$87,000, 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.

### 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.

## Exercise 1(A)

The Howard's Child Tax Worksheet.

Form 1040A—Line 33

## Child Tax Credit Worksheet—Line 33

Keep for Your Records

**Before you begin:** ✓ If you received (before offset) an advance payment of the child tax credit and you filed a joint return for 2002, you and your spouse are each considered to have received one-half of the payment.



If you received Notice 1319, have it available. The notice shows the amount of your advance payment (before offset). If you do not have Notice 1319, you can check the amount of your advance payment (before offset) on the IRS website at [www.irs.gov](http://www.irs.gov). You will need to enter your SSN, your 2002 filing status, and the total number of exemptions you claimed on line 6d of your 2002 Form 1040 or Form 1040A.



- To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2003 and meet the other requirements listed on page 38.
- Do not** use this worksheet if you answered “Yes” to question 1 or 2 on page 38. Instead, use Pub. 972.

<p>1. Number of qualifying children: <u>4</u> × \$1,000. Enter the result.</p>	1	\$4,000
<p>2. Enter the amount, if any, of your advance child tax credit (before offset).</p>	2	\$1,600
<p>3. Is line 1 less than or equal to line 2?</p> <p><input type="checkbox"/> <b>Yes.</b> </p> <p style="margin-left: 20px;">You cannot take this credit. If line 2 is more than line 1, you do not have to pay back the difference.</p> <p><input checked="" type="checkbox"/> <b>No.</b> Subtract line 2 from line 1.</p>	3	\$2,400
<p>4. Enter the amount from Form 1040A, line 28.</p>	4	\$368
<p>5. Add the amounts from Form 1040A, lines 29 through 32.</p>	5	\$0
<p>6. Are the amounts on lines 4 and 5 the same?</p> <p><input type="checkbox"/> <b>Yes.</b> </p> <p style="margin-left: 20px;">You cannot take this credit because there is no tax to reduce. However, you may be able to take the <b>additional child tax credit</b>. See the <b>TIP</b> below.</p> <p><input checked="" type="checkbox"/> <b>No.</b> Subtract line 5 from line 4.</p>	6	\$368
<p>7. Is the amount on line 3 more than the amount on line 6?</p> <p><input checked="" type="checkbox"/> <b>Yes.</b> Enter the amount from line 6. Also, you may be able to take the <b>additional child tax credit</b>. See the <b>TIP</b> below.</p> <p><input type="checkbox"/> <b>No.</b> Enter the amount from line 3.</p>	7	\$368

This is your child tax credit.

Enter this amount on Form 1040A, line 33.



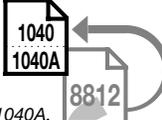
You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered “Yes” on line 6 or line 7 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.



## Exercise 1(B)

## The Howard's Additional Child Tax Credit

Form <b>8812</b>  Department of the Treasury Internal Revenue Service	<h3 style="margin: 0;">Additional Child Tax Credit</h3> <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;">2003</h2> Attachment Sequence No. <b>47</b>
Name(s) shown on return <p style="text-align: center; font-weight: bold;">Emily and Victor Howard</p>		Your social security number <p style="text-align: center; font-weight: bold;">000 : 00 : 4410</p>	
<b>Part I All Filers</b>			
1 Enter the amount from line 3 of your Child Tax Credit Worksheet on page 40 of the Form 1040 instructions or page 39 of the Form 1040A instructions. If you used Pub. 972, enter the amount from line 10 of the worksheet on page 3 of the publication . . . . .	1	\$2,400	
2 Enter the amount from Form 1040, line 49, or Form 1040A, line 33 . . . . .	2	\$368	
3 Subtract line 2 from line 1. If zero, <b>stop</b> ; you cannot take this credit . . . . .	3	\$2,032	
4 Enter your total taxable earned income. See the instructions on back . . . . .	4	\$18,467	
5 Is the amount on line 4 more than \$10,500? <input type="checkbox"/> <b>No.</b> Leave line 5 blank and enter -0- on line 6. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract \$10,500 from the amount on line 4. Enter the result . . . . .	5	\$7,967	
6 Multiply the amount on line 5 by 10% (.10) and enter the result . . . . . <b>Next.</b> Do you have three or more qualifying children? <input type="checkbox"/> <b>No.</b> If line 6 is zero, <b>stop</b> ; you cannot take this credit. Otherwise, skip Part II and enter the <b>smaller</b> of line 3 or line 6 on line 13. <input checked="" type="checkbox"/> <b>Yes.</b> 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	\$797	
<b>Part II Certain Filers Who Have Three or More Qualifying Children</b>			
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	
8 <b>1040 filers:</b> Enter the total of the amounts from Form 1040, lines 28 and 56, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 60. <b>1040A filers:</b> Enter -0-.	8	\$0	
9 Add lines 7 and 8 . . . . .	9	\$1,413	
10 <b>1040 filers:</b> Enter the total of the amounts from Form 1040, lines 63 and 64. <b>1040A filers:</b> 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	
11 Subtract line 10 from line 9. If zero or less, enter -0- . . . . .	11	\$844	
12 Enter the <b>larger</b> of line 6 or line 11 here . . . . . <b>Next,</b> enter the <b>smaller</b> of line 3 or line 12 on line 13.	12	\$844	
<b>Part III Your Additional Child Tax Credit</b>			
13 <b>This is your additional child tax credit</b> . . . . .	13	\$844	
		Enter this amount on Form 1040, line 65, or Form 1040A, line 42.	
For Paperwork Reduction Act Notice, see back of form.		Cat. No. 10644E	Form <b>8812</b> (2003)

**STUDENT NOTES**

# 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

John Marshall, a sophomore in college, wants help with preparing his tax return. He tells you he is 19 years old (born May 28, 1984). Although he lives in the dorm at college, his parents can claim him as a dependent on their tax return. He does not wish to contribute to the presidential campaign fund. If he receives a refund he would like it direct deposited into his checking account (account number xxxxxxxxxxxxxx, routing number xxxxxxxxxxxx). John does not want to name a third party designee. His address and SSN are correct on his Form W-2 and Form 1099-INT.

a Control number <b>3456781</b>		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number <b>xxx-xx-xxxx</b>				1 Wages, tips, other compensation <b>\$2,694.00</b>		2 Federal income tax withheld <b>\$94.00</b>	
c Employer's name, address, and ZIP code <b>Norfolk Trading Company 819 Ferris St. Your City, State, Zip Code</b>				3 Social security wages <b>\$2,694.00</b>		4 Social security tax withheld <b>\$39.00</b>	
				5 Medicare wages and tips <b>\$2,694.00</b>		6 Medicare tax withheld	
				7 Social security tips		8 Allocated tips	
d Employee's social security number <b>xxx-xx-xxxx</b>				9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Last name <b>John Marshall 878 Hudson Ave Your City, State, Zip Code</b>				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 <b>xxx-xx-xxxx</b>	16 State wages, tips, etc. <b>\$2,694.00</b>	17 State income tax <b>\$52.00</b>	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

Form **W-2** Wage and Tax Statement

**2003**

Department of the Treasury—Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return.  
This information is being furnished to the Internal Revenue Service.

# WAGE EARNER COMPREHENSIVE PROBLEMS

CORRECTED (if checked)

PAYER'S name, street address, city, state, ZIP code, and telephone no. <b>First Bank</b> <b>2940 N. Second St.</b> <b>Your City, State, Zip Code</b>		Payer's RTN (optional)	OMB No. 1545-0112 <b>2003</b> Form <b>1099-INT</b>	<b>Interest Income</b>
PAYER'S Federal identification number <b>xx-xxxxxxx</b>	RECIPIENT'S identification number <b>xxx-xx-xxxx</b>	1 Interest income not included in box 3 <b>\$ 50.00</b>		
RECIPIENT'S name <b>John Marshall</b> Street address (including apt. no.) <b>878 Hudson Ave.</b> City, state, and ZIP code <b>Your City, State, Zip Code</b>		2 Early withdrawal penalty \$	3 Interest on U.S. Savings Bonds and Treas. obligations \$	<b>Copy B For Recipient</b> 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 \$	5 Investment expenses \$	
		6 Foreign tax paid \$	7 Foreign country or U.S. possession	
Form <b>1099-INT</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service

# WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form

Form 1040EZ, front

<p>Form <b>1040EZ</b></p> <p><b>Label</b> (See page 14.) <b>Use the IRS label.</b> Otherwise, please print or type.</p> <p><b>Presidential Election Campaign</b> (page 14) </p>	<p>Department of the Treasury—Internal Revenue Service</p> <p><b>Income Tax Return for Single and Joint Filers With No Dependents 2003</b></p> <p>OMB No. 1545-0675</p>	<p>Your social security number</p> <p>Spouse's social security number</p> <p><b>▲ Important! ▲</b> You <b>must</b> enter your SSN(s) above.</p> <p>You      Spouse <input type="checkbox"/> Yes <input type="checkbox"/> No    <input type="checkbox"/> Yes <input type="checkbox"/> No</p>																														
<p><b>Income</b></p> <p><b>Attach Form(s) W-2 here.</b> Enclose, but do not attach, any payment.</p> <p><b>Note.</b> You must check Yes or No.</p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;">Your first name and initial</td> <td style="width:35%;">Last name</td> <td style="width:50%;"></td> </tr> <tr> <td>If a joint return, spouse's first name and initial</td> <td>Last name</td> <td></td> </tr> <tr> <td colspan="2">Home address (number and street). If you have a P.O. box, see page 14.</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 14.</td> </tr> </table> <p><b>Note.</b> 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>	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 14.		Apt. no.	City, town or post office, state, and ZIP code. If you have a foreign address, see page 14.			<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;"><b>1</b></td> <td style="width:60%;">Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.</td> <td style="width:25%; text-align: right;">1</td> </tr> <tr> <td><b>2</b></td> <td>Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.</td> <td style="text-align: right;">2</td> </tr> <tr> <td><b>3</b></td> <td>Unemployment compensation and Alaska Permanent Fund dividends (see page 16).</td> <td style="text-align: right;">3</td> </tr> <tr> <td><b>4</b></td> <td>Add lines 1, 2, and 3. This is your <b>adjusted gross income</b>.</td> <td style="text-align: right;">4</td> </tr> <tr> <td><b>5</b></td> <td>Can your parents (or someone else) claim you on their return? Yes. Enter amount from <input type="checkbox"/> worksheet on back.      No. If <b>single</b>, enter \$7,800. If <b>married filing jointly</b>, enter \$15,600. See back for explanation. <input type="checkbox"/></td> <td style="text-align: right;">5</td> </tr> <tr> <td><b>6</b></td> <td>Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your <b>taxable income</b>. </td> <td style="text-align: right;">6</td> </tr> </table>	<b>1</b>	Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	<b>2</b>	Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.	2	<b>3</b>	Unemployment compensation and Alaska Permanent Fund dividends (see page 16).	3	<b>4</b>	Add lines 1, 2, and 3. This is your <b>adjusted gross income</b> .	4	<b>5</b>	Can your parents (or someone else) claim you on their return? Yes. Enter amount from <input type="checkbox"/> worksheet on back.      No. If <b>single</b> , enter \$7,800. If <b>married filing jointly</b> , enter \$15,600. See back for explanation. <input type="checkbox"/>	5	<b>6</b>	Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your <b>taxable income</b> .	6
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<p><b>Payments and tax</b></p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;"><b>7</b></td> <td style="width:60%;">Federal income tax withheld from box 2 of your Form(s) W-2.</td> <td style="width:25%; text-align: right;">7</td> </tr> <tr> <td><b>8</b></td> <td><b>Earned income credit (EIC).</b></td> <td style="text-align: right;">8</td> </tr> <tr> <td><b>9</b></td> <td>Add lines 7 and 8. These are your <b>total payments</b>. </td> <td style="text-align: right;">9</td> </tr> <tr> <td><b>10</b></td> <td><b>Tax.</b> Use the amount on <b>line 6 above</b> to find your tax in the tax table on pages 25–29 of the booklet. Then, enter the tax from the table on this line.</td> <td style="text-align: right;">10</td> </tr> </table>	<b>7</b>	Federal income tax withheld from box 2 of your Form(s) W-2.	7	<b>8</b>	<b>Earned income credit (EIC).</b>	8	<b>9</b>	Add lines 7 and 8. These are your <b>total payments</b> .	9	<b>10</b>	<b>Tax.</b> Use the amount on <b>line 6 above</b> to find your tax in the tax table on pages 25–29 of the booklet. Then, enter the tax from the table on this line.	10	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;"><b>11a</b></td> <td style="width:60%;">If line 9 is larger than line 10, subtract line 10 from line 9. This is your <b>refund</b>. </td> <td style="width:25%; text-align: right;">11a</td> </tr> <tr> <td><b>b</b></td> <td>Routing number <input style="width:150px;" type="text"/></td> <td><b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings</td> </tr> <tr> <td><b>d</b></td> <td>Account number <input style="width:150px;" type="text"/></td> <td></td> </tr> </table>	<b>11a</b>	If line 9 is larger than line 10, subtract line 10 from line 9. This is your <b>refund</b> .	11a	<b>b</b>	Routing number <input style="width:150px;" type="text"/>	<b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	<b>d</b>	Account number <input style="width:150px;" type="text"/>										
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<p><b>Amount you owe</b></p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;"><b>12</b></td> <td style="width:60%;">If line 10 is larger than line 9, subtract line 9 from line 10. This is the <b>amount you owe</b>. For details on how to pay, see page 22. </td> <td style="width:25%; text-align: right;">12</td> </tr> </table>	<b>12</b>	If line 10 is larger than line 9, subtract line 9 from line 10. This is the <b>amount you owe</b> . For details on how to pay, see page 22.	12	<p>Do you want to allow another person to discuss this return with the IRS (see page 22)? <input type="checkbox"/> <b>Yes</b>. Complete the following. <input type="checkbox"/> <b>No</b></p> <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:40%;">Designee's name </td> <td style="width:20%;">Phone no. </td> <td style="width:40%;">Personal identification number (PIN) </td> </tr> </table>	Designee's name	Phone no.	Personal identification number (PIN)																								
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Designee's name	Phone no.	Personal identification number (PIN)																														
<p><b>Sign here</b></p> <p>Joint return? See page 13. </p> <p>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, <b>both</b> 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, <b>both</b> must sign.	Date	Spouse's occupation		<p><b>Paid preparer's use only</b></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. ( )															
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<p><b>For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 24.</b>      Cat. No. 11329W      Form <b>1040EZ</b> (2003)</p>																																



# WAGE EARNER COMPREHENSIVE PROBLEMS

## PROBLEM 2

Melody York is 34 years old (born August 31, 1969) and single. Melody was laid off from her job as a clerk in September and received unemployment compensation for the remainder of the year. She would like to contribute to the Presidential campaign fund. If she receives a refund, she would like it direct deposited into her savings account (account number xxxxxxxxxxxx; routing transit number xxxxxxxxxxxx). Melody does not want to name a third party designee. Her address and SSN are correct as shown on her Form W-2 and Form 1099-G.

a Control number <b>258963</b>		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number <b>xxx-xx-xxxx</b>				1 Wages, tips, other compensation <b>\$6,923.12</b>		2 Federal income tax withheld <b>\$261.00</b>	
c Employer's name, address, and ZIP code <b>Miller Industries 975 Parks Blvd Your City, State, Zip Code</b>				3 Social security wages <b>\$6,923.12</b>		4 Social security tax withheld <b>\$429.00</b>	
				5 Medicare wages and tips <b>\$6,923.12</b>		6 Medicare tax withheld <b>\$100.00</b>	
				7 Social security tips		8 Allocated tips	
d Employee's social security number <b>xxx-xx-xxxx</b>				9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Last name <b>Melody York 17 North 9th Avenue Your City, State, Zip Code</b>				11 Nonqualified plans		12a See instructions for box 12	
				13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b	
				14 Other		12c	
						12d	
f Employee's address and ZIP code							
15 State Employer's state ID number <b>xxx-xx-xxxx</b>		16 State wages, tips, etc. <b>\$6,923.12</b>		17 State income tax <b>\$68.36</b>		18 Local wages, tips, etc.	
						19 Local income tax	
						20 Locality name	

Form **W-2** Wage and Tax Statement

**2003**

Department of the Treasury—Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return.  
This information is being furnished to the Internal Revenue Service.

# WAGE EARNER COMPREHENSIVE PROBLEMS

<input type="checkbox"/> CORRECTED (if checked)					
PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>Department of Employment Security</b> <b>4010 West Third St.</b> <b>Your City, State, Zipcode</b>		1 Unemployment compensation <b>\$ 3,240.00</b>	OMB No. 1545-0120  <b>2003</b>  Form <b>1099-G</b>		
PAYER'S Federal identification number <b>xx-xxxxxxx</b>		2 State or local income tax refunds, credits, or offsets <b>\$</b>	<b>Certain Government Payments</b>		
RECIPIENT'S identification number <b>xxx-xx-xxxx</b>		3 Box 2 amount is for tax year			
RECIPIENT'S name  <b>Melody York</b> Street address (including apt. no.) <b>17th North 9th Avenue</b> City, state, and ZIP code <b>Your City, State, Zip Code</b>		4 Federal income tax withheld <b>\$ 0.00</b>	<b>Copy B For Recipient</b>  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)		5 			
		6 Taxable grants <b>\$</b>			
		7 Agriculture payments <b>\$</b>	8 Box 2 is trade or business income <input type="checkbox"/>		
Form <b>1099-G</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service	





## 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.



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 \$11,230 (\$12,230 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. Enter "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 2003 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 2003?

**Yes.** *Go to question 5.*  **No.** You cannot take the credit.

5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 18 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 2003?

**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 a descendant of any of them (for example, your grandchild)

or

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as your own child

or

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 2003...**  
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 2003 **or** was born or died in 2003 and your home was the child's home for the entire time he or she was alive in 2003.

**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.

# WAGE EARNER COMPREHENSIVE PROBLEMS

Form 1040EZ, Earned Income Credit Worksheet, page 2

Form 1040EZ—Line 8

## Step 2 Earned Income

1. Figure earned income:

Form 1040EZ, line 1 \_\_\_\_\_

Subtract, if included in line 1, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2
- Amount paid to an inmate in a penal institution for work (enter "PRI" in the space to the left of line 1 on Form 1040EZ)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (enter "DFC" and the amount subtracted in the space to the left of line 1 on Form 1040EZ). This amount may be shown in box 11 of your Form W-2. 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 =

2. Is your earned income less than \$11,230 (\$12,230 if married filing jointly)?

Yes. Go to Step 3.     No. 

You cannot take the credit.

## 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 on 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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
- The only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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, 2004, 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 of 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)

Need more information or forms? See page 7.

- 16 -

## Earned Income Credit (EIC) Worksheet—Line 8

Keep for Your Records



### Part 1

#### All Filers

1. Enter your earned income from Step 2 on page 18.

1	
---	--

2. Look up the amount on line 1 above in the EIC Table on page 20 to find the credit. Be sure you use the correct 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 \$6,250 (\$7,250 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. Be sure you use the correct 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 2003.

# WAGE EARNER COMPREHENSIVE PROBLEMS

## PROBLEM 3

Marvin Simmons is 55 (born on December 4, 1948). His grandson, Eric (SSN xxx-xx-xxxx; born on March 10, 1993), has lived with him for the last two years. Marvin pays the total cost of keeping up a home for himself and his grandson and provides all the support for Eric. Eric is a qualifying child for EIC purposes.

Marvin paid \$978 in child care expenses to allow him to work. The provider information is as follows:

Joy Day Care  
 9192 East Huron St.  
 Your City, State, Zip Code  
 EIN: xx-xxxxxxx

He does not want to contribute to the presidential election fund and if he is due a refund, he would like a direct deposit to his checking account (account xxxxxxxxxxxxxx; routing transit number xxxxxxxxxx). His address and SSN are correct on his Form W-2. Marvin received the \$400 advance child tax credit payment. He does not want to designate a third party. Marvin is a mechanic.

a Control number <b>3495127</b>		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number <b>xxx-xx-xxxx</b>				1 Wages, tips, other compensation <b>\$24,952.00</b>		2 Federal income tax withheld <b>\$1,964.00</b>	
c Employer's name, address, and ZIP code  <b>Endicott Motors</b> <b>473 Endicott Lane</b> <b>Your City, State, Zip Code</b>				3 Social security wages <b>\$24,952.00</b>		4 Social security tax withheld <b>\$1,547.00</b>	
				5 Medicare wages and tips <b>\$24,952.00</b>		6 Medicare tax withheld <b>\$362.00</b>	
				7 Social security tips		8 Allocated tips	
d Employee's social security number				9 Advance EIC payment <b>\$600.00</b>		10 Dependent care benefits	
e Employee's first name and initial      Last name  <b>Marvin Simmons</b> <b>9701 Austin Rd</b> <b>Your City, State, Zip Code</b>				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 <b>xxx-xx-xxxx</b>		16 State wages, tips, etc. <b>\$24,952.00</b>	
				17 State income tax <b>\$875.00</b>		18 Local wages, tips, etc.	
				19 Local income tax		20 Locality name	

Form **W-2** Wage and Tax Statement      **2003**      Department of the Treasury—Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return.  
 This information is being furnished to the Internal Revenue Service.

# WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form

Form 1040A, front

Form <b>1040A</b>	Department of the Treasury—Internal Revenue Service <b>U.S. Individual Income Tax Return</b>	<b>2003</b>	IRS Use Only—Do not write or staple in this space.																																																																								
<b>Label</b> (See page 21.)  <b>Use the IRS label.</b> Otherwise, please print or type.	Your first name and initial Last name	OMB No. 1545-0085																																																																									
	If a joint return, spouse's first name and initial Last name	Your social security number																																																																									
	Home address (number and street). If you have a P.O. box, see page 22.	Apt. no.	Spouse's social security number																																																																								
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 22.		<b>▲ Important! ▲</b> You must enter your SSN(s) above.																																																																								
<b>Presidential Election Campaign</b> (See page 22.) <table style="width:100%; border: none;"> <tr> <td style="border: none;"> <b>Note.</b> 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;"> <b>You</b>      <b>Spouse</b>  <input type="checkbox"/> Yes <input type="checkbox"/> No    <input type="checkbox"/> Yes <input type="checkbox"/> No                 </td> </tr> </table>				<b>Note.</b> 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? . . .	<b>You</b> <b>Spouse</b> <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Yes <input type="checkbox"/> No																																																																						
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<b>Income</b> <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;"><b>7</b> Wages, salaries, tips, etc. Attach Form(s) W-2.</td> <td style="width:15%;"></td> <td style="width:15%; text-align: right;">7</td> <td style="width:55%;"></td> </tr> <tr> <td><b>8a</b> Taxable interest. Attach Schedule 1 if required.</td> <td></td> <td style="text-align: right;">8a</td> <td></td> </tr> <tr> <td><b>b</b> Tax-exempt interest. Do not include on line 8a.</td> <td style="text-align: right;">8b</td> <td></td> <td></td> </tr> <tr> <td><b>9a</b> Ordinary dividends. Attach Schedule 1 if required.</td> <td></td> <td style="text-align: right;">9a</td> <td></td> </tr> <tr> <td><b>b</b> Qualified dividends (see page XX).</td> <td style="text-align: right;">9b</td> <td></td> <td></td> </tr> <tr> <td><b>10a</b> Capital gain distributions (see page 27).</td> <td></td> <td style="text-align: right;">10a</td> <td></td> </tr> <tr> <td><b>b</b> Post-May 5 capital gain distributions (see page 27).</td> <td style="text-align: right;">10b</td> <td></td> <td></td> </tr> <tr> <td><b>11a</b> IRA distributions.</td> <td style="text-align: right;">11a</td> <td><b>11b</b> Taxable amount (see page 27).</td> <td style="text-align: right;">11b</td> </tr> <tr> <td><b>12a</b> Pensions and annuities.</td> <td style="text-align: right;">12a</td> <td><b>12b</b> Taxable amount (see page 28).</td> <td style="text-align: right;">12b</td> </tr> <tr> <td><b>13</b> Unemployment compensation and Alaska Permanent Fund dividends.</td> <td></td> <td style="text-align: right;">13</td> <td></td> </tr> <tr> <td><b>14a</b> Social security benefits.</td> <td style="text-align: right;">14a</td> <td><b>14b</b> Taxable amount (see page 30).</td> <td style="text-align: right;">14b</td> </tr> <tr> <td><b>15</b> Add lines 7 through 14b (far right column). This is your <b>total income</b>.</td> <td></td> <td style="text-align: right;">▶ 15</td> <td></td> </tr> <tr> <td><b>16</b> Educator expenses (see page 30).</td> <td style="text-align: right;">16</td> <td></td> <td></td> </tr> <tr> <td><b>17</b> IRA deduction (see page 30).</td> <td style="text-align: right;">17</td> <td></td> <td></td> </tr> <tr> <td><b>18</b> Student loan interest deduction (see page 33).</td> <td style="text-align: right;">18</td> <td></td> <td></td> </tr> <tr> <td><b>19</b> Tuition and fees deduction (see page 33).</td> <td style="text-align: right;">19</td> <td></td> <td></td> </tr> <tr> <td><b>20</b> Add lines 16 through 19. These are your <b>total adjustments</b>.</td> <td></td> <td style="text-align: right;">20</td> <td></td> </tr> <tr> <td><b>21</b> Subtract line 20 from line 15. This is your <b>adjusted gross income</b>.</td> <td></td> <td style="text-align: right;">▶ 21</td> <td></td> </tr> </table>				<b>7</b> Wages, salaries, tips, etc. Attach Form(s) W-2.		7		<b>8a</b> Taxable interest. Attach Schedule 1 if required.		8a		<b>b</b> Tax-exempt interest. Do not include on line 8a.	8b			<b>9a</b> Ordinary dividends. Attach Schedule 1 if required.		9a		<b>b</b> Qualified dividends (see page XX).	9b			<b>10a</b> Capital gain distributions (see page 27).		10a		<b>b</b> Post-May 5 capital gain distributions (see page 27).	10b			<b>11a</b> IRA distributions.	11a	<b>11b</b> Taxable amount (see page 27).	11b	<b>12a</b> Pensions and annuities.	12a	<b>12b</b> Taxable amount (see page 28).	12b	<b>13</b> Unemployment compensation and Alaska Permanent Fund dividends.		13		<b>14a</b> Social security benefits.	14a	<b>14b</b> Taxable amount (see page 30).	14b	<b>15</b> Add lines 7 through 14b (far right column). This is your <b>total income</b> .		▶ 15		<b>16</b> Educator expenses (see page 30).	16			<b>17</b> IRA deduction (see page 30).	17			<b>18</b> Student loan interest deduction (see page 33).	18			<b>19</b> Tuition and fees deduction (see page 33).	19			<b>20</b> Add lines 16 through 19. These are your <b>total adjustments</b> .		20		<b>21</b> Subtract line 20 from line 15. This is your <b>adjusted gross income</b> .		▶ 21	
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		Cat. No. 11327A	Form 1040A (2003)																																																																								

# WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form

Form 1040A, page 2

Form 1040A (2003)		Page 2
<b>Tax, credits, and payments</b>	<b>22</b> Enter the amount from line 21 (adjusted gross income). <span style="float: right;">22</span>	
<b>Standard Deduction for—</b> • People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 34. • All others: Single or Married filing separately, \$4,750 Married filing jointly or Qualifying widow(er), \$9,500 Head of household, \$7,000	<b>23a</b> Check <input type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind } <b>Total boxes</b> if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind } <b>checked ▶</b> 23a <input style="width: 30px; height: 20px;" type="text"/>	
	<b>b</b> If you are married filing separately and your spouse itemizes deductions, see page 34 and check here <span style="float: right;">▶ 23b <input type="checkbox"/></span>	
	<b>24</b> Enter your <b>standard deduction</b> (see left margin). <span style="float: right;">24</span>	
	<b>25</b> Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-. <span style="float: right;">25</span>	
	<b>26</b> Multiply \$3,050 by the total number of exemptions claimed on line 6d. <span style="float: right;">26</span>	
	<b>27</b> Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your <b>taxable income</b> . <span style="float: right;">▶ 27</span>	
	<b>28</b> <b>Tax</b> , including any alternative minimum tax (see page 35). <span style="float: right;">28</span>	
	<b>29</b> Credit for child and dependent care expenses. Attach Schedule 2. <span style="float: right;">29</span>	
	<b>30</b> Credit for the elderly or the disabled. Attach Schedule 3. <span style="float: right;">30</span>	
	<b>31</b> Education credits. Attach Form 8863. <span style="float: right;">31</span>	
<b>32</b> Retirement savings contributions credit. Attach Form 8880. <span style="float: right;">32</span>		
<b>33</b> Child tax credit (see page 38). <span style="float: right;">33</span>		
<b>34</b> Adoption credit. Attach Form 8839. <span style="float: right;">34</span>		
<b>35</b> Add lines 29 through 34. These are your <b>total credits</b> . <span style="float: right;">35</span>		
<b>36</b> Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-. <span style="float: right;">36</span>		
<b>37</b> Advance earned income credit payments from Form(s) W-2. <span style="float: right;">37</span>		
<b>38</b> Add lines 36 and 37. This is your <b>total tax</b> . <span style="float: right;">▶ 38</span>		
<b>39</b> Federal income tax withheld from Forms W-2 and 1099. <span style="float: right;">39</span>		
<b>40</b> 2003 estimated tax payments and amount applied from 2002 return. <span style="float: right;">40</span>		
<b>41</b> <b>Earned income credit (EIC)</b> . <span style="float: right;">41</span>		
<b>42</b> Additional child tax credit. Attach Form 8812. <span style="float: right;">42</span>		
<b>43</b> Add lines 39 through 42. These are your <b>total payments</b> . <span style="float: right;">▶ 43</span>		
<b>Refund</b>	<b>44</b> If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> . <span style="float: right;">44</span>	
Direct deposit? See page 52 and fill in 45b, 45c, and 45d.	<b>45a</b> Amount of line 44 you want <b>refunded to you</b> . <span style="float: right;">▶ 45a</span>	
	▶ <b>b</b> Routing number <input style="width: 100px; height: 20px;" type="text"/> ▶ <b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
	▶ <b>d</b> Account number <input style="width: 150px; height: 20px;" type="text"/>	
	<b>46</b> Amount of line 44 you want <b>applied to your 2004 estimated tax</b> . <span style="float: right;">46</span>	
<b>Amount you owe</b>	<b>47</b> <b>Amount you owe</b> . Subtract line 43 from line 38. For details on how to pay, see page 53. <span style="float: right;">▶ 47</span>	
	<b>48</b> Estimated tax penalty (see page 53). <span style="float: right;">48</span>	
<b>Third party designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 54)? <input type="checkbox"/> <b>Yes</b> . Complete the following. <input type="checkbox"/> <b>No</b>	
	Designee's name ▶ _____ Phone no. ▶ ( ) _____ Personal identification number (PIN) ▶ <input style="width: 40px; height: 20px;" type="text"/>	
<b>Sign here</b>	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 22. Keep a copy for your records.	Your signature _____ Date _____ Your occupation _____ Daytime phone number ( ) _____	
	Spouse's signature. If a joint return, <b>both</b> must sign. _____ Date _____ Spouse's occupation _____	
<b>Paid preparer's use only</b>	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. ( ) _____	

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Form 1040A (2003)

# 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**

**2003**

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.

3	(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2003 for the person listed in column (a)
	First	Last		

**3** Add the amounts in column (c) of line 2. **Do not** enter more than \$3,000 for one qualifying person or \$6,000 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 jointly, 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—15,000		.35	\$29,000—31,000		.27		
15,000—17,000		.34	31,000—33,000		.26		
17,000—19,000		.33	33,000—35,000		.25		
19,000—21,000		.32	35,000—37,000		.24		
21,000—23,000		.31	37,000—39,000		.23		
23,000—25,000		.30	39,000—41,000		.22		
25,000—27,000		.29	41,000—43,000		.21		
27,000—29,000		.28	43,000—No limit		.20	8	×

**9** Multiply **line 6** by the decimal amount on line 8. If you paid 2002 expenses in 2003, 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. 107491

Schedule 2 (Form 1040A) 2003

# WAGE EARNER COMPREHENSIVE PROBLEMS

Form 1040A Child Tax Credit Worksheet

## Child Tax Credit Worksheet—Line 33

Keep for Your Records

**Before you begin:** ✓ If you received (before offset) an advance payment of the child tax credit and you filed a joint return for 2002, you and your spouse are each considered to have received one-half of the payment.



If you received Notice 1319, have it available. The notice shows the amount of your advance payment (before offset). If you do not have Notice 1319, you can check the amount of your advance payment (before offset) on the IRS website at [www.irs.gov](http://www.irs.gov). You will need to enter your SSN, your 2002 filing status, and the total number of exemptions you claimed on line 6d of your 2002 Form 1040 or Form 1040A.



- To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2003 and meet the other requirements listed on page 38.
- 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: \_\_\_\_\_ × \$1,000.  
Enter the result.

1	
---	--

2. Enter the amount, if any, of your advance child tax credit (before offset).

2	
---	--

3. Is line 1 less than or equal to line 2?

**Yes.**

You cannot take this credit. If line 2 is more than line 1, you do not have to pay back the difference.

**No.** Subtract line 2 from line 1.

3	
---	--

4. Enter the amount from Form 1040A, line 28.

4	
---	--

5. Add the amounts from Form 1040A, lines 29 through 32.

5	
---	--

6. Are the amounts on lines 4 and 5 the same?

**Yes.**

You cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit**. See the **TIP** below.

**No.** Subtract line 5 from line 4.

6	
---	--

7. Is the amount on line 3 more than the amount on line 6?

**Yes.** Enter the amount from line 6. Also, you may be able to take the **additional child tax credit**. See the **TIP** below.

**No.** Enter the amount from line 3.

**This is your child tax credit.**

7	
---	--

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 6 or line 7 above.



- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

## 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 attached 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 2003:
  - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,692 (\$34,692 if married filing jointly)?
  - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,666 (\$30,666 if married filing jointly)?
  - No children live with you, is the amount on Form 1040A, line 22, less than \$11,230 (\$12,230 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 42)?
 

**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 2003?
 

**Yes.** *See Nonresident aliens on page 42.*  **No.** *Go to Step 2.*

### Step 2 Investment Income

- Add the amounts from Form 1040A:

Line 8a \_\_\_\_\_  
 Line 8b + \_\_\_\_\_  
 Line 9a + \_\_\_\_\_  
 Line 10a + \_\_\_\_\_

**Investment Income** =

- Is your investment income more than \$2,600?
 

**Yes.** You cannot take the credit.

**No.** *Continue*
- Did a child live with you in 2003?
 

**Yes.** *Go to Step 3 on page 40.*  **No.** *Go to Step 4 on page 40.*

# WAGE EARNER COMPREHENSIVE PROBLEMS

Form 1040A EIC Worksheet, Page 2

## Step 3 Qualifying Child

A qualifying child is a child who is your...

Son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild)

or

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as you would your own child

or

Foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child)

AND

was at the end of 2003...

Under age 19

or

Under age 24 and a student (see page 42)

or

Any age and permanently and totally disabled (see page 42)

AND

who...

Lived with you in the United States for more than half of 2003. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 41.

**Note.** If the child was married, see page 42.

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 2003?

**Yes.**   **No.** *Continue* →

You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Do you have at least one child who meets the above conditions to be your qualifying child?

**Yes.** *Go to question 3.*  **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 2003?

**Yes.** *See Qualifying Child of More Than One Person on page 42.*  **No.** This child is your qualifying child. The child must have a valid social security number as defined on page 42 unless the child was born and died in 2003. *Skip Step 4; go to Step 5 on page 41.*

## 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 2003?

**Yes.**   **No.** *Continue* →

You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2003 tax return?

**Yes.**   **No.** *Continue* →

You cannot take the credit.

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2003?

**Yes.** *Continue* →  **No.**  You cannot take the credit.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 42 before you answer.

**Yes.** *Go to Step 5 on page 41.*  **No.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.

Draft as of 08/27/2003

## Step 5 Earned Income

### 1. Figure earned income:

Form 1040, line 7 \_\_\_\_\_

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- 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 Form W-2. 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 =

### 2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,692 (\$34,692 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,666 (\$30,666 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,230 (\$12,230 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 43.

## Definitions and Special Rules

(listed in alphabetical order)

**Adopted Child.** An adopted child is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

**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, below.

**Exception to "Time Lived With You" Condition.** A child is considered to have lived with you for all of 2003 if the child was born or died in 2003 and your home was this child's home for the entire time he or she was alive in 2003. 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 7. If you were in the military stationed outside the United States, see Members of the Military on page 42.

**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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
- You are taking the EIC without a qualifying child and the only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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

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 \$6,250 (\$7,250 if married filing jointly)?
  - 1 or more qualifying children, is the amount on line 3 less than \$13,750 (\$14,750 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

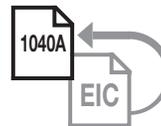
6. This is your earned income credit.

6

Enter this amount on Form 1040A, line 41.

#### Reminder—

- ✓ If you have a qualifying child, complete and attach Schedule EIC.



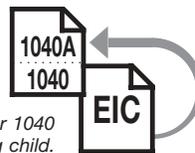
If your EIC for a year after 1996 was reduced or disallowed, see page 43 to find out if you must file Form 8862 to take the credit for 2003.

# WAGE EARNER COMPREHENSIVE PROBLEMS

Schedule EIC

**SCHEDULE EIC**  
(Form 1040A or 1040)

**Earned Income Credit**  
Qualifying Child Information



OMB No. 1545-0074

**2003**

Attachment Sequence No. **43**

Department of the Treasury  
Internal Revenue Service

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.

Name(s) shown on return

Your social security number

**Before you begin:** See the instructions for Form 1040A, line 41, or Form 1040, line 63, 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

**2 Child's SSN**

The child must have an SSN as defined on page 44 of the Form 1040A instructions or page 46 of the Form 1040 instructions unless the child was born and died in 2003. If your child was born and died in 2003 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.

Next, if the child was born after 1984, go to line 4. Otherwise, continue.

**3 If the child was born before 1985—**

**a** Was the child under age 24 at the end of 2003 and a student?

Yes.

No.

Go to line 4.

Continue

Yes.

No.

Go to line 4.

Continue

**b** Was the child permanently and totally disabled during any part of 2003?

Yes.

No.

Continue

The child is not a qualifying child.

Yes.

No.

Continue

The child is not a qualifying child.

**4 Child's relationship to you**

(for example, son, daughter, grandchild, niece, nephew, foster child, etc.)

**5 Number of months child lived with you in the United States during 2003**

- If the child lived with you for more than half of 2003 but less than 7 months, enter "7".
- If the child was born or died in 2003 and your home was the child's home for the entire time he or she was alive during 2003, enter "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 2003, (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 65 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2003

Comprehensive Problems

**CW-21**

**WAGE EARNER**

# WAGE EARNER COMPREHENSIVE PROBLEMS

## Comprehensive Problem 1

Department of the Treasury—Internal Revenue Service <b>Form 1040EZ</b> <b>Income Tax Return for Single and Joint Filers With No Dependents</b> <b>2003</b>		OMB No. 1545-0675																															
<b>Label</b> (See page 14.) <b>Use the IRS label.</b> Otherwise, please print or type.  <b>Presidential Election Campaign</b> (page 14)	Your first name and initial John	Last name Marshall	Your social security number XXX   XX   XXXX																														
	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 14. 878 Hudson Ave		Apt. no.																														
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 14. Your City, State, Zip Code		<b>▲ Important! ▲</b> You <b>must</b> 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?			You                  Spouse <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes <input type="checkbox"/> No																														
<b>Income</b>  <b>Attach Form(s) W-2 here.</b> Enclose, but do not attach, any payment.	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width: 5%;">1</td> <td style="width: 85%;">Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.</td> <td style="width: 5%; text-align: center;">1</td> <td style="width: 5%; text-align: right;">2,694</td> <td style="width: 5%; text-align: right;">00</td> </tr> <tr> <td>2</td> <td>Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.</td> <td style="text-align: center;">2</td> <td style="text-align: right;">50</td> <td style="text-align: right;">00</td> </tr> <tr> <td>3</td> <td>Unemployment compensation and Alaska Permanent Fund dividends (see page 16).</td> <td style="text-align: center;">3</td> <td></td> <td></td> </tr> <tr> <td>4</td> <td>Add lines 1, 2, and 3. This is your <b>adjusted gross income</b>.</td> <td style="text-align: center;">4</td> <td style="text-align: right;">2,744</td> <td style="text-align: right;">00</td> </tr> <tr> <td>5</td> <td>Can your parents (or someone else) claim you on their return?                      Yes. Enter amount from worksheet on back. <input checked="" type="checkbox"/>                      No. If <b>single</b>, enter \$7,800. <input type="checkbox"/>                      If <b>married filing jointly</b>, enter \$15,600. See back for explanation. <input type="checkbox"/></td> <td style="text-align: center;">5</td> <td style="text-align: right;">2,944</td> <td style="text-align: right;">00</td> </tr> <tr> <td>6</td> <td>Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your <b>taxable income</b>.</td> <td style="text-align: center;">6</td> <td></td> <td style="text-align: right;">00</td> </tr> </table>		1	Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	2,694	00	2	Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.	2	50	00	3	Unemployment compensation and Alaska Permanent Fund dividends (see page 16).	3			4	Add lines 1, 2, and 3. This is your <b>adjusted gross income</b> .	4	2,744	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 <b>single</b> , enter \$7,800. <input type="checkbox"/> If <b>married filing jointly</b> , enter \$15,600. See back for explanation. <input type="checkbox"/>	5	2,944	00	6	Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your <b>taxable income</b> .	6		00	
1	Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	2,694	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 <b>taxable income</b> .	6		00																													
<b>Payments and tax</b>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width: 5%;">7</td> <td style="width: 85%;">Federal income tax withheld from box 2 of your Form(s) W-2.</td> <td style="width: 5%; text-align: center;">7</td> <td style="width: 5%; text-align: right;">94</td> <td style="width: 5%; text-align: right;">00</td> </tr> <tr> <td>8</td> <td><b>Earned income credit (EIC).</b></td> <td style="text-align: center;">8</td> <td></td> <td></td> </tr> <tr> <td>9</td> <td>Add lines 7 and 8. These are your <b>total payments</b>.</td> <td style="text-align: center;">9</td> <td style="text-align: right;">94</td> <td style="text-align: right;">00</td> </tr> <tr> <td>10</td> <td><b>Tax.</b> Use the amount on <b>line 6 above</b> to find your tax in the tax table on pages 25–29 of the booklet. Then, enter the tax from the table on this line.</td> <td style="text-align: center;">10</td> <td></td> <td style="text-align: right;">00</td> </tr> </table>		7	Federal income tax withheld from box 2 of your Form(s) W-2.	7	94	00	8	<b>Earned income credit (EIC).</b>	8			9	Add lines 7 and 8. These are your <b>total payments</b> .	9	94	00	10	<b>Tax.</b> Use the amount on <b>line 6 above</b> to find your tax in the tax table on pages 25–29 of the booklet. Then, enter the tax from the table on this line.	10		00											
7	Federal income tax withheld from box 2 of your Form(s) W-2.	7	94	00																													
8	<b>Earned income credit (EIC).</b>	8																															
9	Add lines 7 and 8. These are your <b>total payments</b> .	9	94	00																													
10	<b>Tax.</b> Use the amount on <b>line 6 above</b> to find your tax in the tax table on pages 25–29 of the booklet. Then, enter the tax from the table on this line.	10		00																													
<b>Refund</b> Have it directly deposited! See page 21 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 <b>refund</b> .		11a	94 00																													
▶ b Routing number <input type="text" value="XXXXXX"/>		▶ c Type: <input checked="" type="checkbox"/> Checking <input type="checkbox"/> Savings																															
▶ d Account number <input type="text" value="XXXXXXXXXXXX"/>																																	
<b>Amount you owe</b>	12 If line 10 is larger than line 9, subtract line 9 from line 10. This is the <b>amount you owe</b> . For details on how to pay, see page 22.		12																														
<b>Third party designee</b>	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 checked="" type="checkbox"/> No																																
Designee's name		Phone no. ( )		Personal identification number (PIN)																													
<b>Sign here</b> Joint return? See page 13. 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		Date	Your occupation clerk	Daytime phone number ( )																													
Spouse's signature. If a joint return, <b>both</b> must sign.		Date	Spouse's occupation	( )																													
<b>Paid preparer's use only</b>	Preparer's signature		Date	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 PXX-XX-XXXX																													
		Phone no. ( )																															
For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 24.      Cat. No. 11329W      Form <b>1040EZ</b> (2003)																																	

### Comprehensive Problem 1

Form 1040EZ (2003)

Page **2**

#### Use this form if

- Your filing status is single or married filing jointly.
  - You (and your spouse if married filing jointly) were born after January 1, 1939, and were not blind at the end of 2003.
  - 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, the student loan interest deduction, or the tuition and fees deduction.
  - You do not claim an education credit, the retirement savings contributions credit, or the health insurance credit for eligible recipients.
  - 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 \$1,500. **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 15). If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 16.
  - You did not receive any advance earned income credit payments.
- If you are not sure about your filing status, see page 13. If you have questions about dependents, use TeleTax topic 354 (see page 8). If you **cannot use this form**, use TeleTax topic 352 (see page 8).

#### Filling in your return

For tips on how to avoid common mistakes, see page 23.

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 Form W-2 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 filing jointly) 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 8).

A. Amount, if any, from line 1 on front	2694				
	+ 250.00	Enter total ▶	A.	2944	
B. Minimum standard deduction			B.	750.00	
C. Enter the <b>larger</b> of line A or line B here			C.	2944	
D. Maximum standard deduction. If <b>single</b> , enter \$4,750; if <b>married filing jointly</b> , enter \$9,500			D.	4750	
E. Enter the <b>smaller</b> of line C or line D here. This is your standard deduction			E.	2944	
F. Exemption amount.			}	F.	0
• If single, enter -0-.					
• If married filing jointly and— —both you and your spouse can be claimed as dependents, enter -0-. —only one of you can be claimed as a dependent, enter \$3,050.					
G. Add lines E and F. Enter the total here and on line 5 on the front			G.	2944	

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

- Single, enter \$7,800. This is the total of your standard deduction (\$4,750) and your exemption (\$3,050).
- Married filing jointly, enter \$15,600. This is the total of your standard deduction (\$9,500), your exemption (\$3,050), and your spouse's exemption (\$3,050).

#### Mailing return

Mail your return by **April 15, 2004**. 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.



### 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.



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 \$11,230 (\$12,230 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. Enter "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 2003 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 2003?  
 **Yes.** *Go to question 5.*  
 **No.** You cannot take the credit.

5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 18 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 2003?

**Yes.**

**No.** *Go to Step 2*   
on page 18.

You cannot take the credit. Enter "No" in the space to the left of line 8.

A **qualifying child** is a child who is your—

Son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild)

**or**

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as your own child

**or**

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 2003...**

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 2003 **or** was born or died in 2003 and your home was the child's home for the entire time he or she was alive in 2003.

**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.

# WAGE EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

Form 1040EZ, Earned Income Credit Worksheet, line 8, page 2

Form 1040EZ—Line 8

### Step 2 Earned Income

1. Figure earned income:

Form 1040EZ, line 1 6,923

Subtract, if included in line 1, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2
- Amount paid to an inmate in a penal institution for work (enter "PRI" in the space to the left of line 1 on Form 1040EZ)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (enter "DFC" and the amount subtracted in the space to the left of line 1 on Form 1040EZ). This amount may be shown in box 11 of your Form W-2. 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 = 6,923

2. Is your earned income less than \$11,230 (\$12,230 if married filing jointly)?

Yes. Go to Step 3.     No. 

You cannot take the credit.

### 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 on 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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
- The only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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, 2004, 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 of 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.

**Earned Income Credit (EIC) Worksheet—Line 8**Keep for Your Records **Part 1****All Filers**

1. Enter your earned income from Step 2 on page 18. 

1	6,923
---	-------

2. Look up the amount on line 1 above in the EIC Table on page 20 to find the credit. Be sure you use the correct column for your filing status. Enter the credit here. 

2	329
---	-----

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	10,163
---	--------

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 \$6,250 (\$7,250 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. Be sure you use the correct column for your filing status. Enter the credit here. 

5	81
---	----

  
*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	81
---	----

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 2003.



# WAGE EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

## Comprehensive Problem 3

Form 1040A U.S. Individual Income Tax Return (99) 2003

Department of the Treasury—Internal Revenue Service

OMB No. 1545-0085

Your first name and initial: Marvin Last name: Simmons

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 22. 9701 Austin Rd Apt. no.:

City, town or post office, state, and ZIP code. If you have a foreign address, see page 22. Your City, State, Zip Code:

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

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

**Presidential Election Campaign** 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 23.) If the qualifying person is a child but not your dependent, enter this child's name here.

5  Qualifying widow(er) with dependent child (See page 24.)

**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 25)	No. of boxes checked on 6a and 6b	No. of children on 6c who:
Eric	Simmons	xxx xx xxxx	Grandson	<input checked="" type="checkbox"/>	1	1
				<input type="checkbox"/>		• did not live with you due to divorce or separation (see page 26)
				<input type="checkbox"/>		
				<input type="checkbox"/>		
				<input type="checkbox"/>		
				<input type="checkbox"/>		

d Total number of exemptions claimed. 2

**Income**

Line	Description	Amount
7	Wages, salaries, tips, etc. Attach Form(s) W-2.	24,952.00
8a	Taxable interest. Attach Schedule 1 if required.	
8b	Tax-exempt interest. Do not include on line 8a.	
9a	Ordinary dividends. Attach Schedule 1 if required.	
9b	Qualified dividends (see page XX).	
10a	Capital gain distributions (see page 27).	
10b	Post-May 5 capital gain distributions (see page 27).	
11a	IRA distributions.	
11b	Taxable amount (see page 27).	
12a	Pensions and annuities.	
12b	Taxable amount (see page 28).	
13	Unemployment compensation and Alaska Permanent Fund dividends.	
14a	Social security benefits.	
14b	Taxable amount (see page 30).	
15	Add lines 7 through 14b (far right column). This is your total income.	24,952.00
16	Educator expenses (see page 30).	
17	IRA deduction (see page 30).	
18	Student loan interest deduction (see page 33).	
19	Tuition and fees deduction (see page 33).	
20	Add lines 16 through 19. These are your total adjustments.	0.00
21	Subtract line 20 from line 15. This is your adjusted gross income.	24,952.00

**Adjusted gross income**

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 57. Cat. No. 11327A Form 1040A (2003)

### Comprehensive Problem 3

Form 1040A (2003)		Page <b>2</b>
<b>Tax, credits, and payments</b>	<b>22</b> Enter the amount from line 21 (adjusted gross income).	22      24,952   00
<b>Standard Deduction for—</b> • People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 34. • All others: Single or Married filing separately, \$4,750 Married filing jointly or Qualifying widow(er), \$9,500 Head of household, \$7,000	<b>23a</b> Check <input type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind } <b>Total boxes</b> if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind } <b>checked ▶ 23a</b> <input type="checkbox"/>	
	<b>b</b> If you are married filing separately and your spouse itemizes deductions, see page 34 and check here <b>▶ 23b</b> <input type="checkbox"/>	
	<b>24</b> Enter your <b>standard deduction</b> (see left margin).	24      7,000   00
	<b>25</b> Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25      17,952   00
	<b>26</b> Multiply \$3,050 by the total number of exemptions claimed on line 6d.	26      6,100   00
	<b>27</b> Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your <b>taxable income</b> .	▶ 27      11,852   00
	<b>28 Tax</b> , including any alternative minimum tax (see page 35).	28      1,281   00
	<b>29</b> Credit for child and dependent care expenses. Attach Schedule 2.	29      293   00
	<b>30</b> Credit for the elderly or the disabled. Attach Schedule 3.	30
	<b>31</b> Education credits. Attach Form 8863.	31
<b>32</b> Retirement savings contributions credit. Attach Form 8880.	32	
<b>33</b> Child tax credit (see page 38).	33      600   00	
<b>34</b> Adoption credit. Attach Form 8839.	34	
<b>35</b> Add lines 29 through 34. These are your <b>total credits</b> .	35      893   00	
<b>36</b> Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36      388   00	
<b>37</b> Advance earned income credit payments from Form(s) W-2.	37      600   00	
<b>38</b> Add lines 36 and 37. This is your <b>total tax</b> .	▶ 38      988   00	
<b>39</b> Federal income tax withheld from Forms W-2 and 1099.	39      1,964   00	
<b>40</b> 2003 estimated tax payments and amount applied from 2002 return.	40	
<b>41 Earned income credit (EIC)</b> .	41      750   00	
<b>42</b> Additional child tax credit. Attach Form 8812.	42	
<b>43</b> Add lines 39 through 42. These are your <b>total payments</b> .	▶ 43      2,714   00	
<b>Refund</b>	<b>44</b> If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> .	44      1,726   00
Direct deposit? See page 52 and fill in 45b, 45c, and 45d.	<b>45a</b> Amount of line 44 you want <b>refunded to you</b> .	▶ 45a      1,726   00
	<b>b</b> Routing number <input type="text" value="x x x x x x x x x x"/> <b>c</b> Type: <input checked="" type="checkbox"/> Checking <input type="checkbox"/> Savings	
	<b>d</b> Account number <input type="text" value="x x x x x x x x x x x x x x x x"/>	
	<b>46</b> Amount of line 44 you want <b>applied to your 2004 estimated tax</b> .	46
<b>Amount you owe</b>	<b>47 Amount you owe</b> . Subtract line 43 from line 38. For details on how to pay, see page 53.	▶ 47
	<b>48</b> Estimated tax penalty (see page 53).	48
<b>Third party designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 54)? <input type="checkbox"/> Yes. Complete the following. <input checked="" type="checkbox"/> No	
	Designee's name ▶ _____	Phone no. ▶ ( ) _____
		Personal identification number (PIN) ▶ <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/>
<b>Sign here</b>	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 22. Keep a copy for your records.	Your signature	Date / /      Your occupation mechanic      Daytime phone number ( ) _____
	Spouse's signature. If a joint return, <b>both</b> must sign.	Date / /      Spouse's occupation _____
<b>Paid preparer's use only</b>	Preparer's signature ▶ _____	Date / /      Check if self-employed <input type="checkbox"/> Preparer's SSN or PTIN Pxx-xx-xxxx
	Firm's name (or yours if self-employed), address, and ZIP code ▶ _____	EIN _____      Phone no. ( ) _____



# WAGE EARNER COMPREHENSIVE

## PROBLEMS

## ANSWERS TO PROBLEMS

### Comprehensive Problems

#### Schedule 2 (Form 1040A)

Department of the Treasury—Internal Revenue Service

#### Child and Dependent Care Expenses for Form 1040A Filers

2003

OMB No. 1545-0085

Name(s) shown on Form 1040A

Marvin Simmons

Your social security number

XXX : XX : XXXX

**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)
	Joy Day Care	9192 East Huron Your City, State, Zip Code	XX-XXXXXXXX	978

(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 2003 for the person listed in column (a)
First	Last	
Eric	Simmons	XXX : XX : XXXX 978
3 Add the amounts in column (c) of line 2. <b>Do not</b> enter more than \$3,000 for one qualifying person or \$6,000 for two or more persons. If you completed Part III, enter the amount from line 26.		3 978
4 Enter your <b>earned income</b> .		4 24,952
5 If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); <b>all others</b> , enter the amount from line 4.		5 24,952
6 Enter the <b>smallest</b> of line 3, 4, or 5.		6 978
7 Enter the amount from Form 1040A, line 22.		7 24,952
8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7.		
If line 7 is:		
Over	But not over	Decimal amount is
\$0—15,000		.35
15,000—17,000		.34
17,000—19,000		.33
19,000—21,000		.32
21,000—23,000		.31
23,000—25,000		.30
25,000—27,000		.29
27,000—29,000		.28
If line 7 is:		
Over	But not over	Decimal amount is
\$29,000—31,000		.27
31,000—33,000		.26
33,000—35,000		.25
35,000—37,000		.24
37,000—39,000		.23
39,000—41,000		.22
41,000—43,000		.21
43,000—No limit		.20
		8 × .30
9 Multiply line 6 by the decimal amount on line 8. If you paid 2002 expenses in 2003, see the instructions.		9 293
10 Enter the amount from Form 1040A, line 28.		10 1,281
11 <b>Credit for child and dependent care expenses.</b> Enter the <b>smaller</b> of line 9 or line 10 here and on Form 1040A, line 29.		11 293

For Paperwork Reduction Act Notice, see Form 1040A instructions.

Cat. No. 10749I

Schedule 2 (Form 1040A) 2003

**Child Tax Credit Worksheet—Line 33**

Keep for Your Records

**Before you begin:** ✓ If you received (before offset) an advance payment of the child tax credit and you filed a joint return for 2002, you and your spouse are each considered to have received one-half of the payment.



If you received Notice 1319, have it available. The notice shows the amount of your advance payment (before offset). If you do not have Notice 1319, you can check the amount of your advance payment (before offset) on the IRS website at [www.irs.gov](http://www.irs.gov). You will need to enter your SSN, your 2002 filing status, and the total number of exemptions you claimed on line 6d of your 2002 Form 1040 or Form 1040A.



- To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2003 and meet the other requirements listed on page 38.
- **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 × \$1,000. 

1	1000
---	------

  
Enter the result.

2. Enter the amount, if any, of your advance child tax credit (before offset). 

2	400
---	-----

3. Is line 1 less than or equal to line 2?

Yes.

You cannot take this credit. If line 2 is more than line 1, you do not have to pay back the difference.

No. Subtract line 2 from line 1.

3	600
---	-----

4. Enter the amount from Form 1040A, line 28. 

4	1281
---	------

5. Add the amounts from Form 1040A, lines 29 through 32. 

5	293
---	-----

6. Are the amounts on lines 4 and 5 the same?

Yes.

You cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit**. See the **TIP** below.

No. Subtract line 5 from line 4.

6	988
---	-----

7. Is the amount on line 3 more than the amount on line 6?

Yes. Enter the amount from line 6. Also, you may be able to take the **additional child tax credit**. See the **TIP** below.

**This is your child tax credit.**

No. Enter the amount from line 3.

7	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 6 or line 7 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

Form 1040A, Earned Income Credit Worksheet, line 41, 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 attached 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 2003:

- 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,692 (\$34,692 if married filing jointly)?
- 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,666 (\$30,666 if married filing jointly)?
- No children live with you, is the amount on Form 1040A, line 22, less than \$11,230 (\$12,230 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 42)?

**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 2003?

**Yes.** *See Nonresident aliens on page 42.*  **No.** *Go to Step 2.*

#### Step 2 Investment Income

##### 1. Add the amounts from Form 1040A:

Line 8a	_____
Line 8b +	_____
Line 9a +	_____
Line 10a +	_____
<b>Investment Income =</b>	<input type="text" value="0"/>

##### 2. Is your investment income more than \$2,600?

**Yes.**   **No.** *Continue* →  
You cannot take the credit.

##### 3. Did a child live with you in 2003?

**Yes.** *Go to Step 3 on page 40.*  **No.** *Go to Step 4 on page 40.*

Form 1040A, Earned Income Credit Worksheet, line 41, page 2

Form 1040A—Line 41

### Step 3 Qualifying Child

A qualifying child is a child who is your...

Son, daughter, adopted child, stepchild, or a descendant of any of them (for example, your grandchild)

or

Brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew) whom you cared for as you would your own child

or

Foster child (any child placed with you by an authorized placement agency whom you cared for as you would your own child)

AND

was at the end of 2003...

Under age 19

or

Under age 24 and a student (see page 42)

or

Any age and permanently and totally disabled (see page 42)

AND

who...

Lived with you in the United States for more than half of 2003. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 41.

**Note.** If the child was married, see page 42.

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 2003?

**Yes.**   **No.** *Continue* →

You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Do you have at least one child who meets the above conditions to be your qualifying child?

**Yes.** *Go to question 3.*  **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 2003?

**Yes.** *See Qualifying Child of More Than One Person on page 42.*  **No.** This child is your qualifying child. The child must have a valid social security number as defined on page 42 unless the child was born and died in 2003. *Skip Step 4; go to Step 5 on page 41.*

### 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 2003?

**Yes.**   **No.** *Continue* →

You cannot take the credit. Put "No" to the left of the entry space for line 41.

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2003 tax return?

**Yes.**   **No.** *Continue* →

You cannot take the credit.

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2003?

**Yes.** *Continue* →  **No.**  You cannot take the credit.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2003? Members of the military stationed outside the United States, see page 42 before you answer.

**Yes.** *Go to Step 5 on page 41.*  **No.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.

# WAGE EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

Form 1040A, Earned Income Credit Worksheet, line 41, page 3

### Step 5 Earned Income

1. Figure earned income:

Form 1040, line 7      24,952

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- 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 Form W-2. 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 = 24,952

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,692 (\$34,692 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,666 (\$30,666 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,230 (\$12,230 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 43.

### Definitions and Special Rules

(listed in alphabetical order)

**Adopted Child.** An adopted child is always treated as your own child. An adopted child includes a child placed with you by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person or court authorized by state law to place children for legal adoption.

**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, below.

**Exception to "Time Lived With You" Condition.** A child is considered to have lived with you for all of 2003 if the child was born or died in 2003 and your home was this child's home for the entire time he or she was alive in 2003. 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 7. If you were in the military stationed outside the United States, see Members of the Military on page 42.

**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 you do not have to file Form 8862 if either of the following applies.

- After your EIC was reduced or disallowed in an earlier year (a) you filed Form 8862 (or other documents) and your EIC was then allowed and (b) your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
- You are taking the EIC without a qualifying child and the only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

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.

## 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	24,952
---	--------

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	750
---	-----

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	24,952
---	--------

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 \$6,250 (\$7,250 if married filing jointly)?
  - 1 or more qualifying children, is the amount on line 3 less than \$13,750 (\$14,750 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

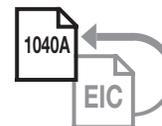
#### Your Earned Income Credit

6. This is your earned income credit.

6	750
---	-----

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 43 to find out if you must file Form 8862 to take the credit for 2003.



## OVERVIEW AND OBJECTIVES

This lesson will cover how to:

- Determine capital gain and loss on the sale of corporate stock,
- Report capital gain distributions on Schedule D, when required,
- Figure tax on Schedule D, and
- Compute capital loss carryover.

Tax terms in the student text are presented in bold-faced type. Emphasize these as they are introduced:

- capital asset
- capital gain distributions
- adjusted basis
- holding period
- gross sale proceeds
- net sale proceeds (gross proceeds less commissions)
- capital gain
- capital loss

## MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the material, you can download the files from [www.irs.gov](http://www.irs.gov).

- Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*
- Form 1099-DIV, *Dividends and Distributions*
- Schedule D (Form 1040), *Capital Gains and Losses*
- Schedule D-1 (Form 1040), *Continuation Sheet for Schedule D (Form 1040)*
- Form 1040
- *Capital Loss Carryover Worksheet*

## **TEACHING TIPS**

Volunteers who study advanced topics often have extensive tax knowledge. Acknowledge their expertise; but explain that, throughout these lessons, situations are identified in which volunteers should refer taxpayers to paid professional tax preparers. Explain also that the reason is not because IRS doubts the volunteer's competence, but because these are complex and sometimes risky areas that are beyond the scope of the VITA/TCE program. IRS wants neither to put the program or the volunteer at risk, nor to misinform taxpayers.

Point out to students that if the shares acquired first by the taxpayer are considered sold first, this method used to figure the cost basis is called "first-in first-out" (FIFO).

## **GUIDED QUESTIONS**

- 1. What adjustment does a stock's adjusted basis include?**  
(Broker's commissions, stock dividends, stock splits.)

## **GROUP ACTIVITY**

*(5–7 min.)*

Ask the entire class to turn to Exhibit 1, which shows a blank Form 1099-B. Explain that IRS uses Form 1099-B as a check against taxpayer-reported information. Walk students through the parts of this form and explain how they will use each part to help taxpayers.

\* Remind students to check the taxpayer-identification information against the taxpayer's Form 1040.

\* Point out that box 1a contains the sale date to use in computing the holding period.

\* Refer students to box 2 and make sure they see where the broker indicates whether gross or net proceeds (gross proceeds less commissions) were reported.

## **TEACHING TIPS**

Make sure that volunteers understand that the dates used to determine holding period do not include the purchase date, but do include the sale date (from box 1a, Form 1099-B).

### **Exercise 1**

Go over these questions with the students. The discussion will tell you how well they are following the course material.

- A. Students should be able to figure the basis (cost) without being distracted by the commission on the sale.



- B. The change means that the holding period goes from long to short-term. Ask students whether they can tell yet how this change in basis will affect the profitability of the sale. (They are not expected to know, because they haven't yet studied how to determine gain or loss. That topic is discussed next. The long-term capital gain on the sale of stock acquired in May 2000 is \$705 (\$3,255 – \$2,550). However, Morris has a capital loss of \$295 (\$3,255 – \$3,550) on the sale of stock bought in October 2001.
- C. Students should be able to figure the basis after the tax-free stock split.

Remind students that a stockbroker can report either the gross proceeds or the net proceeds as the sales price.

1. Have the students look at Parts I through IV of Schedule D so they understand the purpose of each part.
2. Show them a Schedule D-1, the continuation sheet for Schedule D. They will not use it often, if at all, but they should know what it looks like.

## **EXAMPLES 6 AND 7**

Examples 6 and 7 compare and contrast features about completing Parts I and II of Schedule D.

### **Similarities:**

In both Parts I and II the taxpayer:

- \* Adds sales price in column (d) and reports the total.
- \* Reports net proceeds if the broker reported net proceeds on Form 1099-B, or adds selling expenses (such as broker's fees and commissions) to basis (cost) if the broker reported gross sales price (gross proceeds).

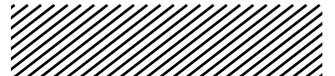
### **Contrasts:**

Example 6 shows:

- \*A short-term transaction (Part I) and
- \*A net loss.

Example 7 shows:

- \*A long-term transaction (Part II) and
- \*A net gain.



## ***EXAMPLE 7***

Tell the students to trace what happened to each stock, one by one. They should start by looking at the holding period, so they will know whether to report the sale in Part I or Part II of Schedule D. Next, they should figure adjusted basis; and then capital gain or loss on the sale.

Let the students know they must follow this procedure with the pieces of information taxpayers show them. There are no shortcuts.

## ***TEACHING TIPS***

### **Exercise 2**

Go over these questions with the students. Students should be able to:

- \*Compute capital gain or loss and
- \*Distinguish between long-term and short-term gain or loss on sale of stock.

## ***TEACHING TIPS***

Remind the students that they already read a brief description of capital gain distributions in Income Lesson, under “Dividend Income and Other Corporate Distributions.”

## ***TEACHING TIPS***

### **Exercise 3**

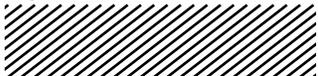
In exercise 3 students need to:

- Combine gains and losses from different transactions;
- Remember not to overlook making entries on lines 3 and 10;
- Take capital gain distributions into consideration (line 13); and
- Avoid letting the bar across the page at line 10 distract them from including the line 8 and 9 amounts when they compute the entries for lines 15 and 16.

## ***PART III***

Point out to the students that when they complete Part III, it is time to transfer the first entry to Form 1040. The entry, either a gain or a loss, goes on line 13a of Form 1040.

Emphasize how important it is to stop and make the entry on Form 1040 at this point. If they wait, they may overlook making it at all.



## **PART IV**

Part IV is simpler in 2003 but it still looks confusing to fill out, and it can be. That is why it pays to fill out Part IV carefully.

Part IV is used only if the taxpayer has net capital gain. Using Part IV will never increase the taxpayer's tax over the Tax Table or Tax Rate Schedule amount. On the contrary, using Part IV can save on tax due for the taxpayer.

## **EXAMPLE 9**

Example 9 shows:

- \*How to fill out Parts III and IV, and
- \*How Part IV can save money for the taxpayer.

## **TAX TIPS**

Remind volunteers that if the taxpayer wants to make an election to report the gain on a *deemed sale* of current holdings to take advantage of the lowered rate, the volunteer should suggest that the taxpayer see a paid professional tax preparer.

## **COMMON QUERIES**

Students may ask what happens to a capital loss carryover if a taxpayer dies. Capital losses cannot be carried over after a taxpayer's death. Losses are deductible on the final income tax return filed for the decedent, but the capital loss limits still apply.

See Publication 559, *Survivors, Executors, and Administrators*.

## **TEACHING TIPS**

Make sure the students notice how:

The *Capital Loss Carryover Worksheet* ensures that a capital loss carryover keeps its short-term or long-term nature from one year to the next.

Because the net result in Example 10 is a capital loss, Part IV of Schedule D is not needed.

## **EXERCISES 5 AND 6**

Exercises 5 and 6 summarize what the students have learned in Lesson 9. In both exercises they complete Schedule D, once for a net capital loss, and once for a net capital gain. The information they use to complete Schedule D is presented to them in a format reasonably close to the way taxpayers will present it. In both exercises the students transfer their results to Form 1040.

Exercise 5 requires that students use Parts I, II, and III of Schedule D and the *Capital Loss Carryover Worksheet*.

Exercise 6 requires that students use Parts I through IV of Schedule D. Students also get more practice at computing adjusted basis.

### **TEACHING TIPS**

It is advisable to divide Exercise 5 in parts and have the class go over each part together before moving on to the next one. Doing that will give students a better chance to keep up. A good division would be:

1. Report the stocks in Parts I and II according to whether they are long-term or short-term.
2. Figure their basis.
3. Finish Parts I and II.
4. Complete Part III and Form 1040, line 13.
5. Complete the *Capital Loss Carryover Worksheet*.

### **GUIDED QUESTIONS**

#### **Exercise 5:**

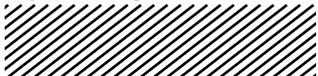
1. **Is the MNO stock short-term or long-term?** (Short-term.)
2. **How much longer would Matthew have needed to wait before the holding period would have been long-term?** (One day.)
3. **How much short-term capital loss will Matthew be able to carry over to 2003?** (None.)
4. **How much long-term capital loss will Matthew be able to carry over to 2003?** (\$395.)

### **TEACHING TIPS**

#### **Exercise 6:**

Exercise 6 is complicated enough that teaching it in parts is probably wise. A good way to divide it would be:

1. Report the stocks in Parts I and II according to whether they are long-term or short-term.
2. Figure their basis.
3. Finish Parts I and II.
4. Complete Part III and Form 1040, line 13.
5. Complete Part IV and Form 1040, line 40.

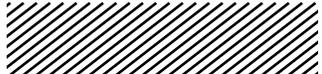


## ***GUIDED QUESTIONS***

- 1. What would be the adjusted basis for the OLE entry if Katherine had told the broker to sell shares from the block she bought in March 2001? \$10,490.  $[(\$10,800 + \$1,080) \div 600] \times 500 = \$9,900$ ;  $\$9,900 + \$590 = \$10,490$ .**
- 2. In that case, how much would be Katherine's capital gain or loss on selling the OLE stock? Instead of \$1,710 gain, she would have a \$2,690 loss.**
- 3. Would the loss be short-term or long-term? Short-term.**

**STUDENT NOTES**

Lined writing area for student notes.



## 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 (On transactions concluded before May 6, 2003.).
- 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 2003.

The Internal Revenue Service (IRS) receives copies of Form 1099-B from the broker and copies of Form 1099-DIV from the payer. The taxpayer should not file these items with the return, but keep them with his or her records.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the 10% and 20% capital gains rates to 5% and 15% for capital gains realized on or after May 6, 2003. For tax year 2003 only the Schedule D will have a column (G) which requires an entry for capital gains transactions after May 5, 2003. The net effect of this law is that taxpayers may have two different tax rates for capital gains transactions in 2003. The key to successful completion of the form and calculation of the correct tax is to follow the Schedule D line requests for information very carefully.

## 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 2.

## Capital Gains Distribution (Only)

The 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 2, Income. Instead, report the total capital gain distribution on Form 1040, line 13a, or on Form 1040A, line 10a. 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.

## 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, 2002 (trade date). Her holding period began the next day, January 12. If she sells that stock on January 11, 2003, 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, 2003, 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



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 were 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.

### 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 2003, 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, 2003. On April 9, 2003, 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 2. 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.

#### POTENTIAL PITFALLS



Shares from a stock dividend may or may not have the same holding period as the original shares.

## 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

7979		<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0715		2003	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 to IRS				
		1b CUSIP no.		\$				
PAYER'S Federal identification number		RECIPIENT'S identification number		3 Bartering		4 Federal income tax withheld		
RECIPIENT'S name		5 Description		\$		\$		
Street address (including apt. no.)		6a Profit or (loss) realized in 2003		6b Post-5/5/2003 profit or (loss) realized				
City, state, and ZIP code		7 Unrealized profit or (loss) on open contracts—12/31/2002		8 Unrealized profit or (loss) on open contracts—12/31/2003				
Account number (optional)		2nd TIN not.						
		<input type="checkbox"/>						
		9a Aggregate profit or (loss)		9b Post-5/5/2003 aggregate profit or (loss)				
		\$		\$				

Form 1099-B      Cat. No. 14411V      Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

## 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:
<b>Box 1a</b> , Date of sale	Schedule D, column (c), of either Part I, line 1, or Part II, line 8
<b>Box 2</b> , 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
<b>Box 4</b> , Federal income tax withheld	Form 1040, line 61
<b>Box 5</b> , 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 standard 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 7764366		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			
<b>1099-INT Interest Income 2003</b>					
Interest income not included in box 3	Early withdrawal penalty	US Savings Bonds and other US Treasury interest	<b>Federal income tax withheld</b>	Foreign tax paid	Foreign country or US possession
Box 1 <b>\$378.00</b>	Box 2	Box 3 <b>\$100.00</b>	Box 4	Box 5	Box 6
<b>1099-DIV Dividends &amp; Distributions 2003</b>					
Ordinary dividends	Capital gain distributions	28% rate gain	Unrecaptured sec. 1250 gain	Section 1202 gain	Non-taxable distributions
Box 1 <b>\$559.00</b>	Box 2a <b>\$179.00</b>	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 <b>\$25.00</b>	Box 7	Box 8	Box 9	
<b>1099-B Proceeds from Broker and Barter Exchange Transactions 2003</b>					
Reference number	Trade date (Box 1a)	CUSIP number (Box 1b)	Quantity Description (Box 5)	Price	Gross proceeds less commissions (Box 2)
145367	7/17/03	765298	200 shrs ABC Corp.	\$16.75	\$3,299.90
239863	10/23/03	927651	300 shrs XYZ Markets, Inc.	\$83.65	\$25,000.20
<b>Totals</b>					<b>\$28,300.10</b>
<b>1099-R Distributions from IRAs 2003</b>					
Gross distribution (Box 1)	Taxable amount (Box 2a)	Taxable amount not determined	Total Distribution (Box 2b)	Federal Income tax withheld (Box 4)	Distribution Code (Box 7)
<b>\$2,000</b>	<b>\$2,000</b>			\$0.00	7-Normal Distribution
					IRA/SEP/SIMPLE Yes

## Qualified 5-Year Gain Applies to transactions prior to May 6, 2003

In 2001, the capital gains rate on qualified property held for more than five years was lowered to 18% (8% for lower income taxpayers). These reduced rates continue to apply to sales of qualified property before May 6, 2003. Sales after May 5, 2003, will be taxed using the reduced tax rates introduced earlier in this lesson. The schedule D has been redesigned to accommodate the multiple tax rates that could apply for 2003. You should exercise caution when completing the Schedule D.

Exhibit 3

2003 Qualified 5-year Worksheet

### Qualified 5-Year Gain Worksheet—Line 35

*Keep for Your Records*



- |  |   |   |
|--|---|---|
| <p>1. Enter the total of all gains that you reported on line 8, column (f), of Schedules D and D-1 from property held more than 5 years and disposed of before May 6, 2003. <b>Do not</b> reduce these gains by any losses . . . . .</p> <p>2. Enter the total of all gains from property held more than 5 years and disposed of before May 6, 2003, from Form 4797, Part I, but <b>only</b> if Form 4797, line 7, column (g), is more than zero. <b>Do not</b> reduce these gains by any losses . . . . .</p> <p>3. Enter the total of all capital gains from property held more than 5 years and disposed of before May 6, 2003, from Form 4684, line 4, but <b>only</b> if Form 4684, line 15, is more than zero. <b>Do not</b> reduce these gains by any losses . . . . .</p> <p>4. Enter the total of all capital gains from property held more than 5 years and disposed of before May 6, 2003, from Form 6252; Form 6781, Part II; and Form 8824. <b>Do not</b> reduce these gains by any losses . . . . .</p> <p>5. Enter the total of any qualified 5-year gain reported to you on:</p> <ul style="list-style-type: none"> <li>• Form 1099-DIV, box 2c;</li> <li>• Form 2439, box 1c; and</li> <li>• Schedule K-1 from a partnership, S corporation, estate, or trust (<b>do not</b> include gains from section 1231 property; take them into account on line 2 above, but <b>only</b> if Form 4797, line 7, column (g), is more than zero).</li> </ul> <p>6. Add lines 1 through 5 . . . . .</p> <p>7. Enter the part, if any, of the gain on line 6 that is:</p> <ul style="list-style-type: none"> <li>• Attributable to 28% rate gain <b>or</b></li> <li>• Included on line 6, 10, 11, or 12 of the <b>Unrecaptured Section 1250 Gain Worksheet</b> on page D-7.</li> </ul> <p>8. <b>Qualified 5-year gain.</b> Subtract line 7 from line 6. Enter the result here and on Schedule D, line 35 . . . . .</p> | <p>1.</p> <p>2.</p> <p>3.</p> <p>4.</p> <p>5.</p> <p>6.</p> <p>7.</p> <p>8.</p> | <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> <div style="border-bottom: 1px solid black; height: 20px; width: 100%;"></div> |
|--|---|---|

## 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, 2003, 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, 2002, 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 2002.
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, 2003, the stock split two-for-one, and she then held a total of 200 shares. On March 6, 2003, 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 2, 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.
- 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:

<b>To Report Capital Gain or Loss in Part I or II, Schedule D</b>		
	<b>Short-Term</b>	<b>Long-Term</b>
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 sales amount:	<b>From</b> Part I, line 2, Schedule D-1	<b>From</b> Part II, line 9, Schedule D-1
	<b>Onto</b> Part I, line 2, Schedule D	<b>Onto</b> 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, 2002, Mary Lou bought 500 shares of XEN, Inc. stock for \$20 a share (\$10,000 total), plus a \$50 commission. On February 26, 2003, 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 with no entry in column (g) because the transaction was completed before May 6, 2003. 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.

<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>						
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
1 500 sh. XEN	11/13/02	2/26/03	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 <b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .					6 ( )	
7a Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. Do not enter more than zero . . . . .					7a	( )
b <b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .					7b (2,000.00)	

**Example 7**

Exhibit 4 shows the three long-term transactions that Tess is reporting on Schedule D, Part II, for 2003. 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, 2003, 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 May 27, 2003, 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).

<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
<b>8</b>							
200 sh. XYZ	8/21/99	1/10/03	1,875 00	1,535 00	340 00		
500 sh. TUV	10/1/00	1/10/03	6,000 00	8,040 00	(2,040 00)		
2,000 sh. QRS	11/18/00	5/27/03	9,950 00	5,000 00	4,950 00	4,950 00	
<b>9</b> Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .							
<b>10 Total long-term sales price amounts.</b> Add lines 8 and 9 in column (d) . . . . .			17,825 00				
<b>11</b> 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 . . . . .							
<b>12</b> Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .							
<b>13</b> Capital gain distributions. See page D-1 of the instructions . . . . .							
<b>14</b> Long-term capital loss carryover. Enter the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .					( )		
<b>15</b> Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .						4,950 00	
<b>16 Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) <b>Next:</b> Go to Part III on the back.					3,250 00		

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, **do not** include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or eligible gain on qualified small business stock (see page D-4 of the instructions).

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Cat. No. 11338H

Schedule D (Form 1040) 2003

## 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, 2002, Bill bought 1,000 shares of stock for \$15,000, including commission. On March 15, 2003, 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, 2003, 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 2, *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. For transactions completed after May 5, 2003, include the gain or loss in Column G also.

### Example 8

Alec received a Form 1099-DIV. Box 2a which 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, 2003. 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 2003 that must be reported on Schedule D.

Exhibit 6

Alec's Form 1099-DIV

9191 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0110		<b>2003</b> Form 1099-DIV	<b>Dividends and Distributions</b>
PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>MIG INC.</b> 4321 Main Street Anytown, VA 00012		<b>1a</b> Total ordinary dividends \$	<b>1b</b> Qualified dividends \$		
PAYER'S Federal identification number  00-0000123		RECIPIENT'S identification number  000-00-0128		<b>2a</b> Total capital gain distr. \$ <b>170.00</b>	<b>2b</b> Post-May 5 capital gain distr. \$
RECIPIENT'S name  <b>Alec Green</b>		<b>2c</b> Qualified 5-year gain \$	<b>2d</b> Unrecap. Sec. 1250 gain \$	<b>Copy A</b> For Internal Revenue Service Center  File with Form 1096.	
Street address (including apt. no.)  1234 A Street		<b>2e</b> Section 1202 gain \$	<b>2f</b> Collectibles (28%) gain \$	For Privacy Act and Paperwork Reduction Act Notice, see the 2003 General Instructions for Forms 1099, 1098, 5498, and W-2G.	
City, state, and ZIP code  Anytown, VA 00013		<b>3</b> Nontaxable distributions \$	<b>4</b> Federal income tax withheld \$	<b>5</b> Investment expenses \$	
Account number (optional)		2nd TIN not. <input type="checkbox"/>	<b>6</b> Foreign tax paid \$	<b>7</b> Foreign country or U.S. possession	<b>8</b> Cash liquidation distributions \$
2nd TIN not. <input type="checkbox"/>		<b>9</b> Noncash liquidation distributions \$	(This area is intentionally left blank.)		
Form 1099-DIV		Cat. No. 14415N		Department of the Treasury - Internal Revenue Service	
Do Not Cut or Separate Forms on This Page			— Do Not Cut or Separate Forms on This Page		

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) for the entire year Subtract (e) from (d)		(g) Post-May 5 gain or (loss)* (see below)
8 600 sh. ABC	2/19/00	8/25/03	1,200	00	1,455	00	(255)	00	(255.00)
9 Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .	9								
10 <b>Total long-term sales price amounts.</b> 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 . . . . .	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					170	00		
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .	14					( )			
15 Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .	15								
16 <b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) <b>Next:</b> Go to Part III on the back.	16					(85)	00		

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, **do not** include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or 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.
- Check Column G of both line 1 or 8 to detail sales, exchanges or conversions completed after May 5, 2003 have been recorded.

### 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 2003. Her broker reported net proceeds as sales price.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
500 sh LSR	1/21/02	1/4/03	\$ 4,000	\$9,000
250 sh BGI	3/11/02	2/12/03	10,000	2,500
75 sh ABC	1/22/01	1/29/03	2,000	7,500
400 sh XYZ	12/3/99	3/6/03	15,000	10,000
100 sh DEF	4/2/99	10/16/03	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 8**

**Complete Parts I and II of Jane's Schedule D.**

<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
<b>1</b>							
<b>2</b> Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .							
<b>3 Total short-term sales price amounts.</b> Add lines 1 and 2 in column (d) . . . . .							
<b>4</b> Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . .							
<b>5</b> Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .							
<b>6</b> Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2002 Capital Loss Carryover Worksheet . . . . .					( )		
<b>7a</b> Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. <b>Do not</b> enter more than zero . . . . .						( )	
<b>b Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .							
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
<b>8</b>							
<b>9</b> Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .							
<b>10 Total long-term sales price amounts.</b> Add lines 8 and 9 in column (d) . . . . .							
<b>11</b> 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 . . . . .							
<b>12</b> Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .							
<b>13</b> Capital gain distributions. See page D-1 of the instructions . . . . .							
<b>14</b> Long-term capital loss carryover. Enter the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .					( )		
<b>15</b> Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .							
<b>16 Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) . . . . .							

**Next: Go to Part III on the back.**

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, **do not** include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or eligible gain on qualified small business stock (see page D-4 of the instructions).

### Part III: Summary of Parts I and II

Combine the amounts from line 7b (net short-term capital gain or loss) and line 16 (net long-term capital gain or loss). Enter the result on line 17a in Part III. This combined number may be a gain or a loss.

- If the line 17a amount is a gain, also enter it on line 13a of Form 1040, and go to line 17b.
- If the line 17a 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 17a or
  - \$3,000 (\$1,500 for a married taxpayer filing separately).

Also enter this amount on line 13a of Form 1040. Because it is a loss, be sure to put parentheses around the number when you enter it on Form 1040.

### 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 40, Taxable Income. Then go to Part IV of Schedule D if:

- Both lines 16 and 17a of Schedule D are gains, and
- Form 1040, line 40, 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 40:       \$65,001

                  Schedule D, line 7b:       (5,000)

                  Schedule D, line 16:       16,000

                  Schedule D, line 17a:     11,000

                  (Transferred to Form 1040, line 13a.)

There is capital gain on Schedule D, lines 16 and 17a, and Form 1040, line 40, is more than zero.

Exhibits 9 and 10 show Edmund's Schedule D, Parts III and IV, and his Form 1040, lines 13a and 41. His tax is \$12,516. Without Schedule D, his tax from the Tax Table would be \$13,066. Using Schedule D saved Edmund \$1,100.

**Part III Taxable Gain or Deductible Loss**

<b>17a</b> Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .	<b>17a</b>	11,000	00
<b>b</b> Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40 . . . . . <b>Next:</b> • If both lines 16 and 17a of Schedule D are gains <b>or</b> you have qualified dividends on Form 1040, line 9b, complete <b>Part IV</b> below (unless Form 1040, line 40, is zero). • Otherwise, skip the rest of Schedule D and complete Form 1040.	<b>17b</b>		
<b>18</b> If line 17a is a loss, enter here and on Form 1040, line 13a, the <b>smaller</b> of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . . <b>Next:</b> • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete <b>Part IV</b> below (but skip lines 19 and 20). • Otherwise, skip <b>Part IV</b> below and complete the rest of Form 1040.	<b>18</b>	(	)

**Part IV Tax Computation Using Maximum Capital Gains Rates**

If line 16 or line 17a is zero or less, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.

<b>19</b> Enter your unrecaptured section 1250 gain, if any, from line 18 of the worksheet on page D-6 . . . . .	<b>19</b>		
<b>20</b> Enter your 28% rate gain, if any, from line 7 of the worksheet on page D-9 of the instructions . . . . .	<b>20</b>		

If lines 19 and 20 are zero, go to line 21. Otherwise, complete the worksheet on page D-10 of the instructions to figure the amount to enter on lines 35 and 53 below, and skip all other lines below.

<b>21</b> Enter your taxable income from Form 1040, line 40 . . . . .	<b>21</b>	65,001	00
<b>22</b> Enter the <b>smaller</b> of line 16 or line 17a, but not less than zero . . . . .	<b>22</b>	11,000	00
<b>23</b> Enter your qualified dividends from Form 1040, line 9b . . . . .	<b>23</b>		
<b>24</b> Add lines 22 and 23 . . . . .	<b>24</b>	11,000	00
<b>25</b> Amount from line 4g of Form 4952 (investment interest expense) . . . . .	<b>25</b>		
<b>26</b> Subtract line 25 from line 24. If zero or less, enter -0- . . . . .	<b>26</b>	11,000	00
<b>27</b> Subtract line 26 from line 21. If zero or less, enter -0- . . . . .	<b>27</b>	54,001	00
<b>28</b> Enter the <b>smaller</b> of line 21 <b>or:</b> • \$56,800 if married filing jointly or qualifying widow(er); • \$28,400 if single or married filing separately; or • \$38,050 if head of household . . . . .	<b>28</b>	28,400	00
<b>If line 27 is more than line 28, skip lines 29–39 and go to line 40.</b>			
<b>29</b> Enter the amount from line 27 . . . . .	<b>29</b>		
<b>30</b> Subtract line 29 from line 28. If zero or less, go to line 40 . . . . .	<b>30</b>		
<b>31</b> Add lines 17b and 23* . . . . .	<b>31</b>		
<b>32</b> Enter the <b>smaller</b> of line 30 or line 31 . . . . .	<b>32</b>		
<b>33</b> Multiply line 32 by 5% (.05) . . . . .	<b>33</b>		
<b>If lines 30 and 32 are the same, skip lines 34–39 and go to line 40.</b>			
<b>34</b> Subtract line 32 from line 30 . . . . .	<b>34</b>		
<b>35</b> Enter your qualified 5-year gain, if any, from line 8 of the worksheet on page D-8 . . . . .	<b>35</b>		
<b>36</b> Enter the <b>smaller</b> of line 34 or line 35 . . . . .	<b>36</b>		
<b>37</b> Multiply line 36 by 8% (.08) . . . . .	<b>37</b>		
<b>38</b> Subtract line 36 from line 34 . . . . .	<b>38</b>		
<b>39</b> Multiply line 38 by 10% (.10) . . . . .	<b>39</b>		
<b>If lines 26 and 30 are the same, skip lines 40–49 and go to line 50.</b>			
<b>40</b> Enter the <b>smaller</b> of line 21 or line 26 . . . . .	<b>40</b>	11,000	00
<b>41</b> Enter the amount from line 30 (if line 30 is blank, enter -0-) . . . . .	<b>41</b>		
<b>42</b> Subtract line 41 from line 40 . . . . .	<b>42</b>	11,000	00
<b>43</b> Add lines 17b and 23* . . . . .	<b>43</b>		
<b>44</b> Enter the amount from line 32 (if line 32 is blank, enter -0-) . . . . .	<b>44</b>		
<b>45</b> Subtract line 44 from line 43 . . . . .	<b>45</b>		
<b>46</b> Enter the <b>smaller</b> of line 42 or line 45 . . . . .	<b>46</b>		
<b>47</b> Multiply line 46 by 15% (.15) . . . . .	<b>47</b>		
<b>48</b> Subtract line 46 from line 42 . . . . .	<b>48</b>	11,000	00
<b>49</b> Multiply line 48 by 20% (.20) . . . . .	<b>49</b>	2,200	00
<b>50</b> Figure the tax on the amount on <b>line 27</b> . Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	<b>50</b>	10,316	00
<b>51</b> Add lines 33, 37, 39, 47, 49, and 50 . . . . .	<b>51</b>	12,516	00
<b>52</b> Figure the tax on the amount on <b>line 21</b> . Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	<b>52</b>	13,066	00
<b>53</b> <b>Tax on all taxable income.</b> Enter the <b>smaller</b> of line 51 or line 52 here and on Form 1040, line 41 . . . . .	<b>53</b>	12,516	00

\*If line 25 is more than zero, see Lines 31 and 43 on page D-9 for the amount to enter. Printed on recycled paper Schedule D (Form 1040) 2003

<b>12</b>	Business income or (loss). Attach Schedule C or C-EZ . . . . .	<b>12</b>		
<b>13a</b>	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	<b>13a</b>	11,000	00
<b>b</b>	If box on 13a is checked, enter post-May 5 capital gain distributions <b>13b</b>			
<b>40</b>	<b>Taxable income.</b> Subtract line 39 from line 38. If line 39 is more than line 38, enter -0-	<b>40</b>		
<b>41</b>	<b>Tax</b> (see page 36). Check if any tax is from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972 . . . . .	<b>41</b>	12,516	00

**Exercise 4**

Melvin sold the following stocks during 2003. 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	7/26/03	\$ 4,000	\$5,000
200 sh MLG	5/10/02	6/7/03	1,200	1,000
150 sh XYZ	4/17/02	3/8/03	5,500	6,000
300 sh MLS	1/13/98	6/19/03	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 40, 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 41? \_\_\_\_\_  
 \_\_\_\_\_

<b>SCHEDULE D</b> <b>(Form 1040)</b>  Department of the Treasury Internal Revenue Service	<b>Capital Gains and Losses</b>  ▶ 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;">2003</div> Attachment Sequence No. 12
Name(s) shown on Form 1040		Your social security number xxx xx xxxx

**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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
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 2002 Capital Loss Carryover Worksheet . . . . .				6	( )
7a	Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. Do not enter more than zero . . . . .				7a	( )
7b	Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f) . . . . .				7b	

**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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .				14	( )
15	Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .				15	
16	Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) . . . . .				16	

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, do not include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or eligible gain on qualified small business stock (see page D-4 of the instructions).

**Part III Taxable Gain or Deductible Loss**

**17a** Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .

**b** Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40 .

- Next:** • If both lines 16 and 17a of Schedule D are gains or you have qualified dividends on Form 1040, line 9b, complete **Part IV** below (unless Form 1040, line 40, is zero).  
 • Otherwise, skip the rest of Schedule D and complete Form 1040.

**18** If line 17a is a loss, enter here and on Form 1040, line 13a, the **smaller** of **(a)** that loss or **(b)** (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . .

- Next:** • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete **Part IV** below (but skip lines 19 and 20).  
 • Otherwise, skip **Part IV** below and complete the rest of Form 1040.

17a		
17b		
18	(	)

**Part IV Tax Computation Using Maximum Capital Gains Rates**

If line 16 or line 17a is zero or less, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.

**19** Enter your unrecaptured section 1250 gain, if any, from line 18 of the worksheet on page D-6 . . . . .

**20** Enter your 28% rate gain, if any, from line 7 of the worksheet on page D-9 of the instructions . . . . .

19		
20		

If lines 19 and 20 are zero, go to line 21. Otherwise, complete the worksheet on page D-10 of the instructions to figure the amount to enter on lines 35 and 53 below, and skip all other lines below.

**21** Enter your taxable income from Form 1040, line 40 . . . . .

**22** Enter the **smaller** of line 16 or line 17a, but not less than zero . . . . .

**23** Enter your qualified dividends from Form 1040, line 9b . . . . .

**24** Add lines 22 and 23 . . . . .

**25** Amount from line 4g of Form 4952 (investment interest expense) . . . . .

**26** Subtract line 25 from line 24. If zero or less, enter -0- . . . . .

**27** Subtract line 26 from line 21. If zero or less, enter -0- . . . . .

**28** Enter the **smaller** of line 21 or:

- \$56,800 if married filing jointly or qualifying widow(er);
- \$28,400 if single or married filing separately; or
- \$38,050 if head of household

If line 27 is more than line 28, skip lines 29–39 and go to line 40.

**29** Enter the amount from line 27 . . . . .

**30** Subtract line 29 from line 28. If zero or less, go to line 40 . . . . .

**31** Add lines 17b and 23\* . . . . .

**32** Enter the **smaller** of line 30 or line 31 . . . . .

**33** Multiply line 32 by 5% (.05) . . . . .

If lines 30 and 32 are the same, skip lines 34–39 and go to line 40.

**34** Subtract line 32 from line 30 . . . . .

**35** Enter your qualified 5-year gain, if any, from line 8 of the worksheet on page D-8 . . . . .

**36** Enter the **smaller** of line 34 or line 35 . . . . .

**37** Multiply line 36 by 8% (.08) . . . . .

**38** Subtract line 36 from line 34 . . . . .

**39** Multiply line 38 by 10% (.10) . . . . .

If lines 26 and 30 are the same, skip lines 40–49 and go to line 50.

**40** Enter the **smaller** of line 21 or line 26 . . . . .

**41** Enter the amount from line 30 (if line 30 is blank, enter -0-) . . . . .

**42** Subtract line 41 from line 40 . . . . .

**43** Add lines 17b and 23\* . . . . .

**44** Enter the amount from line 32 (if line 32 is blank, enter -0-) . . . . .

**45** Subtract line 44 from line 43 . . . . .

**46** Enter the **smaller** of line 42 or line 45 . . . . .

**47** Multiply line 46 by 15% (.15) . . . . .

**48** Subtract line 46 from line 42 . . . . .

**49** Multiply line 48 by 20% (.20) . . . . .

**50** Figure the tax on the amount on **line 27**. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .

**51** Add lines 33, 37, 39, 47, 49, and 50 . . . . .

**52** Figure the tax on the amount on **line 21**. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .

**53** **Tax on all taxable income.** Enter the **smaller** of line 51 or line 52 here and on Form 1040, line 41 . . . . .

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\*If line 25 is more than zero, see **Lines 31 and 43** on page D-9 for the amount to enter. Printed on recycled paper **Schedule D (Form 1040) 2003**

## Capital Loss Carryovers

### TAX TIPS

★★★★★★★

It is easy to double check the carryover from 2003 to 2004. 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 2004.

Use the *Capital Loss Carryover Worksheet* in the Schedule D instructions to figure how much capital loss the taxpayer can carry from 2003 to 2004. 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 2002, enter it on line 6, Part I, Schedule D. Enter it on line 14, Part II, if it is long-term.

**NOTE:** If a capital loss is limited and the remainder must be carried forward to 2004, remind the Taxpayer to bring a copy of the 2003 return for 2004 return preparation.

### Example 10

Andrew sold two stocks in 2003, as summarized here.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
200 sh FFF	5/8/02	1/6/03	\$ 4,000	\$ 3,025
50 sh WWW	11/6/00	3/12/03	8,700	11,000

Andrew's 2002 return showed the following capital loss carryovers to 2003: a \$4,200 short-term loss (line 8 of the 2002 *Capital Loss Carryover Worksheet*) and a \$240 long-term loss (line 13 of the 2002 worksheet). His 2003 Form 1040, line 40, shows \$55,825.

Andrew's Schedule D, Parts I through III, his 2003 Form 1040, line 13a, and his 2002 *Capital Loss Carryover Worksheet* appear below as Exhibits 13 through 16. This example shows how to:

- Report a capital loss carryover from 2002 and work it into the computation on Schedule D as if it had resulted from a 2003 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).

- 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 2004. 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).

**SCHEDULE D  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**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

**2003**

Attachment  
Sequence No. **12**

Name(s) shown on Form 1040

Your social security number

XXX XX XXXX

**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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
1 200 sh. FFF	5/8/02	1/6/03	4,000.00	3,025.00	975.00	
2 Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .			2			
3 <b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .					6 ( 4,200.00)	
7a Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. <b>Do not</b> enter more than zero . . . . .					7a	( )
b <b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .					7b (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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
8 50 sh. WWW	11/6/00	3/12/03	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 <b>Total long-term sales price amounts.</b> 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .					14 ( 240.00)	
15 Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .					15	
16 <b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) <b>Next:</b> Go to Part III on the back.					16 (2,540.00)	

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, **do not** include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or eligible gain on qualified small business stock (see page D-4 of the instructions).

Schedule D (Form 1040) 2003		Page <b>2</b>
<b>Part III Taxable Gain or Deductible Loss</b>		
<p><b>17a</b> Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .</p> <p><b>b</b> Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40 . . . . .</p> <p><b>Next:</b> • If both lines 16 and 17a of Schedule D are gains <b>or</b> you have qualified dividends on Form 1040, line 9b, complete <b>Part IV</b> below (unless Form 1040, line 40, is zero).</p> <p>• Otherwise, skip the rest of Schedule D and complete Form 1040.</p> <p><b>18</b> If line 17a is a loss, enter here and on Form 1040, line 13a, the <b>smaller</b> of <b>(a)</b> that loss or <b>(b)</b> (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . .</p> <p><b>Next:</b> • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete <b>Part IV</b> below (but skip lines 19 and 20).</p> <p>• Otherwise, skip <b>Part IV</b> below and complete the rest of Form 1040.</p>	<p><b>17a</b></p> <p><b>17b</b></p> <p><b>18</b></p>	<p>(5,765 00)</p> <p>(3,000 00)</p>

Exhibit 15

Andrew's Form 1040, line 13a

<p><b>13a</b> Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/></p>	<p><b>13a</b></p>	<p>(3,000 00)</p>
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Exhibit 16

Andrew's Capital Loss Carryover Worksheet

### Capital Loss Carryover Worksheet—Line 18

Use this worksheet to figure your capital loss carryovers from 2003 to 2004 if Schedule D, line 18, is a loss and (a) that loss is a smaller loss than the loss on Schedule D, line 17a, or (b) Form 1040, line 38, is a loss. Otherwise, you do not have any carryovers.

1. Enter the amount from Form 1040, line 38. If a loss, enclose the amount in parentheses . . . . .	1. _____
2. Enter the loss from Schedule D, line 18, as a positive amount . . . . .	2. _____
3. Combine lines 1 and 2. If zero or less, enter -0- . . . . .	3. _____
4. Enter the smaller of line 2 or line 3 . . . . .	4. _____
<b>If line 7b of Schedule D is a loss, go to line 5; otherwise, enter -0- on line 5 and go to line 9.</b>	
5. Enter the loss from Schedule D, line 7b, as a positive amount . . . . .	5. _____
6. Enter any gain from Schedule D, line 16 . . . . .	6. _____
7. Add lines 4 and 6 . . . . .	7. _____
8. Short-term capital loss carryover to 2004. Subtract line 7 from line 5. If zero or less, enter -0- . . . . .	8. _____
<b>If line 16 of Schedule D is a loss, go to line 9; otherwise, skip lines 9 through 13.</b>	
9. Enter the loss from Schedule D, line 16, as a positive amount . . . . .	9. _____
10. Enter any gain from Schedule D, line 7b . . . . .	10. _____
11. Subtract line 5 from line 4. If zero or less, enter -0- . . . . .	11. _____
12. Add lines 10 and 11 . . . . .	12. _____
13. Long-term capital loss carryover to 2004. Subtract line 12 from line 9. If zero or less, enter -0- . . . . .	13. _____

### 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	2/8/03	\$5,050
500 sh ZYX	8/7/03	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	8/7/03	\$4,000
300 sh JKL	8/7/03	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, 2002.
- 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, 2003.
- 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 40, shows \$55,282. When you look at Matthew's Form 1040 and Capital Loss Carryover Worksheet from 2002, you see that he has a \$450 short-term loss and a \$325 long-term loss that he can carry over to his 2003 return.

Use this information to complete Matthew's Schedule D, Parts I, II, and III, and his Form 1040, line 13a, for 2003. Also complete the *Capital Loss Carryover Worksheet* to figure how much capital loss he can carry over to 2004.

<b>SCHEDULE D</b> <b>(Form 1040)</b>  Department of the Treasury Internal Revenue Service	<b>Capital Gains and Losses</b>  ▶ 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  <b>2003</b> Attachment Sequence No. <b>12</b>				
Name(s) shown on Form 1040		Your social security number xxx xx xxxx				
<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>						
<b>(a)</b> Description of property (Example: 100 sh. XYZ Co.)	<b>(b)</b> Date acquired (Mo., day, yr.)	<b>(c)</b> Date sold (Mo., day, yr.)	<b>(d)</b> Sales price (see page D-5 of the instructions)	<b>(e)</b> Cost or other basis (see page D-5 of the instructions)	<b>(f)</b> Gain or (loss) for the entire year Subtract (e) from (d)	<b>(g)</b> Post-May 5 gain or (loss)* (see below)
<b>1</b>						
<b>2</b>	Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .					
<b>3</b>	<b>Total short-term sales price amounts.</b> Add lines 1 and 2 in column (d) . . . . .					
<b>4</b>	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . .					
<b>5</b>	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .					
<b>6</b>	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2002 Capital Loss Carryover Worksheet . . . . .				( )	
<b>7a</b>	Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. <b>Do not</b> enter more than zero . . . . .					( )
<b>7b</b>	<b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .					
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>						
<b>(a)</b> Description of property (Example: 100 sh. XYZ Co.)	<b>(b)</b> Date acquired (Mo., day, yr.)	<b>(c)</b> Date sold (Mo., day, yr.)	<b>(d)</b> Sales price (see page D-5 of the instructions)	<b>(e)</b> Cost or other basis (see page D-5 of the instructions)	<b>(f)</b> Gain or (loss) for the entire year Subtract (e) from (d)	<b>(g)</b> Post-May 5 gain or (loss)* (see below)
<b>8</b>						
<b>9</b>	Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .					
<b>10</b>	<b>Total long-term sales price amounts.</b> Add lines 8 and 9 in column (d) . . . . .					
<b>11</b>	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 . . . . .					
<b>12</b>	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .					
<b>13</b>	Capital gain distributions. See page D-1 of the instructions . . . . .					
<b>14</b>	Long-term capital loss carryover. Enter the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .				( )	
<b>15</b>	Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .					
<b>16</b>	<b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) . . . . .					
<b>Next:</b> Go to Part III on the back.						
*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, <b>do not</b> include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or 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) 2003	

**Exhibit 18**

(B) Complete this form.

Schedule D, Part III

Schedule D (Form 1040) 2003		Page <b>2</b>
<b>Part III Taxable Gain or Deductible Loss</b>		
<p><b>17a</b> Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .</p> <p><b>b</b> Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40 .  <b>Next:</b> • If both lines 16 and 17a of Schedule D are gains <b>or</b> you have qualified dividends on Form 1040, line 9b, complete <b>Part IV</b> below (unless Form 1040, line 40, is zero).          • Otherwise, skip the rest of Schedule D and complete Form 1040.</p> <p><b>18</b> If line 17a is a loss, enter here and on Form 1040, line 13a, the <b>smaller</b> of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . .  <b>Next:</b> • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete <b>Part IV</b> below (but skip lines 19 and 20).          • Otherwise, skip <b>Part IV</b> below and complete the rest of Form 1040.</p>	<p><b>17a</b></p> <p><b>17b</b></p> <p><b>18</b> (      )</p>	

**Exhibit 19**

(C) Complete this line on Matthew’s Form 1040.

Form 1040, line 13a

<p><b>13a</b> Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/></p>	<b>13a</b>	
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**Exhibit 20**

(D) Complete this worksheet.

Capital Loss Carryover Worksheet

**Capital Loss Carryover Worksheet—Line 18**

Use this worksheet to figure your capital loss carryovers from 2003 to 2004 if Schedule D, line 18, is a loss and (a) that loss is a smaller loss than the loss on Schedule D, line 17a, or (b) Form 1040, line 38, is a loss. Otherwise, you do not have any carryovers.

1. Enter the amount from Form 1040, line 38. If a loss, enclose the amount in parentheses . . . . .	1.	
2. Enter the loss from Schedule D, line 18, as a positive amount. . . . .	2.	
3. Combine lines 1 and 2. If zero or less, enter -0- . . . . .	3.	
4. Enter the smaller of line 2 or line 3. . . . .	4.	
If line 7b 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 7b, as a positive amount. . . . .	5.	
6. Enter any gain from Schedule D, line 16 . . . . .	6.	
7. Add lines 4 and 6 . . . . .	7.	
8. Short-term capital loss carryover to 2004. Subtract line 7 from line 5. If zero or less, enter -0- . . . . .	8.	
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.	
10. Enter any gain from Schedule D, line 7b . . . . .	10.	
11. Subtract line 5 from line 4. If zero or less, enter -0- . . . . .	11.	
12. Add lines 10 and 11 . . . . .	12.	
13. Long-term capital loss carryover to 2004. Subtract line 12 from line 9. If zero or less, enter -0- . . . . .	13.	

## 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	4/20/03	\$3,000
50 sh PQR	4/17/03	2,600
500 OLE	6/17/03	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	1/24/03	\$2,500
125 sh XYZ	3/22/03	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, 2003, 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, 2002, 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 (2002), you found she has a \$150 long-term capital loss carryover from 2002 to 2003.

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 40 of her Form 1040 is \$61,221.

<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>						
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
1						
2	Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .		2			
3	<b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .			6	( )	
7a	Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. <b>Do not</b> enter more than zero . . . . .			7a		( )
7b	<b>b Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .			7b		
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>						
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
8						
9	Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .		9			
10	<b>Total long-term sales price amounts.</b> 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .			14	( )	
15	Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .			15		
16	<b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) . . . . . <b>Next:</b> Go to Part III on the back.			16		

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, **do not** include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or 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**

**17a** Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below

<b>17a</b>		
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**b** Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40.

<b>17b</b>		
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**Next:** • If both lines 16 and 17a of Schedule D are gains or you have qualified dividends on Form 1040, line 9b, complete **Part IV** below (unless Form 1040, line 40, is zero).  
• Otherwise, skip the rest of Schedule D and complete Form 1040.

**18** If line 17a is a loss, enter here and on Form 1040, line 13a, the **smaller** of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions)

<b>18</b>	(	)
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**Next:** • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete **Part IV** below (but skip lines 19 and 20).  
• Otherwise, skip **Part IV** below and complete the rest of Form 1040.

**Part IV Tax Computation Using Maximum Capital Gains Rates**

If line 16 or line 17a is zero or less, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.

**19** Enter your unrecaptured section 1250 gain, if any, from line 18 of the worksheet on page D-6

<b>19</b>		
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**20** Enter your 28% rate gain, if any, from line 7 of the worksheet on page D-9 of the instructions

<b>20</b>		
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If lines 19 and 20 are zero, go to line 21. Otherwise, complete the worksheet on page D-10 of the instructions to figure the amount to enter on lines 35 and 53 below, and skip all other lines below.

**21** Enter your taxable income from Form 1040, line 40

<b>21</b>		
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**22** Enter the **smaller** of line 16 or line 17a, but not less than zero

<b>22</b>		
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**23** Enter your qualified dividends from Form 1040, line 9b

<b>23</b>		
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**24** Add lines 22 and 23

<b>24</b>		
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**25** Amount from line 4g of Form 4952 (investment interest expense)

<b>25</b>		
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**26** Subtract line 25 from line 24. If zero or less, enter -0-

<b>26</b>		
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**27** Subtract line 26 from line 21. If zero or less, enter -0-

<b>27</b>		
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**28** Enter the **smaller** of line 21 or:

- \$56,800 if married filing jointly or qualifying widow(er);
- \$28,400 if single or married filing separately; or
- \$38,050 if head of household

<b>28</b>		
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If line 27 is more than line 28, skip lines 29–39 and go to line 40.

**29** Enter the amount from line 27

<b>29</b>		
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**30** Subtract line 29 from line 28. If zero or less, go to line 40

<b>30</b>		
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**31** Add lines 17b and 23\*

<b>31</b>		
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<b>32</b>		
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**32** Enter the **smaller** of line 30 or line 31

<b>33</b>		
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**33** Multiply line 32 by 5% (.05)

If lines 30 and 32 are the same, skip lines 34–39 and go to line 40.

**34** Subtract line 32 from line 30

<b>34</b>		
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**35** Enter your qualified 5-year gain, if any, from line 8 of the worksheet on page D-8

<b>35</b>		
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<b>36</b>		
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**36** Enter the **smaller** of line 34 or line 35

**37** Multiply line 36 by 8% (.08)

<b>37</b>		
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**38** Subtract line 36 from line 34

<b>38</b>		
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**39** Multiply line 38 by 10% (.10)

<b>39</b>		
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If lines 26 and 30 are the same, skip lines 40–49 and go to line 50.

**40** Enter the **smaller** of line 21 or line 26

<b>40</b>		
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**41** Enter the amount from line 30 (if line 30 is blank, enter -0-)

<b>41</b>		
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**42** Subtract line 41 from line 40

<b>42</b>		
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**43** Add lines 17b and 23\*

<b>43</b>		
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<b>44</b>		
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**44** Enter the amount from line 32 (if line 32 is blank, enter -0-)

**45** Subtract line 44 from line 43

<b>45</b>		
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<b>46</b>		
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**46** Enter the **smaller** of line 42 or line 45

**47** Multiply line 46 by 15% (.15)

<b>47</b>		
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**48** Subtract line 46 from line 42

<b>48</b>		
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**49** Multiply line 48 by 20% (.20)

<b>49</b>		
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**50** Figure the tax on the amount on line 27. Use the Tax Table or Tax Rate Schedules, whichever applies

<b>50</b>		
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**51** Add lines 33, 37, 39, 47, 49, and 50

<b>51</b>		
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**52** Figure the tax on the amount on line 21. Use the Tax Table or Tax Rate Schedules, whichever applies

<b>52</b>		
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**53** **Tax on all taxable income.** Enter the **smaller** of line 51 or line 52 here and on Form 1040, line 41

<b>53</b>		
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\*If line 25 is more than zero, see Lines 31 and 43 on page D-9 for the amount to enter. Printed on recycled paper Schedule D (Form 1040) 2003

<b>13a</b>	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	<b>13a</b>		
<b>40</b>	<b>Taxable income.</b> Subtract line 39 from line 38. If line 39 is more than line 38, enter -0-	<b>40</b>		
<b>41</b>	<b>Tax</b> (see page 36). Check if any tax is from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972	<b>41</b>		

▶▶ **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. In 2003, capital gains will be subject to different tax rates depending on the date of the sale. Transactions completed after May 5, 2003 will be taxed at a different rate than transactions completed before May 6, 2003.

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 13a (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 2002, 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 2004.

Report capital gain or loss on Form 1040, line 13a.

### 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

<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
1	500 sh. LSR	1/12/02	1/4/03	4,000.00	9,000.00	(5,000.00)	
	250 sh. BGI	3/11/02	2/12/03	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	<b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .			6	( )		
7a	Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. Do not enter more than zero . . . . .			7a		( )	
7b	<b>b Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .			7b	2,500.00		
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
8	75 sh. ABC	1/22/01	1/29/03	2,000.00	7,500.00	(5,500.00)	
	400 sh. XYZ	12/3/99	3/6/03	15,000.00	10,000.00	5,000.00	
	100 sh. DEF	4/2/99	1/16/03	1,200.00	2,000.00	(800.00)	
9	Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .			9			
10	<b>Total long-term sales price amounts.</b> 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .			14	( )		
15	Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .			15			
16	<b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) . . . . . <b>Next:</b> Go to Part III on the back.			16	(100.00)		

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, do not include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or eligible gain on qualified small business stock (see page D-4 of the instructions).

## Exercise 4

- (A) 1. Form 1040, line 13: \$3,200  
 2. Form 1040, line 41: \$12,766
- (B) Melvin's Schedule D, Page 1

<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
1 50 sh. ABC	3/15/03	7/26/03	4,000.00	5,000.00	(1,000.00)	(1,000.00)	
200 sh. MLG	5/10/03	6/7/03	1,200.00	1,000.00	200.00	200.00	
2 Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .			2				
3 <b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .					6	( )	
7a Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. <b>Do not</b> enter more than zero . . . . .					7a		( )
b <b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .					7b	(800.00)	
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
8 150 sh. XYZ	4/17/00	3/8/03	5,500.00	6,000.00	(500.00)	(500.00)	
300 sh. MLS	1/13/98	6/19/03	6,000.00	3,000.00	3,000.00	3,000.00	
9 Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .			9				
10 <b>Total long-term sales price amounts.</b> 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .					14	( )	
15 Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .					15		3,000.00
16 <b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) . . . . . <b>Next:</b> Go to Part III on the back.					16	4,000.00	

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, **do not** include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or 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**

<b>17a</b> Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .	<b>17a</b>	3,200	00
<b>b</b> Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40. <b>Next:</b> • If both lines 16 and 17a of Schedule D are gains or you have qualified dividends on Form 1040, line 9b, complete <b>Part IV</b> below (unless Form 1040, line 40, is zero). • Otherwise, skip the rest of Schedule D and complete Form 1040.	<b>17b</b>		
<b>18</b> If line 17a is a loss, enter here and on Form 1040, line 13a, the <b>smaller</b> of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . .	<b>18</b> (		)
<b>Next:</b> • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete <b>Part IV</b> below (but skip lines 19 and 20). • Otherwise, skip <b>Part IV</b> below and complete the rest of Form 1040.			

**Part IV Tax Computation Using Maximum Capital Gains Rates**

If line 16 or line 17a is zero or less, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.

<b>19</b> Enter your unrecaptured section 1250 gain, if any, from line 18 of the worksheet on page D-6 . . . . .	<b>19</b>		
<b>20</b> Enter your 28% rate gain, if any, from line 7 of the worksheet on page D-9 of the instructions . . . . .	<b>20</b>		

If lines 19 and 20 are zero, go to line 21. Otherwise, complete the worksheet on page D-10 of the instructions to figure the amount to enter on lines 35 and 53 below, and skip all other lines below.

<b>21</b> Enter your taxable income from Form 1040, line 40 . . . . .	<b>21</b>	67,001	00
<b>22</b> Enter the <b>smaller</b> of line 16 or line 17a, but not less than zero . . . . .	<b>22</b>	3,200	00
<b>23</b> Enter your qualified dividends from Form 1040, line 9b . . . . .	<b>23</b>		
<b>24</b> Add lines 22 and 23 . . . . .	<b>24</b>	3,200	00
<b>25</b> Amount from line 4g of Form 4952 (investment interest expense) . . . . .	<b>25</b>	0	00
<b>26</b> Subtract line 25 from line 24. If zero or less, enter -0- . . . . .	<b>26</b>	3,200	00
<b>27</b> Subtract line 26 from line 21. If zero or less, enter -0- . . . . .	<b>27</b>	63,801	00
<b>28</b> Enter the <b>smaller</b> of line 21 or: • \$56,800 if married filing jointly or qualifying widow(er); • \$28,400 if single or married filing separately; or • \$38,050 if head of household . . . . .	<b>28</b>	28,400	00
<b>If line 27 is more than line 28, skip lines 29-39 and go to line 40.</b>			
<b>29</b> Enter the amount from line 27 . . . . .	<b>29</b>	63,801	00
<b>30</b> Subtract line 29 from line 28. If zero or less, go to line 40 . . . . .	<b>30</b>	0	00
<b>31</b> Add lines 17b and 23* . . . . .	<b>31</b>		
<b>32</b> Enter the <b>smaller</b> of line 30 or line 31 . . . . .	<b>32</b>		
<b>33</b> Multiply line 32 by 5% (.05) . . . . .	<b>33</b>		
<b>If lines 30 and 32 are the same, skip lines 34-39 and go to line 40.</b>			
<b>34</b> Subtract line 32 from line 30 . . . . .	<b>34</b>		
<b>35</b> Enter your qualified 5-year gain, if any, from line 8 of the worksheet on page D-8 . . . . .	<b>35</b>		
<b>36</b> Enter the <b>smaller</b> of line 34 or line 35 . . . . .	<b>36</b>		
<b>37</b> Multiply line 36 by 8% (.08) . . . . .	<b>37</b>		
<b>38</b> Subtract line 36 from line 34 . . . . .	<b>38</b>		
<b>39</b> Multiply line 38 by 10% (.10) . . . . .	<b>39</b>		
<b>If lines 26 and 30 are the same, skip lines 40-49 and go to line 50.</b>			
<b>40</b> Enter the <b>smaller</b> of line 21 or line 26 . . . . .	<b>40</b>	3,200	00
<b>41</b> Enter the amount from line 30 (if line 30 is blank, enter -0-) . . . . .	<b>41</b>	0	00
<b>42</b> Subtract line 41 from line 40 . . . . .	<b>42</b>	3,200	00
<b>43</b> Add lines 17b and 23* . . . . .	<b>43</b>		
<b>44</b> Enter the amount from line 32 (if line 32 is blank, enter -0-) . . . . .	<b>44</b>		
<b>45</b> Subtract line 44 from line 43 . . . . .	<b>45</b>		
<b>46</b> Enter the <b>smaller</b> of line 42 or line 45 . . . . .	<b>46</b>		
<b>47</b> Multiply line 46 by 15% (.15) . . . . .	<b>47</b>		
<b>48</b> Subtract line 46 from line 42 . . . . .	<b>48</b>	3,200	00
<b>49</b> Multiply line 48 by 20% (.20) . . . . .	<b>49</b>	640	00
<b>50</b> Figure the tax on the amount on line 27. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	<b>50</b>		
<b>51</b> Add lines 33, 37, 39, 47, 49, and 50 . . . . .	<b>51</b>	12,766	00
<b>52</b> Figure the tax on the amount on line 21. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	<b>52</b>	13,406	00
<b>53</b> <b>Tax on all taxable income.</b> Enter the <b>smaller</b> of line 51 or line 52 here and on Form 1040, line 41 . . . . .	<b>53</b>	12,766	00

\*If line 25 is more than zero, see Lines 31 and 43 on page D-9 for the amount to enter. Printed on recycled paper Schedule D (Form 1040) 2003

## Exercise 5

### (A) Matthew's Schedule D, Parts I and II

<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
1	100 sh. MNO	2/9/02	2/8/03	5,050 00	7,050 00	(2000 00)	
	200 sh. BCA	1/29/03	8/7/03	4,000 00	3,950 00	50 00	
2	Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .			2			
3	<b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .			6	( 450 00)		
7a	Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. <b>Do not</b> enter more than zero . . . . .			7a		( )	
7b	<b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .			7b	(2,400 00)		
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
8	500 sh. ZYX	3/11/00	8/7/03	5,250 00	5,500 00	(250 00)	(250 00)
	300 sh. JKL	6/26/01	8/7/03	5,910 00	6,330 00	(420 00)	(420 00)
9	Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .			9			
10	<b>Total long-term sales price amounts.</b> 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .			14	( 325 00)		
15	Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .			15		(660 00)	
16	<b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) . . . . .			16	(995 00)		
<b>Next:</b> Go to Part III on the back.							
*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, <b>do not</b> include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or 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) 2003	

### (B) Matthew's Schedule D, Part III

Schedule D (Form 1040) 2003		Page <b>2</b>								
<b>Part III Taxable Gain or Deductible Loss</b>										
<p><b>17a</b> Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .</p> <p><b>b</b> Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40 . . . . .</p> <p><b>Next:</b></p> <ul style="list-style-type: none"> <li>• If both lines 16 and 17a of Schedule D are gains <b>or</b> you have qualified dividends on Form 1040, line 9b, complete <b>Part IV</b> below (unless Form 1040, line 40, is zero).</li> <li>• Otherwise, skip the rest of Schedule D and complete Form 1040.</li> </ul>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%;"><b>17a</b></td> <td style="width: 70%; text-align: right;">(3,395</td> <td style="width: 20%; text-align: right;">00)</td> </tr> <tr> <td><b>17b</b></td> <td></td> <td></td> </tr> <tr> <td><b>18</b></td> <td style="text-align: right;">( 3,000</td> <td style="text-align: right;">00 )</td> </tr> </table>	<b>17a</b>	(3,395	00)	<b>17b</b>			<b>18</b>	( 3,000	00 )
<b>17a</b>	(3,395	00)								
<b>17b</b>										
<b>18</b>	( 3,000	00 )								
<p><b>18</b> If line 17a is a loss, enter here and on Form 1040, line 13a, the <b>smaller</b> of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . .</p> <p><b>Next:</b></p> <ul style="list-style-type: none"> <li>• If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete <b>Part IV</b> below (but skip lines 19 and 20).</li> <li>• Otherwise, skip <b>Part IV</b> below and complete the rest of Form 1040.</li> </ul>										

### (C) Matthew's Form 1040, Line 13a

<p><b>13a</b> Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/></p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%;"><b>13a</b></td> <td style="width: 70%; text-align: right;">(3,000</td> <td style="width: 20%; text-align: right;">00)</td> </tr> </table>	<b>13a</b>	(3,000	00)
<b>13a</b>	(3,000	00)		

### (D) Matthew's Capital Loss Carryover Worksheet

#### Capital Loss Carryover Worksheet—Line 18

Use this worksheet to figure your capital loss carryovers from 2003 to 2004 if Schedule D, line 18, is a loss and (a) that loss is a smaller loss than the loss on Schedule D, line 17a, or (b) Form 1040, line 38, is a loss. Otherwise, you do not have any carryovers.

1. Enter the amount from Form 1040, line 38. If a loss, enclose the amount in parentheses . . . . .	1. _____
2. Enter the loss from Schedule D, line 18, as a positive amount . . . . .	2. _____
3. Combine lines 1 and 2. If zero or less, enter -0- . . . . .	3. _____
4. Enter the <b>smaller</b> of line 2 or line 3 . . . . .	4. _____
If line 7b 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 7b, as a positive amount . . . . .	5. _____
6. Enter any gain from Schedule D, line 16 . . . . .	6. _____
7. Add lines 4 and 6 . . . . .	7. _____
8. <b>Short-term capital loss carryover to 2004.</b> Subtract line 7 from line 5. If zero or less, enter -0- . . . . .	8. _____
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. _____
10. Enter any gain from Schedule D, line 7b . . . . .	10. _____
11. Subtract line 9 from line 10. If zero or less, enter -0- . . . . .	11. _____
12. Add lines 10 and 11 . . . . .	12. _____
13. <b>Long-term capital loss carryover to 2004.</b> Subtract line 12 from line 9. If zero or less, enter -0- . . . . .	13. _____

### 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>

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##### 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		x 50
	=	770
Commission on sale	=	<u>+ 105</u>
Adjusted basis, PQR sold		<u>\$ 875</u>

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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		x 500
	=	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>

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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

<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
1	50 sh. PQR	1/8/03	4/17/03	2,600:00	875:00	1,725:00	
	125 sh. XYZ	10/26/02	3/22/03	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	<b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .		6		( )		
7a	Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. Do not enter more than zero . . . . .		7a			( )	
7b	<b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .		7b		1,775:00		
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>							
(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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)	
8	100 sh. LMN	3/6/00	4/20/03	3,000:00	1,550:00	1,450:00	
	500 sh. OLE	11/27/00	6/17/03	7,800:00	6,090:00	1,710:00	
	75 sh. ABC	10/15/99	1/24/03	2,500:00	2,835:00	(335:00)	
9	Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .		9				
10	<b>Total long-term sales price amounts.</b> 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .		14		( 150:00)		
15	Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .		15			(150:00)	
16	<b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) <b>Next:</b> Go to Part III on the back.		16		3,725:00		

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, do not include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or 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

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#### Part III Taxable Gain or Deductible Loss

<b>17a</b>	Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below	17a	1,950	00
<b>b</b>	Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40.	17b		
	<b>Next:</b> • If both lines 16 and 17a of Schedule D are gains or you have qualified dividends on Form 1040, line 9b, complete <b>Part IV</b> below (unless Form 1040, line 40, is zero). • Otherwise, skip the rest of Schedule D and complete Form 1040.			
<b>18</b>	If line 17a is a loss, enter here and on Form 1040, line 13a, the <b>smaller</b> of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions)	18 (		)
	<b>Next:</b> • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete <b>Part IV</b> below (but skip lines 19 and 20). • Otherwise, skip <b>Part IV</b> below and complete the rest of Form 1040.			

#### Part IV Tax Computation Using Maximum Capital Gains Rates

If line 16 or line 17a is zero or less, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.

<b>19</b>	Enter your unrecaptured section 1250 gain, if any, from line 18 of the worksheet on page D-6	19		
<b>20</b>	Enter your 28% rate gain, if any, from line 7 of the worksheet on page D-9 of the instructions	20		

If lines 19 and 20 are zero, go to line 21. Otherwise, complete the worksheet on page D-10 of the instructions to figure the amount to enter on lines 35 and 53 below, and skip all other lines below.

<b>21</b>	Enter your taxable income from Form 1040, line 40	21	61,221	00
<b>22</b>	Enter the <b>smaller</b> of line 16 or line 17a, but not less than zero	22	1,950	00
<b>23</b>	Enter your qualified dividends from Form 1040, line 9b	23		
<b>24</b>	Add lines 22 and 23	24	1,950	00
<b>25</b>	Amount from line 4g of Form 4952 (investment interest expense)	25	0	00
<b>26</b>	Subtract line 25 from line 24. If zero or less, enter -0-	26	1,950	00
<b>27</b>	Subtract line 26 from line 21. If zero or less, enter -0-	27	59,271	00
<b>28</b>	Enter the <b>smaller</b> of line 21 or: • \$56,800 if married filing jointly or qualifying widow(er); • \$28,400 if single or married filing separately; or • \$38,050 if head of household	28	28,400	00
	If line 27 is more than line 28, skip lines 29-39 and go to line 40.			
<b>29</b>	Enter the amount from line 27	29		
<b>30</b>	Subtract line 29 from line 28. If zero or less, go to line 40	30		
<b>31</b>	Add lines 17b and 23*	31		
<b>32</b>	Enter the <b>smaller</b> of line 30 or line 31	32		
<b>33</b>	Multiply line 32 by 5% (.05)	33		
	If lines 30 and 32 are the same, skip lines 34-39 and go to line 40.			
<b>34</b>	Subtract line 32 from line 30	34		
<b>35</b>	Enter your qualified 5-year gain, if any, from line 8 of the worksheet on page D-8	35		
<b>36</b>	Enter the <b>smaller</b> of line 34 or line 35	36		
<b>37</b>	Multiply line 36 by 8% (.08)	37		
<b>38</b>	Subtract line 36 from line 34	38		
<b>39</b>	Multiply line 38 by 10% (.10)	39		
	If lines 26 and 30 are the same, skip lines 40-49 and go to line 50.			
<b>40</b>	Enter the <b>smaller</b> of line 21 or line 26	40	1,950	00
<b>41</b>	Enter the amount from line 30 (if line 30 is blank, enter -0-)	41	0	00
<b>42</b>	Subtract line 41 from line 40	42	1,950	00
<b>43</b>	Add lines 17b and 23*	43		
<b>44</b>	Enter the amount from line 32 (if line 32 is blank, enter -0-)	44		
<b>45</b>	Subtract line 44 from line 43	45		
<b>46</b>	Enter the <b>smaller</b> of line 42 or line 45	46		
<b>47</b>	Multiply line 46 by 15% (.15)	47		
<b>48</b>	Subtract line 46 from line 42	48	1,950	00
<b>49</b>	Multiply line 48 by 20% (.20)	49	390	00
<b>50</b>	Figure the tax on the amount on line 27. Use the Tax Table or Tax Rate Schedules, whichever applies	50	11,629	00
<b>51</b>	Add lines 33, 37, 39, 47, 49, and 50	51	12,019	00
<b>52</b>	Figure the tax on the amount on line 21. Use the Tax Table or Tax Rate Schedules, whichever applies	52	12,116	00
<b>53</b>	<b>Tax on all taxable income.</b> Enter the <b>smaller</b> of line 51 or line 52 here and on Form 1040, line 41	53	12,019	00

\*If line 25 is more than zero, see Lines 31 and 43 on page D-9 for the amount to enter. Printed on recycled paper **Schedule D (Form 1040) 2003**

(C) Katherine's Form 1040, lines 13 and 42

<b>13a</b> Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	<b>13a</b>	1,950	00
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<b>41</b> Tax (see page 36). Check if any tax is from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972 . . . .	<b>41</b>	12,019	00
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**STUDENT NOTES**

### LESSON OVERVIEW AND OBJECTIVES

This lesson covers the rules that apply to sales of a main home in 2003. See Publication 523, *Selling Your Home*, for more details. Approximately 1 to 1½ hours should be devoted to covering the objectives of this lesson.

At the end of this lesson you will be able to identify the amount of gain a taxpayer may exclude if a primary residence is sold.

### MATERIALS

This lesson will refer to the following IRS forms and publications. If you would like to provide the students with the most current revision of the forms and publications, you can download the files from [www.irs.gov](http://www.irs.gov).

- Publication 523
- Form 1099-S

### TEACHING TIPS

1. Explain to students that this lesson covers the sale of another capital asset, a personal (main) home. A taxable gain on such a sale must be reported on Schedule D.
2. Remind students that it is important to ask the taxpayer all relevant questions to ensure the sale of the home qualifies for the exclusion and need not be reported.
3. Volunteers should request and review Form 1099-S carefully. Stress to students that the person responsible for closing the transaction is generally required to file and furnish Form 1099-S for all sale transactions, unless the seller provides a signed written assurance (certification) that includes the necessary information to support the conclusion that the full gain on the sale is excludable from the seller's gross income. A list of transactions that are not reportable are covered in the *Instructions for Form 1099-S*.
4. Some taxpayers may be reluctant to provide the information that a volunteer needs to determine whether a home is a main home. The volunteer should explain to the taxpayer that he or she needs this information to make sure the taxpayer does not pay unnecessary tax on capital gains from the sale of his or her home. Remind volunteers to get to know the taxpayers first, before asking questions of a personal nature.

5. Make sure that the taxpayer understands that the exclusion of gain does not apply to the part of the property that is used for rental or business. Remember to refer taxpayers in these situations to a paid professional tax preparer.
6. Explain to students that if a taxpayer sold a main home in 2003 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.
7. Caution students that many different situations may occur when taxpayers sell their main home. They must listen carefully to the taxpayer as well as ask probing questions to get all the relevant information regarding the sale.

### ***GUIDED QUESTIONS***

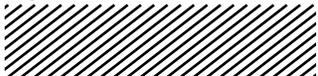
1. **Sam owns a beach house at which he spends most of his weekends. During the week he rents a condominium. Which home is Sam's main home?** (The condominium is Sam's main home because he lives there most of the time.)
2. **Where are the worksheets for computing the gain on the sale of a main home found?** (Publication 523.)

### ***OPTIONAL GROUP ACTIVITY***

*(5 min.)*

Divide the class into groups of three (or four, if necessary), to practice asking questions of a personal nature related to the sale of a home. Have one student play the part of a taxpayer who sold a main home in 2003. Have another student play the volunteer assistor/counselor who will conduct the initial interview. The third (and fourth, if necessary) student will supervise the role-play. Allow three to four minutes for the role-play activity.

Bring the class back together to discuss how to successfully obtain important information about the sale of a home.



## INTRODUCTION AND OBJECTIVES

### Introduction

This lesson generally discusses the tax rules that apply when a taxpayer sells his or her **main home** in 2003. 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.

### 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. Taxpayers cannot choose which home to designate as their main home. Facts and circumstances determine which home is the main home.

### 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..

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 2003, 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		<b>2003</b> Form <b>1099-S</b>	<b>Proceeds From Real Estate Transactions</b>
FILER'S name, street address, city, state, ZIP code, and telephone no.		1 Date of closing	2 Gross proceeds		
FILER'S Federal identification number	TRANSFEROR'S identification number	3 Address or legal description		<b>Copy B For Transferor</b> 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.	
TRANSFEROR'S name		4 Transferor received or will receive property or services as part of the consideration (if checked). . . . ▶ <input type="checkbox"/>			
Street address (including apt. no.)					
City, state, and ZIP code					
Account number (optional)		5 Buyer's part of real estate tax			
		6			
Form <b>1099-S</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service	

### 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 4).

### 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 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 1995, Helen Jones lived in a rented apartment. The apartment building was later changed to a condominium, and she bought her apartment on December 1, 2000. In 2001, Helen became ill and on April 14 of that year she moved in to her daughter's home. On July 10, 2003, 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, 1998, to July 10, 2003, the date she sold the apartment. She owned her apartment from December 1, 2000, to July 10, 2003 (over 2 years). She lived in the apartment from July 11, 1998 (the beginning of the 5-year period), to April 14, 2001 (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 2001. In December 2002, the company she worked for notified her that she would be transferred to another town by the end of 2003. She continued to live in the home until June 2003, 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 2003, 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.

### ▶▶ 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.

- Exercise 1a. \$42,000 (\$297,500 minus \$255,500)  
1b. \$42,000
- Exercise 2. His main home is the St. Louis residence.

**STUDENT NOTES**

### LESSON OVERVIEW

This lesson will explain the concept of taxable and nontaxable retirement income. Specifically, the lesson covers three types of retirement income: pensions, annuities and social security. Most taxpayers must use the Simplified Method to determine the taxable and tax-free parts of retirement income from a qualified plan. The Simplified Method will be used to compute taxable and nontaxable retirement income. Students will also learn how to report pension and social security income on Form 1040 and Form 1040A.

Further, students should be able to determine if estimated tax payments are required due to retirement income, cite options for handling lump-sum distributions, and explain minimum distribution rules.

### MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the publications and forms, you can download the files from *www.irs.gov*.

- Form W-2, *Wage and Tax Statement*
- Form 1040, *U.S. Individual Income Tax Return*
- Form 1040A, *U.S. Individual Income Tax Return*
- Form 1099-R, *Distributions from Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts etc.*
- Form RRB-1099, *Payments by the Railroad Retirement Board*
- Form SSA-1099, *Social Security Benefit Statement*
- Publication 575, *Pension and Annuity Income*
- Publication 590, *Individual Retirement Arrangements*
- Publication 939, *General Rule for Pensions and Annuities*
- *Simplified Method Worksheet*
- *Social Security Benefits Worksheet*

Remind volunteers how important it is to avoid overly complicated tax returns. If a volunteer does not feel qualified to deal with a particular pension situation, or if the taxpayer must use the General Rule, the volunteer should suggest that the taxpayer see a paid professional tax preparer.

## ***TEACHING TIPS – DISABILITY INCOME***

Caution students that taxpayers may believe they are receiving disability income because they are getting sick pay or insurance payments due to illness. Remind the students that the payment can only be treated as disability income if these two requirements are met:

1. The income must be paid under the employer's accident and health plan or pension plan.
2. The income must be included in income as wages or payments in lieu of wages for the time the taxpayer was absent from work because of permanent and total disability.

When these requirements are met and the taxpayer is under the normal retirement age for his employer, the payments will be treated as disability income. The payments will be reported as wages on the tax return.

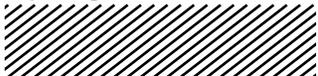
## ***TEACHING TIPS – SIMPLIFIED GENERAL RULE CALCULATION***

Emphasize that taxpayers must use the “old” recovery factors if they retired before Nov. 19, 1996. Use the Simplified Method Worksheet to show the students how to determine the correct number of months to use in the calculation.

Point out to students that line 2 of the Simplified Method Worksheet, refers to the “annuity starting date.” In this case, the word “annuity” refers to both pensions and annuities.

Stress the differences in the recovery periods for line 3 (as reflected in Table 1 and Table 2) of the worksheet.

On the Simplified Method Worksheet, the tax-free amount of each monthly annuity payment (line 4), does not change from year to year. The tax-free portion remains the same even if the amount received from the payer increases due to a cost-of-living adjustment.



## **TEACHING TIPS – SOCIAL SECURITY INCOME**

Students may wonder how a married filing separately status can affect taxability of social security benefits. Call students' attention to the important distinction made on line 8 of the Social Security Benefits Worksheet for a married taxpayer who files separately. If the taxpayer did not live with his or her spouse at any time during the year, the base amount is \$25,000. However, if the husband and wife lived together at any time during the year, the base amount is \$0. This rule has a great impact on the taxability of social security benefits.

Volunteers should remind taxpayers who included part of their social security benefits in taxable income and paid an amount owed with their return that they may have to adjust their withholding or pay estimated tax payments during the year. Volunteers should emphasize to these taxpayers that if they do not pay enough through withholding or estimated tax payments, they may be charged interest and a penalty. As an instructor, you may wish to share with the class additional information from Publication 505, *Tax Withholding and Estimated Tax*.

Remind the students to include any withheld federal income tax from Form SSA-1099, box 6, or from Form RRB-1099, box 10 on Form 1040A, line 39, or Form 1040, line 62.

## **OPTIONAL GROUP ACTIVITY A**

*(7–10 min.)*

Lead a group discussion about students' personal experiences with pension income. The discussion may help some students to understand the concepts presented in this lesson. Begin the discussion by asking if any students receive pension income. Then, ask those students to explain whether their pension incomes are totally taxable or partially taxable and why. Lead students to understand that if they contributed after-tax dollars to the pension plan, then that part is not taxable.

## **OPTIONAL GROUP ACTIVITY B**

*(7-10 min.)*

To help students learn to deal effectively with taxpayers' questions about social security benefits, ask students to role play an interview with a taxpayer who receives social security benefits. Remind students about the possible sensitivity of taxpayers who are living on fixed incomes such as social security.

Divide students into groups of three (or four, if necessary). Have one student play a taxpayer who is receiving social security benefits and who is unsure about whether or not taxes need to be paid.



Have another student play the volunteer who will conduct the initial interview with the taxpayer. The third student (and fourth, if necessary) will serve as the role-play manager(s).

Allow three to four minutes for the role-play activity and one minute for the role-play manager(s) to evaluate the interview. If time allows, you may want to bring the class together to discuss common questions and effective answers.

## **GUIDED QUESTIONS**

These questions can be a good way for you to get information about how well your students understand the tax rules that you have covered. It is always best to avoid asking a specific student to answer the question unless you have arranged this in advance. You could have the students answer the questions on index cards and then anonymously hand in their cards. You could use the answers on the cards to continue your discussion of the tax rules.

**1. How would you compute taxable pension income for a taxpayer who has more than one pension or annuity?**

The taxable part of each pension or annuity should be computed separately and only the totals should be entered on the proper lines of Form 1040 or Form 1040A.

**2. What may occur if a taxpayer does not pay enough tax, either through withholding or through estimated tax payments?**

The IRS may charge the taxpayer interest and a penalty.

**3. How can you determine whether a taxpayer has been paid a lump-sum distribution of his or her pension?**

Lump-sum distributions are reported on Form 1099-R. A check in box 2b, Total distribution, indicates that it is a lump-sum distribution.

**4. By what date, and at what age, is a taxpayer required to receive minimum distributions?**

For IRAs, taxpayers must receive minimum distributions by April 1 of the year following the calendar year in which they turn 70 1/2 years old. For all other retirement plans discussed here, a taxpayer who is still working at age 70 1/2 can postpone receiving distributions until April 1 of the year after he or she retires.

**5. Are social security benefits always nontaxable?**

No; some taxpayers have to include part of their social security benefits in taxable income.

**6. Where on Form 1040A or 1040, do you report the taxpayer's taxable railroad retirement benefits?**

Enter the total benefit received on line 14a or 20a and the taxable portion of the benefit on line 14b or 20b.



**7. Where is the taxable portion of social security benefits entered on Form 1040A and on Form 1040?**

The taxable portion is entered on line 14b of Form 1040A or on line 20b of Form 1040.

**8. What is the maximum amount of social security benefits that is subject to tax?**

The taxable portion of social security benefits is never more than 85 percent of the net benefits.

**9. If some of a taxpayer's social security benefits are taxable, can he or she have tax withheld on the taxable portion?**

Yes; taxpayers may elect to have taxes withheld on their social security benefits.

To make this choice, taxpayers will have to fill out Form W-4V, Voluntary Withholding Request, or equivalent, and give it to the payer.

**10. Explain why taxpayers who do not have any taxable social security benefits cannot automatically use Form 1040EZ.**

Volunteers should not assume, because a person does not have taxable social security benefits, that they do not have any other adjustments to income or will not have itemized deductions that will require Form 1040 or 1040A.

**11. If a nonresident alien with social security benefits comes to your site, how would you handle his or her return?**

He or she should be referred to a paid professional tax preparer because of special rules for these taxpayers.

**12. Which amounts from the Social Security Benefits Worksheet are transferred to Form 1040 or 1040A?**

The amounts on lines 1 and 18

**13. What two options can be used to compute the taxable portion of lump-sum benefit payments, which could be for both the current and prior tax years?**

The first option used to compute the taxable portion of lump-sum benefit payments is to report the whole payment in 2003, the year it was received, and complete the Social Security Benefits Worksheet in the usual manner by including the lump-sum payment on line 1. The second option spreads payments back to the earlier year(s) and figures taxable benefits based on income from the earlier year(s) by using a special procedure. Any part that is taxable is then added to any taxable benefits for 2003.

**14. How is a lump-sum death benefit taxed?**

Lump-sum death benefits are not subject to tax.



### **15. What is an IRA?**

An IRA is an Individual Retirement Arrangement—any of several kinds of tax-sheltered retirement plans set up by the taxpayer.

### **16. Differentiate between an IRA contribution and an IRA distribution.**

An IRA contribution refers to amounts that a taxpayer pays into an IRA, whereas an IRA distribution refers to the withdrawal of funds from the IRA.

### **17. On what form are IRA distributions reported?**

Form 1099-R Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

### **18. Name four types of IRAs.**

Traditional IRAs, SIMPLE IRAs, SEP IRAs, and Roth IRAs.

### **19. How do you know what type of IRA distribution a taxpayer has?**

The type of distribution is indicated in box 7 of Form 1099-R.

### **20. What form is sent to recipients of pension and annuity income? Form 1099-R**

### **21. On which line of Form 1040A or Form 1040 is pension and annuity income reported?**

The total pension and annuity income is reported on line 12a or 16a, and the taxable portion is reported on line 12b or 16b. However, if all the pension and annuity income is taxable, the total is reported on line 12b or 16b only.

## ***LESSON REVIEW***

To review students' understanding of taxable social security and equivalent railroad retirement benefits and how to report them on Form 1040, pass out blank copies of Form 1040 and the Social Security Benefits Worksheet for Form 1040. Read aloud to the class the information in Example 4. Ask the students to complete the Social Security Benefits Worksheet and Form 1040 using the information given. Read the information as many times as necessary for students to gather the figures needed to complete the forms. Let students know that this is not a test but a way to check for understanding. You may want to allow students to discuss questions with other students, to raise questions with the entire class, or to ask questions of you. After students have completed their forms, ask them to turn to Example 4 in their textbook and check their work. Allow time for the class to discuss and answer any questions about the forms.



### INTRODUCTION

In this lesson, you will learn about *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.

### OBJECTIVES

After completing this lesson, you should be able to:

- Identify different types of Retirement Income
- Determine the taxable portion of the Retirement Income
- Report Retirement Income on the Tax Return
- Explain when a Minimum Distribution is required
- Determine when an adjustment to withholding should be made

### DEFINITIONS

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. A pension is fully or partially taxable depending on whether the employee contributed to the pension plan. The total amount of the pension will usually depend on how long the taxpayer worked for the company and how much the taxpayer earned over the years.

Employee contributions that are "after-tax" contributions are amounts that the employer usually deducts 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.

Employee contributions that are “before-tax” include amounts deposited to a 401(K) or 403(b) program. Each year, the employee pays income tax on the salary after the “before-tax” contributions have been deducted.

A **disability pension** is generally paid to a taxpayer who retires because of a disability before the minimum retirement age (set by the employer). The disability pension is considered regular pension income when the taxpayer reaches the minimum retirement age.

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.

An **Individual Retirement Arrangement (IRA)** is a personal savings plan that provides tax advantages for setting money aside for retirement.

**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*.

**Railroad Retirement Benefits (RRB)** are based on the number of months that the taxpayer was working in a job that was covered by the Railroad Retirement Act. The RRA has two components. Tier 1 is the equivalent of Social Security Benefits and Tier 2 is like an employer’s pension plan.

There are several other types of pension plans, including 403(b), Keogh, SEP and SIMPLE. Payments from any of these types of plans should be reported to the taxpayer on Form 1099R. You will use this form to prepare the tax return. It is not necessary for you to understand all of the contribution rules associated with the many types of pension plans.

## ***TAKING A LOOK AT THE FORMS***

Retirement income may be reported on Form 1099R, Form SSA-1099, Form RRB-1099 or Form RRB-1099-R. Disability income may be reported on Form W-2 or Form 1099R. It is very important to enter all of the required information from these forms when using tax preparation software. This allows the software to do its job and help you with the calculations.

## Form 1099-R

The **Form 1099-R** (as seen in Exhibit 1) is used by payers to report distributions from Pensions, Annuities, Retirement or Profit Sharing plans, IRAs, Insurance Contracts etc. While it is important to review all of the boxes on the form, you will be most concerned about the entries in Boxes 1, 2a, 2b, 4, 5, 7 and the little box that indicates whether this is an IRA/SEP/SIMPLE payment.

### Exhibit 1

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0119		<b>2003</b> Form <b>1099-R</b>	<b>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</b>
PAYER'S name, street address, city, state, and ZIP code		<b>1</b> Gross distribution \$	<b>2b</b> Taxable amount not determined <input type="checkbox"/> Total distribution <input type="checkbox"/>		
PAYER'S Federal identification number		<b>2a</b> Taxable amount \$			<b>4</b> Federal income tax withheld \$
RECIPIENT'S identification number		<b>3</b> Capital gain (included in box 2a) \$	<b>6</b> Net unrealized appreciation in employer's securities \$		
RECIPIENT'S name		<b>5</b> Employee contributions or insurance premiums \$			<b>8</b> Other \$ %
Street address (including apt. no.)		<b>7</b> Distribution code(s) <input type="checkbox"/> IRA/SEP/SIMPLE	<b>9b</b> Total employee contributions \$		
City, state, and ZIP code		<b>9a</b> Your percentage of total distribution %			<b>11</b> State/Payer's state no. \$
Account number (optional)		<b>10</b> State tax withheld \$	<b>14</b> Name of locality		
		<b>13</b> Local tax withheld \$			<b>15</b> Local distribution \$
			<b>15</b> Local distribution \$		

Form **1099-R**

Department of the Treasury - Internal Revenue Service

Some 1099-R forms may not look like the one above. Some payer's receive permission to customize the form. In all cases, the box numbers will remain the same.

Exhibit 2 is the instructions for the recipient of the Form 1099-R. While these instructions can be found on the back of copies B and C of the Form 1099-R, the print is small and may be difficult to read. Therefore, we are duplicating the information here in a larger print.

## Instructions for Recipient

Generally, distributions from pensions, annuities, profit-sharing and retirement plans (including section 457 state and local government plans), IRAs, insurance contracts, etc., are reported to recipients on Form 1099-R.

**Qualified plans.** If your annuity starting date is after 1997, you must use the simplified method to figure your taxable amount if your payer did not show the taxable amount in box 2a. See **Pub. 575**, Pension and Annuity Income.

**IRAs.** For distributions from a traditional individual retirement arrangement (IRA), simplified employee pension (SEP), or savings incentive match plan for employees (SIMPLE), generally the payer is not required to compute the taxable amount. Therefore, the amounts in boxes 1 and 2a will be the same most of the time. See the Form 1040 or 1040A instructions to determine the taxable amount. If you are at least age 70½, you must take minimum distributions from your IRA (other than a Roth IRA). If you do not, you may be subject to a 50% excise tax on the amount that should have been distributed. See **Pub. 590**, Individual Retirement Arrangements (IRAs), and **Pub. 560**, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans), for more information on IRAs.

**Roth IRAs.** For distributions from a Roth IRA, generally the payer is not required to compute the taxable amount. You must compute any taxable amount on **Form 8606**, Nondeductible IRAs. An amount shown in box 2a may be taxable earnings on an excess contribution.

**Loans treated as distributions.** If you borrow money from a qualified plan, tax-sheltered annuity, or government plan, you may have to treat the loan as a distribution and include all or part of the amount borrowed in your income. There are exceptions to this rule. If your loan is taxable, Code L will be shown in box 7. See **Pub. 575**.

**Box 1.** Shows the total amount you received this year. The amount may have been a direct rollover, a transfer or conversion to a Roth IRA, a recharacterized IRA contribution; or you may have received it as periodic payments, as nonperiodic payments, or as a total distribution. Report the amount on Form 1040 or 1040A on the line for "IRA distributions" or "Pensions and annuities" (or the line for "Taxable amount"), and on Form 8606, whichever applies. However, if this is a lump-sum distribution, report it on **Form 4972**, Tax on

Lump-Sum Distribution. If you have not reached minimum retirement age, report your disability payments on the line for "Wages, salaries, tips, etc." Also report on that line corrective distributions of excess deferrals, excess contributions, or excess aggregate contributions.

If a life insurance, annuity, or endowment contract was transferred tax free to another trustee or contract issuer, an amount will be shown in this box and Code 6 will be shown in box 7. You need not report this on your tax return.

**Box 2a.** This part of the distribution is generally taxable. If there is no entry in this box, the payer may not have all the facts needed to figure the taxable amount. In that case, the first box in box 2b should be checked. You may want to get one of the following publications from the IRS to help you figure the taxable amount:

**Pub. 560**, **Pub. 571**, Tax-Sheltered Annuity Plans (403(b) Plans) for Employees of Public Schools and Certain Tax-Exempt Organizations, **Pub. 575**, **Pub. 590**, **Pub. 721**, Tax Guide to U.S. Civil Service Retirement Benefits, or **Pub. 939**, General Rule for Pensions and Annuities. For an IRA distribution, see **IRAs** and **Roth IRAs** above. For a direct rollover, zero should be shown, and you must enter zero (-0-) on the "Taxable amount" line of your tax return.

If this is a total distribution from a qualified plan (other than an IRA or tax-sheltered annuity) and you were born before January 2, 1936 (or you are the beneficiary of someone born before January 2, 1936), you may be eligible for the 10-year tax option. See the **Instructions for Form 4972** for more information.

**Box 2b.** If the first box is checked, the payer was unable to determine the taxable amount, and box 2a should be blank. However, if this is a traditional IRA, SEP, or SIMPLE distribution, then see **IRAs** above. If the second box is checked, the distribution was a total distribution that closed out your account.

**Box 3.** If you received a lump-sum distribution from a qualified plan and were born before January 2, 1936 (or you are the beneficiary of someone born before January 2, 1936), you may be able to elect to treat this amount as a capital gain on Form 4972 (not on Schedule D (Form 1040)). See the Instructions for Form 4972. For a charitable gift annuity, report as a long-term capital gain on Schedule D (Form 1040).

*(Continued on the back of Copy C.)*

## Instructions for Recipient (Continued)

**Box 4.** This is the amount of Federal income tax withheld. **Include this on your income tax return as tax withheld, and if box 4 shows an amount (other than zero), attach Copy B to your return.** Generally, if you will receive payments next year that are not eligible rollover distributions, you can change your withholding or elect not to have income tax withheld by giving the payer **Form W-4P**, Withholding Certificate for Pension or Annuity Payments.

**Box 5.** Generally, this shows the employee's investment in the contract (after-tax contributions), if any, recovered tax free this year; the part of premiums paid on commercial annuities or insurance contracts recovered tax free; or the nontaxable part of a charitable gift annuity. This box does not show any IRA contributions.

**Box 6.** If you received a lump-sum distribution from a qualified plan that includes securities of the employer's company, the net unrealized appreciation (NUA) (any increase in value of such securities while in the trust) is taxed only when you sell the securities unless you choose to include it in your gross income this year. See Pub. 575 and the Instructions for Form 4972. If you did not receive a lump-sum distribution, the amount shown is the NUA attributable to employee contributions, which is not taxed until you sell the securities.

**Box 7.** The following codes identify the distribution you received. **1**—Early distribution, no known exception (in most cases, under age 59½). See **Form 5329**, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. For a rollover to a traditional IRA of the entire taxable part of the distribution, do not file Form 5329. See the Form 1040/1040A instructions. **2**—Early distribution, exception applies (under age 59½)\*. **3**—Disability\*. **4**—Death\*. **5**—Prohibited transaction. **6**—Section 1035 exchange (a tax-free exchange of life insurance, annuity, or endowment contracts). **7**—Normal distribution. **8**—Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 2003. **9**—Cost of current life insurance protection (premiums paid by a trustee or custodian for current insurance protection, taxable to you currently). **A**—May be eligible for 10-year tax option. See Form 4972. **D**—Excess contributions plus earnings/excess deferrals taxable in 2001. **E**—Excess annual additions under section 415 and certain excess amounts under section 403(b) plans. Report on Form 1040/1040A on the line for taxable pension or annuity income\*. **F**—Charitable gift

annuity. **G**—Direct rollover to a qualified plan, a tax-sheltered annuity, a governmental 457(b) plan, or an IRA. May also include a transfer from a conduit IRA to a qualified plan\*. **J**—Early distribution from a Roth IRA, no known exception (in most cases, under age 59½). Report on Forms 1040 and 8606 and see Form 5329. **L**—Loans treated as distributions. **N**—Recharacterized IRA contribution made for 2003 and recharacterized in 2003. Report on 2003 Form 1040/1040A and Form 8606, if applicable. **P**—Excess contributions plus earnings/excess deferrals taxable in 2002. **Q**—Roth IRA qualified distribution. You are age 59½ or over and meet the 5-year holding period for a Roth IRA. See the Form 1040/1040A instructions\*. **R**—Recharacterized IRA contribution made for 2002 and recharacterized in 2003. Report on 2002 Form 1040/1040A and Form 8606, if applicable. **S**—Early distribution from a SIMPLE IRA in first 2 years, no known exception (under age 59½). May be subject to an additional 25% tax. See Form 5329. **T**—Roth IRA distribution, exception applies. You are either age 59½ or over or an exception (code 3 or 4) applies. See the Form 1040/1040A instructions.

If the IRA/SEP/SIMPLE box is checked, you have received a traditional IRA, SEP, or SIMPLE distribution.

**Box 8.** If you received an annuity contract as part of a distribution, the value of the contract is shown. It is not taxable when you receive it and should not be included in boxes 1 and 2a. When you receive periodic payments from the annuity contract, they are taxable at that time. If the distribution is made to more than one person, the percentage of the annuity contract distributed to you is also shown. You will need this information if you use the 10-year tax option (Form 4972).

**Box 9a.** If a total distribution was made to more than one person, the percentage you received is shown.

**Box 9b.** For a life annuity from a qualified plan or from a tax-sheltered annuity (with after-tax contributions), an amount may be shown for the employee's total investment in the contract. It is used to compute the taxable part of the distribution. See Pub. 575.

**Boxes 10–15.** If state or local income tax was withheld from the distribution, these boxes may be completed. Boxes 12 and 15 may show the part of the distribution subject to state and/or local tax.

\*You are not required to file Form 5329.

## Exercise 1

Alisha received a Form 1099R for 2003. In box 7 of the form there is a number 7. What does this mean? \_\_\_\_\_

\_\_\_\_\_

## Form SSA-1099

Every person who received Social Security Benefits will receive a Form SSA-1099. Sometimes the taxpayer does not bring this form with them because they didn't think that their Social Security is taxable. You need to know how much is in box 5 of the Form SSA-1099 to correctly calculate the taxpayers return. You may need to ask the taxpayer to go home and get the form. If the taxpayer did not receive the form or has misplaced it, they can get a printout of benefits from the local Social Security office. The amount in box 5 should be entered in the tax software program, even if the benefits aren't taxable (we will explain later how to determine if the benefits are taxable). This is a critical step to calculating the correct tax.

### Exhibit 3

FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT		
<b>2003</b> • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME. • SEE THE REVERSE FOR MORE INFORMATION.		
Box 1. Name		Box 2. Beneficiary's Social Security Number
Box 3. Benefits Paid in 2001	Box 4. Benefits Repaid to SSA in 2001	Box 5. Net Benefits for 2001 (Box 3 minus Box 4)
DESCRIPTION OF AMOUNT IN BOX 3		DESCRIPTION OF AMOUNT IN BOX 4
		Box 6. Voluntary Federal Income Tax Withholding
		Box 7. Address
		Box 8. Claim Number (Use this number if you need to contact SSA.)
Form SSA-1099-SM (1-2003)		<b>DO NOT RETURN THIS FORM TO SSA OR IRS</b>

## Exercise 2

Ralph comes to your site to get help with his taxes. You ask him if he received Social Security benefits. He tells you that he gets the benefits but that they have never been taxable so he didn't bring that information with him. Can you accurately complete his return without the information? \_\_\_\_\_

\_\_\_\_\_

## Forms RRB-1099 and Form RRB-1099R

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*. (An example of this form is contained in Publication 915, *Social Security and Tier 1 Railroad Retirement Benefits*.) Use the amount from box 5 of Form RRB-1099 to complete the Social Security 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* shows an example of this form and explains the items shown on the form.

## Exercise 3

Jacob is a retired railroad switchyard operator. He receives Railroad Retirement Benefits. What Railroad Retirement forms does he need to bring with him when he gets his taxes done?

\_\_\_\_\_

\_\_\_\_\_

## ***DETERMINING THE TAXABLE PORTION OF THE RETIREMENT INCOME***

To make the correct determinations about the taxability of the taxpayer's retirement income, you may need to ask the taxpayer several questions. 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.

### **Pensions In General**

Generally, if the taxpayer did not pay any part of the cost of his or her employee pension or annuity and his or her employer did not withhold part of the cost from his or her pay while he or she worked, the amounts received each year are fully taxable.

#### **Example 1**

Delilah worked for a software development company for 20 years. She retired in 2003 and she receives a monthly pension of \$1,348. She never contributed to the pension plan while she was working, her employer made all of the contributions. Her pension is fully taxable.

#### **Exercise 4**

Dotty worked for the local tire plant for 32 years. She retired in June of 2003 and she receives a monthly pension of \$1,679 (she received 6 payments in 2003). Dotty never contributed to the pension plan. Her employer made all of the contributions. How much of her pension is taxable? \_\_\_\_\_

\_\_\_\_\_

If the taxpayer made contributions to a pension plan with "before tax" dollars, then the entire distribution will be taxable. The contribution that the taxpayer made was with money that had not been taxed. This is common in 401(K) and Thrift Savings plans.

If the taxpayer paid part of the cost of the annuity or pension with "after tax" dollars, he or she is not taxed on the part of the annuity or pension he or she receives that represents a return of his or her cost. Generally, this amount will be clearly stated on the Form 1099R. See the next section for more information on determining the taxable portion of an annuity or pension.

## Example 2

Joseph retired in 2003 after working 30 years for a construction company. Each week, he contributed to the Carpenter's Pension Plan. Every year, he paid tax on the gross amount of his salary. His pension contributions were made with dollars that had already been taxed. Joseph's pension payments will be partially taxable.

## Partially Taxable Pensions and Annuities Other Than IRAs

### General Rule

The General Rule is one of the two methods used to figure the tax-free part of each pension/annuity payment. It is based on the ratio of the investment in the contract to the total expected return.

Most taxpayers who retire after 1996 can no longer use the General Rule. Unless the exception applies, retirees must use the Simplified Method for annuity payments from a qualified plan.

The General Rule must be used if the pension or annuity payment is from a nonqualified plan (for example, a private annuity, a purchased commercial annuity, or a nonqualified employee plan).

The calculation of the taxable portion of a payment under the General Rule is outside of the scope of the volunteer program. However, if the exclusion percentage has already been computed, you can assist the taxpayer with the return.

If you need more information, please see Publication 939, *General Rule for Pensions and Annuities*.

### Simplified Method

Under the Simplified Method, the tax-free portion of each pension/annuity payment is figured by dividing the taxpayer's cost in the contract by the total number of expected monthly payments. For a pension/annuity that is payable for the life of the taxpayer (and his or her beneficiary), the number of expected months is based on the age of the taxpayer and is determined from a table.

## Example 3

James retired from a manufacturing plant in 2003. While he was working at the plant, his employer withheld money from each paycheck and sent it to the Engineer's Pension Fund. James will receive a monthly pension payment for the rest of his life. James will use the table at the bottom of the Simplified Method worksheet to determine the number of expected monthly payments.

To determine the taxable portion of a pension or annuity, you will use the Simplified General Rule Worksheet (see Exhibit 4). Once figured, the monthly exclusion amount remains the same even when the pension income increases.

**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 1040, line 16b. Enter the total pension or annuity payments received in 2003 on Form 1040, line 16a.

1. Enter the total pension or annuity payments received in 2003. Also, enter this amount on Form 1040, line 16a . . .	1.	_____
2. Enter your cost in the plan at the annuity starting date . . . . .	2.	_____
3. Enter the appropriate number from <b>Table 1</b> below. <b>But</b> if your annuity starting date was <b>after 1997 and</b> the payments are for your life and that of your beneficiary, enter the appropriate number from <b>Table 2</b> 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 <b>before 1987</b> , 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 <b>smaller</b> of line 5 or line 7 . . . . .	8.	_____
9. <b>Taxable amount.</b> 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 . . . . .	9.	_____

**Table 1 for Line 3 Above**

IF the age at annuity starting date (see page 26) 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 26) were . . .	THEN enter on line 3 . . .
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

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.

**Example 4**

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, 2003.

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 5 for a completed Simplified Method Worksheet for Peter.

**Exhibit 5**

**Simplified Method Worksheet from Peter and Mary**

**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 1040, line 16b. Enter the total pension or annuity payments received in 2003 on Form 1040, line 16a.

1. Enter the total pension or annuity payments received in 2003. Also, enter this amount on Form 1040, line 16a . . .	1.	<b>14,400</b>
2. Enter your cost in the plan at the annuity starting date . . . . .	2.	<b>31,000</b>
3. Enter the appropriate number from <b>Table 1</b> below. <b>But</b> if your annuity starting date was <b>after 1997 and</b> the payments are for your life and that of your beneficiary, enter the appropriate number from <b>Table 2</b> below . . . . .	3.	<b>310</b>
4. Divide line 2 by the number on line 3 . . . . .	4.	<b>100</b>
5. Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was <b>before 1987</b> , skip lines 6 and 7 and enter this amount on line 8. Otherwise, go to line 6 . . . . .	5.	<b>1,200</b>
6. Enter the amount, if any, recovered tax free in years after 1986 . . . . .	6.	
7. Subtract line 6 from line 2 . . . . .	7.	<b>1,200</b>
8. Enter the <b>smaller</b> of line 5 or line 7 . . . . .	8.	<b>1,200</b>
9. <b>Taxable amount.</b> 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 . . . . .	9.	<b>13,200</b>

**Table 1 for Line 3 Above**

IF the age at annuity starting date (see page 26) 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 26) were . . .	THEN enter on line 3 . . .
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

We use the Simplified Method for Peter because his annuity starting date is after November 18, 1986, 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.

After Peter has excluded a total of \$31,000 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).

### **Exercise 5**

George, age 65, began receiving pension income under a joint and survivor annuity. George's annuity starting date is January 1, 2003. George had contributed \$26,000 to a qualified plan and had received no distribution before 2003. 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. Complete the Simplified Method Worksheet for George.

**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 1040, line 16b. Enter the total pension or annuity payments received in 2003 on Form 1040, line 16a.

1. Enter the total pension or annuity payments received in 2003. Also, enter this amount on Form 1040, line 16a . . .	1.	<input type="text"/>
2. Enter your cost in the plan at the annuity starting date . . . . .	2.	<input type="text"/>
3. Enter the appropriate number from <b>Table 1</b> below. <b>But</b> if your annuity starting date was <b>after 1997 and</b> the payments are for your life and that of your beneficiary, enter the appropriate number from <b>Table 2</b> below . . . . .	3.	<input type="text"/>
4. Divide line 2 by the number on line 3 . . . . .	4.	<input type="text"/>
5. Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was <b>before</b> 1987, skip lines 6 and 7 and enter this amount on line 8. Otherwise, go to line 6 . . . . .	5.	<input type="text"/>
6. Enter the amount, if any, recovered tax free in years after 1986 . . . . .	6.	<input type="text"/>
7. Subtract line 6 from line 2 . . . . .	7.	<input type="text"/>
8. Enter the <b>smaller</b> of line 5 or line 7 . . . . .	8.	<input type="text"/>
9. <b>Taxable amount.</b> 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 . . . . .	9.	<input type="text"/>

**Table 1 for Line 3 Above**

IF the age at annuity starting date (see page 26) 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 26) were . . .	THEN enter on line 3 . . .
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

**Exercise 6**

Gustav retired in 2003 at the age of 63. He has never been married. He paid in to his pension with after tax dollars, so part of his pension payments will not be taxable. How many months of life expectancy will you use when you determine the taxable portion of his pension? \_\_\_\_\_

\_\_\_\_\_

## Individual Retirement Arrangement

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 taxable, non-taxable or partly taxable **distributions**.

There are four kinds of IRAs, each of which offer tax advantages.

### 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.

If the taxpayer made nondeductible contributions to a traditional IRA he or she has a cost basis (investment in the contract) equal to the amount of those contributions. The nondeductible contributions are not taxed when they are distributed. They are a return of investment.

Form 8606, *Nondeductible IRAs*, must be completed and attached to the return if the taxpayer received a distribution from a traditional IRA and he or she has ever made a nondeductible contribution to any traditional IRAs.

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. She will use Form 8606, *Nondeductible IRAs* to determine the taxable portion of her distribution.

## 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. For the distribution of earnings to be excluded from income, the following requirements must be met:

1. The distribution is made after the 5-year period beginning with the first taxable year for which a contribution was made to a Roth IRA set up for the taxpayer's benefit, and
2. The distribution is:
  - a) Made on or after age 59 1/2,
  - b) made because the taxpayer was disabled,
  - c) made to a beneficiary or to an estate, or
  - d) to pay certain qualified first-time homebuyer amounts.

## Social Security Benefits

Social security benefits are reported to the taxpayer on Form SSA-1099, *Social Security Benefit Statement*. 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.

Generally, if Social Security benefits were the taxpayers only source of income, the benefits are not taxable and the taxpayer probably does not need to file a federal income tax return. If the taxpayer received Social Security benefits plus other income, the answer to how much, if any, is taxable can be found by completing the Social Security Benefits Worksheet.

The *Social Security Benefits Worksheet* is found in the instruction booklets for Forms 1040 and 1040A. The worksheet is also available on tax software packages. If you are using Taxwise you will not

need to complete the worksheet. The software will calculate the taxable portion of the benefits. 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 2003
- \$0 if married filing separately, and the taxpayer **did** live with his or her spouse at any time during 2003

The taxable amount of benefits received is figured using the worksheet provided in the instruction booklets for Forms 1040 and 1040A. The amount in box 5, Net benefits for 2003, 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 or on the tax preparation software.

### Example 7

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.

Ray also receives social security benefits. His Form SSA-1099 is shown in Exhibit 7. Susan worked and earned wages of \$21,000 (Form 1040, line 7) in 2003. 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 8.

**FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT**

**2003** • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME.  
 • SEE THE REVERSE FOR MORE INFORMATION.

Box 1. Name <b>Ray Maple</b>	Box 2. Beneficiary's Social Security Number <b>xxx-xx-xxxx</b>
---------------------------------	---

Box 3. Benefits Paid in 2003 <b>\$7,056.00</b>	Box 4. Benefits Repaid to SSA in 2003	Box 5. Net Benefits for 2003 (Box 3 minus Box 4) <b>\$7,056.00</b>
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DESCRIPTION OF AMOUNT IN BOX 3	DESCRIPTION OF AMOUNT IN BOX 4
Draft as of 09/01/2003	
	Box 6. Voluntary Federal Income Tax Withholding
	Box 7. Address  <b>123 Ash Street Your Town, IL 00000</b>
	Box 8. Claim Number (Use this number if you need to contact SSA.)

Form SSA-1099-SM (1-2004)

**DO NOT RETURN THIS FORM TO SSA OR IRS**

- Before you begin:**
- ✓ Complete Form 1040, lines 21, 23, 24, and 27 through 32a, if they apply to you.
  - ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
  - ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2003, enter "D" to the right of the word "benefits" on line 20a.
  - ✓ Be sure you have read the **Exception** on page 26 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 <b>box 5</b> of all your <b>Forms SSA-1099</b> and <b>Forms RRB-1099</b> .....	1.	7,056	
2. Enter one-half of line 1 .....	2.		3,528
3. Enter the total of the amounts from Form 1040, lines 7, 8a, 9a, 10 through 12, 13a, 14, 15b, 16b, 17 through 19, and 21. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099 .....	3.		36,000
4. Enter the amount, if any, from Form 1040, line 8b .....	4.		
5. Add lines 2, 3, and 4. ....	5.		39,528
6. Enter the total of the amounts from Form 1040, lines 23, 24, and 27 through 32a, plus any amount you entered on the dotted line next to line 33 .....	6.		560
7. Is the amount on line 6 less than the amount on line 5? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 6 from line 5 .....	7.		38,968
8. If you are: <input checked="" type="checkbox"/> Married filing jointly, enter \$32,000 <input type="checkbox"/> Single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter \$25,000 <input type="checkbox"/> Married filing separately and you lived with your spouse at any time in 2003, skip lines 8 through 15; multiply line 7 by 85% (.85) and enter the result on line 16. Then go to line 17	8.		32,000
9. Is the amount on line 8 less than the amount on line 7? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. You do not have to enter any amounts on lines 20a or 20b of Form 1040. <b>But</b> if you are married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter -0- on line 20b. Be sure you entered "D" to the right of the word "benefits" on line 20a. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 8 from line 7 .....	9.		6,968
10. Enter: \$12,000 if married filing jointly; \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003	10.		12,000
11. Subtract line 10 from line 9. If zero or less, enter -0- .....	11.		0
12. Enter the <b>smaller</b> of line 9 or line 10 .....	12.		6,968
13. Enter one-half of line 12 .....	13.		3,484
14. Enter the <b>smaller</b> of line 2 or line 13 .....	14.		3,484
15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0- .....	15.		0
16. Add lines 14 and 15 .....	16.		3,484
17. Multiply line 1 by 85% (.85) .....	17.		5,998
18. <b>Taxable social security benefits.</b> Enter the <b>smaller</b> of line 16 or line 17 .....	18.		3,484
<input type="checkbox"/> Enter the amount from line 1 above on Form 1040, line 20a. <input checked="" type="checkbox"/> Enter the amount from line 18 above on Form 1040, line 20b.			



If part of your benefits are taxable for 2003 **and** they include benefits paid in 2003 that were for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

### Exercise 7

Jules and Olga are both over 65 and they both received Social Security benefits. They will file a joint return. They had \$2,093 of tax-exempt interest income. Do you need to include this amount on the Social Security benefits worksheet ? \_\_\_\_\_

\_\_\_\_\_

### Example 8

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.

### Exercise 8

Antoinette's husband was killed by a drunk driver. He was only 34 and he left behind three young children in addition to his wife. Each of the three kids will receive Social Security benefits until they turn 18. Antoinette does not receive a survivor's benefit for herself. Since Antoinette will claim the children on her return, should she include the children's Social Security benefits on her return? \_\_\_\_\_

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 9

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.

## Disability Pension Income

Generally, a taxpayer who retires on disability must include all of his or her disability payments in 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.

(Some taxpayers with retirement income may be eligible for the credit for the elderly or the disabled. See Lesson 14 for more information.)

## **REPORTING THE RETIREMENT INCOME**

### Reporting Pension Income

Total pension income is entered on 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. Social Security benefits and IRA distributions are not reported on the pension line of the tax return. Later in this lesson, you will learn where to report these payments. 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. If you are using tax preparation software, the totals will be computed for you and placed on the appropriate lines, if you correctly enter all of the information from the 1099 forms.

When the taxpayer has more than one pension or annuity, and you are preparing the return by hand, 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.

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 9

Verna comes to you for help with her tax return. She tells you that she worked for 17 years in a factory and then she worked for 22 years in a state job. She opens up a big brown envelope and takes out many pieces of paper. After you help her sort through the papers, you determine that she had the following income:

- Form 1099INT for Interest on her savings - \$3,951
- Form 1099INT for Interest on her checking - \$504
- Form 1099INT for Interest on her CDs - \$1,832
- Form 1099R for Pension from her Factory employer - \$2,637 (fully taxable)
- Form 1099R for IRA distribution - \$1,030 (fully taxable)
- Form 1099R for Pension from her state employer - \$17,044 (she has been getting this for several years and she shows you the simplified general rule worksheet that indicates that \$219 of each monthly payment is non-taxable).
- Form SSA1099 with an amount of \$3,692 in box 5.

She also had receipts for medical bills, prescriptions, real estate taxes and contributions. They totaled \$3,904.

What amount should you enter on lines 12 a and 12b of Verna's form 1040A? \_\_\_\_\_

## DISABILITY REPORTING

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.

### Exercise 10

Annie Jo is 47 years old and she tells you that she has retired on disability from her job. She used to load cargo for a tractor-trailer company, but a large box fell on her and left her paralyzed. She receives a monthly payment from her former employer's pension plan. She has not reached the minimum retirement age set by her company's pension plan. Where should you report her disability income? \_\_\_\_\_

### Reporting Social Security Benefits

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.

## Exercise 11

Hank comes to your site for some help with his tax return. He is really upset because his neighbor told him that he would have to pay tax on all of his Social Security benefits this year. After talking to Hank, you learn that his wife died in 2002 and that he decided to sell his farm and move into senior housing in 2003. The sale of the farm created \$31,896 of taxable income for Hank. His neighbor told him that with that much income, the entire \$11,724 of his Social Security benefits would be taxable. What is the maximum taxable amount of Hank's benefits? \_\_\_\_\_

\_\_\_\_\_

## 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.

## Exercise 12

Steve and Sally need you to help them with their taxes. They have done most of the work, but they are not sure what to put on lines 11a, 11b, 12a and 12b of their Form 1040A. You look at the 1099R forms that they have brought with them and you make the following observations:

- ABC Pension - fully taxable - \$4,382
- XYZ Pension - partially taxable - Gross amount = \$9,202, Taxable portion = \$7,834
- Sally's IRA withdrawal - fully taxable - \$3,809
- Steve's IRA withdrawal - partially taxable - Gross amount = \$4,800, Taxable amount \$4,193

What amount should Steve and Sally put on:

Line 11a \_\_\_\_\_  
Line 11b \_\_\_\_\_  
Line 12a \_\_\_\_\_  
Line 12b \_\_\_\_\_

## Premature Distributions

Most distributions (both periodic and lump-sum) from qualified retirement plans made before the taxpayer has reached age 59 1/2 are subject to an additional tax of 10%. The tax applies to the taxable portion of the distribution or payment. Certain early distributions are excepted for the early distribution tax. If the distribution code in box 7 of Form 1099R is 2, 3, or 4, the taxpayer does not have to pay the additional tax. If the Form 1099R shows a code 1 in box 7 you may need to complete Form 5329 to determine the additional tax on the distribution. However, if the taxpayer does not meet one of the exceptions to the additional tax (as noted on Form 5329), you can just enter 10% of the distribution on line 57 of Form 1040.

## 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.

**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.

### Exercise 13

Helen turned 71 on March 17, 2004. She retired in 1998. She has never taken any distribution from her traditional IRA accounts. She is asking for your help, because she knows that she will have to take a distribution from the IRA this year. The bank where she has her IRA told her that she needs to take a minimum distribution of \$1,479 per year. What does Helen need to do?

- a) Helen only needs to take a distribution of \$1,479 by 12-31-04.
- b) Helen needs to take a distribution of at least \$1,479 by 4-1-04 and at least another \$1,479 by 12-31-04.
- c) Helen needs to take a distribution of \$2,958 by 12-31-04.
- d) Helen does not need to take any distributions until 2005.

### Lump-Sum Benefit Payments

Some taxpayers may have received a **lump-sum benefit payment** in 2003. 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 2003, 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 (2003) and included on Form 1040, line 20b.

If the taxpayer chooses to spread the payments back to earlier years, only 2003 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*.

## IRAs 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 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. Generally, Form W-4P is used to request a change in withholding on a pension. The taxpayer should complete the form

and send it to the payer of the pension. The taxpayer can request withholding from their Social Security benefits by completing Form W-4V, Voluntary Withholding Request, and filing it with the Social Security Administration.

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*. Failure to have enough federal income tax paid in throughout the year can result in an estimated tax penalty. Also, it can result in a large amount of tax due when the return is filed. If the taxpayer owes more than \$1,000 on the tax return, you should discuss their withholding and estimated tax options with them.

### Exercise 14

FaithMae comes to your site to get her 2003 tax return done. When you finish her return, you explain to her that she owes \$985. You tell her that she needs to pay this amount by April 15, 2004. She says that she will pay the amount, but she wants to know if there is some way to have more tax withheld from her pension so that she doesn't owe so much at the end of the year. What form should she complete to increase the withholding from her pension? Who does she give the form to? \_\_\_\_\_

\_\_\_\_\_

### Health Coverage Tax Credit

The following information is provided for awareness only. You are not expected to calculate this new credit.

The Health Coverage Tax Credit (HCTC) is a federal tax credit that was established to assist the following groups of people:

1. Workers who lose their jobs due to the effects of international trade. The worker must be eligible for either certain Trade Adjustment Assistance benefits or Alternative Trade Adjustment Assistance.
2. People who receive benefits from the Pension Benefit Guaranty Corporation (PBGC) and are at least 55 years old.

Taxpayers who are potentially eligible for this credit will be notified by mail. Shortly after the mailing, the HCTC Customer Contact Center will mail the taxpayer a packet describing the program and eligibility requirements.

For additional information on this topic, you can visit the IRS website at: [www.irs.gov](http://www.irs.gov).

## ▶▶ 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.

### Answers to Exercises

#### Exercise 1

The distribution was a “normal distribution”.

#### Exercise 2

No

#### Exercise 3

Form RRB-1099 and Form RRB 1099-R.

#### Exercise 4

All of it. \$10,074

### Exercise 5

**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 1040, line 16b. Enter the total pension or annuity payments received in 2003 on Form 1040, line 16a.

1. Enter the total pension or annuity payments received in 2003. Also, enter this amount on Form 1040, line 16a . . .	1.	<u>12,000</u>
2. Enter your cost in the plan at the annuity starting date . . . . .	2.	<u>26,000</u>
3. Enter the appropriate number from <b>Table 1</b> below. <b>But</b> if your annuity starting date was <b>after 1997 and</b> the payments are for your life and that of your beneficiary, enter the appropriate number from <b>Table 2</b> below . . . . .	3.	<u>260</u>
4. Divide line 2 by the number on line 3 . . . . .	4.	<u>100</u>
5. Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was <b>before 1987</b> , skip lines 6 and 7 and enter this amount on line 8. Otherwise, go to line 6 . . . . .	5.	<u>1,200</u>
6. Enter the amount, if any, recovered tax free in years after 1986 . . . . .	6.	
7. Subtract line 6 from line 2 . . . . .	7.	<u>1,200</u>
8. Enter the <b>smaller</b> of line 5 or line 7 . . . . .	8.	<u>1,200</u>
9. <b>Taxable amount.</b> 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 . . . . .	9.	<u>10,800</u>

**Table 1 for Line 3 Above**

IF the age at annuity starting date (see page 26) 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 26) were . . .	THEN enter on line 3 . . .
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

### **Exercise 6**

260 months

### **Exercise 7**

Yes

### **Exercise 8**

No

### **Exercise 9**

Line 12a \$19,681

Line 12b \$17,053

### **Exercise 10**

Line 7 - Wages

### **Exercise 11**

\$9,965.40 85%

### **Exercise 12**

Line 11a \$8,609

Line 11b \$8,002

Line 12a \$13,584

Line 12b \$12,216

### **Exercise 13**

B

### **Exercise 14**

Form W-4P

Give to the payer of the pension.

**STUDENT NOTES**

Lined area for student notes.

## INTRODUCTION AND OBJECTIVE

In the basic lesson we learned how to handle pension income, both regular and disability. In this segment we will learn about Thrift Savings Plan (TSP) that affects many military participants. The TSP is a retirement saving and investment plan that has been available to civilian employees of the Federal Government since 1987 and was made available to members of the Armed Forces in 2002. It offers participants the same type of savings and tax benefits that many private corporations offer their employees in a 401(k) type plan. The TSP allows participants to save a portion of their pay in a special retirement account administered by the Federal Retirement Thrift Investment Board. The money that participants invest in TSP comes from pre-tax dollars and reduces their current taxable income and therefore their federal income tax. Investments and earnings are not taxed until they are withdrawn.

Participation in TSP is optional. Armed Forces members must sign up with their respective service to participate in TSP. Uniformed members of the Army, Navy, Air Force, Marine Corps, Coast Guard, Public Health Service, and the National Oceanic and Atmospheric Administration serving on active duty and members of the Ready Reserve or National Guard of those services in any pay status can contribute to TSP.

At the end of this segment you will be able to:

- Determine the maximum amount a uniformed service member can contribute to TSP.
- Explain the combat zone rule for uniformed service members.
- Determine the Tax Saver's Credit for uniformed service members.

## CONTRIBUTIONS

Your participation in the TSP does not affect your eligibility to contribute to an IRA.

The IRS sets annual limits on the amounts that a participant can contribute to TSP. For tax-deferred contributions, the IRS imposes an annual elective deferral limit. Law adjusts it each year to take into account increases in the cost of living. The elective deferral limit does not affect most uniformed services participants. Their contributions to the TSP are limited to 8 percent of their basic pay each pay period. For 2003, the limit is \$12,000. However, participants who are also making contributions from incentive, special, or bonus pay must be aware of these limits because they can contribute all or any portion of these payments to the TSP (as

long as they are also contributing from basic pay). The TSP will not accept contributions that exceed this limit, unless you are over age 50, in which case your contributions cannot exceed the sum of the elective deferral limit plus the “catch-up” contribution limit (\$2,000 for 2003.)

If you are a member of the Ready Reserve and also contribute to a Federal civil service TSP account or to another qualified plan, the total tax-deferred contributions you make to all TSP plans cannot exceed the elective deferral limit. If you contribute to a civilian and uniformed services TSP account in a single calendar year, the TSP will refund to you any excess contributions to your TSP account.

In addition to the elective deferral limit, for participants who are age 50 or older there is an **IRS limit on the amount of catch-up contributions** that a participant can make. These contributions are in addition to regular (including incentive, special and bonus pay) tax-deferred contributions, and thus have their own limits that are in addition to the annual elective deferral limit. As with regular tax-deferred contributions, the combined total of catch-up contributions to all eligible plans cannot exceed the annual catch-up contribution limit.

**If you contribute to two TSP accounts (civilian and uniformed services)** during the year, your combined contributions to both plans cannot exceed the IRS limit. If you exceed the elective deferral limit because you made excess contributions to two TSP accounts, the TSP will notify you that the excess money will be returned to you from your uniformed services account (unless you specify otherwise) in order to reduce the effect on matching contributions.

A service members’ payroll office will deduct contributions from military pay each pay period based on the election and will remit these contributions to the TSP. Service members cannot send a check to the TSP; once the service member receives his pay, he or she cannot contribute any of it to the TSP.

### **Combat Zone rules.**

If the service member served in a combat zone, special rules apply. Because all or part of pay earned during a month in a combat zone is tax exempt, they do not receive the benefit of tax deferral when they contribute it to the TSP. As a consequence, contributions from tax-exempt pay are not subject to the elective deferral limit.

### **Tax Saver’s Credit**

Members, who participate in the TSP during tax years 2003 through 2006, may be eligible for a tax credit on their federal income tax return for each year they contribute to the plan. For married members who file a joint return, the maximum credit is \$2,000.



For single members, the maximum credit is \$1,000. However, the amount of the tax credit may be offset by any taxable distribution paid directly to them by the TSP. This benefit, called the saver's tax credit, is available to participants with an adjusted gross income of no more than \$50,000 if married filing jointly, \$37,500 if head of household, or \$25,000 if single or married filing separately.

### ▶▶ SUMMING UP THIS SEGMENT ◀◀

In this segment you have learned that:

- ▶ Military members deployed to a combat zone have 180 days of additional time, to make qualified retirement contribution to an IRA, after they leave the combat zone.
- ▶ The Thrift Savings Plan is a retirement savings and investment plan that is now available to members of the Armed Forces. Service members could contribute up to 8 percent of their basic pay earned each pay period in 2003. Service members were also able to contribute all or any whole percentage of special, incentive, or bonus pay they received. The maximum amount they could contribute in 2003 was \$12,000.



**STUDENT NOTES**

Lined area for student notes.



## LESSON OVERVIEW

This lesson will explain the credit for the elderly or disabled. The non-refundable credit is based on either age or disability. Due to income limitations, few taxpayers qualify for this credit.

## MATERIALS

This lesson will refer to the following IRS publications and forms. If you would like to provide your students with the most current revision of the publications and forms, you can download the files from [www.irs.gov](http://www.irs.gov).

- Publication 524, *Credit for the Elderly or Disabled*
- Schedule R (Form 1040), *Credit for the Elderly or Disabled*
- Schedule 3 (Form 1040A), *Credit for the Elderly or Disabled*

## TEACHING TIPS

Some elderly or disabled taxpayers may feel entitled to the tax credit even if they are ineligible. Advise students that it is important to be as tactful as possible when assisting these taxpayers. If the taxpayer becomes emotional, the volunteer should listen to what the taxpayer has to say. Then, the volunteer should calmly explain why the taxpayer is ineligible, using actual information from the taxpayer's forms.

Students may ask whether a taxpayer is considered to be permanently and totally disabled if, because of a physical or mental condition, the taxpayer cannot engage in the trade or profession in which he or she is trained or experienced. Point out that, for the purposes of this tax credit, the taxpayer must not be able to perform any substantial gainful activity and a physician must have determined that the taxpayer's disabling physical or mental condition has lasted or can be expected to last continuously for at least a year or can lead to death.

A substantial gainful activity consists of the performance of significant duties over a reasonable period of time for pay or for profit, or performance of such duties which generally are done for pay or for profit. Full-time or part-time work done at the employer's convenience, in a competitive work situation for at least the minimum wage, shows that a taxpayer is able to engage in a substantial gainful activity.

The fact that a taxpayer has not worked for an extended period of time is not conclusive evidence that the taxpayer cannot engage in substantial gainful activity.

Emphasize to students that, as volunteers, they should not treat disabled taxpayers differently from other taxpayers. Even though it may be tempting to help disabled taxpayers with more than their taxes, explain to students that most disabled people are self-sufficient and resent being patronized. It is usually best to wait for the disabled person to ask for assistance.

### ***GUIDED QUESTIONS***

**1. What two criteria determine whether a taxpayer is permanently and totally disabled?**

A taxpayer is permanently and totally disabled if he or she cannot engage in any substantial gainful activity because of a physical or mental condition, and a physician certifies that the disability has lasted, or is expected to last, continuously for one year or more, or is expected to result in death.

**2. How is disability income reported?**

Before the taxpayer reaches mandatory retirement age, disability income is reported as normal wages on Form W-2. After the taxpayer has reached retirement age, disability income is reported on Form 1099-R.



## INTRODUCTION AND OBJECTIVES

Although few taxpayers will qualify for this credit, we still get questions about who qualifies for the credit. Even if a taxpayer meets the basic qualifications, he or she may not have a credit due to the income limits on their nontaxable social security, veterans benefits, or other excludable pension, annuity, or disability benefit.

In this lesson, you will learn about the credit for the elderly or the disabled. After completing this lesson you should be able to:

- Determine who is a qualified individual for the “credit for the elderly or disabled”
- Apply the income limits to the qualified individual
- Calculate the credit

## WHO IS A QUALIFIED INDIVIDUAL FOR THE “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.

Although physician statements are no longer required to be attached to the return, they must be completed and kept with the taxpayer’s records.

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.

**Exhibit 1** helps to determine if the taxpayer is a qualified individual for this credit.

## Income Limits

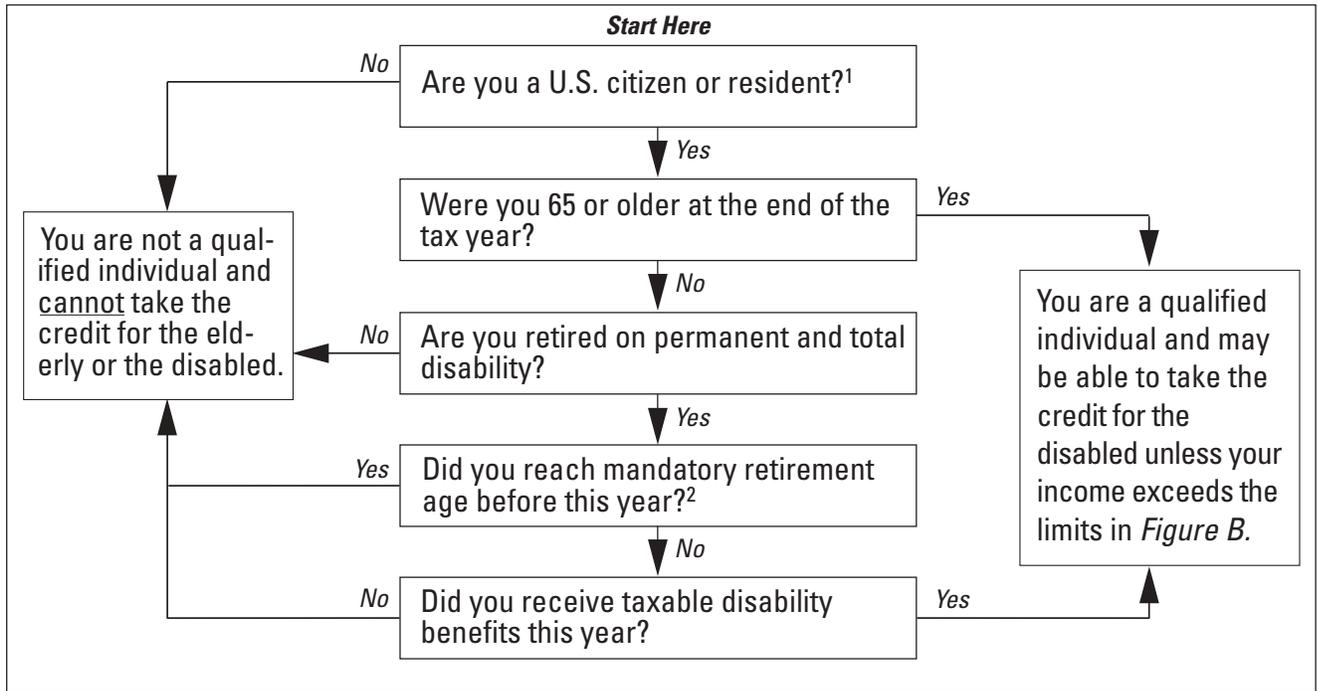
Taxpayers cannot exceed the income limits for their filing status (see **Exhibit 2**).

### ***CALCULATE THE CREDIT***

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 nearly identical.

#### **Example 1**

John (000-00-9850) and Sarah Hillsdale are married and file a joint return. Their respective ages are 66 and 68. They received nontaxable social security benefits of \$4,500 in 2003. 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 2003. (Part II need not be completed since both are age 65 or older.) See Exhibits 3 and 4.



<sup>1</sup> 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.

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

Exhibit 2

Income Limits

**Even if you qualify (see Figure A), you CANNOT take the credit if:**

<b>Your filing status is</b>	<b>AND your adjusted gross income (AGI)* is equal to or more than</b>	<b>OR your nontaxable social security or other nontaxable pension(s) is equal to or more than</b>
Single, Head of household, or Qualifying widow(er) with dependent child	\$17,500	\$5,000
Married filing a joint return <b>and</b> both spouses qualify in <i>Figure A</i>	\$25,000	\$7,500
Married filing a joint return <b>and</b> only one spouse qualifies in <i>Figure A</i>	\$20,000	\$5,000
Married filing a separate return <b>and</b> you did not live with your spouse at any time during the year	\$12,500	\$3,750

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

Schedule R (Form 1040)

Credit for the Elderly or the Disabled

OMB No. 1545-0074

2003

Attachment Sequence No. 16

Department of the Treasury Internal Revenue Service (99)

Attach to Form 1040. See instructions for Schedule R (Form 1040).

Name(s) shown on Form 1040

John and Sarah Hillsdale

Your social security number

000 00 9850

You may be able to take this credit and reduce your tax if by the end of 2003\*:

- 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.

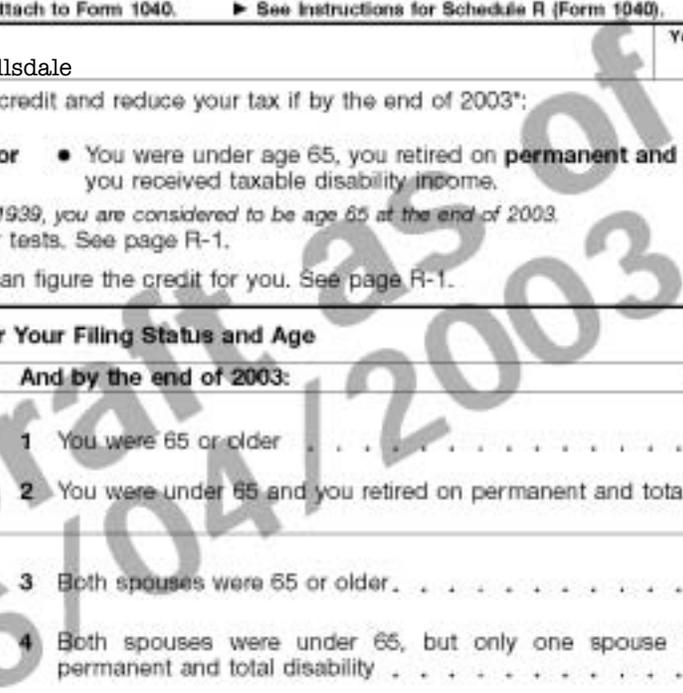
If you were born on January 1, 1939, you are considered to be age 65 at the end of 2003. But you must also meet other tests. See page R-1.

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 2003: Check only one box:

- Single, Head of household, or Qualifying widow(er) 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 [x] 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 2003 8 [ ] 9 You were under 65, you retired on permanent and total disability, and you lived apart from your spouse for all of 2003 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 2003, check this box [ ]

- If you checked this box, you do not have to get another statement for 2003. 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.

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11359K

Schedule R (Form 1040) 2003

**Part III Figure Your Credit**

<b>10 If you checked (in Part I):</b>		<b>Enter:</b>			
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			
<b>Did you check box 2, 4, 5, 6, or 9 in Part I?</b>		<b>Yes</b> →	You <b>must</b> complete line 11.		
		<b>No</b> →	Enter the amount from line 10 on line 12 and go to line 13.		
<b>11 If you checked (in Part I):</b>					
<ul style="list-style-type: none"> <li>Box 6, add \$5,000 to the taxable disability income of the spouse who was under age 65. Enter the total.</li> <li>Box 2, 4, or 9, enter your taxable disability income.</li> <li>Box 5, add your taxable disability income to your spouse's taxable disability income. Enter the total.</li> </ul>			11		
<b>TIP</b> For more details on what to include on line 11, see page R-3.					
<b>12</b> If you completed line 11, enter the <b>smaller</b> of line 10 or line 11; <b>all others</b> , enter the amount from line 10				12	7,500 00
<b>13</b> Enter the following pensions, annuities, or disability income that you (and your spouse if filing a joint return) received in 2003.					
<b>a</b> 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>b</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		
<b>c</b> Add lines 13a and 13b. (Even though these income items are not taxable, they <b>must</b> 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	
<b>14</b> Enter the amount from Form 1040, line 35			14	13,000 00	
<b>15 If you checked (in Part I):</b>		<b>Enter:</b>			
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			
<b>16</b> Subtract line 15 from line 14. If zero or less, enter -0-			16	3,000 00	
<b>17</b> Enter one-half of line 16			17	1,500 00	
<b>18</b> Add lines 13c and 17			18	6,000 00	
<b>19</b> Subtract line 18 from line 12. If zero or less, <b>stop</b> ; you <b>cannot</b> take the credit. Otherwise, go to line 20			19	1,500 00	
<b>20</b> Multiply line 19 by 15% (.15)			20	225 00	
<b>21</b> Enter the amount from Form 1040, line 43			21		
<b>22</b> Add the amounts from Form 1040, lines 44 and 45, and enter the total			22		
<b>23</b> Subtract line 22 from line 21			23	0 00	
<b>24 Credit for the elderly or the disabled.</b> Enter the <b>smaller</b> of line 20 or line 23 here and on Form 1040, line 46			24	225 00	

The credit for the elderly will be calculated automatically. The software will check age, income, and filing status to determine eligibility. However, it is extremely important to input Social Security Benefit income even if you know it is not taxable. Without this information the software may incorrectly calculate the credit.

**▶▶ SUMMING UP THIS LESSON ◀◀**

- ▶ The credit for the elderly or disabled is a nonrefundable credit which allows a taxpayer to reduce their liability.
- ▶ Due to the income limitations, very few taxpayers are eligible to receive this credit.
- ▶ The credit is based on filing status, age, and income.
- ▶ The credit is calculated and reported on Form 1040, Schedule R, or Form 1040A, Schedule 3.

# *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*

Stuart Morehouse (born July 2, 1935) and Donna Morehouse (born December 28, 1950) are married and will file a joint tax return. Neither one wishes to contribute to the presidential campaign fund.

Stuart is retired and received a pension from his former employer as well as social security benefits.

Donna is a secretary and received a Form W-2. She made a \$900 payment to her 2003 traditional IRA on January 15, 2004. Stuart and Donna do not want to name a third party designee.

If they are entitled to a refund they would like the check mailed to them. Their address and social security numbers are correct on their income statements.

# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Form W-2, First Bank of Hillsdale

a Control number 8162834		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number XX-XXXXXXX				1 Wages, tips, other compensation \$18,526.00		2 Federal income tax withheld \$2,423.00	
c Employer's name, address, and ZIP code First Bank of Hillsdale 1000 Main St. Your City, State, Zip Code				3 Social security wages \$18,526.00		4 Social security tax withheld \$1,149.00	
				5 Medicare wages and tips \$18,526.00		6 Medicare tax withheld \$269.00	
				7 Social security tips		8 Allocated tips	
d Employee's social security number				9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Last name Donna Morehouse 10923 Fullerton Your City, State, Zip Code				11 Nonqualified plans		12a See instructions for box 12	
				13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b	
				14 Other		12c	
						12d	
f Employee's address and ZIP code							
15 State Employer's state ID number XX-XXXXXXX		16 State wages, tips, etc. \$18,526.00		17 State income tax \$984.00		18 Local wages, tips, etc.	
						19 Local income tax	
						20 Locality name	

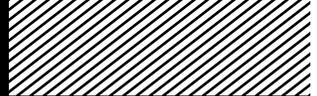
Form **W-2** Wage and Tax Statement

**2003**

Department of the Treasury—Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return.  
This information is being furnished to the Internal Revenue Service.

# PENSION EARNER COMPREHENSIVE PROBLEMS



Form 1099, Social Security Benefit Statement

FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT		
<b>2003</b> • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME. • SEE THE REVERSE FOR MORE INFORMATION.		
Box 1. Name <b>Stuart Morehouse</b>	Box 2. Beneficiary's Social Security Number <b>xxx-xx-xxxx</b>	
Box 3. Benefits Paid in 2003 <b>10,499</b>	Box 4. Benefits Repaid to SSA in 2003	Box 5. Net Benefits for 2003 (Box 3 minus Box 4) <b>10,499</b>
DESCRIPTION OF AMOUNT IN BOX 3	DESCRIPTION OF AMOUNT IN BOX 4	
<p style="text-align: center; font-size: 2em; opacity: 0.5; transform: rotate(-15deg);">Draft as of 09/01/2003</p>	Box 6. Voluntary Federal Income Tax Withholding	
	Box 7. Address  <b>10923 Fullerton</b> <b>Your City, State, Zip Code</b>	
	Box 8. Claim Number (Use this number if you need to contact SSA.)	
Form SSA-1099-SM (1-2004)	<b>DO NOT RETURN THIS FORM TO SSA OR IRS</b>	

# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Form 1099-R, AB Industries

<input type="checkbox"/> CORRECTED (if checked)				
PAYER'S name, street address, city, state, and ZIP code  <b>AB Industries</b>  <b>346 North 3rd Terrace</b>  Your City, State, Zip Code		<b>1</b> Gross distribution \$ 13,567.00	OMB No. 1545-0119  <b>2003</b>  Form 1099-R	<b>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</b>  <b>Copy B</b> Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.  This information is being furnished to the Internal Revenue Service.
		<b>2a</b> Taxable amount \$ 13,567.00		
PAYER'S Federal identification number  xx-xxxxxxx	RECIPIENT'S identification number  xxx-xx-xxxx	<b>3</b> Capital gain (included in box 2a)  \$	<b>4</b> Federal income tax withheld  \$ 1,357.00	
RECIPIENT'S name  <b>Stuart Morehouse</b>  Street address (including apt. no.)  <b>10923 Fullerton</b>  City, state, and ZIP code <b>Your City, State, Zip Code</b>		<b>5</b> Employee contributions or insurance premiums  \$	<b>6</b> Net unrealized appreciation in employer's securities  \$	
		<b>7</b> Distribution code(s) 7	<b>8</b> Other \$ %	
		<b>9a</b> Your percentage of total distribution %	<b>9b</b> Total employee contributions \$	
Account number (optional)	<b>10</b> State tax withheld \$ \$	<b>11</b> State/Payer's state no. \$	<b>12</b> State distribution \$ \$	
	<b>13</b> Local tax withheld \$ \$	<b>14</b> Name of locality	<b>15</b> Local distribution \$ \$	

Form 1099-R

Department of the Treasury - Internal Revenue Service

# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Form 1099-INT, Fisk Bank

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0112		<b>2003</b> Form <b>1099-INT</b>	<b>Interest Income</b>
PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>Fisk Bank</b>  <b>4010 North Second St.</b>  <b>Your City, State, Zip Code</b>		Payer's RTN (optional)			
PAYER'S Federal identification number <b>xx-xxxxxxx</b>	RECIPIENT'S identification number <b>xxx-xx-xxxx</b>	<b>1</b> Interest income not included in box 3 \$ <b>235.00</b>		<b>Copy B</b> <b>For Recipient</b>  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  <b>Stuart Morehouse</b>  Street address (including apt. no.) <b>10923 Fullerton</b>  City, state, and ZIP code <b>Your City, State, Zip Code</b>		<b>2</b> Early withdrawal penalty \$	<b>3</b> Interest on U.S. Savings Bonds and Treas. obligations \$		
Account number (optional)		<b>4</b> Federal income tax withheld \$	<b>5</b> Investment expenses \$		
		<b>6</b> Foreign tax paid \$	<b>7</b> Foreign country or U.S. possession		
Form <b>1099-INT</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service	

# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Form 1040A, page 1

Form <b>1040A</b>	Department of the Treasury—Internal Revenue Service <b>U.S. Individual Income Tax Return</b>	<b>2003</b>	IRS Use Only—Do not write or staple in this space.																																														
<b>Label</b> (See page 21.)  <b>Use the IRS label.</b> Otherwise, please print or type.	Your first name and initial	Last name	OMB No. 1545-0085																																														
	If a joint return, spouse's first name and initial	Last name	Your social security number																																														
	Home address (number and street). If you have a P.O. box, see page 22.	Apt. no.	Spouse's social security number																																														
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 22.		<b>▲ Important! ▲</b> You <b>must</b> enter your SSN(s) above.																																														
<b>Presidential Election Campaign</b> (See page 22.) <table style="width:100%; border: none;"> <tr> <td style="border: none;"> <b>Note.</b> 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: center;"> <table style="border: none;"> <tr> <td style="text-align: center;">You</td> <td style="text-align: center;">Spouse</td> </tr> <tr> <td style="text-align: center;"> <input type="checkbox"/> Yes <input type="checkbox"/> No                             </td> <td style="text-align: center;"> <input type="checkbox"/> Yes <input type="checkbox"/> No                             </td> </tr> </table> </td> </tr> </table>				<b>Note.</b> 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="border: none;"> <tr> <td style="text-align: center;">You</td> <td style="text-align: center;">Spouse</td> </tr> <tr> <td style="text-align: center;"> <input type="checkbox"/> Yes <input 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 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 57.																																																	

# PENSION EARNER COMPREHENSIVE PROBLEMS

Form 1040A (2003)

Page 2

<b>Tax, credits, and payments</b>	<b>22</b>	Enter the amount from line 21 (adjusted gross income).	22	
<b>Standard Deduction for—</b> <ul style="list-style-type: none"> <li>• People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 34.</li> <li>• All others: Single or Married filing separately, \$4,750 Married filing jointly or Qualifying widow(er), \$9,500 Head of household, \$7,000</li> </ul>	<b>23a</b>	Check <input type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind } <b>Total boxes</b> if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind } <b>checked ▶</b> 23a <input style="width: 30px; height: 20px;" type="text"/>		
	<b>b</b>	If you are married filing separately and your spouse itemizes deductions, see page 34 and check here ▶ 23b <input type="checkbox"/>		
	<b>24</b>	Enter your <b>standard deduction</b> (see left margin).	24	
	<b>25</b>	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25	
	<b>26</b>	Multiply \$3,050 by the total number of exemptions claimed on line 6d.	26	
	<b>27</b>	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your <b>taxable income</b> . ▶ 27	27	
	<b>28</b>	<b>Tax</b> , including any alternative minimum tax (see page 35).	28	
	<b>29</b>	Credit for child and dependent care expenses. Attach Schedule 2.	29	
	<b>30</b>	Credit for the elderly or the disabled. Attach Schedule 3.	30	
	<b>31</b>	Education credits. Attach Form 8863.	31	
<b>32</b>	Retirement savings contributions credit. Attach Form 8880.	32		
<b>33</b>	Child tax credit (see page 38).	33		
<b>34</b>	Adoption credit. Attach Form 8839.	34		
<b>35</b>	Add lines 29 through 34. These are your <b>total credits</b> .	35		
<b>36</b>	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36		
<b>37</b>	Advance earned income credit payments from Form(s) W-2.	37		
<b>38</b>	Add lines 36 and 37. This is your <b>total tax</b> . ▶ 38	38		
<b>39</b>	Federal income tax withheld from Forms W-2 and 1099.	39		
<b>40</b>	2003 estimated tax payments and amount applied from 2002 return.	40		
If you have a qualifying child, attach Schedule EIC.	<b>41</b>	<b>Earned income credit (EIC)</b> .	41	
	<b>42</b>	Additional child tax credit. Attach Form 8812.	42	
	<b>43</b>	Add lines 39 through 42. These are your <b>total payments</b> . ▶ 43	43	
<b>Refund</b>	<b>44</b>	If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> .	44	
Direct deposit? See page 52 and fill in 45b, 45c, and 45d.	<b>45a</b>	Amount of line 44 you want <b>refunded to you</b> . ▶ 45a	45a	
	<b>b</b>	Routing number <input style="width: 100px;" type="text"/> ▶ <b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
	<b>d</b>	Account number <input style="width: 100px;" type="text"/>		
<b>46</b>	Amount of line 44 you want <b>applied to your 2004 estimated tax</b> .	46		
<b>Amount you owe</b>	<b>47</b>	<b>Amount you owe</b> . Subtract line 43 from line 38. For details on how to pay, see page 53. ▶ 47	47	
<b>48</b>	Estimated tax penalty (see page 53).	48		
<b>Third party designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 54)? <input type="checkbox"/> <b>Yes</b> . Complete the following. <input type="checkbox"/> <b>No</b>			
	Designee's name ▶	Phone no. ▶ ( )	Personal identification number (PIN) ▶	<input style="width: 30px;" type="text"/>
<b>Sign here</b>	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 22. Keep a copy for your records.	Your signature	Date	Your occupation	Daytime phone number ( )
	Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation	<div style="background-color: #cccccc; width: 100px; height: 20px;"></div>
<b>Paid preparer's use only</b>	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. ( )		



# PENSION EARNER COMPREHENSIVE PROBLEMS

## PROBLEM 2

Jay Lehigh (born February 10, 1930) and Sandra Lehigh (November 27, 1935) are married and will file a joint return. They both wish to contribute to the presidential election campaign. Jay's social security number and address are correct as shown on his income statements. Sandra's social security number is xxx-xx-xxxx. Jay and Sandra do not want to name a third party designee.

Jay is retired, receives a pension from his former employer, and receives social security benefits.

Sandra is a housewife. She provided day care for her 3 grandchildren. The state paid her for this service and issued her a Form 1099-MISC. She incurred no expenses.

Jay and Sandra sold some stock in 2003 and provided the following information: The principal business code for child care is 624410.

Company	# of Shares	Purchase Date	Per Share Basis	Sale Date	Per Share Sales Price
ABC Inc	100	12/01/1985	24.00	07/15/2003	51.24
XYZ Inc	200	12/20/1987	28.50	11/14/2003	53.98

2003 Form 1099-R, CD Associates

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution		OMB No. 1545-0119		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
CD Associates 345 East 100th St. Your City, State, Zip Code		\$ 18,945.00 2a Taxable amount \$ 18,945.00		2003 Form 1099-R		
PAYER'S Federal identification number xx-xxxxxxx		RECIPIENT'S identification number xxx-xx-xxxx		3 Capital gain (included in box 2a) \$		Copy B Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.
RECIPIENT'S name Jay Lehigh Street address (including apt. no.) 99 Danville Ave City, state, and ZIP code Your City, State, Zip Code		5 Employee contributions or insurance premiums \$		4 Federal income tax withheld \$ 1,895.00		
Account number (optional)		7 Distribution code(s) 7		6 Net unrealized appreciation in employer's securities \$		This information is being furnished to the Internal Revenue Service.
9a Your percentage of total distribution %		8 Other \$ %		9b Total employee contributions \$		
10 State tax withheld \$		11 State/Payer's state no. \$		12 State distribution \$		
13 Local tax withheld \$		14 Name of locality \$		15 Local distribution \$		

Form 1099-R

Department of the Treasury - Internal Revenue Service

Comprehensive Problems

CP-9

PENSION EARNER

# PENSION EARNER COMPREHENSIVE PROBLEMS

Form 1099, Social Security Benefit Statement

FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT		
<b>2003</b> : PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME. : SEE THE REVERSE FOR MORE INFORMATION.		
Box 1. Name <b>Jay Lehigh</b>		Box 2. Beneficiary's Social Security Number <b>XXX-XX-XXXX</b>
Box 3. Benefits Paid in 2003 <b>\$14,263.00</b>	Box 4. Benefits Repaid to SSA in 2003	Box 5. Net Benefits for 2003 (Box 3 minus Box 4) <b>\$14,263.00</b>
DESCRIPTION OF AMOUNT IN BOX 3		DESCRIPTION OF AMOUNT IN BOX 4
		Box 6. Voluntary Federal Income Tax Withholding
		Box 7. Address  <b>99 Danville</b> <b>Your City, State, Zip Code</b>
		Box 8. Claim Number (Use this number if you need to contact SSA.)

Form SSA-1099-SM (1-2004) **DO NOT RETURN THIS FORM TO SSA OR IRS**

Draft as of  
09/01/2003

# PENSION EARNER COMPREHENSIVE PROBLEMS

Reserved for Form 1099-MISC

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0115		<b>Miscellaneous Income</b>
PAYER'S name, street address, city, state, ZIP code, and telephone no.  Division of Social Services 1000 N. 16th St. Your City, State, Zip Code		1 Rents \$	<b>2003</b>	
		2 Royalties \$		Form <b>1099-MISC</b>
		3 Other income \$	<b>4 Federal income tax withheld</b> \$	<b>Copy B For Recipient</b>
PAYER'S Federal identification number XX-XXXXXXX	RECIPIENT'S identification number XXX-XX-XXXX	5 Fishing boat proceeds \$	6 Medical and health care payments \$	
RECIPIENT'S name Sandra Lehigh		7 Nonemployee compensation \$ <b>6,000.00</b>	8 Substitute payments in lieu of dividends or interest \$	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.
Street address (including apt. no.) 99 Danville Ave		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>	10 Crop insurance proceeds \$	
City, state, and ZIP code Your City, State, Zip Code		11	12	
Account number (optional)		13 Excess golden parachute payments \$	14 Gross proceeds paid to an attorney \$	
15		16 State tax withheld \$	17 State/Payer's state no.	

Form **1099-MISC**

(keep for your records)

Department of the Treasury - Internal Revenue Service

# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Form 1040, page 1

Form <b>1040</b>	Department of the Treasury—Internal Revenue Service <b>U.S. Individual Income Tax Return 2003</b>	IRS Use Only—Do not write or staple in this space. OMB No. 1545-0074																																																																																																						
<b>Label</b> (See instructions on page 21.)  <b>Use the IRS label.</b> Otherwise, please print or type.  <b>Presidential Election Campaign</b> (See page 21.)	For the year Jan. 1–Dec. 31, 2003, or other tax year beginning _____, 2003, ending _____, 20	Your social security number _____																																																																																																						
	Your first name and initial _____ Last name _____	Spouse's 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 21. _____ Apt. no. _____ City, town or post office, state, and ZIP code. If you have a foreign address, see page 21. _____	<b>▲ Important! ▲</b> You <b>must</b> enter your SSN(s) above.																																																																																																						
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 <input type="checkbox"/> Yes <input type="checkbox"/> No	Spouse <input type="checkbox"/> Yes <input type="checkbox"/> No																																																																																																						
<b>Filing Status</b> 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. 5 <input type="checkbox"/> Qualifying widow(er) with dependent child. (See page 21.)																																																																																																						
<b>Exemptions</b>  If more than five dependents, see page 22.	6a <input type="checkbox"/> <b>Yourself.</b> 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"/> <b>Spouse</b> c <b>Dependents:</b> <table border="1" style="width:100%; border-collapse: collapse;"> <thead> <tr> <th style="width:30%;">(1) First name</th> <th style="width:30%;">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 22)</th> </tr> </thead> <tbody> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> </tbody> </table> d Total number of exemptions claimed _____	(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 22)					<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 22) _____ Dependents on 6c not entered above _____ Add numbers on lines above ▶ <input style="width:40px; height:20px;" type="text"/>																																																																								
(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 22)																																																																																																				
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<b>Income</b>  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 23.  Enclose, but do not attach, any payment. Also, please use Form 1040-V.	7 Wages, salaries, tips, etc. Attach Form(s) W-2 8a <b>Taxable</b> interest. Attach Schedule B if required b <b>Tax-exempt</b> interest. Do not include on line 8a 9a Ordinary dividends. Attach Schedule B if required b Qualified dividends (see page 25) 10 Taxable refunds, credits, or offsets of state and local income taxes (see page 25) 11 Alimony received 12 Business income or (loss). Attach Schedule C or C-EZ 13a Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/> b If box on 13a is checked, enter post-May 5 capital gain distributions 14 Other gains or (losses). Attach Form 4797 15a IRA distributions b Taxable amount (see page 25) 16a Pensions and annuities b Taxable amount (see page 25) 17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E 18 Farm income or (loss). Attach Schedule F 19 Unemployment compensation 20a Social security benefits b Taxable amount (see page 27) 21 Other income. List type and amount (see page 29) 22 Add the amounts in the far right column for lines 7 through 21. This is your <b>total income</b> ▶	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:5%;">7</td><td style="width:15%;"></td><td style="width:15%;"></td><td style="width:15%;"></td><td style="width:15%;"></td><td style="width:15%;"></td></tr> <tr><td>8a</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>9a</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>10</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>11</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>12</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>13a</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>13b</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>14</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>15b</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>16b</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>17</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>18</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>19</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>20b</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>21</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>22</td><td></td><td></td><td></td><td></td><td></td></tr> </table>	7						8a						9a						10						11						12						13a						13b						14						15b						16b						17						18						19						20b						21						22					
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<b>Adjusted Gross Income</b>	23 Educator expenses (see page 29) 24 IRA deduction (see page 29) 25 Student loan interest deduction (see page 31) 26 Tuition and fees deduction (see page 32) 27 Moving expenses. Attach Form 3903 28 One-half of self-employment tax. Attach Schedule SE 29 Self-employed health insurance deduction (see page 33) 30 Self-employed SEP, SIMPLE, and qualified plans 31 Penalty on early withdrawal of savings 32a Alimony paid    b Recipient's SSN ▶ 33 Add lines 23 through 32a 34 Subtract line 33 from line 22. This is your <b>adjusted gross income</b> ▶	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:5%;">23</td><td style="width:15%;"></td><td style="width:15%;"></td><td style="width:15%;"></td><td style="width:15%;"></td><td style="width:15%;"></td></tr> <tr><td>24</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>25</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>26</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>27</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>28</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>29</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>30</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>31</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>32a</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>33</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td>34</td><td></td><td></td><td></td><td></td><td></td></tr> </table>	23						24						25						26						27						28						29						30						31						32a						33						34																																			
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# PENSION EARNER COMPREHENSIVE PROBLEMS

Form 1040 (2003)

Page **2**

## Tax and Credits

### Standard Deduction for—

• People who checked any box on line 36a or 36b or who can be claimed as a dependent, see page 34.

• All others:  
Single or Married filing separately, \$4,750

Married filing jointly or Qualifying widow(er), \$9,500

Head of household, \$7,000

<b>35</b>	Amount from line 34 (adjusted gross income)	<b>35</b>	
<b>36a</b>	Check <input type="checkbox"/> <b>You</b> were born before January 2, 1939, <input type="checkbox"/> <b>Blind.</b> } <b>Total boxes</b> if: <input type="checkbox"/> <b>Spouse</b> was born before January 2, 1939, <input type="checkbox"/> <b>Blind.</b> } <b>checked ▶ 36a</b> <input type="checkbox"/>		
<b>b</b>	If you are married filing separately and your spouse itemizes deductions, or you were a dual-status alien, see page 34 and check here <input type="checkbox"/> <b>▶ 36b</b> <input type="checkbox"/>		
<b>37</b>	<b>Itemized deductions</b> (from Schedule A) or your <b>standard deduction</b> (see left margin)	<b>37</b>	
<b>38</b>	Subtract line 37 from line 35	<b>38</b>	
<b>39</b>	If line 35 is \$104,625 or less, multiply \$3,050 by the total number of exemptions claimed on line 6d. If line 35 is over \$104,625, see the worksheet on page 35	<b>39</b>	
<b>40</b>	<b>Taxable income.</b> Subtract line 39 from line 38. If line 39 is more than line 38, enter -0-	<b>40</b>	
<b>41</b>	<b>Tax</b> (see page 36). Check if any tax is from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972	<b>41</b>	
<b>42</b>	<b>Alternative minimum tax</b> (see page 37). Attach Form 6251	<b>42</b>	
<b>43</b>	Add lines 41 and 42 <input type="checkbox"/> <b>▶</b>	<b>43</b>	
<b>44</b>	Foreign tax credit. Attach Form 1116 if required	<b>44</b>	
<b>45</b>	Credit for child and dependent care expenses. Attach Form 2441	<b>45</b>	
<b>46</b>	Credit for the elderly or the disabled. Attach Schedule R	<b>46</b>	
<b>47</b>	Education credits. Attach Form 8863	<b>47</b>	
<b>48</b>	Retirement savings contributions credit. Attach Form 8880	<b>48</b>	
<b>49</b>	Child tax credit (see page 39)	<b>49</b>	
<b>50</b>	Adoption credit. Attach Form 8839	<b>50</b>	
<b>51</b>	Credits from: <b>a</b> <input type="checkbox"/> Form 8396 <b>b</b> <input type="checkbox"/> Form 8859	<b>51</b>	
<b>52</b>	Other credits. Check applicable box(es): <b>a</b> <input type="checkbox"/> Form 3800 <b>b</b> <input type="checkbox"/> Form 8801 <b>c</b> <input type="checkbox"/> Specify	<b>52</b>	
<b>53</b>	Add lines 44 through 52. These are your <b>total credits</b>	<b>53</b>	
<b>54</b>	Subtract line 53 from line 43. If line 53 is more than line 43, enter -0- <input type="checkbox"/> <b>▶</b>	<b>54</b>	

## Other Taxes

<b>55</b>	Self-employment tax. Attach Schedule SE	<b>55</b>	
<b>56</b>	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137	<b>56</b>	
<b>57</b>	Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required	<b>57</b>	
<b>58</b>	Advance earned income credit payments from Form(s) W-2	<b>58</b>	
<b>59</b>	Household employment taxes. Attach Schedule H	<b>59</b>	
<b>60</b>	Add lines 54 through 59. This is your <b>total tax</b> <input type="checkbox"/> <b>▶</b>	<b>60</b>	

## Payments

If you have a qualifying child, attach Schedule EIC.

<b>61</b>	Federal income tax withheld from Forms W-2 and 1099	<b>61</b>	
<b>62</b>	2003 estimated tax payments and amount applied from 2002 return	<b>62</b>	
<b>63</b>	<b>Earned income credit (EIC)</b>	<b>63</b>	
<b>64</b>	Excess social security and tier 1 RRTA tax withheld (see page 56)	<b>64</b>	
<b>65</b>	Additional child tax credit. Attach Form 8812	<b>65</b>	
<b>66</b>	Amount paid with request for extension to file (see page 56)	<b>66</b>	
<b>67</b>	Other payments from: <b>a</b> <input type="checkbox"/> Form 2439 <b>b</b> <input type="checkbox"/> Form 4136 <b>c</b> <input type="checkbox"/> Form 8885	<b>67</b>	
<b>68</b>	Add lines 61 through 67. These are your <b>total payments</b> <input type="checkbox"/> <b>▶</b>	<b>68</b>	

## Refund

Direct deposit? See page 56 and fill in 70b, 70c, and 70d.

<b>69</b>	If line 68 is more than line 60, subtract line 60 from line 68. This is the amount you <b>overpaid</b>	<b>69</b>	
<b>70a</b>	Amount of line 69 you want <b>refunded to you</b> <input type="checkbox"/> <b>▶</b>	<b>70a</b>	
<b>b</b>	Routing number <input type="text"/>	<b>c</b>	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
<b>d</b>	Account number <input type="text"/>		
<b>71</b>	Amount of line 69 you want <b>applied to your 2004 estimated tax</b> <input type="checkbox"/> <b>▶</b>	<b>71</b>	

## Amount You Owe

<b>72</b>	<b>Amount you owe.</b> Subtract line 68 from line 60. For details on how to pay, see page 57 <input type="checkbox"/> <b>▶</b>	<b>72</b>	
<b>73</b>	Estimated tax penalty (see page 57)	<b>73</b>	

## Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see page 58)?  **Yes.** Complete the following.  **No**

Designee's name <input type="text"/>	Phone no. <input type="text"/>	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 complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See page 21. Keep a copy for your records. <input type="checkbox"/>	Your signature <input type="text"/>	Date <input type="text"/>	Your occupation <input type="text"/>	Daytime phone number <input type="text"/>
	Spouse's signature. If a joint return, <b>both</b> must sign. <input type="text"/>	Date <input type="text"/>	Spouse's occupation <input type="text"/>	<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"/>	Preparer's SSN or PTIN <input type="text"/>
Firm's name (or yours if self-employed), address, and ZIP code <input type="text"/>	EIN <input type="text"/>	Phone no. <input type="text"/>	

# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Schedule C-EZ

**SCHEDULE C-EZ  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**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

**2003**

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:**

- 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-4 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, & 9

**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**

<p><b>1 Gross receipts. Caution.</b> If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <b>Statutory Employees</b> in the instructions for Schedule C, line 1, on page C-3 and check here . . . . . <input type="checkbox"/></p>	<b>1</b>		
<p><b>2 Total expenses</b> (see instructions). If more than \$2,500, you <b>must</b> use Schedule C . . . . .</p>	<b>2</b>		
<p><b>3 Net profit.</b> Subtract line 2 from line 1. If less than zero, you <b>must</b> use Schedule C. Enter on <b>Form 1040, line 12</b>, and <b>also on Schedule SE, line 2</b>. (Statutory employees <b>do not</b> report this amount on Schedule SE, line 2. Estates and trusts, enter on Form 1041, line 3.) . . . . .</p>	<b>3</b>		

**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 2003, 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) 2003

# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Form 1040 Schedule SE

<b>SCHEDULE SE</b> <b>(Form 1040)</b>  <small>Department of the Treasury Internal Revenue Service</small>	<b>Self-Employment Tax</b>  ▶ Attach to Form 1040. ▶ See Instructions for Schedule SE (Form 1040).	OMB No. 1545-0074  <b>2003</b> 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

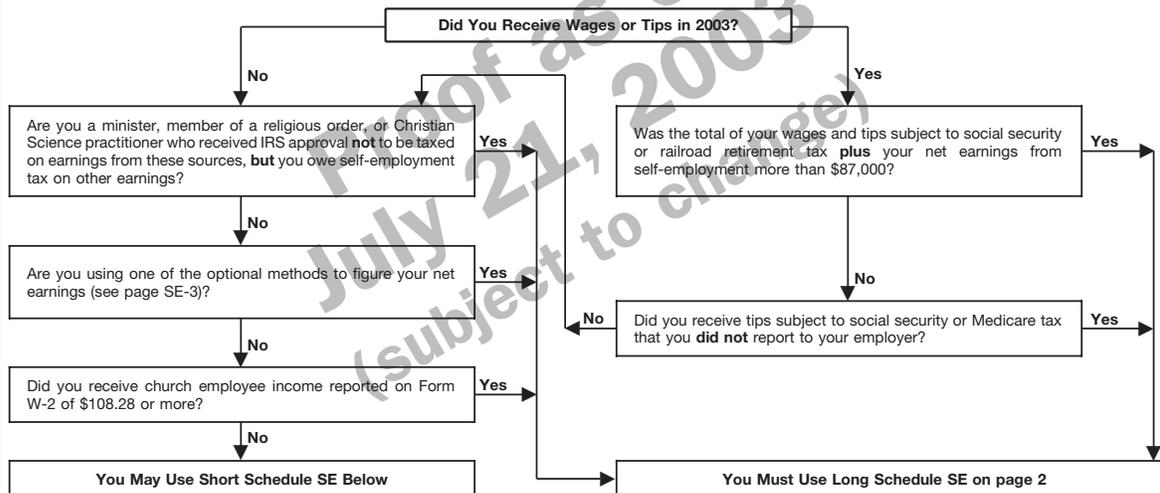
You must file Schedule SE if:

- 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 55.

### 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.

<p><b>1</b> Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a . . . . .</p> <p><b>2</b> 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 . . . . .</p> <p><b>3</b> Combine lines 1 and 2 . . . . .</p> <p><b>4</b> <b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax . . . . . ▶</p> <p><b>5</b> <b>Self-employment tax.</b> If the amount on line 4 is:</p> <ul style="list-style-type: none"> <li>• \$87,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 55.</b></li> <li>• More than \$87,000, multiply line 4 by 2.9% (.029). Then, add \$10,788.00 to the result. Enter the total here and on <b>Form 1040, line 55.</b></li> </ul> <p><b>6</b> <b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 28</b> . . . . . <b>6</b></p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="text-align: center;">1</td><td style="width: 40px;"></td><td style="width: 40px;"></td></tr> <tr><td style="text-align: center;">2</td><td></td><td></td></tr> <tr><td style="text-align: center;">3</td><td></td><td></td></tr> <tr><td style="text-align: center;">4</td><td></td><td></td></tr> <tr><td style="text-align: center;">5</td><td></td><td></td></tr> <tr style="background-color: #cccccc;"><td style="text-align: center;">6</td><td></td><td></td></tr> </table>	1			2			3			4			5			6		
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# PENSION EARNER COMPREHENSIVE PROBLEMS

2003 Schedule D, page 1

<b>SCHEDULE D</b> <b>(Form 1040)</b>  <small>Department of the Treasury Internal Revenue Service</small>	<b>Capital Gains and Losses</b>  ▶ 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="text-align: center; font-size: 24pt; font-weight: bold;">2003</div> Attachment Sequence No. 12				
Name(s) shown on Form 1040		Your social security number xxx : xx : xxxx				
<b>Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less</b>						
<b>(a)</b> Description of property <small>(Example: 100 sh. XYZ Co.)</small>	<b>(b)</b> Date acquired <small>(Mo., day, yr.)</small>	<b>(c)</b> Date sold <small>(Mo., day, yr.)</small>	<b>(d)</b> Sales price <small>(see page D-5 of the instructions)</small>	<b>(e)</b> Cost or other basis <small>(see page D-5 of the instructions)</small>	<b>(f)</b> Gain or (loss) for the entire year <small>Subtract (e) from (d)</small>	<b>(g)</b> Post-May 5 gain or (loss)* <small>(see below)</small>
1						
2	Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .		2			
3	<b>Total short-term sales price amounts.</b> 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 2002 Capital Loss Carryover Worksheet . . . . .		6	( )		
7a	Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. <b>Do not</b> enter more than zero . . . . .		7a		( )	
7b	<b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .		7b			
<b>Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year</b>						
<b>(a)</b> Description of property <small>(Example: 100 sh. XYZ Co.)</small>	<b>(b)</b> Date acquired <small>(Mo., day, yr.)</small>	<b>(c)</b> Date sold <small>(Mo., day, yr.)</small>	<b>(d)</b> Sales price <small>(see page D-5 of the instructions)</small>	<b>(e)</b> Cost or other basis <small>(see page D-5 of the instructions)</small>	<b>(f)</b> Gain or (loss) for the entire year <small>Subtract (e) from (d)</small>	<b>(g)</b> Post-May 5 gain or (loss)* <small>(see below)</small>
8						
9	Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .		9			
10	<b>Total long-term sales price amounts.</b> 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 the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .		14	( )		
15	Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .		15			
16	<b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) . . . . . <b>Next:</b> Go to Part III on the back.		16			
<small>*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, <b>do not</b> include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or eligible gain on qualified small business stock (see page D-4 of the instructions).</small>						
<b>For Paperwork Reduction Act Notice, see Form 1040 instructions.</b>			Cat. No. 11338H		<b>Schedule D (Form 1040) 2003</b>	

# PENSION EARNER COMPREHENSIVE PROBLEMS

Schedule D (Form 1040) 2003

Page **2**

**Part III Taxable Gain or Deductible Loss**

- 17a** Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .
- b** Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40. **Next:**
- If both lines 16 and 17a of Schedule D are gains **or** you have qualified dividends on Form 1040, line 9b, complete **Part IV** below (unless Form 1040, line 40, is zero).
  - Otherwise, skip the rest of Schedule D and complete Form 1040.
- 18** If line 17a is a loss, enter here and on Form 1040, line 13a, the **smaller** of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . .
- Next:**
- If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete **Part IV** below (but skip lines 19 and 20).
  - Otherwise, skip **Part IV** below and complete the rest of Form 1040.

17a			
17b			
18	(	)	

**Part IV Tax Computation Using Maximum Capital Gains Rates**

If line 16 or line 17a is zero or less, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.

- 19** Enter your unrecaptured section 1250 gain, if any, from line 18 of the worksheet on page D-6 . . . . .
- 20** Enter your 28% rate gain, if any, from line 7 of the worksheet on page D-9 of the instructions . . . . .

19			
20			

If lines 19 and 20 are zero, go to line 21. Otherwise, complete the worksheet on page D-10 of the instructions to figure the amount to enter on lines 35 and 53 below, and skip all other lines below.

- 21** Enter your taxable income from Form 1040, line 40 . . . . .
- 22** Enter the **smaller** of line 16 or line 17a, but not less than zero . . . . .
- 23** Enter your qualified dividends from Form 1040, line 9b . . . . .
- 24** Add lines 22 and 23 . . . . .
- 25** Amount from line 4g of Form 4952 (investment interest expense) . . . . .
- 26** Subtract line 25 from line 24. If zero or less, enter -0- . . . . .
- 27** Subtract line 26 from line 21. If zero or less, enter -0- . . . . .
- 28** Enter the **smaller** of line 21 **or:**
- \$56,800 if married filing jointly or qualifying widow(er);
  - \$28,400 if single or married filing separately; or
  - \$38,050 if head of household
- If line 27 is more than line 28, skip lines 29-39 and go to line 40.
- 29** Enter the amount from line 27 . . . . .
- 30** Subtract line 29 from line 28. If zero or less, go to line 40 . . . . .
- 31** Add lines 17b and 23\* . . . . .
- 32** Enter the **smaller** of line 30 or line 31 . . . . .
- 33** Multiply line 32 by 5% (.05) . . . . .
- If lines 30 and 32 are the same, skip lines 34-39 and go to line 40.
- 34** Subtract line 32 from line 30 . . . . .
- 35** Enter your qualified 5-year gain, if any, from line 8 of the worksheet on page D-8 . . . . .
- 36** Enter the **smaller** of line 34 or line 35 . . . . .
- 37** Multiply line 36 by 8% (.08) . . . . .
- 38** Subtract line 36 from line 34 . . . . .
- 39** Multiply line 38 by 10% (.10) . . . . .
- If lines 26 and 30 are the same, skip lines 40-49 and go to line 50.
- 40** Enter the **smaller** of line 21 or line 26 . . . . .
- 41** Enter the amount from line 30 (if line 30 is blank, enter -0-) . . . . .
- 42** Subtract line 41 from line 40 . . . . .
- 43** Add lines 17b and 23\* . . . . .
- 44** Enter the amount from line 32 (if line 32 is blank, enter -0-) . . . . .
- 45** Subtract line 44 from line 43 . . . . .
- 46** Enter the **smaller** of line 42 or line 45 . . . . .
- 47** Multiply line 46 by 15% (.15) . . . . .
- 48** Subtract line 46 from line 42 . . . . .
- 49** Multiply line 48 by 20% (.20) . . . . .
- 50** Figure the tax on the amount on line 27. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .
- 51** Add lines 33, 37, 39, 47, 49, and 50 . . . . .
- 52** Figure the tax on the amount on line 21. Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .
- 53 Tax on all taxable income.** Enter the **smaller** of line 51 or line 52 here and on Form 1040, line 41

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\*If line 25 is more than zero, see Lines 31 and 43 on page D-9 for the amount to enter. Printed on recycled paper Schedule D (Form 1040) 2003

# PENSION EARNER COMPREHENSIVE PROBLEMS

## 2003 Social Security Benefits Worksheet

- Before you begin:**
- ✓ Complete Form 1040, lines 21, 23, 24, and 27 through 32a, if they apply to you.
  - ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
  - ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2003, enter "D" to the right of the word "benefits" on line 20a.
  - ✓ Be sure you have read the **Exception** on page 26 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 <b>box 5</b> of all your <b>Forms SSA-1099</b> and <b>Forms RRB-1099</b> .....	1.	
2. Enter one-half of line 1 .....	2.	
3. Enter the total of the amounts from Form 1040, lines 7, 8a, 9a, 10 through 12, 13a, 14, 15b, 16b, 17 through 19, and 21. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099 .....	3.	
4. Enter the amount, if any, from Form 1040, line 8b .....	4.	
5. Add lines 2, 3, and 4. ....	5.	
6. Enter the total of the amounts from Form 1040, lines 23, 24, and 27 through 32a, plus any amount you entered on the dotted line next to line 33 .....	6.	
7. Is the amount on line 6 less than the amount on line 5? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. <input type="checkbox"/> <b>Yes.</b> Subtract line 6 from line 5 .....	7.	
8. If you are: <ul style="list-style-type: none"> <li>• Married filing jointly, enter \$32,000</li> <li>• Single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter \$25,000</li> <li>• Married filing separately and you lived with your spouse at any time in 2003, skip lines 8 through 15; multiply line 7 by 85% (.85) and enter the result on line 16. Then go to line 17</li> </ul>	8.	
9. Is the amount on line 8 less than the amount on line 7? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. You do not have to enter any amounts on lines 20a or 20b of Form 1040. <b>But</b> if you are married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter -0- on line 20b. Be sure you entered "D" to the right of the word "benefits" on line 20a. <input type="checkbox"/> <b>Yes.</b> Subtract line 8 from line 7 .....	9.	
10. Enter: \$12,000 if married filing jointly; \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003	10.	
11. Subtract line 10 from line 9. If zero or less, enter -0- .....	11.	
12. Enter the <b>smaller</b> of line 9 or line 10. ....	12.	
13. Enter one-half of line 12 .....	13.	
14. Enter the <b>smaller</b> 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. <b>Taxable social security benefits.</b> Enter the <b>smaller</b> of line 16 or line 17 .....	18.	
<ul style="list-style-type: none"> <li>• Enter the amount from line 1 above on Form 1040, line 20a.</li> <li>• Enter the amount from line 18 above on Form 1040, line 20b.</li> </ul>		



If part of your benefits are taxable for 2003 **and** they include benefits paid in 2003 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

2003 Form 1040A, page 2

Form 1040A (2003)		Page <b>2</b>
<b>Tax, credits, and payments</b>	<b>22</b> Enter the amount from line 21 (adjusted gross income).	22 33,767 00
	<b>23a</b> Check <input checked="" type="checkbox"/> You were born before January 2, 1939, <input type="checkbox"/> Blind } Total boxes if: <input type="checkbox"/> Spouse was born before January 2, 1939, <input type="checkbox"/> Blind } checked ▶ 23a <span style="border: 1px solid black; padding: 2px;">1</span>	
	<b>b</b> If you are married filing separately and your spouse itemizes deductions, see page 34 and check here ▶ 23b <input type="checkbox"/>	
	<b>24</b> Enter your <b>standard deduction</b> (see left margin).	24 10,450 00
	<b>25</b> Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25 23,317 00
	<b>26</b> Multiply \$3,050 by the total number of exemptions claimed on line 6d.	26 6,100 00
	<b>27</b> Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your <b>taxable income</b> .	27 17,217 00
	<b>28</b> <b>Tax</b> , including any alternative minimum tax (see page 35).	28 1,884 00
	<b>29</b> Credit for child and dependent care expenses. Attach Schedule 2.	29
	<b>30</b> Credit for the elderly or the disabled. Attach Schedule 3.	30
	<b>31</b> Education credits. Attach Form 8863.	31
	<b>32</b> Retirement savings contributions credit. Attach Form 8880.	32
	<b>33</b> Child tax credit (see page 38).	33
	<b>34</b> Adoption credit. Attach Form 8839.	34
	<b>35</b> Add lines 29 through 34. These are your <b>total credits</b> .	35 0 00
	<b>36</b> Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36 1,884 00
	<b>37</b> Advance earned income credit payments from Form(s) W-2.	37
	<b>38</b> Add lines 36 and 37. This is your <b>total tax</b> .	38 1,884 00
	<b>39</b> Federal income tax withheld from Forms W-2 and 1099.	39 3,780 00
	<b>40</b> 2003 estimated tax payments and amount applied from 2002 return.	40
	<b>41</b> <b>Earned income credit (EIC)</b> .	41
	<b>42</b> Additional child tax credit. Attach Form 8812.	42
	<b>43</b> Add lines 39 through 42. These are your <b>total payments</b> .	43 3,780 00
	<b>44</b> If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you <b>overpaid</b> .	44 1,896 00
	<b>45a</b> Amount of line 44 you want <b>refunded to you</b> .	45a 1,896 00
	<b>b</b> Routing number <span style="border: 1px solid black; display: inline-block; width: 100px; height: 15px;"></span> ▶ <b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
	<b>d</b> Account number <span style="border: 1px solid black; display: inline-block; width: 150px; height: 15px;"></span>	
	<b>46</b> Amount of line 44 you want <b>applied to your 2004 estimated tax</b> .	46
	<b>47</b> <b>Amount you owe</b> . Subtract line 43 from line 38. For details on how to pay, see page 53.	47
	<b>48</b> Estimated tax penalty (see page 53).	48
	<b>Third party designee</b> Do you want to allow another person to discuss this return with the IRS (see page 54)? <input type="checkbox"/> Yes. Complete the following. <input checked="" type="checkbox"/> No	
	Designee's name ▶ _____	Phone no. ▶ ( ) _____
	Personal identification number (PIN) ▶ <span style="border: 1px solid black; display: inline-block; width: 50px; height: 15px;"></span>	
	<b>Sign here</b> 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 / / _____
	Spouse's signature. If a joint return, <b>both</b> must sign. ▶ _____	Date / / _____
	Your occupation Retired	Daytime phone number ( ) _____
	Spouse's occupation Secretary	<span style="background-color: #cccccc; width: 100%; height: 15px;"></span>
	<b>Paid preparer's use only</b> Preparer's signature ▶ _____	Date / / _____
	Firm's name (or yours if self-employed), address, and ZIP code ▶ _____	Check if self-employed <input type="checkbox"/>
	EIN _____	Preparer's SSN or PTIN Pxx-xx-xxxx
	Phone no. ( ) _____	



Form 1040A (2003)

# PENSION EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

### 2003 Social Security Benefits Worksheet

#### 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 32a, if they apply to you.
  - ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
  - ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2003, enter "D" to the right of the word "benefits" on line 20a.
  - ✓ Be sure you have read the **Exception** on page 26 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 <b>box 5</b> of all your <b>Forms SSA-1099</b> and <b>Forms RRB-1099</b> .....	1.	<b>10,499</b>
2. Enter one-half of line 1 .....	2.	<b>5,250</b>
3. Enter the total of the amounts from Form 1040, lines 7, 8a, 9a, 10 through 12, 13a, 14, 15b, 16b, 17 through 19, and 21. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099 .....	3.	<b>32,328</b>
4. Enter the amount, if any, from Form 1040, line 8b .....	4.	<b>0</b>
5. Add lines 2, 3, and 4 .....	5.	<b>37,578</b>
6. Enter the total of the amounts from Form 1040, lines 23, 24, and 27 through 32a, plus any amount you entered on the dotted line next to line 33 .....	6.	<b>900</b>
7. Is the amount on line 6 less than the amount on line 5? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 6 from line 5 .....	7.	<b>36,678</b>
8. If you are: <input checked="" type="checkbox"/> Married filing jointly, enter \$32,000 <input type="checkbox"/> Single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter \$25,000 <input type="checkbox"/> Married filing separately and you lived with your spouse at any time in 2003, skip lines 8 through 15; multiply line 7 by 85% (.85) and enter the result on line 16. Then go to line 17	8.	<b>32,000</b>
9. Is the amount on line 8 less than the amount on line 7? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. You do not have to enter any amounts on lines 20a or 20b of Form 1040. <b>But</b> if you are married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter -0- on line 20b. Be sure you entered "D" to the right of the word "benefits" on line 20a. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 8 from line 7 .....	9.	<b>4,678</b>
10. Enter: \$12,000 if married filing jointly; \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003 .....	10.	<b>12,000</b>
11. Subtract line 10 from line 9. If zero or less, enter -0- .....	11.	<b>0</b>
12. Enter the <b>smaller</b> of line 9 or line 10 .....	12.	<b>4,678</b>
13. Enter one-half of line 12 .....	13.	<b>2,339</b>
14. Enter the <b>smaller</b> of line 2 or line 13 .....	14.	<b>2,339</b>
15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0- .....	15.	<b>0</b>
16. Add lines 14 and 15 .....	16.	<b>2,339</b>
17. Multiply line 1 by 85% (.85) .....	17.	<b>8,924</b>
18. <b>Taxable social security benefits.</b> Enter the <b>smaller</b> of line 16 or line 17 .....	18.	<b>2,339</b>
<ul style="list-style-type: none"> <li>• Enter the amount from line 1 above on Form 1040, line 20a.</li> <li>• Enter the amount from line 18 above on Form 1040, line 20b.</li> </ul>		



If part of your benefits are taxable for 2003 **and** they include benefits paid in 2003 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

Comprehensive Problem 2

2003 Form 1040, page 1

Form <b>1040</b>	Department of the Treasury—Internal Revenue Service <b>U.S. Individual Income Tax Return 2003</b>	(99) IRS Use Only—Do not write or staple in this space.																																																																		
<b>Label</b> (See instructions on page 21.) <b>Use the IRS label.</b> Otherwise, please print or type. <b>Presidential Election Campaign</b> (See page 21.)	For the year Jan. 1–Dec. 31, 2003, or other tax year beginning _____, 2003, ending _____, 20____	OMB No. 1545-0074																																																																		
	Your first name and initial Jay	Last name Lehigh	Your social security number XXX XX XXXX																																																																	
	If a joint return, spouse's first name and initial Sandra	Last name Lehigh	Spouse's social security number XXX XX XXXX																																																																	
	Home address (number and street). If you have a P.O. box, see page 21. 99 Danville		Apt. no.																																																																	
City, town or post office, state, and ZIP code. If you have a foreign address, see page 21. Your City, State Zip Code		<b>Important!</b> You <b>must</b> enter your SSN(s) above.																																																																		
<b>Note.</b> 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 <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No      Spouse <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No																																																																				
<b>Filing Status</b> Check only one box.	1 <input type="checkbox"/> Single 2 <input checked="" 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.		5 <input type="checkbox"/> Qualifying widow(er) with dependent child. (See page 21.)																																																																		
<b>Exemptions</b> If more than five dependents, see page 22.	6a <input checked="" type="checkbox"/> <b>Yourself.</b> 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 checked="" type="checkbox"/> <b>Spouse</b>		No. of boxes checked on 6a and 6b: 2																																																																		
c <b>Dependents:</b>		No. of children on 6c who: • lived with you _____ • did not live with you due to divorce or separation (see page 22) _____ Dependents on 6c not entered above _____																																																																		
<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 25%;">(1) First name</th> <th style="width: 25%;">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: 20%;">(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 22)</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 22)					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>	Add numbers on lines above: 2																																				
(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 22)																																																																
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<b>Income</b> 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 23. Enclose, but do not attach, any payment. Also, please use Form 1040-V.	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%;">7 Wages, salaries, tips, etc. Attach Form(s) W-2</td> <td style="width: 10%;">7</td> <td style="width: 20%;"></td> </tr> <tr> <td>8a Taxable interest. Attach Schedule B if required</td> <td>8a</td> <td></td> </tr> <tr> <td>b Tax-exempt interest. Do not include on line 8a</td> <td>8b</td> <td></td> </tr> <tr> <td>9a Ordinary dividends. Attach Schedule B if required</td> <td>9a</td> <td></td> </tr> <tr> <td>b Qualified dividends (see page 25)</td> <td>9b</td> <td></td> </tr> <tr> <td>10 Taxable refunds, credits, or offsets of state and local income taxes (see page 25)</td> <td>10</td> <td></td> </tr> <tr> <td>11 Alimony received</td> <td>11</td> <td></td> </tr> <tr> <td>12 Business income or (loss). Attach Schedule C or C-EZ</td> <td>12</td> <td style="text-align: right;">6,000 00</td> </tr> <tr> <td>13a Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/></td> <td>13a</td> <td style="text-align: right;">7,820 00</td> </tr> <tr> <td>b If box on 13a is checked, enter post-May 5 capital gain distributions</td> <td>13b</td> <td></td> </tr> <tr> <td>14 Other gains or (losses). Attach Form 4797</td> <td>14</td> <td></td> </tr> <tr> <td>15a IRA distributions</td> <td>15a</td> <td></td> </tr> <tr> <td>b Taxable amount (see page 25)</td> <td>15b</td> <td></td> </tr> <tr> <td>16a Pensions and annuities</td> <td>16a</td> <td></td> </tr> <tr> <td>b Taxable amount (see page 25)</td> <td>16b</td> <td style="text-align: right;">18,945 00</td> </tr> <tr> <td>17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E</td> <td>17</td> <td></td> </tr> <tr> <td>18 Farm income or (loss). Attach Schedule F</td> <td>18</td> <td></td> </tr> <tr> <td>19 Unemployment compensation</td> <td>19</td> <td></td> </tr> <tr> <td>20a Social security benefits</td> <td>20a</td> <td style="text-align: right;">14,263 00</td> </tr> <tr> <td>b Taxable amount (see page 27)</td> <td>20b</td> <td style="text-align: right;">3,737 00</td> </tr> <tr> <td>21 Other income. List type and amount (see page 29)</td> <td>21</td> <td></td> </tr> <tr> <td>22 Add the amounts in the far right column for lines 7 through 21. This is your <b>total income</b></td> <td>22</td> <td style="text-align: right;">36,502 00</td> </tr> </table>		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		9a Ordinary dividends. Attach Schedule B if required	9a		b Qualified dividends (see page 25)	9b		10 Taxable refunds, credits, or offsets of state and local income taxes (see page 25)	10		11 Alimony received	11		12 Business income or (loss). Attach Schedule C or C-EZ	12	6,000 00	13a Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13a	7,820 00	b If box on 13a is checked, enter post-May 5 capital gain distributions	13b		14 Other gains or (losses). Attach Form 4797	14		15a IRA distributions	15a		b Taxable amount (see page 25)	15b		16a Pensions and annuities	16a		b Taxable amount (see page 25)	16b	18,945 00	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	14,263 00	b Taxable amount (see page 27)	20b	3,737 00	21 Other income. List type and amount (see page 29)	21		22 Add the amounts in the far right column for lines 7 through 21. This is your <b>total income</b>	22	36,502 00
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For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 76.

Cat. No. 11320B

Form **1040** (2003)

# PENSION EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

2003 Form 1040, page 2

Form 1040 (2003)		Page <b>2</b>
<b>Tax and Credits</b>	<p><b>35</b> Amount from line 34 (adjusted gross income) . . . . . <b>35</b> 36,078 00</p> <p><b>36a</b> Check <input checked="" type="checkbox"/> <b>You</b> were born before January 2, 1939, <input type="checkbox"/> <b>Blind.</b> } <b>Total boxes</b> if: <input checked="" type="checkbox"/> <b>Spouse</b> was born before January 2, 1939, <input type="checkbox"/> <b>Blind.</b> } <b>checked</b> ▶ <b>36a</b> <span style="border: 1px solid black; padding: 2px;">2</span></p> <p><b>b</b> If you are married filing separately and your spouse itemizes deductions, or you were a dual-status alien, see page 34 and check here . . . . . ▶ <b>36b</b> <input type="checkbox"/></p> <p><b>37</b> <b>Itemized deductions</b> (from Schedule A) or your <b>standard deduction</b> (see left margin) . . . . . <b>37</b> 11,400 00</p> <p><b>38</b> Subtract line 37 from line 35 . . . . . <b>38</b> 24,678 00</p> <p><b>39</b> If line 35 is \$104,625 or less, multiply \$3,050 by the total number of exemptions claimed on line 6d. If line 35 is over \$104,625, see the worksheet on page 35 . . . . . <b>39</b> 6,100 00</p> <p><b>40</b> <b>Taxable income.</b> Subtract line 39 from line 38. If line 39 is more than line 38, enter -0- . . . . . <b>40</b> 18,578 00</p> <p><b>41</b> <b>Tax</b> (see page 36). Check if any tax is from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972 . . . . . <b>41</b> 2,086 00</p> <p><b>42</b> <b>Alternative minimum tax</b> (see page 37). Attach Form 6251 . . . . . <b>42</b></p> <p><b>43</b> Add lines 41 and 42 . . . . . ▶ <b>43</b> 2,086 00</p> <p><b>44</b> Foreign tax credit. Attach Form 1116 if required . . . . . <b>44</b></p> <p><b>45</b> Credit for child and dependent care expenses. Attach Form 2441 . . . . . <b>45</b></p> <p><b>46</b> Credit for the elderly or the disabled. Attach Schedule R . . . . . <b>46</b></p> <p><b>47</b> Education credits. Attach Form 8863 . . . . . <b>47</b></p> <p><b>48</b> Retirement savings contributions credit. Attach Form 8880 . . . . . <b>48</b></p> <p><b>49</b> Child tax credit (see page 39) . . . . . <b>49</b></p> <p><b>50</b> Adoption credit. Attach Form 8839 . . . . . <b>50</b></p> <p><b>51</b> Credits from: <b>a</b> <input type="checkbox"/> Form 8396 <b>b</b> <input type="checkbox"/> Form 8859 . . . . . <b>51</b></p> <p><b>52</b> Other credits. Check applicable box(es): <b>a</b> <input type="checkbox"/> Form 3800 <b>b</b> <input type="checkbox"/> Form 8801 <b>c</b> <input type="checkbox"/> Specify . . . . . <b>52</b></p> <p><b>53</b> Add lines 44 through 52. These are your <b>total credits</b> . . . . . <b>53</b> 0 00</p> <p><b>54</b> Subtract line 53 from line 43. If line 53 is more than line 43, enter -0- . . . . . ▶ <b>54</b> 2086 00</p>	
<b>Other Taxes</b>	<p><b>55</b> Self-employment tax. Attach Schedule SE . . . . . <b>55</b> 848 00</p> <p><b>56</b> Social security and Medicare tax on tip income not reported to employer. Attach Form 4137 . . . . . <b>56</b></p> <p><b>57</b> Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required . . . . . <b>57</b></p> <p><b>58</b> Advance earned income credit payments from Form(s) W-2 . . . . . <b>58</b></p> <p><b>59</b> Household employment taxes. Attach Schedule H . . . . . <b>59</b></p> <p><b>60</b> Add lines 54 through 59. This is your <b>total tax</b> . . . . . ▶ <b>60</b> 2934 00</p>	
<b>Payments</b>	<p><b>61</b> Federal income tax withheld from Forms W-2 and 1099 . . . . . <b>61</b> 1,895 00</p> <p><b>62</b> 2003 estimated tax payments and amount applied from 2002 return . . . . . <b>62</b></p> <p><b>63</b> <b>Earned income credit (EIC)</b> . . . . . <b>63</b></p> <p><b>64</b> Excess social security and tier 1 RRTA tax withheld (see page 56) . . . . . <b>64</b></p> <p><b>65</b> Additional child tax credit. Attach Form 8812 . . . . . <b>65</b></p> <p><b>66</b> Amount paid with request for extension to file (see page 56) . . . . . <b>66</b></p> <p><b>67</b> Other payments from: <b>a</b> <input type="checkbox"/> Form 2439 <b>b</b> <input type="checkbox"/> Form 4136 <b>c</b> <input type="checkbox"/> Form 8885 . . . . . <b>67</b></p> <p><b>68</b> Add lines 61 through 67. These are your <b>total payments</b> . . . . . ▶ <b>68</b> 1,895 00</p>	
<b>Refund</b>	<p><b>69</b> If line 68 is more than line 60, subtract line 60 from line 68. This is the amount you <b>overpaid</b> . . . . . <b>69</b></p> <p><b>70a</b> Amount of line 69 you want <b>refunded to you</b> . . . . . ▶ <b>70a</b></p> <p>Direct deposit? See page 56 and fill in 70b, 70c, and 70d.</p> <p>▶ <b>b</b> Routing number <input type="text"/> ▶ <b>c</b> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings</p> <p>▶ <b>d</b> Account number <input type="text"/> <input type="text"/></p> <p><b>71</b> Amount of line 69 you want <b>applied to your 2004 estimated tax</b> . . . . . ▶ <b>71</b></p>	
<b>Amount You Owe</b>	<p><b>72</b> <b>Amount you owe.</b> Subtract line 68 from line 60. For details on how to pay, see page 57 . . . . . ▶ <b>72</b> 1,039 00</p> <p><b>73</b> Estimated tax penalty (see page 57) . . . . . <b>73</b></p>	
<b>Third Party Designee</b>	<p>Do you want to allow another person to discuss this return with the IRS (see page 58)? <input type="checkbox"/> <b>Yes.</b> Complete the following. <input checked="" type="checkbox"/> <b>No</b></p> <p>Designee's name ▶ _____ Phone no. ▶ ( ) _____ Personal identification number (PIN) ▶ <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/></p>	
<b>Sign Here</b>	<p>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.</p> <p>Your signature _____ Date / / _____ Your occupation _____ Daytime phone number ( ) _____</p> <p>Spouse's signature. If a joint return, <b>both</b> must sign. _____ Date / / _____ Spouse's occupation _____</p>	
<b>Paid Preparer's Use Only</b>	<p>Preparer's signature ▶ _____ Date / / _____ Check if self-employed <input type="checkbox"/> Preparer's SSN or PTIN PXX-XX-XXXX</p> <p>Firm's name (or yours if self-employed), address, and ZIP code ▶ _____ EIN _____ Phone no. ( ) _____</p>	

Form 1040 (2003)

# PENSION EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

2003 Schedule C-EZ, page 1

**SCHEDULE C-EZ  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

Name of proprietor

**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

**2003**

Attachment  
Sequence No. **09A**

Sandra Leigh

Social security number (SSN)

xxx xx xxxx

**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-4 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  
Day Care

**B** Enter code from pages C-7, 8, & 9

▶ 6 2 4 4 1 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**

<b>1</b>	<b>Gross receipts. Caution.</b> If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <b>Statutory Employees</b> in the instructions for Schedule C, line 1, on page C-3 and check here . . . . .	<input type="checkbox"/>	<b>1</b>	6,000
<b>2</b>	<b>Total expenses</b> (see instructions). If more than \$2,500, you <b>must</b> use Schedule C . . . . .		<b>2</b>	
<b>3</b>	<b>Net profit.</b> Subtract line 2 from line 1. If less than zero, you <b>must</b> use Schedule C. Enter on <b>Form 1040, line 12</b> , and <b>also</b> on <b>Schedule SE, line 2</b> . (Statutory employees <b>do not</b> report this amount on Schedule SE, line 2. Estates and trusts, enter on Form 1041, line 3.) . . . . .		<b>3</b>	6,000

**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 2003, 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) 2003

# PENSION EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

2003 Schedule SE

**SCHEDULE SE  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Self-Employment Tax**

▶ Attach to Form 1040. ▶ See Instructions for Schedule SE (Form 1040).

OMB No. 1545-0074

**2003**

Attachment  
Sequence No. **17**

Name of person with self-employment income (as shown on Form 1040)

Sandra Leigh

Social security number of person with self-employment income ▶

xxx : xx : xxxx

**Who Must File Schedule SE**

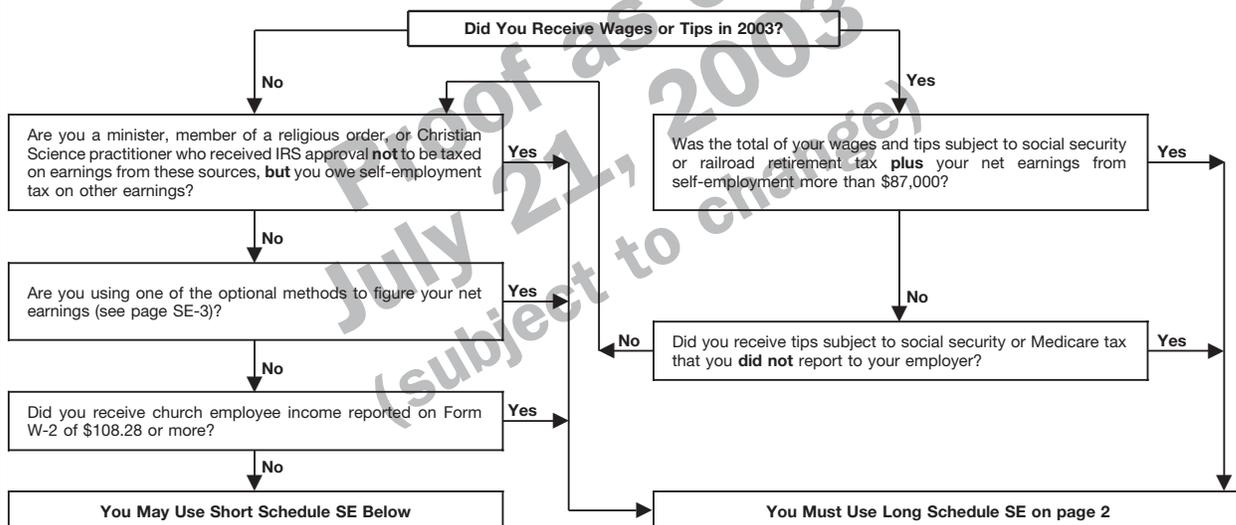
You must file Schedule SE if:

- 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 55.

**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	6,000	00
3	Combine lines 1 and 2	3	6,000	00
4	<b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax ▶	4	5,541	00
5	<b>Self-employment tax.</b> If the amount on line 4 is: <ul style="list-style-type: none"> <li>• \$87,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 55.</b></li> <li>• More than \$87,000, multiply line 4 by 2.9% (.029). Then, add \$10,788.00 to the result. Enter the total here and on <b>Form 1040, line 55.</b></li> </ul>	5	848	00
6	<b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 28</b>	6	424	00

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11358Z

Schedule SE (Form 1040) 2003

# PENSION EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

2003 Schedule D, page 1

**SCHEDULE D  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**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

**2003**

Attachment  
Sequence No. **12**

Name(s) shown on Form 1040

Your social security number

Jay and Sandra Lehigh

xxx xx xxxx

**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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
<b>1</b>						
<b>2</b> Enter your short-term totals, if any, from Schedule D-1, line 2 . . . . .	<b>2</b>					
<b>3 Total short-term sales price amounts.</b> Add lines 1 and 2 in column (d) . . . . .	<b>3</b>					
<b>4</b> Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . .	<b>4</b>					
<b>5</b> Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .	<b>5</b>					
<b>6</b> Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2002 Capital Loss Carryover Worksheet . . . . .	<b>6</b>				( )	
<b>7a</b> Combine lines 1 through 5 in column (g). If the result is a loss, enter the result. Otherwise, enter -0-. Do not enter more than zero . . . . .	<b>7a</b>					( )
<b>b Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (f) . . . . .	<b>7b</b>					

**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) for the entire year Subtract (e) from (d)	(g) Post-May 5 gain or (loss)* (see below)
<b>8</b>						
100 sh. ABC Inc	12/01/85	07/15/03	5,124 00	2,400 00	2,724 00	2,724 00
200 sh. XYZ Inc	12/20/87	11/14/03	10,796 00	5,700 00	5,096 00	5,096 00
<b>9</b> Enter your long-term totals, if any, from Schedule D-1, line 9 . . . . .	<b>9</b>					
<b>10 Total long-term sales price amounts.</b> Add lines 8 and 9 in column (d) . . . . .	<b>10</b>		105 22			
<b>11</b> 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 . . . . .	<b>11</b>					
<b>12</b> Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .	<b>12</b>					
<b>13</b> Capital gain distributions. See page D-1 of the instructions . . . . .	<b>13</b>					
<b>14</b> Long-term capital loss carryover. Enter the amount, if any, from line 13 of your 2002 Capital Loss Carryover Worksheet . . . . .	<b>14</b>				( )	
<b>15</b> Combine lines 8 through 13 in column (g). If zero or less, enter -0- . . . . .	<b>15</b>					7,820 00
<b>16 Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.	<b>16</b>				7,820 00	

\*Include in column (g) all gains and losses from column (f) from sales, exchanges, or conversions (including installment payments received) after May 5, 2003. However, do not include gain attributable to unrecaptured section 1250 gain, "collectibles gains and losses" (as defined on page D-6 of the instructions) or 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) 2003

# PENSION EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

Schedule D (Form 1040) 2003

Page **2**

### Part III Taxable Gain or Deductible Loss

<b>17a</b> Combine lines 7b and 16 and enter the result. If a loss, enter -0- on line 17b and go to line 18. If a gain, enter the gain on Form 1040, line 13a, and go to line 17b below . . . . .	<b>17a</b>	7,820	00
<b>b</b> Combine lines 7a and 15. If zero or less, enter -0-. Then complete Form 1040 through line 40 . . . . .	<b>17b</b>	7,820	00
<b>Next:</b> • If both lines 16 and 17a of Schedule D are gains <b>or</b> you have qualified dividends on Form 1040, line 9b, complete <b>Part IV</b> below (unless Form 1040, line 40, is zero). • Otherwise, skip the rest of Schedule D and complete Form 1040.			
<b>18</b> If line 17a is a loss, enter here and on Form 1040, line 13a, the <b>smaller</b> of <b>(a)</b> that loss or <b>(b)</b> (\$3,000) (or, if married filing separately, (\$1,500)) (see page D-6 of the instructions) . . . . .	<b>18</b>	(	)
<b>Next:</b> • If you have qualified dividends on Form 1040, line 9b, complete Form 1040 through line 40, and then complete <b>Part IV</b> below (but skip lines 19 and 20). • Otherwise, skip <b>Part IV</b> below and complete the rest of Form 1040.			

### Part IV Tax Computation Using Maximum Capital Gains Rates

If line 16 or line 17a is zero or less, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.

<b>19</b> Enter your unrecaptured section 1250 gain, if any, from line 18 of the worksheet on page D-6 . . . . .	<b>19</b>		
<b>20</b> Enter your 28% rate gain, if any, from line 7 of the worksheet on page D-9 of the instructions . . . . .	<b>20</b>		
<b>If lines 19 and 20 are zero, go to line 21. Otherwise, complete the worksheet on page D-10 of the instructions to figure the amount to enter on lines 35 and 53 below, and skip all other lines below.</b>			
<b>21</b> Enter your taxable income from Form 1040, line 40 . . . . .	<b>21</b>	18,578	00
<b>22</b> Enter the <b>smaller</b> of line 16 or line 17a, but not less than zero . . . . .	<b>22</b>	7,820	00
<b>23</b> Enter your qualified dividends from Form 1040, line 9b . . . . .	<b>23</b>		
<b>24</b> Add lines 22 and 23 . . . . .	<b>24</b>	7,820	00
<b>25</b> Amount from line 4g of Form 4952 (investment interest expense) . . . . .	<b>25</b>		
<b>26</b> Subtract line 25 from line 24. If zero or less, enter -0- . . . . .	<b>26</b>	7,820	00
<b>27</b> Subtract line 26 from line 21. If zero or less, enter -0- . . . . .	<b>27</b>	10,758	00
<b>28</b> Enter the <b>smaller</b> of line 21 <b>or:</b> • \$56,800 if married filing jointly or qualifying widow(er); • \$28,400 if single or married filing separately; or • \$38,050 if head of household . . . . .	<b>28</b>	18,578	00
<b>If line 27 is more than line 28, skip lines 29–39 and go to line 40.</b>			
<b>29</b> Enter the amount from line 27 . . . . .	<b>29</b>	10,758	00
<b>30</b> Subtract line 29 from line 28. If zero or less, go to line 40 . . . . .	<b>30</b>	7,820	00
<b>31</b> Add lines 17b and 23* . . . . .	<b>31</b>	7,820	00
<b>32</b> Enter the <b>smaller</b> of line 30 or line 31 . . . . .	<b>32</b>	7,820	00
<b>33</b> Multiply line 32 by 5% (.05) . . . . .	<b>33</b>	391	00
<b>If lines 30 and 32 are the same, skip lines 34–39 and go to line 40.</b>			
<b>34</b> Subtract line 32 from line 30 . . . . .	<b>34</b>		
<b>35</b> Enter your qualified 5-year gain, if any, from line 8 of the worksheet on page D-8 . . . . .	<b>35</b>		
<b>36</b> Enter the <b>smaller</b> of line 34 or line 35 . . . . .	<b>36</b>		
<b>37</b> Multiply line 36 by 8% (.08) . . . . .	<b>37</b>		
<b>38</b> Subtract line 36 from line 34 . . . . .	<b>38</b>		
<b>39</b> Multiply line 38 by 10% (.10) . . . . .	<b>39</b>		
<b>If lines 26 and 30 are the same, skip lines 40–49 and go to line 50.</b>			
<b>40</b> Enter the <b>smaller</b> of line 21 or line 26 . . . . .	<b>40</b>		
<b>41</b> Enter the amount from line 30 (if line 30 is blank, enter -0-) . . . . .	<b>41</b>		
<b>42</b> Subtract line 41 from line 40 . . . . .	<b>42</b>		
<b>43</b> Add lines 17b and 23* . . . . .	<b>43</b>		
<b>44</b> Enter the amount from line 32 (if line 32 is blank, enter -0-) . . . . .	<b>44</b>		
<b>45</b> Subtract line 44 from line 43 . . . . .	<b>45</b>		
<b>46</b> Enter the <b>smaller</b> of line 42 or line 45 . . . . .	<b>46</b>		
<b>47</b> Multiply line 46 by 15% (.15) . . . . .	<b>47</b>		
<b>48</b> Subtract line 46 from line 42 . . . . .	<b>48</b>		
<b>49</b> Multiply line 48 by 20% (.20) . . . . .	<b>49</b>		
<b>50</b> Figure the tax on the amount on <b>line 27</b> . Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	<b>50</b>	1,078	00
<b>51</b> Add lines 33, 37, 39, 47, 49, and 50 . . . . .	<b>51</b>	1,469	00
<b>52</b> Figure the tax on the amount on <b>line 21</b> . Use the Tax Table or Tax Rate Schedules, whichever applies . . . . .	<b>52</b>	2,086	00
<b>53 Tax on all taxable income.</b> Enter the <b>smaller</b> of line 51 or line 52 here and on Form 1040, line 41 . . . . .	<b>53</b>	1,469	00

\*If line 25 is more than zero, see **Lines 31 and 43** on page D-9 for the amount to enter. Printed on recycled paper **Schedule D (Form 1040) 2003**

# PENSION EARNER COMPREHENSIVE PROBLEMS

## ANSWERS TO PROBLEMS

### Social Security Benefits Worksheet.

**Before you begin:**

- ✓ Complete Form 1040, lines 21, 23, 24, and 27 through 32a, if they apply to you.
- ✓ Figure any amount to be entered on the dotted line next to line 33 (see page 32.)
- ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2003, enter "D" to the right of the word "benefits" on line 20a.
- ✓ Be sure you have read the **Exception** on page 26 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 <b>box 5</b> of all your <b>Forms SSA-1099</b> and <b>Forms RRB-1099</b> . . . . .	1.	<u>14,263</u>	
2. Enter one-half of line 1 . . . . .	2.	<u>7,132</u>	
3. Enter the total of the amounts from Form 1040, lines 7, 8a, 9a, 10 through 12, 13a, 14, 15b, 16b, 17 through 19, and 21. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099 . . . . .	3.	<u>32,765</u>	
4. Enter the amount, if any, from Form 1040, line 8b . . . . .	4.	<u>0</u>	
5. Add lines 2, 3, and 4 . . . . .	5.	<u>39,897</u>	
6. Enter the total of the amounts from Form 1040, lines 23, 24, and 27 through 32a, plus any amount you entered on the dotted line next to line 33 . . . . .	6.	<u>424</u>	
7. Is the amount on line 6 less than the amount on line 5? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 6 from line 5 . . . . .	7.	<u>39,473</u>	
8. If you are: <ul style="list-style-type: none"> <li>• Married filing jointly, enter \$32,000</li> <li>• Single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter \$25,000</li> <li>• Married filing separately and you lived with your spouse at any time in 2003, skip lines 8 through 15; multiply line 7 by 85% (.85) and enter the result on line 16. Then go to line 17</li> </ul>	8.	<u>32,000</u>	
9. Is the amount on line 8 less than the amount on line 7? <input type="checkbox"/> <b>No.</b> None of your social security benefits are taxable. You do not have to enter any amounts on lines 20a or 20b of Form 1040. <b>But</b> if you are married filing separately and you <b>lived apart</b> from your spouse for all of 2003, enter -0- on line 20b. Be sure you entered "D" to the right of the word "benefits" on line 20a. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract line 8 from line 7 . . . . .	9.	<u>7,473</u>	
10. Enter: \$12,000 if married filing jointly; \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you <b>lived apart</b> from your spouse for all of 2003	10.	<u>12,000</u>	
11. Subtract line 10 from line 9. If zero or less, enter -0- . . . . .	11.	<u>0</u>	
12. Enter the <b>smaller</b> of line 9 or line 10 . . . . .	12.	<u>7,473</u>	
13. Enter one-half of line 12 . . . . .	13.	<u>3,737</u>	
14. Enter the <b>smaller</b> of line 2 or line 13 . . . . .	14.	<u>3,737</u>	
15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0- . . . . .	15.	<u>0</u>	
16. Add lines 14 and 15 . . . . .	16.	<u>3,737</u>	
17. Multiply line 1 by 85% (.85) . . . . .	17.	<u>12,124</u>	
18. <b>Taxable social security benefits.</b> Enter the <b>smaller</b> of line 16 or line 17 . . . . . <ul style="list-style-type: none"> <li>• Enter the amount from line 1 above on Form 1040, line 20a.</li> <li>• Enter the amount from line 18 above on Form 1040, line 20b.</li> </ul>	18.	<u>3,737</u>	



If part of your benefits are taxable for 2003 **and** they include benefits paid in 2003 that were for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

In lesson 15, 16, 17 and 18 we will discuss information about tax situations specific to military and international taxpayers. The topics to be covered are:

**Foreign Earned Income Exclusion:** The foreign earned income exclusion is voluntary and your students' responsibility will include providing taxpayers information about the exclusion and assisting them in claiming it.

**Tax Options for Combat Zone Participants:** Military personnel serving in combat zones have special tax benefits/options. These benefits are discussed in this lesson.

**Aliens:** Discussions will focus on the importance of "alien" status in determining federal income tax reporting requirements for Armed Forces personnel.

**Home Leave:** Certain expenses incurred while taxpayers travel to their home in the United States under orders from the head of a Foreign Affairs agency are deductible. These expenses are discussed in this lesson.

### GUIDED QUESTIONS – FOREIGN EARNED INCOME EXCLUSION

#### 1. What is the Bona Fide Resident Test?

The person must set up permanent residence in a foreign country and be there for an uninterrupted period that includes an entire tax year.

#### 2. If the person is using the Physical Presence Test how many days must they be in the foreign country?

The person must be in the foreign country for 330 days of a twelve consecutive months period.

#### 3. If a taxpayer finds out about the foreign income exclusion after they file their return, and they meet all the requirements can they file an amended return?

No, the election to file the Form 2555EZ or Form 2555 is only available on an original timely filed return and you cannot amend a return to claim the exclusion.

## ***GUIDED QUESTIONS – TAX OPTIONS FOR COMBAT ZONE PARTICIPANTS***

**1. How does a person determine if the decedent's family qualifies for the Combat Zone Forgiveness?**

- The person's death was the result of wounds, disease, or injury incurred while in a combat zone. The combat zone is an area that was designated by the President of the U.S. by Executive Order as a combat zone (discussed in Chapter 2).

**2. How does the decedent's family claim a refund because the person's death was either in a combat zone, or the result of Military or Terroristic actions?**

- They must attach, to the Federal Income Tax Return, a Form 1310, Statement of Person Claiming Refund Due to Deceased Taxpayer and attach a statement to it from either the Department of Defense (DOD Form 1300) or U.S. Department of State with the pertinent information.

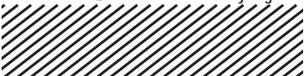
## ***GUIDED QUESTION FOR ALIEN ISSUES***

**1. When is it most common to have a Dual-Status Alien situation?**

- The year someone enters the U.S. or the year the person leaves the U.S. is when you would most likely encounter that type of situation.

**2. What should a parent do for tax purposes if their child is born while they are stationed abroad?**

- Seek assistance from the Legal Assistance Office and/or the Embassy. Information is also available on [www.irs.gov](http://www.irs.gov).



# FOREIGN EARNED INCOME EXCLUSION

Lesson 15  
Military Segment

## INTRODUCTION AND OBJECTIVES

This lesson will discuss the *foreign earned income exclusion*. Certain taxpayers can exclude income earned in foreign countries. For 2003, the maximum exclusion amount is \$80,000. However, the foreign earned income exclusion **does not apply** to wages and salaries of military and civilian employees of the U.S. Government. Employees of the U.S. Government, include those who work at Armed Forces post exchanges, officers' and enlisted personnel clubs, and embassy commissaries. Other foreign income earned by military personnel for their spouses may be eligible for the exclusion.

To qualify for the foreign earned income exclusion, the taxpayer's tax home must be in a foreign country throughout your period of stay. This lesson will explain this requirement.

**After completing this lesson, you should be able to:**

- Determine whether the taxpayer qualifies for the foreign earned income exclusion.
- Calculate the foreign earned income exclusion.

## REQUIREMENTS TO QUALIFY FOR THE FOREIGN EARNED INCOME EXCLUSION

There are two requirements to qualify for the foreign earned income exclusion. First, the taxpayer must show that his or her **tax home** is in a foreign country. ("Foreign country" does not include Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, or U.S. possessions such as America Samoa, Wake Island, the Midway Islands and Johnston Island.) The second requirement is that the taxpayer must meet either the **bona fide residence test** or the **physical presence test**.

### Exercise 1

Miranda has lived in Puerto Rico since 1998. Is she eligible for the foreign earned income exclusion?

Answer \_\_\_\_\_

The requirements are applied separately to each individual. If a husband and wife are each working overseas, each must meet both requirements, to apply the exclusion. If they do so, each is entitled to an exclusion of up to \$80,000 (on qualified income) for 2003. **(Remember military pay is not eligible for the exclusion.)**

**Tax Home.** To claim the foreign earned income exclusion, the taxpayer's home must be in a foreign country. Generally, one's tax home is the area of the taxpayer's main place of business, employment or post of duty, regardless of where the taxpayer maintains his or her family home. If the taxpayer does not have a regular place of business because of the nature of the work, their tax home is the place where they regularly live.

**Military Note:** The tax home for military personnel is the permanent duty station, either land based or on a ship. This is true whether it is feasible or permissible for the taxpayer's family to live with him or her. **Generally, most military personnel and their dependents will not qualify for the Foreign Earned Income Exclusion.**

### Example 1

John and Mary are both in the armed forces and have been permanently stationed in Germany since August 2001. Their tax home for 2003 would be Germany.

### Exercise 2

Alan has lived and worked in China since August 16, 1999. For 2003, what country is his tax home?

Answer \_\_\_\_\_

When the taxpayer has a tax home in the U.S. and goes overseas temporarily, or on business, the tax home has not changed. If the taxpayer is assigned overseas on business for an indefinite period, the tax home is overseas and the taxpayer may be eligible for the foreign earned income exclusion.

The law provides that the taxpayer will not be treated as temporarily away from home if the employment away from home exceeds one year. Therefore the person will generally be considered to have a tax home in a foreign country if the employment in the foreign country will be for more than one year. However for purposes of the foreign earned income exclusion a person will not be considered to have a tax home in a foreign country for any time during which his abode is in the United States.

## ***DETERMINING THE REGULAR PLACE OF ABODE***

Three questions are important in showing whether or not a U.S. home is the regular place of abode. The questions that you should ask the taxpayer are:

1. Did you use your home in the United States as a residence while you worked at your job in the United States just before going abroad to your new job, and did you continue to maintain



work contacts, job seeking, leave of absence, ongoing business, etc.) in that area in the United States during the time you worked abroad?

2. Are your living expenses duplicated at the U.S. and foreign home because your work requires you to be away from your U.S. home?
3. Do you have a family member or members continuing to live at your U.S. home, or do you frequently use your U.S. home for lodging during the period you work abroad?

If the taxpayer **cannot** answer “yes” to at least two of these three questions, the taxpayer will be considered indefinitely assigned to the new location abroad. Thus, since the tax home is abroad, no expenses for travel, meals, or lodging while there are deductible. However, one may be able to exclude earnings from income under the foreign earned income exclusion rules.

If he/she realistically expects the job to last, and it does last, less than 1 year and that he/she will return to the U.S. home, and can answer “yes” to all three questions, the taxpayer is considered temporarily away from home. The taxpayer does not qualify for the foreign earned income exclusion, but may qualify to deduct away-from-home expenses.

If the taxpayer can answer “yes” to two of the questions, with the same expectation of job duration and return to the U.S. home, the location of the tax home depends on all the facts and circumstances.

### Example 2

Henry is in the Armed Forces. He was assigned to a post in Japan in 2003. This assignment was for an indefinite period. Margaret, his wife, accompanied him to Japan and has foreign earned income. Their tax home for 2003 would be Japan.

**Period of Stay.** Another qualification for the exclusion is the length of time the taxpayer stays overseas. This requirement can be satisfied in one of two ways.

The taxpayer must be:

1. A U.S. citizen or resident alien from a tax treaty country who is a **bona fide resident** of a foreign country (or countries) for an uninterrupted period that includes an entire tax year, or
2. A U.S. citizen or U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.



### Exercise 3

Jennifer is a U.S. citizen who has lived in Israel since October 1, 2003. She expects to return to the U.S. in May, 2004. Does she meet either period of stay test?

Answer \_\_\_\_\_

**Bona Fide Resident Test.** To meet the test, the taxpayer must show that he or she has set up permanent quarters in a foreign country. The period must be for an uninterrupted period that includes an entire tax year. Taking a brief trip to the U.S. will not prevent the taxpayer from being a bona fide resident, as long as the intention is clear to return to the foreign country.

### Example 3

Jane is a military spouse who has lived in England since 1999. Her mother still lives in the U.S. Jane came to the U.S. for two weeks in 2003 to be with her mother after she had surgery. Jane's trip to the U.S. does not affect her status as a bona fide resident of a foreign country.

**Physical Presence Test.** The other test that may be met instead of the bona fide residence test is the physical presence test. To qualify, the taxpayer must be physically present in a foreign country 330 full days during a period of twelve consecutive months.

In order for a day to count for the test, it must be a full day in a foreign country. When arriving from the U.S., or returning to the U.S., any day in which part of the time is spent in the U.S. or over international waters does not count as a qualifying day in a foreign country.

The taxpayer may move about from one place to another in a foreign country, or to another foreign country without losing full days. But if any part of the taxpayer's travel is not within a foreign country or countries and takes 24 hours or more, the taxpayer will lose full days.

### Example 4

The taxpayer leaves Southampton, England, by ship at 10:00 p.m. on July 6 and arrives in Lisbon at 6:00 a.m. on July 8. Since the trip takes more than 24 hours, the taxpayer loses as full days, July 6, 7, and 8. If the taxpayer remains in Lisbon, the first full day is July 9.



#### Exercise 4

Shauntell is using the twelve months of 2003 to determine if she qualifies for the physical presence test. She arrived in Kenya on January 3, 2003 and worked there until August 12, 2003 when she returned to the U.S. for 6 weeks. On October 1, 2003 she returned to Kenya and worked there until she permanently returned to the U.S. on January 1, 2004. Does she meet the physical presence test for 2003?

Answer \_\_\_\_\_

**Figuring the 12 Month Period.** Any 12-month period may be used if the 330 days in a foreign country fall within that period. If necessary, more than one period may be used, including periods that overlap. By using more than one period, it may be possible to meet the physical presence test for an entire stay, even though there may have been intervening visits to the U.S.

**Waiver of Time Requirements.** The minimum time requirements for period of stay may be waived, if the taxpayer is forced to leave a foreign country because of war, civil unrest, or similar adverse conditions in that country. The taxpayer must show that he/she could have met the minimum time requirements if it had not been for the adverse conditions.

### *QUALIFYING INCOME*

To qualify for the exclusion, income must be **earned income**. Examples of earned income are salaries, wages, commissions and professional fees. Earned income does not include dividends, interest, capital gains, alimony, social security benefits, pensions or annuities. To qualify for the exclusion, the earned income must be for services (other than military or U.S. government) performed in a foreign country.

Amounts paid by the United States or its agencies to its employees **do not qualify** for the exclusion. This includes military pay and payment for such activities as post exchanges, commissaries, and officers clubs.

#### Example 5

Maria, a U.S. resident, is in the armed forces and has lived in Lisbon since 1999. Her military pay is not eligible for the foreign earned income exclusion. In her spare time, she is a self-employed DJ in Lisbon and the surrounding area. The income from her self-employment may qualify for the exclusion.

**Source of earned income.** The source of earned income is the place where the services are performed. To qualify for the exclusion, services must be performed in a foreign country. Where the payments come from for the service or where they are deposited is not a factor in the determining source of the income. If a taxpayer



works predominantly in a foreign country, but does some work in the U.S., an adjustment must be made to the total of foreign earned income.

### Example 6

Charles Thompson works and lives in the Bahamas. After vacation, he worked 50 weeks in 2003. For one week, he attended a business meeting in Florida.  $1/50$  or 2% of his wages are not foreign earned income, because that week was spent working in Florida.

### Exercise 5

Maurice is stationed in Germany. His only income is from his U.S. military salary. Does he qualify for the foreign earned income exclusion?

Answer \_\_\_\_\_

### Exercise 6

Juanita lives in Scotland. She is retired and her income consists of U.S. Social Security, a pension and several stock dividends. Does she qualify for the foreign earned income exclusion?

Answer \_\_\_\_\_

### Exercise 7

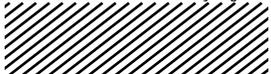
Jose and Kim live in a foreign country. Jose has wages from the U.S. military. Kim has wages from a bank that she works at in the foreign country. Do they have qualifying income for the foreign earned income exclusion?

Answer \_\_\_\_\_

## CHOOSING THE EXCLUSION

The foreign earned income exclusion is voluntary. (There are times when it may be to the taxpayer's advantage to not claim the exclusion. An example is that a taxpayer may not claim the Earned Income Tax Credit, if foreign income is excluded.) The initial choice of the exclusion on Form 2555 or Form 2555EZ must be filed with a timely return (including extensions). Exceptions do apply that allow the initial choice to be made after a return is filed. Taxpayers who wish to take advantage of these exceptions should seek professional tax assistance.

The taxpayer may revoke the election for any tax year. When the exclusion is revoked, the taxpayer may not claim the exclusion again for the next five tax years without the approval of the IRS.



If the taxpayer is qualified to, and wishes to claim the foreign earned income exclusion, it is necessary to complete Form 2555 or 2555EZ and attach it to Form 1040. The tax return should be filed with Internal Revenue Service Processing Campus, Philadelphia, PA, 19255.

To be able to use Form 2555EZ, the taxpayer must be a U.S. citizen or resident alien who has wages and salaries, but not self-employment income. The total foreign earned income must be \$80,000 or less, and the person cannot be claiming any business or moving expenses. Taxpayers, who do not meet these restrictions, should file Form 2555 to claim the credit.

### Example 7

Michael and his wife Melissa have been stationed in Hong Kong since 2001. Michael is employed by the armed forces. Melissa operates a home day care business. Their tax home is Hong Kong. They meet the physical presence test. Melissa wants to exclude her self-employment income from U.S. taxation.

She will need to complete Form 2555 instead of Form 2555EZ, because her income is from self-employment.

### Exercise 8

Assuming that the following taxpayers meet the period of stay test, should they file a Form 2555, or Form 2555EZ?

- a.** Mallory has \$34,000 of foreign earned income. She has no other income. Which form should she file?

Answer \_\_\_\_\_

- b.** Jacob has U.S. military wages and self-employment income he earned in a foreign country. Which form should he file?

Answer \_\_\_\_\_

- c.** Ramie has \$86,000 of foreign earned income. Which form should he file?

Answer \_\_\_\_\_

Taxpayers, who are eligible to file Form 2555EZ, should complete all four sections of the form.

On the following two pages, you will find a blank copy of Form 2555EZ for your reference.



Form **2555-EZ**

# Foreign Earned Income Exclusion

OMB No. 1545-1326

**2003**

Department of the Treasury  
Internal Revenue Service (99)

▶ See separate instructions. ▶ Attach to Form 1040.

Attachment  
Sequence No. **34A**

Name shown on Form 1040

Your social security number

### You May Use This Form If You:

- Are a U.S. citizen or a resident alien.
- Earned wages/salaries in a foreign country.
- Had total foreign earned income of \$80,000 or less.
- Are filing a calendar year return that covers a 12-month period.

### And You:

- Do not have self-employment income.
- Do not have business/moving expenses.
- Do not claim the foreign housing exclusion or deduction.

## Part I Tests To See If You Can Take the Foreign Earned Income Exclusion

### 1 Bona Fide Residence Test

- a Were you a bona fide resident of a foreign country or countries for a period that includes an entire tax year (see page 2 of the instructions)?  Yes  No
- If you answered "Yes," you meet this test. Fill in line 1b and then go to line 3.
  - If you answered "No," you **do not** meet this test. Go to line 2 to see if you meet the Physical Presence Test.
- b Enter the date your bona fide residence began ▶ \_\_\_\_\_, and ended (see instructions) ▶ \_\_\_\_\_.

### 2 Physical Presence Test

- a Were you physically present in a foreign country or countries for at least 330 full days during—  
 { 2003 or any other period of 12 months in a row starting or ending in 2003? }  Yes  No
- If you answered "Yes," you meet this test. Fill in line 2b and then go to line 3.
  - If you answered "No," you **do not** meet this test. You **cannot** take the exclusion unless you meet the Bona Fide Residence Test above.
- b The physical presence test is based on the 12-month period from ▶ \_\_\_\_\_ through ▶ \_\_\_\_\_.

### 3 Tax Home Test. Was your tax home in a foreign country or countries throughout your period of bona fide residence or physical presence, whichever applies?

- Yes  No
- If you answered "Yes," you can take the exclusion. Complete Part II below and then go to page 2.
  - If you answered "No," you **cannot** take the exclusion. **Do not** file this form.

## Part II General Information

4 Your foreign address (including country)

5 Your occupation

6 Employer's name

7 Employer's U.S. address (including ZIP code)

8 Employer's foreign address

9 Employer is (check any that apply):

- a A U.S. business
- b A foreign business
- c Other (specify) ▶ \_\_\_\_\_

10a If you filed Form 2555 or 2555-EZ after 1981, enter the last year you filed the form. ▶ \_\_\_\_\_

b If you did not file Form 2555 or 2555-EZ after 1981, check here  and go to line 11a now.

c Have you ever revoked the foreign earned income exclusion?  Yes  No

d If you answered "Yes," enter the tax year for which the revocation was effective. ▶ \_\_\_\_\_

11a List your tax home(s) during 2003 and date(s) established. ▶ \_\_\_\_\_

b Of what country are you a citizen/national? ▶ \_\_\_\_\_

For Paperwork Reduction Act Notice, see page 3 of separate instructions.

Cat. No. 13272W

Form **2555-EZ** (2003)

**Part III Days Present in the United States**—Complete this part if you were in the United States or its possessions during 2003.

12	(a) Date arrived in U.S.	(b) Date left U.S.	(c) Number of days in U.S. on business	(d) Income earned in U.S. on business (attach computation)

**Part IV Figure Your Foreign Earned Income Exclusion**

13	Maximum foreign earned income exclusion . . . . .	13	\$80,000	00
14	Enter the number of days in your qualifying period that fall within 2003 . . . . .	14	days	
15	Did you enter 365 on line 14? <input type="checkbox"/> <b>Yes.</b> Enter "1.000." <input type="checkbox"/> <b>No.</b> Divide line 14 by 365 and enter the result as a decimal (rounded to at least three places).	15	×	.
16	Multiply line 13 by line 15 . . . . .	16		
17	Enter, in U.S. dollars, the total foreign earned income you earned and received in 2003 (see instructions). Be sure to include this amount on Form 1040, line 7 . . . . .	17		
18	<b>Foreign earned income exclusion.</b> Enter the <b>smaller</b> of line 16 or line 17 here and in parentheses on <b>Form 1040, line 21</b> . Next to the amount enter "2555-EZ." On Form 1040, subtract this amount from your income to arrive at total income on Form 1040, line 22 . . . . . ▶	18		



For those who must file Form 2555, the first section of the form is for general information, and must be completed by all taxpayers who claim the exclusion.

Taxpayers who claim the bona fide residence test must complete Part II of Form 2555. Taxpayers who qualify under the physical presence test must complete Part III.

Part IV, completed by all taxpayers, is where foreign earned income is listed. It must be completed in U.S. dollars. If the taxpayer has difficulty in converting income, IRS can provide exchange rates to be used. However, the taxpayer is not required to use only rates provided by the IRS or the federal government. Note that earned income includes not only wages and salaries but also non-cash income and allowances and reimbursements received by the taxpayer.

**Military Note:** Do not list military wages in this section; they are not considered foreign earned income.

Page 3 of the form is where the exclusion is computed. Taxpayers claiming only the basic exclusion fill out Parts V and VII. Most of the lines are self-explanatory. The concept of qualifying period is essential. For those qualifying under the bona fide residence test, this qualifying period is the period of actual residence. For the physical presence test, the qualifying period or periods is chosen by the taxpayer. Any period may be chosen as long as 330 days are spent in a foreign country during the period.

**Military Note:** Generally, armed forces personnel and their spouses will not qualify for the housing exclusion (the housing allowance is already considered non-taxable income).

On the following three pages, you will find a blank Form 2555 for your reference.



Form **2555**  
Department of the Treasury  
Internal Revenue Service (99)

**Foreign Earned Income**

OMB No. 1545-0067

**2003**

Attachment  
Sequence No. **34**

▶ See separate instructions. ▶ Attach to Form 1040.

**For Use by U.S. Citizens and Resident Aliens Only**

Name shown on Form 1040

Your social security number

**Part I General Information**

- 1 Your foreign address (including country) \_\_\_\_\_
- 2 Your occupation \_\_\_\_\_
- 3 Employer's name ▶ \_\_\_\_\_
- 4a Employer's U.S. address ▶ \_\_\_\_\_
- 4b Employer's foreign address ▶ \_\_\_\_\_
- 5 Employer is (check ▶):
  - a  A foreign entity
  - b  A U.S. company
  - c  Self
  - d  A foreign affiliate of a U.S. company
  - e  Other (specify) ▶ \_\_\_\_\_
- 6a If, after 1981, you filed Form 2555 to claim either of the exclusions or Form 2555-EZ to claim the foreign earned income exclusion, enter the last year you filed the form. ▶ \_\_\_\_\_
- 6b If you did not file Form 2555 or 2555-EZ after 1981 to claim either of the exclusions, check here ▶  and go to line 7.
- 6c Have you ever revoked either of the exclusions? . . . . .  Yes  No
- 6d If you answered "Yes," enter the type of exclusion and the tax year for which the revocation was effective. ▶ \_\_\_\_\_
- 7 Of what country are you a citizen/national? ▶ \_\_\_\_\_
- 8a Did you maintain a separate foreign residence for your family because of adverse living conditions at your tax home? See **Second foreign household** on page 3 of the instructions . . . . .  Yes  No
- 8b If "Yes," enter city and country of the separate foreign residence. Also, enter the number of days during your tax year that you maintained a second household at that address. ▶ \_\_\_\_\_
- 9 List your tax home(s) during your tax year and date(s) established. ▶ \_\_\_\_\_

**Next, complete either Part II or Part III. If an item does not apply, enter "NA." If you do not give the information asked for, any exclusion or deduction you claim may be disallowed.**

**Part II Taxpayers Qualifying Under Bona Fide Residence Test** (See page 2 of the instructions.)

- 10 Date bona fide residence began ▶ \_\_\_\_\_, and ended ▶ \_\_\_\_\_
  - 11 Kind of living quarters in foreign country ▶ a  Purchased house b  Rented house or apartment c  Rented room  
d  Quarters furnished by employer
  - 12a Did any of your family live with you abroad during any part of the tax year? . . . . .  Yes  No
  - 12b If "Yes," who and for what period? ▶ \_\_\_\_\_
  - 13a Have you submitted a statement to the authorities of the foreign country where you claim bona fide residence that you are not a resident of that country? (See instructions.) . . . . .  Yes  No
  - 13b Are you required to pay income tax to the country where you claim bona fide residence? (See instructions.)  Yes  No
- If you answered "Yes" to 13a and "No" to 13b, you do not qualify as a bona fide resident. Do not complete the rest of this part.**
- 14 If you were present in the United States or its possessions during the tax year, complete columns (a)-(d) below. **Do not** include the income from column (d) in Part IV, but report it on Form 1040.

(a) Date arrived in U.S.	(b) Date left U.S.	(c) Number of days in U.S. on business	(d) Income earned in U.S. on business (attach computation)	(a) Date arrived in U.S.	(b) Date left U.S.	(c) Number of days in U.S. on business	(d) Income earned in U.S. on business (attach computation)

- 15a List any contractual terms or other conditions relating to the length of your employment abroad. ▶ \_\_\_\_\_
- 15b Enter the type of visa under which you entered the foreign country. ▶ \_\_\_\_\_
- 15c Did your visa limit the length of your stay or employment in a foreign country? If "Yes," attach explanation  Yes  No
- 15d Did you maintain a home in the United States while living abroad? . . . . .  Yes  No
- 15e If "Yes," enter address of your home, whether it was rented, the names of the occupants, and their relationship to you. ▶ \_\_\_\_\_

For Paperwork Reduction Act Notice, see page 4 of separate instructions.

Cat. No. 11900P

Form **2555** (2003)

**Part III Taxpayers Qualifying Under Physical Presence Test** (See page 2 of the instructions.)

- 16 The physical presence test is based on the 12-month period from ► ..... through ► .....
- 17 Enter your principal country of employment during your tax year. ► .....
- 18 If you traveled abroad during the 12-month period entered on line 16, complete columns (a)–(f) below. Exclude travel between foreign countries that did not involve travel on or over international waters, or in or over the United States, for 24 hours or more. If you have no travel to report during the period, enter “Physically present in a foreign country or countries for the entire 12-month period.” **Do not** include the income from column (f) below in Part IV, but report it on Form 1040.

(a) Name of country (including U.S.)	(b) Date arrived	(c) Date left	(d) Full days present in country	(e) Number of days in U.S. on business	(f) Income earned in U.S. on business (attach computation)

**Part IV All Taxpayers**

**Note:** Enter on lines 19 through 23 all income, including noncash income, you earned and actually or constructively received during your 2003 tax year for services you performed in a foreign country. If any of the foreign earned income received this tax year was earned in a prior tax year, or will be earned in a later tax year (such as a bonus), see the instructions. **Do not** include income from line 14, column (d), or line 18, column (f). Report amounts in U.S. dollars, using the exchange rates in effect when you actually or constructively received the income.

**If you are a cash basis taxpayer, report on Form 1040 all income you received in 2003, no matter when you performed the service.**

2003 Foreign Earned Income		Amount (in U.S. dollars)	
19	Total wages, salaries, bonuses, commissions, etc. . . . .	19	
20	Allowable share of income for personal services performed (see instructions):	20a	
	a In a business (including farming) or profession . . . . .	20b	
	b In a partnership. List partnership’s name and address and type of income. ► .....		
21	Noncash income (market value of property or facilities furnished by employer—attach statement showing how it was determined):		
	a Home (lodging) . . . . .	21a	
	b Meals . . . . .	21b	
	c Car . . . . .	21c	
	d Other property or facilities. List type and amount. ► .....	21d	
22	Allowances, reimbursements, or expenses paid on your behalf for services you performed:		
	a Cost of living and overseas differential . . . . .	22a	
	b Family . . . . .	22b	
	c Education . . . . .	22c	
	d Home leave . . . . .	22d	
	e Quarters . . . . .	22e	
	f For any other purpose. List type and amount. ► .....	22f	
	g Add lines 22a through 22f . . . . .	22g	
23	Other foreign earned income. List type and amount. ► .....	23	
24	Add lines 19 through 21d, line 22g, and line 23 . . . . .	24	
25	Total amount of meals and lodging included on line 24 that is excludable (see instructions) . . . . .	25	
26	Subtract line 25 from line 24. Enter the result here and on line 27 on page 3. This is your <b>2003 foreign earned income</b> . . . . .	26	

**Part V All Taxpayers**

27 Enter the amount from line 26 . . . . .	27		
Are you claiming the housing exclusion or housing deduction?			
<input type="checkbox"/> <b>Yes.</b> Complete Part VI.			
<input type="checkbox"/> <b>No.</b> Go to Part VII.			

**Part VI Taxpayers Claiming the Housing Exclusion and/or Deduction**

28 Qualified housing expenses for the tax year (see instructions) . . . . .	28		
29 Number of days in your qualifying period that fall within your 2003 tax year (see instructions) . . . . .	29	days	
30 Multiply \$30.77 by the number of days on line 29. If 365 is entered on line 29, enter \$11,233.00 here	30		
31 Subtract line 30 from line 28. If the result is zero or less, do not complete the rest of this part or any of Part IX . . . . .	31		
32 Enter employer-provided amounts (see instructions) . . . . .	32		
33 Divide line 32 by line 27. Enter the result as a decimal (rounded to at least three places), but do not enter more than "1.000" . . . . .	33	× .	
34 <b>Housing exclusion.</b> Multiply line 31 by line 33. Enter the result but do not enter more than the amount on line 32. Also, complete Part VIII . . . . . ▶	34		

**Note:** The housing deduction is figured in Part IX. If you choose to claim the foreign earned income exclusion, complete Parts VII and VIII before Part IX.

**Part VII Taxpayers Claiming the Foreign Earned Income Exclusion**

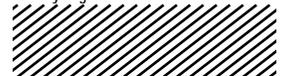
35 Maximum foreign earned income exclusion . . . . .	35	\$80,000	00
36 • If you completed Part VI, enter the number from line 29. • All others, enter the number of days in your qualifying period that fall within your 2003 tax year (see the instructions for line 29). } . . . . .	36	days	
37 • If line 36 and the number of days in your 2003 tax year (usually 365) are the same, enter "1.000." • Otherwise, divide line 36 by the number of days in your 2003 tax year and enter the result as a decimal (rounded to at least three places). } . . . . .	37	× .	
38 Multiply line 35 by line 37 . . . . .	38		
39 Subtract line 34 from line 27 . . . . .	39		
40 <b>Foreign earned income exclusion.</b> Enter the <b>smaller</b> of line 38 or line 39. Also, complete Part VIII ▶	40		

**Part VIII Taxpayers Claiming the Housing Exclusion, Foreign Earned Income Exclusion, or Both**

41 Add lines 34 and 40 . . . . .	41		
42 Deductions allowed in figuring your adjusted gross income (Form 1040, line 34) that are allocable to the excluded income. See instructions and attach computation . . . . .	42		
43 Subtract line 42 from line 41. Enter the result here and in parentheses on <b>Form 1040, line 21.</b> Next to the amount enter "Form 2555." On Form 1040, subtract this amount from your income to arrive at total income on Form 1040, line 22 . . . . . ▶	43		

**Part IX Taxpayers Claiming the Housing Deduction—Complete this part only if (a) line 31 is more than line 34 and (b) line 27 is more than line 41.**

44 Subtract line 34 from line 31 . . . . .	44		
45 Subtract line 41 from line 27 . . . . .	45		
46 Enter the <b>smaller</b> of line 44 or line 45 . . . . .	46		
<b>Note:</b> If line 45 is <b>more than</b> line 46 and you could not deduct all of your 2002 housing deduction because of the 2002 limit, use the worksheet on page 4 of the instructions to figure the amount to enter on line 47. Otherwise, go to line 48.			
47 Housing deduction carryover from 2002 (from worksheet on page 4 of the instructions) . . . . .	47		
48 <b>Housing deduction.</b> Add lines 46 and 47. Enter the total here and on Form 1040 to the left of line 33. Next to the amount on Form 1040, enter "Form 2555." Add it to the total adjustments reported on that line . . . . . ▶	48		



Although the exclusion may never be more than the foreign earned income, it may be less. The exclusion can be no more than \$80,000. If the number of qualifying days in the tax year is less than 365, the \$80,000 limit is lowered proportionally.

### Example 8

Tina York is claiming the exclusion. Her qualifying period is March 15, 2002 to March 14, 2003. On line 36 of Form 2555, Tina enters 73 days because 73 days of her qualifying period fall in the 2003 tax year.

On line 37, she divides 73 by 365, and enters the result, “.200.”

On line 38, \$80,000 is multiplied by .200, which results in \$16,000.”

Exhibit 6

Form 2555, lines 35-40

Part VII Taxpayers Claiming the Foreign Earned Income Exclusion			
35	Maximum foreign earned income exclusion . . . . .	35	\$80,000 00
36	<ul style="list-style-type: none"> <li>If you completed Part VI, enter the number from line 29.</li> <li>All others, enter the number of days in your qualifying period that fall within your 2003 tax year (see the instructions for line 29).</li> </ul>	36	73 days
37	<ul style="list-style-type: none"> <li>If line 36 and the number of days in your 2003 tax year (usually 365) are the same, enter “1.000.”</li> <li>Otherwise, divide line 36 by the number of days in your 2003 tax year and enter the result as a decimal (rounded to at least three places).</li> </ul>	37	× .200
38	Multiply line 35 by line 37 . . . . .	38	\$16,000 00
39	Subtract line 34 from line 27 . . . . .	39	
40	Foreign earned income exclusion. Enter the smaller of line 38 or line 39. Also, complete Part VIII ▶	40	

Regardless of how much foreign earned income Tina had, her exclusion can be no more than \$16,000.

## DEDUCTIONS ALLOCABLE TO EXCLUDED INCOME

In section VIII of Form 2555, the taxpayer is required to list the deductions allowed in figuring adjusted gross income that are allocable to the excluded income. To the extent a deduction that is allocable to the excluded income is claimed, the exclusion must be reduced by the deduction.

The three most common deductions that may affect the exclusion are **self-employment tax**, **itemized deductions** and **moving expenses**.

**1. Self-Employment Tax.** The taxpayer must take all earned income into account in figuring self-employment tax, even though the income is exempt from income tax because of the foreign earned income exclusion.

An individual is allowed a deduction for one-half of self-employment tax on the Form 1040. This deduction is related to the operation of the business. If foreign earned income is excluded, the deduction for S.E. tax must be allocated to the excluded income. The amount allocated to the excluded income reduces the Foreign Earned Income exclusion allowed.



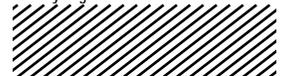
The following formula is used to determine the amount of the deduction allocable to excluded income:

$$\frac{\text{Excluded Earned Income}}{\text{Qualifying Earned Income}} \times \text{Self-Employment Tax Deduction (From Form 1040, Line 28)}$$

When the qualifying earned income is fully excluded, none of the self-employment tax deduction is allowed; therefore the full amount of this deduction is put on line 42 of Form 2555. This will reduce your Foreign Earned Income exclusion by the amount of the deduction. However, the self-employment tax deduction is still entered on line 28 of Form 1040.

- 2. Itemized Deductions.** The treatment for itemized deductions is somewhat different. In reporting itemized deductions on Schedule A (Form 1040) that are wholly or partly allocable to excluded income, the taxpayer must reduce the gross deduction by the disallowed amount in arriving at the net deduction shown on Schedule A. Then the taxpayer attaches a statement showing how the deductible amount was figured and writes “Form 2555” in the upper right corner of Schedule A. The most common itemized deductions that are allocable to excluded foreign earned income are unreimbursed employee business expenses. The same formula, as presented above, is used to determine the amounts allocable to the excluded foreign income.
- 3. Moving Expenses.** The rules for deducting moving expenses allocable to excluded income are still more complex. In the year of the move, if the taxpayer has at least 120 days of his qualifying period during the tax year, the moving expense is allocated solely to the year of the move. If the taxpayer has less than 120 full days in the tax year, the moving expense is allocated to income in the year of the move, and the year after. Taxpayers affected by this provision may want to seek assistance from the IRS or a tax preparer.

After adjusting the exclusion for any deductions allocable to excluded income the net exclusion needs to be carried to Form 1040. The amount from Form 2555 EZ line 18 or Form 2555 line 43 is entered in parenthesis on Form 1040 line 21. It is subtracted from other sources of income.



## ▶▶ SUMMING UP THIS LESSON ◀◀

The foreign earned income exclusion does not apply to income from the U.S. government, regardless of the tax home. The exclusion can be up to \$80,000 for income earned in a foreign country. It is necessary to complete either Form 2555 or 2555EZ to claim the exclusion.

In this lesson, we have discussed the basic examples of the exclusion. When a taxpayer has a more complex situation, he or she will need to seek professional tax assistance.



# ***FOREIGN EARNED INCOME EXCLUSION***

## ***ANSWERS TO EXERCISES***

1. No, Puerto Rico is not considered a foreign country.
2. His 2003 tax home is China.
3. No.
4. No, she was not present in the foreign country for a full 330 days.
5. No, U.S. military pay is not eligible.
6. No, only earned income is eligible.
7. Yes, Kim's salary.
8.
  - a. Form 2555EZ
  - b. Form 2555
  - c. Form 2555

## ***SUMMARY EXERCISES***

1. List the two forms that the foreign earned income exclusion can be claimed on.
2. Is a taxpayer required to take the exclusion on foreign earned income?
3. Are military wages eligible for the foreign earned income exclusion?
4. Complete the form 2555EZ on the next two pages using the following information.

Robert (000-00-0001) and Sara (000-00-0002) Johnson (both U.S. citizens) have lived in Germany since August, 2002. Robert is employed by the U.S. Armed Forces. In 2003, Sara worked at a local bakery (Gulden's, 349028 Gulden Lane, Munich, Germany) in Germany and earned the equivalent of \$12,000. Robert and Sara do not consider themselves bona fide residents of Germany. During 2003, they resided in Germany for the full year, except for a three day vacation period in France. Their address in Germany is 239084 Marzolf Lane, Munich, Germany. They have never claimed the foreign earned income exclusion before.



Form **2555-EZ**

**Foreign Earned Income Exclusion**

Department of the Treasury  
Internal Revenue Service (99)

▶ See separate instructions. ▶ Attach to Form 1040.

OMB No. 1545-1326

**2003**

Attachment  
Sequence No. **34A**

Name shown on Form 1040

Your social security number

**You May Use This Form If You:**

- Are a U.S. citizen or a resident alien.
- Earned wages/salaries in a foreign country.
- Had total foreign earned income of \$80,000 or less.
- Are filing a calendar year return that covers a 12-month period.

**And You:**

- Do not have self-employment income.
- Do not have business/moving expenses.
- Do not claim the foreign housing exclusion or deduction.

**Part I Tests To See If You Can Take the Foreign Earned Income Exclusion**

**1 Bona Fide Residence Test**

- a Were you a bona fide resident of a foreign country or countries for a period that includes an entire tax year (see page 2 of the instructions)?  Yes  No
- If you answered "Yes," you meet this test. Fill in line 1b and then go to line 3.
  - If you answered "No," you **do not** meet this test. Go to line 2 to see if you meet the Physical Presence Test.
- b Enter the date your bona fide residence began ▶ \_\_\_\_\_, and ended (see instructions) ▶ \_\_\_\_\_.

**2 Physical Presence Test**

- a Were you physically present in a foreign country or countries for at least 330 full days during—  
 { 2003 or any other period of 12 months in a row starting or ending in 2003? }  Yes  No
- If you answered "Yes," you meet this test. Fill in line 2b and then go to line 3.
  - If you answered "No," you **do not** meet this test. You **cannot** take the exclusion unless you meet the Bona Fide Residence Test above.
- b The physical presence test is based on the 12-month period from ▶ \_\_\_\_\_ through ▶ \_\_\_\_\_.

**3 Tax Home Test.** Was your tax home in a foreign country or countries throughout your period of bona fide residence or physical presence, whichever applies?  Yes  No

- If you answered "Yes," you can take the exclusion. Complete Part II below and then go to page 2.
- If you answered "No," you **cannot** take the exclusion. **Do not** file this form.

**Part II General Information**

4 Your foreign address (including country) \_\_\_\_\_ 5 Your occupation \_\_\_\_\_

6 Employer's name \_\_\_\_\_ 7 Employer's U.S. address (including ZIP code) \_\_\_\_\_ 8 Employer's foreign address \_\_\_\_\_

- 9 Employer is (check any that apply):
- a A U.S. business
  - b A foreign business
  - c Other (specify) ▶ \_\_\_\_\_

- 10a If you filed Form 2555 or 2555-EZ after 1981, enter the last year you filed the form. ▶ \_\_\_\_\_
- b If you did not file Form 2555 or 2555-EZ after 1981, check here  and go to line 11a now.
- c Have you ever revoked the foreign earned income exclusion?  Yes  No
- d If you answered "Yes," enter the tax year for which the revocation was effective. ▶ \_\_\_\_\_

11a List your tax home(s) during 2003 and date(s) established. ▶ \_\_\_\_\_

b Of what country are you a citizen/national? ▶ \_\_\_\_\_

**Part III Days Present in the United States**—Complete this part if you were in the United States or its possessions during 2003.

12 (a) Date arrived in U.S.	(b) Date left U.S.	(c) Number of days in U.S. on business	(d) Income earned in U.S. on business (attach computation)

**Part IV Figure Your Foreign Earned Income Exclusion**

13	Maximum foreign earned income exclusion . . . . .	13	\$80,000	00
14	Enter the number of days in your qualifying period that fall within 2003 . . . . .	14	days	
15	Did you enter 365 on line 14? <input type="checkbox"/> <b>Yes.</b> Enter "1.000." <input type="checkbox"/> <b>No.</b> Divide line 14 by 365 and enter the result as a decimal (rounded to at least three places).	15	×	.
16	Multiply line 13 by line 15 . . . . .	16		
17	Enter, in U.S. dollars, the total foreign earned income you earned and received in 2003 (see instructions). Be sure to include this amount on Form 1040, line 7 . . . . .	17		
18	<b>Foreign earned income exclusion.</b> Enter the <b>smaller</b> of line 16 or line 17 here and in parentheses on <b>Form 1040, line 21</b> . Next to the amount enter "2555-EZ." On Form 1040, subtract this amount from your income to arrive at total income on Form 1040, line 22 . . . . . ▶	18		



# *FOREIGN EARNED INCOME EXCLUSION*

## *ANSWERS TO EXERCISES*

### *ANSWERS TO SUMMARY EXERCISE*

1. Form 2555 and Form 2555EZ.
2. No, it is voluntary.
3. No.
4. See the completed form on the next two pages.

# FOREIGN EARNED INCOME EXCLUSION

## ANSWERS TO EXERCISES

Form 2555EZ, page 1

Form <b>2555-EZ</b> Department of the Treasury Internal Revenue Service (99)	<b>Foreign Earned Income Exclusion</b> ▶ See separate instructions. ▶ Attach to Form 1040.	OMB No. 1545-1326 <b>2003</b> Attachment Sequence No. <b>34A</b> Your social security number 000 : 00 : 0001
Name shown on Form 1040 Robert & Sara Johnson		

- |   |                 |  |
|---|-----------------|--|
| <b>You May Use This Form If You:</b> <ul style="list-style-type: none"> <li>• Are a U.S. citizen or a resident alien.</li> <li>• Earned wages/salaries in a foreign country.</li> <li>• Had total foreign earned income of \$80,000 or less.</li> <li>• Are filing a calendar year return that covers a 12-month period.</li> </ul> | <b>And You:</b> | <ul style="list-style-type: none"> <li>• Do not have self-employment income.</li> <li>• Do not have business/moving expenses.</li> <li>• Do not claim the foreign housing exclusion or deduction.</li> </ul> |
|---|-----------------|--|

### Part I Tests To See If You Can Take the Foreign Earned Income Exclusion

- 1 Bona Fide Residence Test**
- a Were you a bona fide resident of a foreign country or countries for a period that includes an entire tax year (see page 2 of the instructions)?  Yes  No
- If you answered "Yes," you meet this test. Fill in line 1b and then go to line 3.
  - If you answered "No," you **do not** meet this test. Go to line 2 to see if you meet the Physical Presence Test.
- b Enter the date your bona fide residence began ▶ \_\_\_\_\_, and ended (see instructions) ▶ \_\_\_\_\_.
- 2 Physical Presence Test**
- a Were you physically present in a foreign country or countries for at least 330 full days during—  
 { 2003 or any other period of 12 months in a row starting or ending in 2003? }  Yes  No
- If you answered "Yes," you meet this test. Fill in line 2b and then go to line 3.
  - If you answered "No," you **do not** meet this test. You **cannot** take the exclusion unless you meet the Bona Fide Residence Test above.
- b The physical presence test is based on the 12-month period from ▶ 8/2002 through ▶ 12/31/03.
- 3 Tax Home Test.** Was your tax home in a foreign country or countries throughout your period of bona fide residence or physical presence, whichever applies?  Yes  No
- If you answered "Yes," you can take the exclusion. Complete Part II below and then go to page 2.
  - If you answered "No," you **cannot** take the exclusion. **Do not** file this form.

### Part II General Information

<b>4</b> Your foreign address (including country) 239084 Marzolf Lane Munich, Germany	<b>5</b> Your occupation Bakery Sales	
<b>6</b> Employer's name Gulden's Bakery	<b>7</b> Employer's U.S. address (including ZIP code)	<b>8</b> Employer's foreign address 349028 Gulden Lane Munich, Germany
<b>9</b> Employer is (check any that apply): a A U.S. business <input type="checkbox"/> b A foreign business <input checked="" type="checkbox"/> c Other (specify) ▶ _____ <input type="checkbox"/>		
<b>10a</b> If you filed Form 2555 or 2555-EZ after 1981, enter the last year you filed the form. ▶ _____ <b>b</b> If you did not file Form 2555 or 2555-EZ after 1981, check here ▶ <input checked="" type="checkbox"/> and go to line 11a now. <b>c</b> Have you ever revoked the foreign earned income exclusion? <input type="checkbox"/> Yes <input type="checkbox"/> No <b>d</b> If you answered "Yes," enter the tax year for which the revocation was effective. ▶ _____		
<b>11a</b> List your tax home(s) during 2003 and date(s) established. ▶ <u>8/2000</u> <u>239084 Marzolf Lane Munich, Germany</u> <b>b</b> Of what country are you a citizen/national? ▶ _____		

For Paperwork Reduction Act Notice, see page 3 of separate instructions. Cat. No. 13272W Form **2555-EZ** (2003)



**STUDENT NOTES**

Lined area for student notes.



# TAX OPTIONS FOR COMBAT ZONE PARTICIPANTS

Lesson 16  
Military Segment

## INTRODUCTION AND OBJECTIVES

This lesson will discuss some of the tax benefits that are available to Armed Services personnel serving in a combat zone. Service in the Persian Gulf area, the former Yugoslavia, Afghanistan and its airspace, and Yemen are eligible for combat zone tax treatment. In addition, U. S. military personnel located in the Federal Republic of Yugoslavia, Albania, the Adriatic Sea, and the northern Ionian Sea, including all of their air space in connection with the Kosovo operation, are eligible for combat zone tax treatment.

Members of the Armed Forces deployed overseas away from their permanent duty station in support of operations in a qualified hazardous duty area, but outside the qualified hazardous duty area, are treated as if they are in a combat zone solely for the purposes of the extension deadlines. These personnel are not entitled to other combat zone tax benefits. The IRS will not impose penalties or interest on members during an extension period.

After completing this lesson, you should be able to:

1. Determine who qualifies for an extension of deadline.
2. Identify special tax benefits that are available to persons who die in a combat zone or from a terrorist or military action.
3. Explain how to file claims for tax forgiveness for these individuals.

## EXTENSION OF DEADLINE

Members of the Armed Forces who served in a combat zone are allowed additional time to take care of tax matters. This extension also applies to any individual who is deployed from his or her permanent duty station in support of operations in a qualified hazardous duty area, or performing qualifying service outside the qualified hazardous duty area. The law provides that certain periods of time are disregarded when determining whether certain tax matters have been taken care of on time. For ease of understanding, this publication refers to these provisions as “extensions of deadlines.” These deadline extensions should not be confused with other parts of the tax law that refer to extensions of time for performing acts.

The deadline for filing tax returns, paying taxes, filing claims for refund, and taking other actions with the IRS is automatically extended if the taxpayer serves in the Armed Forces in a combat zone. The deadline for IRS to take certain actions, such as collection and examination actions, is also extended.

Additionally, if members of the Armed Forces are deployed overseas away from their permanent duty station in support of operations in a qualified hazardous duty area, but outside the qualified hazardous duty area, they also receive these extensions (but not other combat zone benefits). The deadline for IRS to take certain actions, such as collection and examination actions, is also extended. See Lesson 1 for the beginning dates for the Afghanistan area combat zone, the Kosovo area combat zone, the Persian Gulf area combat zone, and the qualified hazardous duty areas.

The deadline for taking actions with the IRS is extended for 180 days after the later of:

1. The last day the taxpayer is in a combat zone/qualified hazardous duty area or have qualifying service outside of the combat zone/qualified hazardous duty area (or the last day the area qualifies as a combat zone or qualified hazardous duty area), or
2. The last day of any continuous qualified hospitalization (defined later) for injury from service in the combat zone/qualified hazardous duty area or while performing qualifying service outside of the combat zone/qualified hazardous duty area.

In addition to the 180 days, the deadline is also extended by the number of days remaining for the member to take the action with the IRS when he/she entered a combat zone/qualified hazardous duty area (or began performing qualifying service outside the combat zone/qualified hazardous duty area). If a taxpayer entered the combat zone/qualified hazardous duty area (or began performing qualifying service outside the combat zone/qualified hazardous duty area) before the period of time to take the action began, the deadline is extended by the entire period of time he/she has to take the action.

### Example 1

Captain Margaret Jones entered Saudi Arabia on December 1, 2001. She remained there through March 31, 2003, when she departed for the United States. She was not injured and did not return to the combat zone. The deadlines for filing Captain Jones' 2001, 2002, and 2003 returns are figured as follows.

- **The 2001 tax return.** The deadline is January 10, 2004. This deadline is 285 days (180 plus 105) after Captain Jones' last day in the combat zone (March 31, 2003). The 105 additional days are the number of days in the 3 1/2 month filing period that were left when she entered the combat zone (January 1 - April 15, 2002).
- **The 2002 tax return.** The deadline is January 10, 2004. The deadline is 285 days (180 plus 105) after Capt. Jones' last day in the combat zone (March 31, 2003).
- **The 2003 tax return.** The deadline is not extended because the 180-day extension period after March 31, 2003, ends on September 27, 2003, which is before the start of the filing period for her 2003 return (January 1 - April 15, 2004).



## Example 2

Petty Officer Leonard Brown's ship entered the Persian Gulf on January 5, 2002. On February 15, 2002, Leonard was injured and was flown to a U. S. hospital. He remained in the hospital through April 20, 2003. The deadlines for filing Petty Officer Brown's 2001, 2002, and 2003 returns are figured as follows.

- **The 2001 tax return.** The deadline is January 27, 2004. Petty Officer Brown has 280 days (180 plus 100) after his last day in the hospital (April 21, 2003) to file his 2001 return. The 100 additional days are the number of days in the 3 1/2 month filing period that were left when he entered the combat zone (January 5 - April 15).
- **The 2002 tax return.** The deadline is January 27, 2004. Petty Officer Brown has 280 days (180 plus 100) after April 21, 2003, to file his 2002 tax return. The 100 additional days are the number of days in the 2003 filing period that were left when he entered the combat zone.
- **The 2003 tax return.** The deadline is not extended because the 180-day extension period after April 21, 2003, ends on October 18, 2003, which is before the start of the filing period for his 2003 return (January 1 - April 15, 2004).

## Example 3

You generally have 3 years from April 15, 1999, to file a claim for refund against your timely filed 1998 tax return. This means that your claim normally must be filed by April 15, 2002. However, if you served in a combat zone from November 1, 2001, through March 23, 2002, and were not injured, your deadline for filing that claim is extended 346 days (180 plus 166) after you leave the combat zone. This extends your deadline to March 4, 2003. The 166 additional days are the number of days in the 3-year period for filing the refund claim that were left when you entered the combat zone on November 1 (November 1, 2001 - April 15, 2002).

**Missing status.** Time in a missing status (missing in action or prisoner of war) counts as time in a combat zone or a qualified hazardous duty area.

**Support personnel.** The deadline extension provision also applies if a taxpayer is serving in a combat zone or a qualified hazardous duty area in support of the Armed Forces. This includes Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces in support of those forces.

**Qualified hospitalization.** The hospitalization must be the result of an injury received while serving in a combat zone or a qualified hazardous duty area. Qualified hospitalization means:

1. Any hospitalization outside the United States, and
2. Up to 5 years of hospitalization in the United States.



## Actions Extended

The actions to which the deadline extension provision applies include:

- Filing any return of income, estate, or gift tax (except employment and withholding taxes),
- Paying any income, estate, or gift tax (except employment and withholding taxes),
- Filing a petition with the Tax Court for redetermination of a deficiency or for review of a Tax Court decision,
- Filing a claim for credit or refund of any tax,
- Bringing suit for any claim for credit or refund,
- Making a qualified retirement contribution to an IRA,
- Allowing a credit or refund of any tax by IRS,
- Assessment of any tax by the IRS,
- Giving or making any notice or demand by the IRS for the payment of any tax or for any liability for any tax,
- Collection by the IRS of any tax due, and
- Bringing suit by the United States for any tax due.

If the IRS takes any actions covered by these provisions or sends the taxpayer a notice of examination before learning that they are entitled to an extension of the deadline, the taxpayer should contact their legal assistance office. No penalties or interest will be imposed for failure to file a return or pay taxes during the extension period.

**Spouses.** Spouses of individuals who served in a combat zone are entitled to the same deadline extension with two exceptions.

1. The extension does not apply to a spouse for any tax year beginning more than 2 years after the date the area ceases to be a combat zone.
2. The extension does not apply to a spouse for any period the qualifying individual is hospitalized in the United States for injuries incurred in a combat zone.

**Not in a combat zone.** Reservists called to active duty or regular military member who are not in a combat zone may still qualify to defer the payment of back taxes. To qualify, these individuals must:

- Be serving their initial period of service and
- Show that their ability to pay the back taxes has been materially impaired.

**Initial period of service.** The initial period of service is defined as the period of active duty following recall to active duty from an inactive reserve or National Guard unit. For regular military personnel, it is the period following induction or first enlistment in the Armed Forces or the first period of reenlistment for a person who



has been out of the service for a year or more. For an officer, the initial period of service is limited to two years of active service after one of the above occurrences.

**Material impairment.** To indicate material impairment, the taxpayer must show that his or her income dropped as a result of going into military service.

**Request for deferment.** Military members who have a current payment agreement or who have received a notice requesting payment must make a written request for deferment to the IRS office where you have the agreement.

**Information needed.** The request for deferment must include the member's name, social security number, monthly income and source of income before military service, current monthly income, military rank, date of entry into the military service, and date the member is eligible for discharge. Enclosing a copy of the military orders is helpful.

The IRS will review each request and advise the taxpayer in writing of its decision. Should the taxpayer need further assistance, they can call the IRS at **1-800-829-1040** to discuss their situation. If the IRS grants the request for deferment, the taxpayer will be able to defer payment of back taxes until 6 months after the end of his/her initial period of service.

## DECEDENTS

Special tax forgiveness provisions apply to individuals who:

- Die while serving in a combat zone or from wounds, disease, or injury incurred while serving in a combat zone, or
- Die from wounds or injury incurred in a terrorist or military action while a U. S. employee.

### Filing a Decedent Return

The personal representative (executor, administrator, or anyone who is in charge of the decedent's property) must file the final income tax return (Form 1040) of the decedent for the year of death and any returns not filed for preceding years. A surviving spouse, under certain circumstances, may have to file the returns for the decedent. See *Joint Return*, later.

**Return for preceding year.** If an individual died after the close of the tax year, but before the return for that year was filed, the return for the year just closed will not be the final return. The return for that year will be a regular return and the personal representative must file it.

#### Example 4

Samantha Smith died on March 21, 2002, before filing her 2001 tax return. Her personal representative must file her 2001 return by April 15, 2002. Her final tax return is due April 15, 2003.

## When and Where To File

The final income tax return is due at the same time the decedent's return would have been due had death not occurred. A final return for a decedent who was a calendar year taxpayer is generally due on April 15 following the year of death, regardless of when during that year death occurred.

The tax return must be prepared on a form for the year of death regardless of when during the year death occurred.

Generally, you must file the final income tax return of the decedent with the Internal Revenue Service center for the place where you live. A tax return for a decedent cannot be electronically filed. A paper tax return must be filed for the decedent.

## Combat Zone Forgiveness

Federal income tax liability is forgiven for U. S. military personnel who die while serving in a combat zone or as a result of wounds, disease, or injury incurred while so serving. The forgiveness of tax applies for the year of death and for any prior year ending on or after the first day that the individual served in a combat zone in active service. Any forgiven tax liability that has already been paid will be refunded, and any unpaid tax liability at the date of death will be forgiven.

This forgiveness provision also applies to a member of the Armed Forces serving outside the combat zone if the service:

1. Was in direct support of military operations in the zone, and
2. Qualified the member for special military pay for duty subject to hostile fire or imminent danger.

**Missing status.** The date of death for a member of the Armed Forces who was in a missing status (missing in action or prisoner of war) is the date his or her name is removed from missing status for military pay purposes. This is true even if death actually occurred earlier.

## Tax Forgiveness for Deaths Due to Military or Terroristic Actions

A decedent's income tax liability may be forgiven if his or her death was due to service in a combat zone or to military or terroristic actions.

*The Victims of Terrorism Tax Relief Act of 2001 provides tax relief for those injured or killed as a result of terrorist attacks, certain survivors of those killed as a result of terrorist attacks, and others who were affected by terrorist attacks. For information on that Act, see Publication 3920.*



## Military or Terroristic Actions

The decedent's income tax liability is forgiven if, at death, he or she was a military or civilian employee of the United States who died because of wounds or injury incurred:

- While a U. S. employee, and
- In a military or terroristic action.

*For tax years ending after September 10, 2001, tax liability is forgiven for an individual who dies from wounds or injury incurred while a U. S. employee in a terroristic or military action regardless of where the action occurred.*

The forgiveness applies to the tax year in which death occurred and for any prior tax year in the period beginning with the year before the year in which the wounds or injury occurred.

**Military or terroristic action defined.** A military or terroristic action means the following.

- Any terroristic activity that most of the evidence indicates was directed against the United States or any of its allies.
- Any military action involving the U. S. Armed Forces and resulting from violence or aggression against the United States or any of its allies, or the threat of such violence or aggression.

Military action does not include training exercises. Any multinational force in which the United States is participating is treated as an ally of the United States.

## Claims for Credit or Refund

If any of these tax-forgiveness situations applies to a prior year tax, any tax paid for which the period for filing a claim has not ended will be credited or refunded. If any tax is still due, it will be canceled. The normal period for filing a claim for credit or refund is 3 years after the return was filed or 2 years after the tax was paid, whichever is later.

If death occurred in a combat zone or from wounds, disease, or injury incurred in a combat zone, the period for filing the claim is extended by:

- The amount of time served in the combat zone (including any period in which the individual was in missing status), plus
- The period of continuous qualified hospitalization for injury from service in the combat zone, if any, plus
- The next 180 days.
- Qualified hospitalization means any hospitalization outside the United States and any hospitalization in the United States of not more than 5 years.

**Filing a claim.** Use the following procedures to file a claim.

- File Form 1040, 1040A, or 1040EZ if an income tax return has not been filed for the tax year. Form W-2, *Wage and Tax Statement*, must accompany all returns.
- File Form 1040X if an income tax return has been filed. A separate Form 1040X must be filed for each year in question.

These returns and claims must be filed with the Internal Revenue Service, P. O. Box 4053, Woburn, MA 01888.

All returns and claims must be identified by writing “Enduring Freedom—KIA,” “Kosovo Operation—KIA,” “Desert Storm—KIA,” or “Former Yugoslavia—KIA” in bold letters on the top of page 1 of the return or claim. On Forms 1040 and 1040X, the phrase “Enduring Freedom—KIA,” “Kosovo Operation — KIA,” “Desert Storm—KIA,” or “Former Yugoslavia—KIA” must be written on the line for total tax. If the individual was killed in a terroristic or military action outside the United States, put “KITA” on the front of the return and on the line for total tax.

An attachment should accompany any return or claim that includes a computation of the decedent’s tax liability before any amount is forgiven and the amount that is to be forgiven. For joint returns, see *Joint returns*, later.

**Necessary documents.** The following documents must accompany all returns and claims for refund. For returns and claims relating to individuals who died as a result of a terrorist attack, see Publication 3920.

- Form 1310, *Statement of Person Claiming Refund Due a Deceased Taxpayer*.
- A certification from the Department of Defense or the Department of State that the death was due to a military or terroristic action.

For military employees and civilian employees of the Department of Defense, certification must be made by that department on Form DOD 1300, *Report of Casualty*. For other civilian employees who die as a result of wounds or injury incurred outside the United States, certification must be a letter signed by the Director General of the Foreign Service, Department of State, or his/her delegate. The certification must include the individual’s name and social security number, the date of injury, the date of death, and a statement that the individual died as the result of a military or terroristic action outside the United States and was an employee of the United States at the date of injury and at the date of death.

If the certification has been received, but you do not have enough tax information to file a timely claim for refund, file Form 1040X. Attach Form 1310 and a statement that an amended claim will be filed as soon as the required tax information is available.



**Joint returns.** Only the decedent's part of the joint income tax liability is eligible for the refund or tax forgiveness. To determine the part for the decedent, the person filing the claim must complete the following steps:

1. Figure the income tax for which the decedent would have been liable if a separate return had been filed.
2. Figure the income tax for which the spouse would have been liable as if a separate return had been filed.
3. Multiply the joint tax liability by a fraction. The top number of the fraction is the amount in (1) above. The bottom number of the fraction is the total of (1) and (2).

The amount in (3) is the decedent's tax liability that is eligible for the refund or tax forgiveness. If a taxpayer is unable to complete this process, he or she should attach a statement of all income and deductions indicating the part that belongs to each spouse. The IRS will make the proper allocation.

**Residents of community property states.** If the member of the Armed Forces was domiciled in a community property state and the spouse reported half the military pay on a separate return, the spouse can get a refund of taxes paid on his or her share of the pay for the years involved. The forgiveness of unpaid tax on the military pay would also apply to the half owed by the spouse for the years involved.

### Exercise 1

Major Joe Wells entered Afghanistan on 6 January 2003. He remained there through 7 April 2003, when he departed for the United States. He was not injured and did not return to the combat zone.

What is the deadline for filing Major Wells' 2002 tax return?

Answer \_\_\_\_\_



**Exercise 2**

Mr. Tim Morris, a civilian employee of the United States, died in 2004 as a result of injuries he suffered during a terrorist attack in 2002.

What years are Mr. Morris' income liabilities forgiven?

Answer \_\_\_\_\_



# TAX BENEFITS FOR COMBAT ZONE PARTICIPANTS

ANSWERS TO EXERCISES

Lesson 16  
Military Segment

Exercise 1– **The 2003 tax return.** The deadline is 12 January 2005. The deadline is 280 days (180 plus 100) after Major West's last day in the combat zone (7 April 2003). The 100 additional days are the number of days in the 3 1/2 month filing period that were left when he entered the combat zone (6 January - 15 April 2003).

Exercise 2– 2001-2004

## ▶▶ SUMMING UP THIS LESSON ◀◀

In this lesson you have learned that:

- ▶ The deadline for filing tax returns, paying taxes, and taking other actions with the Internal Revenue Service is automatically extended if an individual serves in a combat zone.
- ▶ The income tax liability of a member of the Armed Forces is forgiven if a member dies as a result of service in a combat zone or from a terrorist or military action outside the United States.
- ▶ The terrorist or military action forgiveness also applies to an individual who is a U.S. employee at death and who dies from wounds or injury incurred while a U.S. employee in a terrorist or military action regardless of where the action occurred.

**STUDENT NOTES**



## INTRODUCTION AND OBJECTIVES

This lesson will discuss the importance of “alien” status in determining federal income tax reporting requirements for Armed Forces personnel. Publication 519, U.S. Tax Guide for Aliens is a major source of information on this subject.

After completing this lesson, you should be able to:

1. Determine whether an alien should file a resident, non-resident, or dual-status tax return.
2. Determine what sources of income an alien must report on his or her return.
3. Explain the special choice that permits a nonresident alien spouse of a U. S. citizen or resident to be treated as a resident alien and file a joint return.
4. Determine the use for an ITIN for undocumented aliens.
5. Explain the process for securing a social security number for children born abroad.

## NONRESIDENT ALIENS

A nonresident alien is an individual who is not a citizen or resident of the United States. A nonresident alien generally must pay tax only on income received from sources within the United States. If the income is connected with conducting a trade or business in the United States, the income (after allowable deductions) is taxed at regular U. S. tax rates. If other income from U. S. sources is not connected with conducting a trade or business in the United States, it is taxed at a flat 30%(or lower treaty) rate. For example, Survivor Benefit Plan payments made to a nonresident alien surviving spouse may be subject to a 30%withholding (or lower treaty) rate. In either case, the nonresident alien must file a Form 1040NR, *U. S. Nonresident Alien Income Tax Return*.

## RESIDENT ALIENS

### ALERT



The Social Security Administration does not issue social security numbers (SSNs) to nonresident aliens unless they have legal permission to work in the United States. SSNs will be issued to lawful permanent residents.

An alien may qualify as a U. S. resident for tax purposes by meeting either the *green card test* or the *substantial presence test* for the calendar year.

**Green card test.** An alien is a resident for tax purposes if he or she is a lawful permanent resident of the United States (holder of a green card) at any time during the calendar year. However, see the discussion on *Dual-Status Aliens*, later.

**Substantial presence test.** If the alien does not meet the green card test, the alien may still be a U. S. resident for tax purposes if the substantial presence test for the calendar year is met. To meet this test, the alien must have been physically present in the United States for at least 31 days during 2003 and for a total of at least 183 days in 2003, 2002, and 2001.

When you count the days for the substantial presence test, count:

1. All the days the alien was present in 2003,
2. One-third of the days present in 2002, and
3. One-sixth of the days present in 2001.

### Example

Ana Garcia was present in the United States for several years. She believes that she can qualify for the substantial presence test. Ana was here from December 1 through December 31 of 2003. She was present in the U. S. all of 2002. In 2001, she stayed in the United States from June 1 through December 31. Here's how to figure if Ana meets the substantial presence test:

<u>YEAR</u>	<u>MULTIPLY BY</u>	<u>DAYS PRESENT</u>		<u>TOTAL</u>
2003	1	31	=	31
2002	1/3	365	=	122
2001	1/6	214	=	<u>36</u>
				189

Since Ana was present in the United States at least 31 days in 2003 and at least 183 days during the current and last two years, she meets the test in 2003 to qualify as a resident of the U. S.

**Exceptions.** For purposes of counting days for the substantial presence test, there are exceptions for regular commuters from Canada or Mexico, persons in transit through the United States, persons who are unable to leave because of becoming ill while in the United States, diplomats, employees of international organizations, teachers, trainees, and students. Also, the substantial presence test does not apply if the alien was present in the United



States for fewer than 183 days during 2003 and establishes that he or she has a closer connection to a foreign country. Publication 519 has more details on these exceptions.

**First-year choice.** If the alien does not meet the green card test or the substantial presence test for 2002 or 2003, and did not choose to be treated as a resident for part of 2001, but will meet the substantial presence test for 2004, he or she can choose to be treated as a U. S. resident for part of 2003. To make this choice, he or she must have been:

1. Present in the U. S. for at least 31 consecutive days in 2003, and
2. Present in the U. S. for at least 75% of the days beginning with the first day of the 31-day period in (1) and ending with the last day of 2003.

The taxpayer should be referred to Publication 519 for complete details concerning this special first-year choice. This choice, once made, cannot be revoked without the consent of the Internal Revenue Service.

Resident aliens generally are taxed on their worldwide income, the same as U. S. citizens. Resident aliens use the same tax forms as U.S. citizens.

## ***DUAL-STATUS ALIENS***

An alien may be both a nonresident and resident alien during the same tax year. The most common dual-status tax years are the years of arrival and departure. Dual-status aliens are taxed on income from all sources for the part of the year they are resident aliens. They are taxed only on income from U. S. sources for the time they are nonresident aliens. They must file Form 1040 and mark it “Dual Status Return” if they are resident aliens on the last day of the tax year. If they are nonresident aliens at the end of the year, they must file Form 1040NR and mark it “Dual Status Return.” In either case, they must attach a separate statement to explain their income and compute the tax for the other part of their dual-status year. Dual-status aliens must either itemize their allowable deductions or claim zero deductions because they cannot use the standard deduction.



### Exercise 1

Sgt. Zapata is stationed in Korea and is married to a Korean citizen. Sgt. and Mrs. Zapata came to the United States for a 3-week visit and returned to his post of duty in Korea. Mrs. Zapata entered the United States on a non-immigrant visa.

- a. What is Mrs. Zapata's U. S. alien status?

Answer \_\_\_\_\_

- b. If the Zapatas moved to the United States in June 2003 and Mrs. Zapata got a green card, what would Mrs. Zapata's U. S. alien status be for 2003?

Answer \_\_\_\_\_

### Exercise 2

Karen is a British citizen and a U. S. resident alien (green card holder). She married Lt. Trimble, a U. S. citizen, who has a permanent residence in New York. The Trimbles moved to Germany in 2002 for a 2-year tour of duty. They plan to return to New York when his duty ends. Karen earned \$12, 000 a year working for a German employer while they were stationed in Germany.

- a. If Lt. Trimble files a separate return, does Karen have to file a U. S. federal tax return?

Answer \_\_\_\_\_

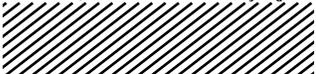
- b. If the Trimbles were divorced in 2003 and Karen gave up her green card and moved to England, what would her U. S. alien status be for 2003?

Answer \_\_\_\_\_

## **UNDOCUMENTED (ILLEGAL) ALIENS**

Undocumented aliens who meet the substantial presence test are considered resident aliens for tax purposes. They are not eligible for an SSN because they have no legal work authorization. These aliens should apply for an ITIN; however, the ITIN does not give them permission to work.

A common scenario is that the undocumented alien "acquires" (buys, trades etc.) an SSN to provide to their employer. The employer hires the alien and gives them a W-2 at the end of the year with the invalid SSN. The alien then files a tax return with



their ITIN listed as their identification number. This causes a processing problem for the IRS. The refund will most likely be held until the issue can be resolved.

If the spouse of a U. S. citizen or resident is an illegal resident alien, he/she should have an ITIN.

### ***CHILDREN BORN ABROAD***

Military families living overseas who experience the birth of a child in a host nation hospital or “off base on the economy” should check with their base legal office or U. S. embassy officials for exact procedures for securing the Report of Birth Abroad. This document serves as proof of citizenship and can be used in the future. To formally register the birth of a child born abroad, the U. S. citizen parent or parents should bring the child to the Embassy/Consulate office along with:

- An original of the child’s birth certificate
- The parent’s marriage certificate
- Any divorce (original) decree or death certificate from any previous marriage
- Cash or bank check to pay the fee (usually \$65)

Parents should also apply for a passport for their child at the same time as the Report of Birth. Along with your application for Report of Birth and passport, it is also advisable to request the form to apply for an SSN for the child. The Social Security International Office in Baltimore, MD assigns an SSN. The SSN will be mailed directly to the taxpayer. The process takes several months. But without an SSN the parents will NOT be able to claim the EITC even if all of the other prerequisites are met.

### ***ALIEN MILITARY PERSONNEL***

As a general rule, most alien enlistees in the Armed Forces are resident aliens. This would almost certainly be true of an alien who has lived in the United States before enlistment. In peacetime, the enlistment requirements of the Armed Services state that no person may enlist unless that person is a citizen or has been lawfully admitted to the United States for permanent residence under the immigration laws. These two factors, voluntary enlistment and admittance for permanent residence, are usually enough to classify an alien enlistee as a resident alien. The United States has treaty agreements with certain nations that allow a very limited number of their citizens to retain their nonresident alien status. Alien enlistees in this category should seek advice from their base legal officer. Other aliens who are present in the United States merely because of military assignment and who have a residence outside the United States are nonresident aliens.



## CHOICE TO TREAT NONRESIDENT SPOUSE AS A RESIDENT

A nonresident alien spouse may choose to be treated as a resident alien if all the following conditions are met.

1. The nonresident alien spouse must be married to a U. S. citizen or resident alien at the end of the tax year.
2. Both spouses must choose to treat the alien spouse as a resident alien.
3. One of the spouses must be a U. S. citizen or resident alien on the last day of the tax year.

### How to Make the Choice

A statement signed by both spouses must be attached to their joint return for the first tax year for which the choice applies. The statement should contain:

1. A declaration that one spouse was a nonresident alien and the other spouse was a U. S. citizen or resident alien on the last day of their tax year and that the nonresident alien spouse chooses to be treated as a U. S. resident for the entire tax year, and
2. The name, address, and social security number of each spouse. If the nonresident alien spouse is not eligible to get a social security number, he or she should file Form W-7, *Application for IRS Individual Taxpayer Identification Number*.

**Caution.** Once the choice is made, the worldwide income of the nonresident alien spouse is subject to U. S. tax. If the nonresident alien spouse has substantial foreign income, there may be no advantage to making the choice.

### Ending the Choice

Once made, this choice applies to all later tax years unless one of the following situations occurs.

- **Revocation**—Either spouse may revoke the choice for any tax year if both the choice and the revocation are made by the due date for filing the tax return for that tax year.
- **Death**—The death of either spouse will end the choice. This ordinarily begins with the first year following the year in which the spouse died. If the spouse who survived is a U. S. citizen or resident and is entitled to the joint return rates as a surviving spouse, the choice will not end until the close of the last year for which these joint rates may be used.
- **Legal separation**—A legal separation under a decree of divorce or separate maintenance will end the choice beginning January 1 of the tax year in which the legal separation occurs.



- Inadequate records—The Internal Revenue Service can end the choice for any year that either spouse fails to keep adequate tax records, to provide adequate access to those records, or to supply other information reasonably necessary to determine the correct income tax liability.

If the choice is ended for any of these reasons, neither spouse can make a choice for any future tax year. For example, divorced individuals who previously made the choice and later remarry cannot make another choice.

### Choice Not Made

If the choice is not made:

1. The nonresident alien spouse cannot file a joint return.
2. The nonresident alien spouse is generally not eligible for certain credits, such as the earned income credit or the education credits.
3. The spouse who is a U. S. citizen or resident may claim an exemption for the nonresident alien spouse if the nonresident alien has no gross income for U. S. tax purposes and is not another taxpayer's dependent. Check the box on line 6b of Form 1040 or Form 1040A and write "NRA" to the right of the word "spouse."
4. The nonresident alien spouse does not have to file a federal income tax return if he or she had no U. S. source income. He or she does not have to report any income from sources outside the United States so long as he or she remains a nonresident alien.

Questions concerning alien status and the special choice can be complex. Further information can be found in Publication 519.



### Exercise 3

Stephen Rowan is a Navy officer who resides in New York and is on duty in Japan. He has \$30,000 in taxable income for the year. His wife, to whom he has been married for 3 years, is a Japanese citizen who has never visited the United States. She earned \$5,000 from employment in Japan during the year.

a. Is he required to file a U. S. income tax return?

Answer \_\_\_\_\_

b. Is Mrs. Rowan required to file a U. S. income tax return?

Answer \_\_\_\_\_

c. Can the Rowans file a joint return?

Answer \_\_\_\_\_

### ▶▶ SUMMING UP THIS LESSON ◀◀

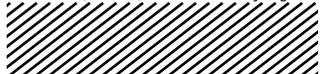
Questions of alien status can be difficult. To find answers to their questions and to learn whether they qualify for the option to treat the nonresident spouse as a U.S. resident, military personnel should see Publication 519, visit their base legal office, or call the IRS at 1-800-829-1040.



1.
  - a. Nonresident alien
  - b. Dual-status alien
2.
  - a. Yes. She is a resident alien.
  - b. Dual-status alien
3.
  - a. Yes
  - b. No
  - c. Yes. They can make the choice, but they should figure their tax both ways to determine which option is best for them.

# STUDENT NOTES

Lined area for student notes.



## INTRODUCTION AND OBJECTIVES

This lesson will discuss what “home leave expenses” can be deducted by U.S. taxpayers traveling to their home in the United States under orders from the head of Foreign Affairs agency.

After completing this lesson, you should be able to:

1. Determine who is eligible for home leave expenses.
2. Determine what expenses are deductible.

## HOME LEAVE

Section 903 of the Foreign Service Act of 1980 provides that the head of a Foreign Affairs Agency may order a member of the Service who is a citizen of the United States to take home leave upon completion of 18 months of continuous service abroad; and shall so order as soon as possible after completion of 3 years of continuous service abroad. The intent of this legislation is to “re-Americanize” foreign service employees..

Because members of the foreign service are required by law to take a leave of absence, they are allowed to deduct amounts paid for travel, meals, and lodging while on home leave as employee business expenses. The taxpayers who are eligible for this leave will deduct these expenses on a Form 2106 just like an employee that is conducting business away from the home.

As with all deductible employee business expenses, records and receipts must be maintained to support the deductions that are taken. The deductible expenses are those we discussed in the previous lesson and these expenses are subject to the same limitations.

Any expenses paid for on behalf of a foreign service member’s family are personal expenses and therefore are not deductible.

▶▶ **SUMMING UP THIS LESSON** ◀◀

- ▶ Taxpayers who are U.S. citizens and members of the foreign service can deduct travel, meals and lodging expenses, while on home leave, as employee business expenses by using Form 2106.
- ▶ Expenses incurred by members of the family are personal expenses and therefore they are not deductible.

***SUMMARY EXERCISE***

1. Larry Lee is a foreign service employee. He has been stationed in a foreign country for 3 years and comes back to the United States for 4 weeks on home leave. His family accompanies him. He incurred expenses for travel of \$1,500; meals \$850; and lodging \$1,400. His family incurred expenses for travel of \$2,500; meals \$1,700; and lodging \$2,200. Larry was reimbursed \$450 for his travel to and from his post of duty and did not show it as income. (Larry rented a car. He did not use his own car.)
  - a. Is Larry eligible for a home leave deduction? Yes or No.
  - b. Can Larry deduct the expenses that this family members incur? Yes or No.
  - c. Complete Form 2106.



Form **2106**  
 Department of the Treasury  
 Internal Revenue Service (99)

### Employee Business Expenses

▶ See separate instructions.

▶ Attach to Form 1040.

OMB No. 1545-0139

**2003**

Attachment  
 Sequence No. **54**

Your name	Occupation in which you incurred expenses	Social security number
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**Part I** Employee Business Expenses and Reimbursements

Step 1 Enter Your Expenses	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.) . . . . .	1	
2 Parking fees, tolls, and transportation, including train, bus, etc., that <b>did not</b> involve overnight travel or commuting to and from work . . . . .	2	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Do not</b> include meals and entertainment. . . . .	3	
4 Business expenses not included on lines 1 through 3. <b>Do not</b> include meals and entertainment . . . . .	4	
5 Meals and entertainment expenses (see instructions) . . . . .		
6 <b>Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5 . . . . .	6	

**Note:** If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.

**Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1**

7 Enter reimbursements received from your employer that were <b>not</b> reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions) . . . . .	7	
--	---	--

**Step 3 Figure Expenses To Deduct on Schedule A (Form 1040)**

8 Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7 . . . . .	8	
<b>Note:</b> If <b>both columns</b> of line 8 are zero, you cannot deduct employee business expenses. Stop here and attach Form 2106 to your return.		
9 In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses by 65% (.65) instead of 50%. For details, see instructions.) . . . . .	9	
10 Add the amounts on line 9 of both columns and enter the total here. <b>Also, enter the total on Schedule A (Form 1040), line 20.</b> (Fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter the total.) . . . . . ▶	10	

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11700N

Form **2106** (2003)

1.
  - a. Yes
  - b. No
  - c. See completed Form 2106

Form <b>2106</b> Department of the Treasury Internal Revenue Service (99)	<b>Employee Business Expenses</b> ▶ See separate instructions. ▶ Attach to Form 1040.	OMB No. 1545-0139 <b>2003</b> Attachment Sequence No. <b>54</b>
Your name <b>Larry Lee</b>	Occupation in which you incurred expenses <b>Foreign Service</b>	Social security number .....
<b>Part I Employee Business Expenses and Reimbursements</b>		
<b>Step 1 Enter Your Expenses</b>	<b>Column A</b> Other Than Meals and Entertainment	<b>Column B</b> Meals and Entertainment
1 Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.)	1	
2 Parking fees, tolls, and transportation, including train, bus, etc., that <b>did not</b> involve overnight travel or commuting to and from work	2	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Do not</b> include meals and entertainment	3	2,900.00
4 Business expenses not included on lines 1 through 3. <b>Do not</b> include meals and entertainment	4	
5 Meals and entertainment expenses (see instructions)	5	850.00
6 <b>Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5	6	2,900.00      850.00
<b>Note:</b> If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.		
<b>Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1</b>		
7 Enter reimbursements received from your employer that were <b>not</b> reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions)	7	450.00
<b>Step 3 Figure Expenses To Deduct on Schedule A (Form 1040)</b>		
8 Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7	8	2,450.00      850.00
<b>Note:</b> If <b>both columns</b> of line 8 are zero, you cannot deduct employee business expenses. Stop here and attach Form 2106 to your return.		
9 In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses by 65% (.65) instead of 50%. For details, see instructions.)	9	2,450.00      425.00
10 Add the amounts on line 9 of both columns and enter the total here. <b>Also, enter the total on Schedule A (Form 1040), line 20.</b> (Fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter the total.)	10	2,875.00
For Paperwork Reduction Act Notice, see instructions. <span style="float: right;">Cat. No. 11700N      Form <b>2106</b> (2003)</span>		

**STUDENT NOTES**

Lined area for student notes.



# INTEGRATED TRAINING

## INTEGRATED TRAINING

Integrated training is composed of six modules of instruction. At the conclusion of the training, all lessons in the existing Publication 678, Volunteer Assistor's Guide — Student text, will be taught. Certification will be completed using the existing Form 6744, Test.

As the student moves through the tax preparation software, they will receive tax law foundation training. Each module of instruction will cover specific Publication 678 lessons or parts of lessons. The modules of instruction are not distinguished as basic, wage earner, or pension earner nor can they be distinguished as basic, intermediate, or advanced. Each of the first three modules contains an exercise with certain income, adjustments, deductions, and credits. The determining factor for each module was ensuring all tax law was taught in a manner that conserved time, kept the student's interest, and maintained a stepped approach to the level of difficulty in tax law. The module exercises are found at the back of Publication 678.

### Pre-Class Preparation

**Instructors:** Instructors must have tax law and TaxWise training experience. There should be a minimum of two instructors for each class. While one instructor is teaching the other should be available to help students. Instructors with previous TaxWise training experience will be best able to handle the many hardware and software issues that can arise during a training session.

**Students:** Students should have average to better than average computer skills. Although the instruction will be conducted at an easy pace, the students must be familiar with using software in a Windows environment.

**Classroom:** The classroom should have the following:

- Computers for each student
- Instructor computer module
- Projector

Prior to the class, the instructors should visit the computer lab and ensure the same TaxWise version is loaded and operational on each computer. Each computer should have the same tax form defaults as detailed in Publication 3189, Volunteer e-file Administrator's Guide.

## Materials

Each student should have the following:

Publication 678, Volunteer Assistor's Guide — Student Text Kit  
Form 1040

Form 1040A

Form 1040EZ

List of social security numbers, employer identification numbers, routing transit numbers, and depositor account numbers

Instructors must develop the list of SSNs, EINs, RTNs, and DANs prior to the class. Due to the TaxWise restrictions on creating these numbers during training, the numbers are indicated as x's in exercises and income statements. This also allows instructors the ability to teach multiple days on the same computer equipment with the same EFIN.

## Classroom Instruction

The student module exercises are located at the back of Publication 678. We suggest you ask the students to carefully tear them out for ease of use.

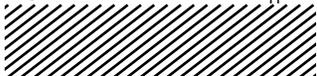
The lesson plans for each module begin on page (N-A-4). The lesson plans include suggested teaching times, lesson and page references to the student material.

The answers to the module exercises are included at the end of each module. These answers are based on TaxWise Version 17.10. Modifications to the lesson plans and answers will need to be conducted for Version 18.0 and higher. We recommend you print a copy of the TaxWise return for reference.

Publication 678 will include all new tax law available up to a cut-off date of approximately mid-September. The TaxWise version 17.10 will not have this new tax law. When this occurs, the new tax law still must be taught. Remind students to check the later versions of TaxWise for the software treatment of the new law.

## Practice Returns

If time permits, the comprehensive problems located at the end of Publication 678 wage earner and pension earner sections are available for use. TaxWise version 17.10 answers are included with the traditional training approach answers.



## Testing and Certification

This year, the VITA/TCE test is designed to allow students to use tax preparation software to complete the test. The requirements for certification are the same as the traditional approach. If a student fails one or more sections, they must take the retest.

## Evaluation

Evaluations of this new training approach are extremely important. Please refer to the evaluation procedures found in the traditional training instructor notes.



## Module 1 (Suggested Teaching Time: 6 hours)

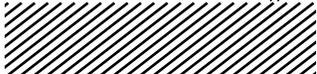
Before students can work in this module you must go through the initial familiarization of TaxWise (i.e., tool bars, help feature, etc.). This familiarization process should take the students to the point they are at the screen where they can select “Create a New Return.”

Walk the students through Module 1 starting with the Main Information Sheet. After completing this module, students should be able to:

- Open and create a new tax return.
- Complete the main information sheet for this module in TaxWise.
- Identify and enter pertinent taxpayer information into the return.
- Determine the qualifications for the single filing status.
- Define wages and input a Form W-2 using the software.
- Determine taxable and non-taxable interest income and input applicable information from Form 1099-INT.
- Identify Unemployment Compensation and input a Form 1099-G.
- Define the Educators Expense adjustment and input applicable information for the calculation of the adjustment.
- Define the qualifications for the “Student Loan Interest” adjustment and input applicable information for the calculation of the adjustment.
- Know the qualifications for an IRA contribution and input applicable information.
- Define early withdrawal penalty.
- Identify who qualifies for the “Credit for Qualified Retirement Savings Contribution” and input applicable information.
- Identify proper procedures for finishing the return.

**Note:** Discuss all automatic computations with the students. You need to ensure the students understand why TaxWise puts information on a particular line.

- Lesson 1 — Getting Started
  - Discuss social security numbers (page 1-1)
  - Discuss the qualifications for single filing status (page 1-19).
  - Discuss personal exemptions (pages 1-2 through 1-3) and how to annotate them in TaxWise.
  - Review Exercise 1 (page 1-16).



- Discuss who must file — who should file (pages 1-30 through 1-34).
- Review Exercises 20 and 21 (page 1-35).
- Discuss which form to use (page 1-37).
- Walk students through the remainder of the main information sheet, entering applicable information as you move through the sheet.
- Discuss default settings (site specific).
- The Teaching Tips on page N-1-7 about “Must and Should” is very important.

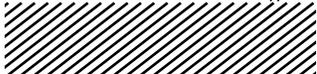
### ■ Lesson 2 — Income

- Discuss taxable and non-taxable income (pages 2-1 through 2-3).
- Review Exercise 1 (page 2-4).
- Discuss earned income (pages 2-4 through 2-7).
- Review Exercise 2 (page 2-9).
- Input Form W-2 from Sunshine School District (link to NEW W-2 from Form 1040, line 7).
- Discuss address differences, automatic calculations, and importance of identical paper and electronic Forms W-2.
- Input Form W-2 from Kathy’s Restaurant.
- Discuss taxable and tax-exempt interest income (pages 2-9 through 2-16).
- Review Exercise 3 (page 2-17).
- Input interest income (link to Schedule B from Form 1040, line 8a; then link to Interest Stmt Schedule B from Schedule B, line 1b)
- Discuss unemployment compensation (page 2-27).
- Input Form 1099-G (link to new W-2G from Form 1040, line 19).
- While in this lesson stress the fact that all income, no matter how it is derived, is taxable unless explicitly exempt by law.

### ■ Lesson 3 — Adjustments

- Discuss qualifications for the educators expense deduction (pages 3-1 through 3-2).
- Input qualified expenses (link to 1040 Wkt2 student loan, education worksheet, from Form 1040, line 23).
- Discuss IRA contribution limits, deemed IRAs, spousal IRAs and excess contributions (pages 3-2 through 3-5).
- Review Exercise 1 (page 3-6).

- Discuss deductible IRAs, MAGI limitations, employer retirement plan limitations (pages 3-6 through 3-10).
  - Review Exercise 2 (page 3-10).
  - Discuss when to deduct IRA contributions and nondeductible contributions (pages 3-10 through 3-15)
  - Input IRA contribution (link to NEW IRA wkt Traditional, Roth IRA, ESAs worksheet, from Form 1040, line 24).
  - Review Exercise 3 (page 3-16).
  - Discuss additional taxes and penalties (page 3-16).
  - Discuss qualifications for the student loan interest deduction (pages 3-18 through 3-21).
  - Input the qualified student loan interest (reopen the 1040 Wkt 2).
  - Discuss penalty on early withdrawal of savings (page 3-25).
  - Review with the students how this information was automatically entered when the interest income (Form 1099-INT) was input.
- Lesson 4 — Standard and Itemized Deductions and Tax Computation
- Discuss the standard deduction (pages 4-1 through 4-2).
  - Review Exercise 1A through 1F (page 4-3).
  - Review with the students how the standard deduction is automatically calculated based on information input on main information sheet.
  - Review tax computation (pages 4-17 through 4-18).
- Lesson 5 — Credit for Qualified Retirement Savings Contributions, Mortgage Interest and Foreign Tax Credit
- Discuss refundable and nonrefundable credits (page 5-1).
  - Discuss the credit for qualified retirement savings contributions (pages 5-2 through 5-4).
  - Review with the students how TaxWise automatically drops a Form 8880 based on the IRA contribution.
  - Open the Form 8880 and complete the required information. (Hint: If you do not complete Form 8880 before you run the diagnostics, there will be a note saying it appears this person qualifies for the credit except that part of the form has not been completed).



■ Lesson 6 — Finishing the Return

- Walk students through the completed Form 1040 return. Show them how the federal income tax withholding is automatically entered. Discuss any other lines which contain data.
- Discuss how the refund is calculated.
- Explain the importance of accurate bank account and routing transit information, when the students re-enter this information.
- Run diagnostics.
- Correct any errors.
- Create an e-file return.
- Explain to the students the requirement for taxpayers to sign Form 8453 and the disposition of the forms.

Using TaxWise version 17.10 software, the answer should result in:

AGI:	\$9,190
Taxable Income	\$1,490
Tax	\$0
Refund	\$716

## Module 2 (Suggested Teaching Time: 6 hours)

Before students begin work in this module, review the process of navigating to the “Create a New Return” option. Instruct them to start a new return using the Module 2 taxpayer information.

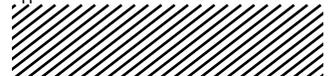
Walk the students through Module 2 starting again with the Main Information Sheet. After completing this module, students should be able to:

- Create a new tax return by completing the main information sheet for this module in TaxWise.
- Determine the qualifications for head of household and married filing separately filing status.
- Use the 5 tests for dependents, to determine dependency status.
- Determine who is eligible for the credit for child and dependent care expenses.
- Use the EIC eligibility requirements, to determine an EIC qualifying child.
- Determine who is eligible for the child tax credit.
- Input applicable information from Form 1099-DIV.
- Determine who can use Schedule C-EZ and complete Schedule C-EZ and Schedule SE.
- Complete Form 2441.
- Complete the Child Tax Credit Worksheet.
- Complete the EIC Worksheet
- Explain the benefits of AEIC and review where AEIC is reported on Form 1040 or Form 1040A.
- Identify proper procedures for finishing the return.

**Note:** Discuss all automatic computations with the students. You need to ensure the students understand why TaxWise puts information on a particular line.

- Lesson 1 — Getting Started
  - Head of Household and Married Filing Separately Filing Status (pages 1-20 through 1-23).
  - Review Exhibit 10 (page 1-25).
  - Review Exercises 11 through 15.
  - Dependent Exemptions (pages 1-3 through 1-14).
  - Explain importance of Exhibit 1 when determining support (page 1-8).
  - Discuss Form 8332 and e-file (page 1-11).
  - Review Exercises 2 through 6 and 8 (page 1-16 through 1-17).

- Lesson 7 — Credit for Child and Dependent Care Expenses
  - Discuss qualifying child requirements (pages 7-1 through 7-5).
- Lesson 9 — Earned Income Tax Credit
  - Discuss qualifying child requirements (pages 9-6 through 9-7).
- Lesson 10 — Child Tax Credit
  - The purpose of teaching this lesson is to ensure the student understands how TaxWise automatically checks the box on the main information sheet.
  - Discuss the qualifications (pages 10-1 through 10-5).
- Lesson 2 — Income
  - Review how to enter Form W-2 information (From Form 1040, line 7, link to NEW W-2 using F-9)
  - Discuss dividend income (page 2-17 through 2-18).
  - Income from Business (pages 2-21 through 2-26)
  - Link from Form 1040, line 12 to Schedule C-EZ.
  - Walk students through how TaxWise calculates and completes Schedule C-EZ and Schedule SE.
- Lesson 3 — Adjustments
  - Review with students the entry made on Form 1040, line 29 (page 3-24).
- Lesson 7 — Credit for Child and Dependent Care Expenses
  - Discuss qualifying expenses (pages 7-5 through 7-6).
  - Review Exercise 1A - through 1C (page 7-6).
  - Complete applicable entries on Form 2441.
  - Discuss the exclusion and credit using Example 7 (page 7-7).
  - Compare the TaxWise form with Example 7.
- Lesson 10 — Child Tax Credit
  - Review entries on Form 1040, Line 49, and discuss how they were calculated.
  - Discuss the advance child tax credit payment.
- Lesson 9 — Earned Income Credit
  - Discuss eligibility rules for taxpayers (pages 9-1 through 9-5).
  - Review Exercise 1A through 1F (page 9-9).
  - Discuss completion of Schedule EIC (pages 9-10).
  - Review Exercise 2A and 2B (page 9-11).
  - Complete applicable entries on EIC wkt.



- Discuss advance EIC (page 6-2, pages 6-16 through 6-17, and page 9-20).
- Review the entries made on Form 1040, lines 63.
- Discuss disallowed EIC and precertification (page 9-8).
- Lesson 10 — Additional Child Tax Credit
  - Discuss qualifications for the additional tax credit (pages 10-6 through 10-11).
  - Review the entries made on Form 8812.
  - Review the entry made on Form 1040, line 65.
- Lesson 6 — Finishing the Return
  - Walk students through the completed Form 1040 return. Discuss any other lines which contain data.
  - Review how the refund was calculated.
  - Input bank information.
  - Run diagnostics.
  - Correct any errors.
  - Create an e-file return.
  - Review procedures for Form 8453.

Using TaxWise version 17.10 software, the answer should result in:

AGI:	\$18,652
Taxable Income	\$2,752
Tax	\$1,572
Refund	\$4,047



## Module 3 (Suggested Teaching Time: 6 hours)

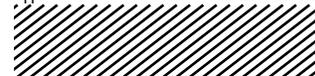
Before students begin work in this module, review the process of navigating to the “Create a New Return” option. Instruct them to start a new return using the Module 3 taxpayer information.

Walk the students through Module 3 starting again with the Main Information Sheet. After completing this module, students should be able to:

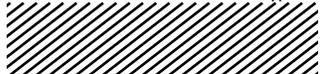
- Create a new tax return by completing the main information sheet for this module in TaxWise.
- Determine the qualifications for married filing jointly and qualifying widower filing status.
- Determine basis and capital gain/loss on sale of stock.
- Determine if IRA distributions are taxable, nontaxable, or partly taxable and calculate the taxable portion.
- Determine if retirement income is taxable and calculate the taxable portion.
- Distinguish between taxable and nontaxable social security benefits and calculate the taxable portion.
- Identify how other types of income are reported.
- Determine the qualifications for the tuition and fees deduction.
- Determine the qualifications for the education credits.
- Determine the most advantageous method for reporting tuition and fees.
- Determine which items are allowed when itemizing deductions.
- Know where to report estimated tax payments.
- Determine if the estimated tax penalty applies.

**Note:** Discuss all automatic computations with the students. You need to ensure the students understand why TaxWise puts information on a particular line.

- Lesson 1 — Getting Started
  - Married Filing Jointly Filing Status (page 1-19)
  - Qualifying Widow(er) with Dependent Child Filing Status (pages 1-24 through 1-25).
  - Review Exercises 9, 10, and 19.
  - Review dependent exemptions.
- Lesson 2 — Income
  - Discuss capital gain distributions (pages 2-18 through 2-20).
- Lesson 11 — Sale of Stock
  - Review basis and general reporting requirements (pages 11-1 through 11-8).



- Review Exercise 11 (page 11-8).
  - Discuss capital gains/losses (pages 11-9 through 11-33).
  - Input sale of stock.
  - Review line entries automatically calculated by the software.
- Lesson 13 — Pensions
- Review types of pensions and how they are reported to the taxpayer (pages 13-1 through 13-7).
  - Discuss IRAs and their tax treatment (pages 13-11 through 13-12).
  - Input IRA distribution (link to new Form 1099-R from Form 1040, line 15b).
  - Discuss pensions and annuities (pages 13-8 through 13-13).
  - Input retirement income (link to new Form 1099-R from Form 1040, line 16b).
  - Discuss taxation of social security benefits (pages 13-13 through 13-17).
  - Input social security benefits (link to 1040 Wkt 1 from Form 1040, line 20b).
- Lesson 2 — Income
- Discuss reporting any other taxable income (page 2-20).
  - Input gambling winnings (use line 21 to input directly or link out to complete forms, e.g., Form W-2G).
- Lesson 3 — Adjustments
- Discuss the qualifications for the tuition and fees deduction (pages 3-22 through 3-24).
  - Input the tuition and fees expenses (link to 1040 wkt 2 from Form 1040, line 25).
- Lesson 4 — Standard and Itemized Deductions, and Tax Computation
- Discuss itemized deductions (pages 4-3 through 4-14).
  - Input itemized deductions (link to Sch A Detail from Form 1040, line 37).
- Lesson 8 — Education Credits
- Discuss the qualifications for the Hope credit and the lifetime learning credit (pages 8-1 through 8-10).
  - Have the students record the calculated tax on line 54.
  - Ask the students to remove the tuition and fees expenses from line 26.



- Input the tuition and fees expenses on Form 8812 (link to Form 8812 from Form 1040, line 47) and record the calculated tax on line 54.
- Discuss the advantages/disadvantages of using the above the line adjustment versus the non-refundable credit.

■ Lesson 6 — Finishing the Return

- Withholding (Information for this line automatically comes from the information entered on the W-2s and 1099s)
- Discuss when estimated tax payments are required (pages 6-8, page 6-9, and pages 6-11 through 6-15).
- Input estimated tax payments (link to Estimated Tax Payments wkst from Form 1040, line 62)
- Review estimated tax penalties and Form 2210 (pages 6-11).
- Discuss payment options for balance due returns (page 6-10).
- Discuss adjustments to Form W-4 or Form W-4P (pages 6-15 through 6-16).

Using TaxWise version 17.10, the answer should result in:

AGI:	\$45,860
Taxable Income:	\$27,110
Tax:	\$3,081
Balance Due:	\$482

## Module 4 (Suggested Teaching Time: 6 hours)

Module 4 is a compilation of subjects not previously covered. These subjects should be taught even though there are no exercises specifically built for integrated training.

### Wage Earner Objectives

After completing this module students should be able to:

- Identify when Individual Taxpayer Identification Numbers are required (page 1-2).
- Define multiple support as it applies to dependent exemptions (page 1-9).
- Determine when and how tip income is reported (pages 2-7 through 2-8).
- Determine when scholarship and fellowship grants are taxable (pages 2-8 through 2-9).
- Determine when state and local tax refunds are taxable (page 2-20).
- Distinguish between alimony and child support and identify where to report the receipt of alimony (page 2-20).
- Identify where alimony payments are reported (page 3-25).
- Identify where jury payments returned to an employer are reported (page 3-25).
- Explain foreign tax credit and mortgage interest credit (pages 5-6 through 5-7).

### Pension Earner Objectives

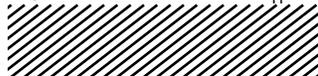
After completing this module students should be able to:

- Determine when a gain from the sale of a home is reported (pages 12-1 through 12-6).
- Determine when Coverdell ESAs are taxable (page 2-13).
- Determine the qualifications for the credit for the elderly and disabled (pages 14-1 through 14-6).

### Military Objectives

After completing this module students should be able to:

- Know when an Armed Forces member can be claimed as a dependent on someone else's return (page M-1-1 to include exercise).
- Know the special rule for claiming Head of Household when married to a non-resident alien (M-1-7).
- Know how to calculate the taxable wages for a member of the Armed Forces who receives medical separation pay (pages M-2-3 through M-2-4 to include example).
- Know which states have community property laws (M-2-8).



- Know when a person is required to report a net profit or loss from self-employment using a Schedule C-EZ (M-2-15 through M-2-16).
- Know when a person is required to complete a Schedule E to report rental income and expenses (M-2-17).
- Know the filing deadline extensions for people outside the U.S. and those in a combat zone (M-6-2 through M-6-5 to include exercises).
- Know how the military thrift savings plan is treated for tax purposes (M-13-29 through M-13-30).
- Know who qualifies for the foreign income exclusion and how to calculate it (M-15-1 through M-15-15 to include exercises).
- Know the tax options for combat zone participants (M-16-1 through M-16-10).



## Module 5 – Military Segment

Before the students can work in this module, review the process of navigating to the “Create a New Return” option. Instruct them to start a new return using the Module 5 taxpayer information.

Walk the students through Module 5 starting again with the Main Information Sheet.

After completing this module, students should be able to:

- Complete the Main Information Sheet and all other information covered in previous modules.
- Determine the effect on income for personnel assigned to a “Combat Zone”.
- Determine other benefits for personnel in a designated “Combat Zone”.
- Determine qualified moving expenses and input applicable information for the calculation of the adjustment.
- Determine qualifying miscellaneous expenses for military personnel that can be listed as itemized deductions.

**Note:** Discuss all automatic computations with the students. You need to ensure the students understand why TaxWise puts information on a particular line

- Lesson 1 — Getting Started
  - Using the 5 tests for dependency, determine whether the mother and/or the brother are dependents (pages M-1-1 through M-1-4).
  - Review Exercise 4 (page M-1-3).
  - Complete Main Information Sheet
- Lesson 2 — Income
  - Discuss taxable and nontaxable income as it applies to military pay (pages M-2-2 through M-2-3).
  - Discuss the “Combat Zone” exclusion (pages M-2-4 through M-2-8).
  - Alert the students to potentially high withholding amounts when a military person has combat zone excluded wages. If the amount on Form W-2, box 2 is more than 50% of the amount in box 1 the return cannot be e-filed. A paper return needs to be filed.
  - Review Exercises 1 and 2 (page M-2-9).
- Lesson 3 — Adjustments
  - Discuss expenses which qualify for the moving expense adjustment (pages M-3-1 through M-3-6).
  - Review Exercise 2 (page M-3-3) and Exercise 3 (page M-3-4).



- Input allowable moving expenses (Link to Form 3906 from Form 1040, line 27).
- Lesson 4 — Standard and Itemized Deductions, and Tax Computation
- Discuss to what extent expenses can be claimed on Form 2106 (pages M-4-1 through M-4-8).
  - Review Exercise 2 (page M-4-6).
  - Discuss to what extent miscellaneous expenses can be claimed on Schedule A (pages M-4-9 through M-4-13).
  - Ensure students understand when uniform expenses are deductible.
  - Review Exercise 1 (page M-4-10) and Exercises 2 through 4 (page M-4-12).
  - Discuss when educational expenses can be deducted (page M-4-5).
- Lesson 16 — Tax Benefits for Combat Zone Participants
- Explain the allowable extensions for military members serving in a combat zone (pages M-16-1 through M-16-5).
  - Explain the tax provisions for decedents (pages M-16-5 through M-16-10).
- Lesson 6 — Finishing the return
- Discuss taxpayer identification information, how to change an address, and where military members should file (page M-6-1).
  - Discuss extensions as they apply to military members (M-6-2 through M-6-5).
  - Review Exercises 1 through 3 (page M-6-7).
  - Run diagnostics.
  - Correct any errors.
  - Create an e-file return.
  - Discuss any differences in the answers.

Using TaxWise version 17.10 software, the answer should result in:

AGI:	\$29,445
Taxable Income	\$ -0-
Tax	\$ -0-
Refund	\$10,096

## Module 6 – Military Segment

Before the students can work in this module, review the process of navigating to the “Create a New Return” option. Instruct them to start a new return using the Module 5 taxpayer information.

Walk the students through Module 5 starting again with the Main Information Sheet.

After completing this module, students should be able to:

- Complete the Main Information Sheet and all other information covered in previous modules.
- Determine the correct filing status.
- Determine dependency status of all persons in the household.

**Note:** Discuss all automatic computations with the students. You need to ensure the students understand why TaxWise puts information on a particular line.

### ■ Lesson 1 — Getting Started

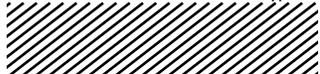
- Remind students of the effects an ITIN has on a tax return (page 1-2).
- Discuss dependency exemptions for non-residents (pages M-1-1).
- Discuss exemptions for a foreign spouse (page M-1-5).
- Discuss filing status as it pertains to a non-resident spouse (pages M-1-7).
- Remind students of the importance of entering the correct dependency code into TaxWise. Jung Ling is not a dependent therefore, not an eligible child for child tax credit.

### ■ Lesson 6 — Finishing the Return

- Complete all TaxWise entries.
- Run diagnostics.
- Correct any errors.
- Create an e-file return.
- Discuss any differences in the answers.

Using TaxWise version 17.10, the answer should result in:

AGI:	\$19,247
Taxable Income:	\$2,397
Tax:	\$233
Refund:	\$2,730



## MODULE 1

### Objectives

After completing this module you should be able to:

- Open and create a new tax return.
- Complete the main information sheet for this module in TaxWise.
- Identify and enter pertinent taxpayer information into the return.
- Determine the qualifications for the single filing status.
- Define wages and input a Form W-2 using the software.
- Determine taxable and non-taxable interest income and input applicable information from Form 1099-INT.
- Identify Unemployment Compensation and input a Form 1099-G.
- Define the Educators Expense adjustment and input applicable information for the calculation of the adjustment.
- Define the qualifications for the “Student Loan Interest” adjustment and input applicable information for the calculation of the adjustment.
- Know the qualifications for an IRA contribution and input applicable information.
- Define early withdrawal penalty.
- Identify who qualifies for the “Credit for Qualified Retirement Savings Contribution” and input applicable information.
- Identify proper procedures for finishing the return.

## Taxpayer Profile

Taxpayer Name	James Fairmont
TP SSN	XXX-XX-XXXX
Spouse Name	
SP SSN	
Street Address	76 Fisk Ave
City, State, Zip	Your City State and Zip Code
Phone Number	(412) 555-1212
Date of birth TP	03/10/1979
Date of birth Spouse	
Occupation TP	3 <sup>rd</sup> Grade Teacher
SP	
Blind? TP	No
SP	
Donate to Presidential Fund?	
TP	No
SP	
Filing Status	Single
Can be claimed as dependent by someone else? TP	No
SP	
State Return Info (Yes or No)	No
Direct Deposit	Yes
Bank Routing Number	112200001
Account number	987123

### Other considerations:

He tells you he spent \$537.26 on classroom supplies.

He meets the 900 hour teaching requirement.

He is repaying a student loan and received a statement from his loan institution showing he paid \$235.87 in interest.

He made a traditional IRA contribution of \$450.

Documents taxpayer gives you:

Form W-2 Kathy's Restaurant

a Control number <b>123456</b>		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number <b>XX-XXXXXXX</b>		1 Wages, tips, other compensation <b>\$2,226.15</b>		2 Federal income tax withheld <b>\$203.12</b>			
c Employer's name, address, and ZIP code <b>Kathy's Restaurant 10 Franklin St. Your City, State, and Zip Code</b>		3 Social security wages <b>\$2,226.15</b>		4 Social security tax withheld <b>\$139.02</b>			
		5 Medicare wages and tips <b>\$2,226.15</b>		6 Medicare tax withheld <b>\$32.38</b>			
		7 Social security tips		8 Allocated tips			
d Employee's social security number		9 Advance EIC payment		10 Dependent care benefits			
e Employee's first name and initial Last name <b>James Fairmont 76 Fisk Ave. Your City, State, and Zip Code</b>		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			
f Employee's address and ZIP code				12d			
15 State	Employer's state ID number <b>XX-XXXXXXX</b>	16 State wages, tips, etc. <b>\$2,226.15</b>	17 State income tax <b>\$160.34</b>	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

Form **W-2** Wage and Tax Statement **2003** Department of the Treasury—Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return. This information is being furnished to the Internal Revenue Service.

Form W-2 Sunshine School District

a Control number <b>123456</b>		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number <b>XX-XXXXXXX</b>		1 Wages, tips, other compensation <b>\$6,432.67</b>		2 Federal income tax withheld <b>\$432.28</b>			
c Employer's name, address, and ZIP code <b>Sunshine School District 45 North Third Street Your City, State, and Zip Code</b>		3 Social security wages <b>\$0.00</b>		4 Social security tax withheld <b>\$0.00</b>			
		5 Medicare wages and tips <b>\$6,432.67</b>		6 Medicare tax withheld <b>\$93.23</b>			
		7 Social security tips		8 Allocated tips			
d Employee's social security number		9 Advance EIC payment		10 Dependent care benefits			
e Employee's first name and initial Last name <b>James Fairmont 76 Fisk Ave. Your City, State, and Zip Code</b>		11 Nonqualified plans		12a See instructions for box 12 <b>D \$435.87</b>			
		13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b			
		14 Other		12c			
f Employee's address and ZIP code				12d			
15 State	Employer's state ID number <b>XX-XXXXXXX</b>	16 State wages, tips, etc. <b>\$6,432.67</b>	17 State income tax <b>\$795.43</b>	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

Form **W-2** Wage and Tax Statement **2003** Department of the Treasury—Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return. This information is being furnished to the Internal Revenue Service.

CORRECTED (if checked)

PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>Division of Employment Security</b>  <b>290 West 4th St.</b>  <b>Your City, State and Zip Code</b>		1 Unemployment compensation \$ <b>1,340.00</b>  2 State or local income tax refunds, credits, or offsets \$	OMB No. 1545-0120  <div style="font-size: 2em; font-weight: bold; text-align: center;">2003</div> Form <b>1099-G</b>	<b>Certain Government Payments</b>
PAYER'S Federal identification number <b>xx-xxxxxxx</b>	RECIPIENT'S identification number <b>xxx-xx-xxxx</b>	3 Box 2 amount is for tax year \$	4 Federal income tax withheld \$ <b>80.98</b>	<b>Copy B For Recipient</b>  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  <b>James Fairmont</b>  Street address (including apt. no.) <b>76 Fisk Ave</b>  City, state, and ZIP code <b>Your City, State, and Zip Code</b>  Account number (optional)		5	6 Taxable grants \$	
7 Agriculture payments \$		8 Box 2 is trade or business income <input type="checkbox"/>		

Form **1099-G** (keep for your records) Department of the Treasury - Internal Revenue Service

CORRECTED (if checked)

PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>First Bank</b>  <b>99 W. 48th St.</b>  <b>Your City, State, Zip Code</b>		Payer's RTN (optional)	OMB No. 1545-0112  <div style="font-size: 2em; font-weight: bold; text-align: center;">2003</div> Form <b>1099-INT</b>	<b>Interest Income</b>
PAYER'S Federal identification number <b>xx-xxxxxxx</b>	RECIPIENT'S identification number <b>xxx-xx-xxxx</b>	1 Interest income not included in box 3 \$ <b>147.48</b>		<b>Copy B For Recipient</b>  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  <b>James Fairmont</b>  Street address (including apt. no.) <b>76 Fisk Ave</b>  City, state, and ZIP code <b>Your City, State, Zip Code</b>  Account number (optional)		2 Early withdrawal penalty \$ <b>19.68</b>	3 Interest on U.S. Savings Bonds and Treas. obligations \$	
4 Federal income tax withheld \$		5 Investment expenses \$		
6 Foreign tax paid \$		7 Foreign country or U.S. possession		

Form **1099-INT** (keep for your records) Department of the Treasury - Internal Revenue Service

**Module 2****Objectives**

After completing this module you should be able to:

- Create a new tax return by completing the main information sheet for this module in TaxWise.
- Determine the qualifications for head of household and married filing separately filing status.
- Use the 5 tests for dependents, to determine dependency status.
- Determine who is eligible for the credit for child and dependent care expenses.
- Use the EIC eligibility requirements, to determine an EIC qualifying child.
- Determine who is eligible for the child tax credit.
- Input applicable information from Form 1099-DIV.
- Determine who can use Schedule C-EZ and complete Schedule C-EZ and Schedule SE.
- Complete Form 2441.
- Complete the Child Tax Credit Worksheet.
- Complete the EIC Worksheet
- Explain the benefits of AEIC and review where AEIC is reported on Form 1040 or Form 1040A.
- Identify proper procedures for finishing the return.
- Complete Form 8880.

## Taxpayer Profile

Taxpayer Name	Betsy Curry
TP SSN	XXX-XX-XXXX
Spouse Name	
SP SSN	
Street Address	614 Howard Ave
City, State, Zip	Your City State and Zip Code
Phone Number	402-555-1212
Date of birth TP	08/23/1969
Date of birth Spouse	
Occupation TP	Executive Assistant
SP	
Blind? TP	No
SP	
Donate to Presidential Fund?	
TP	Yes
SP	
Filing status	Head of Household
Can be claimed as dependent by someone else? TP	No
SP	
State Return Info (Yes or No)	No
Direct Deposit	
Bank Routing Number	XXXXXXXXXX
Account number	XXXXXXX

## Other Members of Household

Name	Date of Birth	SSN or ITIN	Relationship	Citizenship	# of Months in Home
Mary Curry	07/21/1994	xxx-xx-xxxx	Daughter	U.S.	12
James Curry	08/24/1997	xxx-xx-xxxx	Son	U.S.	12

## Other considerations:

Betsy is divorced and keeps up a main home for herself and her children.

She provides 100% of her children's support.

Both children lived with her for the entire year.

Betsy has a small word processing business (Code: 561900) which she runs out of her home. Her gross income was \$4,850. Her total expenses for materials were \$363 and she has written records for

1,200 business miles and 9,000 other miles on her only car. Her car was put into business use on January 1, 2002. Her business takes up only a very small area in her home and she uses her computer mainly for personal use. She elects to take the standard mileage rate.

Betsy's neighbor, Mary King, cares for her two children after school. Betsy paid \$1,750 for each child during 2003. Mary's SSN is xxx-xx-xxxx and her address is 628 Howard Ave., Your City, State, and Zip Code.

**Documents taxpayer gives you:**

Form W-2, State of Nebraska

a Control number <b>123456</b>		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number <b>xx-xxxxxxx</b>		1 Wages, tips, other compensation <b>\$14,834.56</b>		2 Federal income tax withheld <b>\$1,739.86</b>			
c Employer's name, address, and ZIP code  <b>State of Nebraska 1345 South 10th Street Omaha, Nebraska 68104</b>		3 Social security wages <b>\$17,834.56</b>		4 Social security tax withheld <b>\$1,106.00</b>			
		5 Medicare wages and tips <b>\$17,834.56</b>		6 Medicare tax withheld <b>\$259.00</b>			
		7 Social security tips		8 Allocated tips			
d Employee's social security number <b>xxx-xx-xxxx</b>		9 Advance EIC payment <b>\$1,000.00</b>		10 Dependent care benefits <b>\$1,000.00</b>			
e Employee's first name and initial      Last name  <b>Betsy Curry 7614 Howard Ave. Your City, State, Zip Code</b>		11 Nonqualified plans		12a See instructions for box 12 <b>D</b> <b>\$2,000.00</b>			
		13 Statutory employee      Retirement plan      Third-party sick pay <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b			
		14 Other		12c			
				12d			
f Employee's address and ZIP code							
15 State	Employer's state ID number <b>xx-xxxxxxx</b>	16 State wages, tips, etc. <b>\$14,834.56</b>	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

**Form W-2 Wage and Tax Statement**      **2003**      Department of the Treasury—Internal Revenue Service

**Copy B To Be Filed with Employee's FEDERAL Tax Return.**  
This information is being furnished to the Internal Revenue Service.

CORRECTED (if checked)

PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>ABC Corporation</b> <b>3333 North Tenth Street</b> <b>Your City, State, Zip Code</b>		<b>1a</b> Total ordinary dividends \$ <b>54.00</b>	OMB No. 1545-0110  <b>2003</b>  Form <b>1099-DIV</b>	<b>Dividends and Distributions</b>
		<b>1b</b> Qualified dividends \$		
PAYER'S Federal identification number  <b>XX-XXXXXXX</b>		<b>2a</b> Total capital gain distr. \$		<b>2b</b> Post-May 5 capital gain distr. \$
		<b>2c</b> Qualified 5-year gain \$		
RECIPIENT'S identification number  <b>XXX-XX-XXXX</b>		<b>2e</b> Section 1202 gain \$		<b>2f</b> Collectibles (28%) gain \$
RECIPIENT'S name  <b>Betsy Curry</b>  Street address (including apt. no.) <b>614 Howard Ave.</b>  City, state, and ZIP code <b>Your City, State, Zip Code</b>		<b>3</b> Nontaxable distributions \$		
		Account number (optional)		<b>5</b> Investment expenses \$
Account number (optional)		<b>6</b> Foreign tax paid \$		<b>7</b> Foreign country or U.S. possession
		<b>8</b> Cash liquidation distributions \$		<b>9</b> Noncash liquidation distributions \$

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-DIV**

(keep for your records)

Department of the Treasury - Internal Revenue Service

**Module 3****Objectives**

After completing this module you should be able to:

- Create a new tax return by completing the main information sheet for this module in TaxWise.
- Determine the qualifications for married filing jointly and qualifying widower filing status.
- Determine basis and capital gain/loss on sale of stock.
- Determine if IRA distributions are taxable, nontaxable, or partly taxable and calculate the taxable portion.
- Determine if retirement income is taxable and calculate the taxable portion.
- Distinguish between taxable and nontaxable social security benefits and calculate the taxable portion.
- Identify how other types of income are reported.
- Determine the qualifications for the tuition and fees deduction.
- Determine the qualifications for the education credits.
- Determine the most advantageous method for reporting tuition and fees.
- Determine which items are allowed when itemizing deductions.
- Know where to report estimated tax payments.
- Determine if the estimated tax penalty applies.

## Taxpayer Profile

Taxpayer Name	Don Hillsdale
TP SSN	XXX-XX-XXXX
Spouse Name	Sarah Wilson
SP SSN	xxx-xx-xxxx
Street Address	129 Pembroke Ave.
City, State, Zip	Your City, State, Zip Code
Phone Number	402-555-1212
Date of birth TP	03/12/1932
Date of birth Spouse	12/21/1940
Occupation TP	Retired
SP	Housewife
Blind? TP	No
SP	No
Donate to Presidential Fund?	
TP	Yes
SP	No
Filing Status	MFJ
Can be claimed as dependent by someone else? TP	No
SP	No
State Return Info (Yes or No)	
Direct Deposit	
Bank Routing Number	XXXXXXXXXX
Account number	XXXXXXXXXXXXXXXXXX

## Other Members of Household

Name	Date of Birth	SSN or ITIN	Relationship	Citizenship	# of Months in Home
Betty Wilson	05/23/1983	xxx-xx-xxxx	Granddaughter	U.S.	12

## Other considerations:

- Don paid \$1,350 for tuition and fees to the local college for his granddaughter's education. She is a junior and a full-time student.
- Don and Sarah's previous year tax liability was \$2,011.

- Sarah provided the following information on the sale of stock.

Company	# of Shares	Purchase Date	Per Share Basis	Sale Date	Per Share Sales Price
ABC Co.	100	05/28/1985	48.00	05/30/2003	55.00
XYZ Co.	100	11/05/2002	32.00	04/10/2003	49.00

- Don and Sarah had the following expenses for the year:

Medical insurance	\$2,250
Medical travel	500 miles
Dental bills	\$275
New glasses	\$165
Prescription drugs	\$1,263
Over the counter medication	\$120
Church donations	\$1,000
Donation to neighbor whose house burnt	\$100
Other charities (cash)	\$82
Clothing to Salvation Army	\$327
Home mortgage interest	\$3,175
City real estate tax	\$550
County real estate tax	\$1,721
Car license fee	\$35
Personal property tax	\$817
Gambling losses	\$1,500

- Don made the following estimated tax payments:

04/12/2003	\$200
06/15/2003	\$200
09/10/2003	\$200
01/15/2004	\$200

- Don and Sarah had \$200 of their previous year's tax refund applied to this year's taxes.

Documents taxpayer gives you:

Form 1099-R, Emerson Utility

<input type="checkbox"/> CORRECTED (if checked)				
PAYER'S name, street address, city, state, and ZIP code <b>Emerson Utilities</b> 555 East 10th St. Your City, State, Zip Code		<b>1</b> Gross distribution OMB No. 1545-0119 \$ 31,562.00	<b>2003</b> Form 1099-R	<b>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</b>  <b>Copy B</b> Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.  This information is being furnished to the Internal Revenue Service.
		<b>2a</b> Taxable amount \$ 31,562.00		
PAYER'S Federal identification number xx-xxxxxxx	RECIPIENT'S identification number xxx-xx-xxxx	<b>3</b> Capital gain (included in box 2a) \$	<b>4</b> Federal income tax withheld \$ 1,250.00	
RECIPIENT'S name Don Hillsdale  Street address (including apt. no.) 129 Pembroke Ave City, state, and ZIP code Your City, State Zip Code		<b>5</b> Employee contributions or insurance premiums \$	<b>6</b> Net unrealized appreciation in employer's securities \$	
		<b>7</b> Distribution code(s) 7	IRA/SEP/SIMPLE <input type="checkbox"/> <b>8</b> Other \$ %	
Account number (optional)		<b>9a</b> Your percentage of total distribution %	<b>9b</b> Total employee contributions \$	
		<b>10</b> State tax withheld \$	<b>11</b> State/Payer's state no. \$	
		<b>13</b> Local tax withheld \$	<b>14</b> Name of locality \$	
		\$	<b>15</b> Local distribution \$	

Form 1099-R Department of the Treasury - Internal Revenue Service

Form 1099-R, First Security

<input type="checkbox"/> CORRECTED (if checked)				
PAYER'S name, street address, city, state, and ZIP code <b>First Security</b> 895 West Whittier Your City, State, Zip Code		<b>1</b> Gross distribution OMB No. 1545-0119 \$ 2,252.00	<b>2003</b> Form 1099-R	<b>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</b>  <b>Copy B</b> Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.  This information is being furnished to the Internal Revenue Service.
		<b>2a</b> Taxable amount \$ 2,252.00		
PAYER'S Federal identification number xx-xxxxxxx	RECIPIENT'S identification number xxx-xx-xxxx	<b>3</b> Capital gain (included in box 2a) \$	<b>4</b> Federal income tax withheld \$ 225.00	
RECIPIENT'S name Don Hillsdale  Street address (including apt. no.) 129 Pembroke Ave City, state, and ZIP code Your City, State Zip Code		<b>5</b> Employee contributions or insurance premiums \$	<b>6</b> Net unrealized appreciation in employer's securities \$	
		<b>7</b> Distribution code(s) 7	IRA/SEP/SIMPLE <input checked="" type="checkbox"/> <b>8</b> Other \$ %	
Account number (optional)		<b>9a</b> Your percentage of total distribution %	<b>9b</b> Total employee contributions \$	
		<b>10</b> State tax withheld \$	<b>11</b> State/Payer's state no. \$	
		<b>13</b> Local tax withheld \$	<b>14</b> Name of locality \$	
		\$	<b>15</b> Local distribution \$	

Form 1099-R Department of the Treasury - Internal Revenue Service

3232		<input type="checkbox"/> CORRECTED		OMB No. 1545-0238	
PAYER'S name <b>ABC Casino</b> Street address <b>2233 N. 33rd St.</b> City, state, and ZIP code <b>Your City, State, Zip Code</b> Federal identification number      Telephone number		1 Gross winnings <b>\$1,500.00</b>	2 Federal income tax withheld	<div style="font-size: 2em; font-weight: bold;">2003</div> <div style="font-weight: bold;">Form W-2G</div> <div style="font-weight: bold;">Certain Gambling Winnings</div> <p style="font-size: 0.8em;">For Privacy Act and Paperwork Reduction Act Notice, see the 2003 General Instructions for Forms 1099, 1098, 5498, and W-2G.</p> <div style="font-weight: bold;">File with Form 1096.</div>	
		3 Type of wager <b>Slots</b>	4 Date won <b>3 : 31 : 2003</b>		
		5 Transaction	6 Race		
		7 Winnings from identical wagers	8 Cashier		
WINNER'S name <b>Sarah Wilson</b> Street address (including apt. no.) <b>129 Pembroke Ave.</b> City, state, and ZIP code <b>Your City, State, Zip Code</b>		9 Winner's taxpayer identification no. <b>XXX-XX-XXXX</b>	10 Window	<div style="font-weight: bold;">Copy A</div> <div style="font-weight: bold;">For Internal Revenue Service Center</div>	
		11 First I.D.	12 Second I.D.		
		13 State/Payer's state identification no.	14 State income tax withheld		
		Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments.			
Signature ►		Date ►			
Form <b>W-2G</b>		Cat. No. 10138V		Department of the Treasury - Internal Revenue Service	

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0110		
PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>ABC Securities</b> <b>3333 North Tenth Street</b> <b>Your City, State, Zip Code</b>		1a Total ordinary dividends \$	<div style="font-size: 2em; font-weight: bold;">2003</div> <div style="font-weight: bold;">Form 1099-DIV</div>	<div style="font-weight: bold;">Dividends and Distributions</div>
		1b Qualified dividends \$		
		2a Total capital gain distr. \$ <b>1,236.00</b>		
PAYER'S Federal identification number <b>XX-XXXXXXX</b>	RECIPIENT'S identification number <b>XXX-XX-XXXX</b>	2c Qualified 5-year gain \$ <b>236.00</b>	2d Unrecap. Sec. 1250 gain \$	<div style="font-weight: bold;">Copy B</div> <div style="font-weight: bold;">For Recipient</div>
RECIPIENT'S name <b>Sarah Wilson</b>  Street address (including apt. no.) <b>129 Pembroke Ave.</b>  City, state, and ZIP code <b>Your City, State, Zip Code</b>		2e Section 1202 gain \$	2f Collectibles (28%) gain \$	
		3 Nontaxable distributions \$	4 Federal income tax withheld \$ <b>124.00</b>	
		Account number (optional)		5 Investment expenses \$
7 Foreign country or U.S. possession	8 Cash liquidation distributions \$			
		9 Noncash liquidation distributions \$		
Form <b>1099-DIV</b>		(keep for your records)		Department of the Treasury - Internal Revenue Service

**FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT**

**2003** • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME.  
 • SEE THE REVERSE FOR MORE INFORMATION.

Box 1. Name <b>Don Hillsdale</b>	Box 2. Beneficiary's Social Security Number <b>xxx-xx-xxxx</b>
-------------------------------------	---

Box 3. Benefits Paid in 2003 <b>12,240.00</b>	Box 4. Benefits Repaid to SSA in 2003	Box 5. Net Benefits for 2003 (Box 3 minus Box 4) <b>12,240.00</b>
--	---------------------------------------	--

DESCRIPTION OF AMOUNT IN BOX 3          	DESCRIPTION OF AMOUNT IN BOX 4          
Box 6. Voluntary Federal Income Tax Withholding  <p style="text-align: center;"><b>0</b></p>	
Box 7. Address  <p style="text-align: center;"><b>129 Pembroke Ave</b> <b>Your City, State, Zip Code</b></p>	
Box 8. Claim Number (Use this number if you need to contact SSA.)	

Draft as of  
09/01/2003

**Module 4****Wage Earner Objectives**

After completing this module you should be able to:

- Identify when Individual Taxpayer Identification Numbers are required.
- Define multiple support as it applies to dependent exemptions.
- Determine when and how tip income is reported.
- Determine when scholarship and fellowship grants are taxable.
- Determine when state and local tax refunds are taxable.
- Distinguish between alimony and child support and identify where to report the receipt of alimony.
- Identify where alimony payments are reported.
- Identify where jury duty payments returned to an employer are reported.
- Explain foreign tax credit and mortgage interest credit.

**Pension Earner Objectives**

After completing this module you should be able to:

- Determine when a gain from the sale of a home is reported.
- Determine when Coverdell ESAs are taxable.
- Determine the qualifications for the credit for the elderly and disabled.

**MILITARY OBJECTIVES**

After completing this module you should be able to:

- Know when an Armed Forces member can be claimed as a dependent on someone else's return.
- Know the special rule for claiming Head of Household when married to a non-resident alien.
- Know how to calculate the taxable wages for a member of the Armed Forces who receives medical separation pay.
- Know which states have community property laws.
- Know when a person is required to report a net profit or loss from self-employment using a Schedule C or Schedule C-EZ.
- Know when a person is required to complete a Schedule E to report rental income and expenses.
- Know the filing deadline extensions for people outside the U.S. and those in a combat zone.

- Know how the military thrift savings plan is treated for tax purposes.
- Know who qualifies for the foreign income exclusion and how to calculate it.

## Module 5

### Objectives

After completing this module you will be able to:

- Complete the Main Information Sheet and all other information covered in previous modules.
- Determine the effect on income for personnel assigned to a “Combat Zone”.
- Determine other benefits for personnel in a designated “Combat Zone”.
- Determine qualified moving expenses and input applicable information for the calculation of the adjustment.
- Determine qualifying miscellaneous expenses for military personnel that can be listed as itemized deductions.

### Taxpayer Profile

Taxpayer Name	MSgt Mary Bennett
TP SSN	XXX-XX-XXXX
Spouse Name	Gary Bennett
SP SSN	XXX-XX-XXXX
Street Address	345 Lake Huron Place
City, State, Zip	Your City, State, Zip Code
Phone Number	852-555-1212
Date of birth TP	11/24/1967
Date of birth Spouse	01/30/1965
Occupation TP	Air Force Lab Tech
SP	Nurse
Blind? TP	No
SP	No
Donate to Presidential Fund? TP	Yes
SP	Yes
Filing Status	Married Filing Jointly
Can be claimed as dependent by someone else? TP	No
SP	No
State Return Info (Yes or No)	No
Direct Deposit	
Bank Routing Number	XXXXXXXXXX
Account number	XXXXXXX

## Other Members of Household

Name	Date of Birth	SSN or ITIN	Relationship	Citizenship	# Months in Home
Terri Bennett	09/06/1992	xxx-xx-xxxx	Daughter	U.S.	12
Jason Bennett	01/27/1998	xxx-xx-xxxx	Son	U.S.	12
Kyle Bennett	07/18/2000	xxx-xx-xxxx	Son	U.S.	12

### Other considerations:

Mary was stationed in Afghanistan in a combat zone from March 5, 2003 to September 2, 2003.

While in the combat zone she earned wages of \$23,394, BAH of \$13,545, Separation Allowance of \$1750, Hazardous Duty Pay of \$1050, and Imminent Danger/Hostile Fire pay of \$1575.

Mary reenlisted while in the combat zone and received a \$20,000 reenlistment bonus.

Mary has an allotment of \$1000 a month coming out of her check that is sent to her mother. This allotment pays for more than half of the cost of support for her mother and her 14 year old brother who lives with her mother in Mississippi. Her mother receives \$650 a month social security benefits for minor children. This is the only other income their household receives.

Name	Date of Birth	SSN or ITIN	Relationship	Citizenship	# Months in Home
Nancy Taft	05/23/1949	xxx-xx-xxxx	Mother	U.S.	0
Jeffery Taft	09/15/1989	xxx-xx-xxxx	Brother	U.S.	0

Mary and Gary have the following expenses. They are not sure if they can itemize.

Home mortgage interest	\$9,368
Real Estate Taxes	\$2,245
New roof to replace leaking roof:	\$4,200
Donated clothes FMV:	\$422
Church donations	\$1,000
Military uniform cleaning expenses:	\$ 969 (local policy prohibits wearing of all military uniforms off-duty; Mary receives a clothing allowance of \$342 a year)
Nurse uniform cleaning expenses:	\$653
Periodicals:	\$124 AMA Journal of Medicine, \$18 Woodworking,

\$22 Nursing Reporter,

\$28 Air Force Times,

\$23 Quilter's  
Newsletter

\$360

Nurses union dues for Gary

Gary and Mary moved from Louisiana to Virginia in January 2003  
and had the following DITY move expenses:

\$2,300 U-Haul Rental,

\$280 Lodging 2 nights

\$215 meals enroute

1175 miles

a Control number		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number XX-XXXXXXX				1 Wages, tips, other compensation \$13,767.84		2 Federal income tax withheld \$5,369.92	
c Employer's name, address, and ZIP code  Department of Defense  Your City, State, Zip Code				3 Social security wages \$33,040.80		4 Social security tax withheld \$2,048.48	
				5 Medicare wages and tips \$33,040.80		6 Medicare tax withheld \$479.09	
				7 Social security tips		8 Allocated tips	
d Employee's social security number XXX-XX-XXXX				9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial      Last name  Mary Bennett 345 Lake Huron Place Your City, State, Zip Code				11 Nonqualified plans		12a See instructions for box 12	
				13 Statutory employee      Retirement plan      Third-party sick pay <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b	
				14 Other		12c	
						12d	
f Employee's address and ZIP code							
15 State      Employer's state ID number XX-XXXXXXX		16 State wages, tips, etc. \$13,767.84		17 State income tax \$1,521.85		18 Local wages, tips, etc.	
						19 Local income tax	
						20 Locality name	

Form **W-2** Wage and Tax  
Statement

**2003**

Department of the Treasury—Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return.  
This information is being furnished to the Internal Revenue Service.

a Control number		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number XX-XXXXXXX		1 Wages, tips, other compensation \$2,219.36		2 Federal income tax withheld \$688.00			
c Employer's name, address, and ZIP code Department of Defense Your City, State, Zip Code		3 Social security wages \$2,219.36		4 Social security tax withheld \$137.00			
		5 Medicare wages and tips \$2,219.36		6 Medicare tax withheld \$32.18			
		7 Social security tips		8 Allocated tips			
d Employee's social security number XXX-XX-XXXX		9 Advance EIC payment		10 Dependent care benefits			
e Employee's first name and initial Last name Mary Bennett 345 Lake Huron Place Your City, State, Zip Code		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			
f Employee's address and ZIP code				12d			
15 State Employer's state ID number XX-XXXXXXX	16 State wages, tips, etc. \$2,219.36	17 State income tax \$0.00	18 Local wages, tips, etc.	19 Local income tax	20 Locality name		

**Form W-2 Wage and Tax Statement 2003** Department of the Treasury—Internal Revenue Service

**Copy B To Be Filed with Employee's FEDERAL Tax Return.**  
This information is being furnished to the Internal Revenue Service.

a Control number		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number XX-XXXXXXX		1 Wages, tips, other compensation \$15,320.00		2 Federal income tax withheld \$1,637.00			
c Employer's name, address, and ZIP code City Hospital #1 Hospital Plaza Your City, State, Zip Code		3 Social security wages \$15,320.00		4 Social security tax withheld \$949.84			
		5 Medicare wages and tips \$15,320.00		6 Medicare tax withheld \$222.14			
		7 Social security tips		8 Allocated tips			
d Employee's social security number XXX-XX-XXXX		9 Advance EIC payment		10 Dependent care benefits			
e Employee's first name and initial Last name Gary Bennett 345 Lake Huron Place Your City, State, Zip Code		11 Nonqualified plans		12a See instructions for box 12			
		13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b			
		14 Other		12c			
f Employee's address and ZIP code				12d			
15 State Employer's state ID number XX-XXXXXXX	16 State wages, tips, etc. \$15,320.00	17 State income tax \$750.96	18 Local wages, tips, etc.	19 Local income tax	20 Locality name		

**Form W-2 Wage and Tax Statement 2003** Department of the Treasury—Internal Revenue Service

**Copy B To Be Filed with Employee's FEDERAL Tax Return.**  
This information is being furnished to the Internal Revenue Service.

CORRECTED (if checked)

PAYER'S name, street address, city, state, ZIP code, and telephone no.  <b>First Federal Credit Union</b> <b>8500 Baylor Ave</b> <b>Your City, State, Zip Code</b>		Payer's RTN (optional)	OMB No. 1545-0112  <b>2003</b>  Form <b>1099-INT</b>	<b>Interest Income</b>
PAYER'S Federal identification number <b>XX-XXXXXXX</b>	RECIPIENT'S identification number <b>XXX-XX-XXXX</b>	1 Interest income not included in box 3 <b>\$ 871.00</b>		
RECIPIENT'S name  <b>Gary and Mary Bennett</b> Street address (including apt. no.) <b>345 Lake Huron Place</b> City, state, and ZIP code <b>Your City, State, Zip Code</b>		2 Early withdrawal penalty  \$	3 Interest on U.S. Savings Bonds and Treas. obligations  \$	<b>Copy B For Recipient</b>  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  \$	5 Investment expenses  \$	
		6 Foreign tax paid  \$	7 Foreign country or U.S. possession	
Form <b>1099-INT</b>		(keep for your records)	Department of the Treasury - Internal Revenue Service	

**Objectives**

After completing this module you will be able to:

- Complete the Main Information Sheet and all other information covered in previous modules.
- Determine the correct filing status.
- Determine dependency status of all persons in the household.

**Taxpayer Profile**

Taxpayer Name	PFC Joe Wells
TP SSN	xxx-xx-xxxx
Spouse Name	Lee Wells
SP SSN	923-76-xxxx (ITIN)
Street Address	4433 Sterling Avenue
City, State, Zip	Your City, State, Zip Code
Phone Number	512-555-1212
Date of birth TP	02/04/1977
Date of birth Spouse	04/18/1979
Occupation TP	Soldier
SP	Housewife
Blind? TP	No
SP	No
Donate to Presidential Fund?	
TP	Yes
SP	Yes
Filing Status	Married Filing Jointly
Can be claimed as dependent by someone else? TP	No
SP	No
State Return Info (Yes or No)	No
Direct Deposit	
Bank Routing Number	XXXXXXXXXX
Account number	XXXXXXXXXX

## Other Members of Household

Name	Date of Birth	SSN or ITIN	Relationship	Citizenship	# Months in Home
Jung Ling	05/16/2000	923-76-XXXX	Step-son	Korea	12
Myung Joe	08/24/2003	XXX-XX-XXXX	Daughter	U.S.	12

### Other considerations:

Joe and Lee lived in Korea till November 20, 2003.

Lee is not a U.S. citizen but they agree to file a joint return.

Jung Ling is Lee's son from a previous marriage. Joe has not legally adopted Jung Ling.

Joe received military benefits that include Hostile Fire Pay, Imminent Danger pay, Basic Allowance for Housing, and Basic Allowance for Subsistence.

a Control number		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS Web Site at <a href="http://www.irs.gov">www.irs.gov</a> .	
b Employer identification number XX-XXXXXXX				1 Wages, tips, other compensation \$19,246.88		2 Federal income tax withheld \$2,369.32	
c Employer's name, address, and ZIP code Department of Defense				3 Social security wages \$19,246.88		4 Social security tax withheld \$1,193.30	
				5 Medicare wages and tips \$19,246.88		6 Medicare tax withheld \$279.08	
				7 Social security tips		8 Allocated tips	
d Employee's social security number XXX-XX-XXXX				9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Last name Joe Wells 4433 Sterling Avenue Your City, State, Zip Code				11 Nonqualified plans		12a See instructions for box 12	
				13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input checked="" 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

**2003**

Department of the Treasury—Internal Revenue Service

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This information is being furnished to the Internal Revenue Service.

**STUDENT NOTES**

While every class is unique, we strive to have consistency in the training that is presented to the volunteers. To assist you in planning your class, the following pages present a variety of Suggested Class Schedules. The schedules cover a variety of situations and are divided into three basic categories: New Students, Returning Students and a Combination of New and Returning Students. There is even a suggested schedule for a Tax Law Refresher. At the top of each schedule, you will find information about the type of student and kind of returns the students will prepare. You should use the schedule that best fits your situation.

You will note that the amount of time devoted to a lesson will vary throughout the schedules. In determining the amount of time to devote to a lesson, we considered the following factors:

- Difficulty of topic presented in the lesson
- Amount of new tax law in the lesson
- Experience level of the student
- Expected frequency of the subject for the student
- Topics that contain the most commonly found errors on tax returns
- Total amount of class time

## **Schedules 1-4, New Students**

These four schedules are based on the following premises:

- Your class is primarily composed of students who have no prior tax experience, and
- The students have not participated in the program in the past, and
- You are not using integrated training for this class (schedules for integrated training are contained in the next section of this chapter).

## **Schedules 5-8, Returning Students**

These four schedules are based on the following premises:

- Your class is primarily composed of students who have prior tax experience, and
- The students have participated in the program in the past, and
- You are not using the integrated training for this class (schedules for integrated training are contained in Appendix A).

## Schedules 9-12, Combination of New and Returning Students

These four schedules are based on the following premises:

- You have a class that composed of both new and returning students, and
- Some of the students have prior tax experience

## Schedule 13 - Tax Law Refresher Only

This schedule provides a condensed training schedule for a tax law refresher class. This schedule should *not* be used with new volunteers.

### ***INSTRUCTIONAL METHODS/APPROACHES***

This training material is designed to provide you the flexibility you need to convey the information your students require to prepare accurate and complete tax returns. The information can be taught using various approaches as follows:

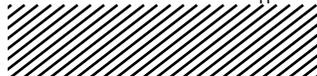
**Traditional Classroom Training** (self-explanatory).

Appendix B contains recommended syllabuses/class schedules for presenting the course materials in one to 5-days.

**Self-Study.** Volunteers with prior experience may be comfortable studying the material on their own. New volunteers may find the self-study approach more convenient. If you choose this training approach, at least one formal meeting/classroom session will be helpful to address specific questions and administrative requirements.

**Tax Law/TaxWise Integrated Training.** Integrated training refers to teaching tax law in harmony with teaching the students how to use the Service's official volunteer e-file software - TaxWise. Appendix A contains extensive information on conducting a comprehensive integrated class.

**C-VITA** – The Condensed VITA training approach is designed for volunteers who already possess certain skill sets. C-VITA is not designed as a stand alone training option. For additional information see Publication 3888, C-VITA Training Guide.



## Suggested Class Schedule 1

<b>Student experience level:</b>	No prior tax training
<b>Prior VITA/TCE experience:</b>	No prior experience
<b>Types of returns:</b>	<b><i>Domestic Military Basic Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

<b>Day</b>	<b>Time</b>	<b>Topic</b>	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 2, Pub 678M: Income	
	11:30	Lunch	
	12:30	Continue Lesson 2	
	1:30	Short break	
	1:40	Lesson 11, Pub 678M: Sale of Stock	
	2:40	Break	
	3:00	Continue Lesson 11	
	4:00	Dismiss	
	2	9:00	Review key points from yesterday and answer any questions
		9:30	Lesson 3, Pub 678M: Adjustments
		10:00	Break
10:15		Continue Lesson 3	
11:30		Lunch	
12:30		Lesson 4, Pub 678M: Standard and Itemized Deductions	
1:30		Break	
1:45		Continue Lesson 4	
2:45		Break	
3:00		Lesson 5, Pub 678M: Miscellaneous Credits	
4:00		Dismiss	
3		9:00	Review key points from yesterday and answer any questions
		9:30	Lesson 7, Pub 678M: Child Care Credit
		10:15	Break
	10:30	Lesson 8, Pub 678M: Education Credits	
	11:30	Lunch	
	12:30	Lesson 9, Pub 678M: Earned Income Credit	
	1:30	Break	
	1:45	Continue Lesson 9	
	3:00	Break	
	3:15	Review and work on Comprehensive problems	
	4:00	Dismiss	



4	9:00	Review key points from yesterday and answer any questions
	9:30	Lesson 10, Pub 678M: Child Tax Credit
	10:15	Break
	10:30	Continue Lesson 10
	11:30	Lunch
	12:30	Lesson 6, Pub 678M: Finishing the Return
	1:30	Break
	1:45	Work on Comprehensive problems
	2:30	Break
	2:45	Review and final questions
	3:30	Wrap-up
	4:00	Dismiss



## Suggested Class Schedule 2

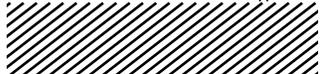
<b>Student experience level:</b>	No prior tax training
<b>Prior VITA/TCE experience:</b>	No prior experience
<b>Types of returns:</b>	<b><i>Domestic Military Advanced Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

Day	Time	Topic	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 2, Pub 678M: Income	
	11:30	Lunch	
	12:30	Continue Lesson 2	
	1:30	Break	
	1:40	Lesson 11, Pub 678M: Sale of Stock	
	2:40	Break	
	3:00	Continue Lesson 11	
	4:00	Dismiss	
	2	8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 12, Pub 678M: Sale of Home
		9:00	Break
9:15		Lesson 13, Pub 678M: Pensions	
10:15		Break	
10:30		Continue Lesson 13	
11:30		Lunch	
12:30		Lesson 3, Pub 678M: Adjustments	
1:30		Break	
1:45		Lesson 4, Pub 678M: Standard and Itemized Deductions	
2:45		Break	
3:00		Lesson 5, Pub 678M: Miscellaneous Credits	
4:00		Dismiss	
3		8:00	Work on comprehensive problems and test
	9:00	Review key points from yesterday and answer any questions	
	9:30	Lesson 7, Pub 678M: Child Care Credit	
	10:15	Break	
	10:30	Lesson 8, Pub 678M: Education Credits	
	11:30	Lunch	
	12:30	Lesson 9, Pub 678M: Earned Income Credit	
	1:30	Break	



	1:45	Continue Lesson 9
	3:00	Break
	3:15	Review and work on Comprehensive problems
	4:00	Dismiss
4	8:00	Work on comprehensive problems and test
	9:00	Review key points from yesterday and answer any questions
	9:30	Lesson 10, Pub 678M: Child Tax Credit
	10:15	Break
	10:30	Continue Lesson 10
	11:30	Lunch
	12:30	Lesson 6, Pub 678M: Finishing the Return
	1:30	Break
	1:45	Work on Comprehensive problems
	2:30	Break
	2:45	Review and final questions
	3:30	Wrap-up
	4:00	Dismiss



### Suggested Class Schedule 3

<b>Student experience level:</b>	No prior tax training
<b>Prior VITA/TCE experience:</b>	No prior experience
<b>Types of returns:</b>	<b><i>International Military Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

<b>Day</b>	<b>Time</b>	<b>Topic</b>	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 17, Pub 678M: Aliens	
	11:30	Lunch	
	12:30	Lesson 2, Pub 678M: Income	
	1:30	Break	
	1:45	Lesson 2 contunued	
	2:45	Break	
	3:00	Lesson 16, Pub 678M: Combat Zone Provisions	
	4:00	Dismiss	
	2	8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 15, Pub 678M: Foreign Earned Income Exclusion
		9:30	Break
9:45		Lesson 11, Pub 678M: Sale of Stock	
10:45		Break	
11:00		Continue Lesson 11	
12:00		Lunch	
1:00		Lesson 12, Pub 678M: Sale of Home	
1:30		Break	
1:45		Lesson 13, Pub 678M: Pensions	
3:15		Break	
3:30		Lesson 3, Pub 678M: Adjustments	
4:30		Dismiss	
3		8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 4, Pub 678M: Standard and Itemized Deductions	
	9:30	Break	
	9:45	Continue Lesson 4	
	10:45	Break	
	11:00	Lesson 5, Pub 678M: Miscellaneous Credits	
	12:00	Lunch	
	1:00	Lesson 7, Pub 678M: Child Care Credits	
	2:00	Break	
	2:15	Lesson 8, Pub 678M: Education Credits	



	3:15	Break
	3:45	Work on comprehensive problems or test
	4:30	Dismiss
4	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 9, Pub 678M: Earned Income Credit
	9:30	Break
	9:45	Continue Lesson 9
	10:45	Break
	11:00	Lesson 10, Pub 678M: Child Tax Credit
	Noon	Lunch
	1:00	Continue Lesson 10
	2:00	Break
	2:15	Lesson 6, Pub 678M: Finishing the Return
	3:30	Wrap-up
	4:00	Dismiss



## Suggested Class Schedule 4

<b>Student experience level:</b>	No prior tax training
<b>Prior VITA/TCE experience:</b>	No prior experience
<b>Types of returns:</b>	<b><i>US taxpayers Abroad (Non-military)</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

<b>Day</b>	<b>Time</b>	<b>Topic</b>	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 17, Pub 678M: Aliens	
	11:30	Lunch	
	12:30	Lesson 2, Pub 678M: Income	
	1:30	Break	
	1:45	Lesson 2 contunued	
	2:45	Break	
	3:00	Lesson 16, Pub 678M: Combat Zone Provisions	
	3:30	Lesson 18, Pub 678M: Home Leave Provisions	
	4:00	Dismiss	
	2	8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 15, Pub 678M: Foreign Earned Income Exclusion
9:30		Break	
9:45		Lesson 11, Pub 678M: Sale of Stock	
10:45		Break	
11:00		Continue Lesson 11	
12:00		Lunch	
1:00		Lesson 12, Pub 678M: Sale of Home	
1:30		Break	
1:45		Lesson 13, Pub 678M: Pensions	
3:15		Break	
3:30		Lesson 3, Pub 678M: Adjustments	
4:30		Dismiss	
3		8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 4, Pub 678M: Standard and Itemized Deductions	
	9:30	Break	
	9:45	Continue Lesson 4	
	10:45	Break	
	11:00	Lesson 5, Pub 678M: Miscellaneous Credits	
	12:00	Lunch	
	1:00	Lesson 7, Pub 678M: Child Care Credits	



	2:00	Break
	2:15	Lesson 8, Pub 678M: Education Credits
	3:15	Break
	3:45	Work on comprehensive problems or test
	4:30	Dismiss
4	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 9, Pub 678M: Earned Income Credit
	9:30	Break
	9:45	Continue Lesson 9
	10:45	Break
	11:00	Lesson 10, Pub 678M: Child Tax Credit
	Noon	Lunch
	1:00	Continue Lesson 10
	2:00	Break
	2:15	Lesson 6, Pub 678M: Finishing the Return
	3:30	Wrap-up
	4:00	Dismiss

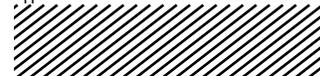


## Suggested Class Schedule 5

<b>Student experience level:</b>	Prior tax training
<b>Prior VITA/TCE experience:</b>	Prior experience
<b>Types of returns:</b>	<b><i>Domestic Military Basic Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

Day	Time	Topic	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 2, Pub 678M: Income	
	11:30	Lunch	
	12:30	Continue Lesson 2	
	1:30	Short break	
	1:40	Lesson 11, Pub 678M: Sale of Stock	
	2:40	Break	
	3:00	Continue Lesson 11	
	4:00	Dismiss	
	2	8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 3, Pub 678M: Adjustments
		9:00	Break
9:15		Lesson 4, Pub 678M: Standard and Itemized Deductions	
10:30		Lesson 5, Pub 678M: Miscellaneous Credits	
11:30		Lunch	
12:30		Lesson 7, Pub 678M: Child Care Credit	
1:30		Break	
1:45		Lesson 8, Pub 678M: Education Credits	
2:30		Break	
2:45		Lesson 9, Pub 678M: Earned Income Credit	
4:30		Dismiss	
3		8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 10, Pub 678M: Child Tax Credit
	9:15	Break	
	9:30	Continue Lesson 10	
	10:30	Lesson 6, Pub 678M: Finishing the Return	
	11:30	Wrap-up and Review	
	Noon	Dismiss	



## Suggested Class Schedule 6

<b>Student experience level:</b>	Prior tax training
<b>Prior VITA/TCE experience:</b>	Prior experience
<b>Types of returns:</b>	<b><i>Domestic Military Advanced Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

<b>Day</b>	<b>Time</b>	<b>Topic</b>	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 2, Pub 678M: Income	
	11:30	Lunch	
	12:30	Lesson 11, Pub 678M: Sale of Stock	
	1:30	Break	
	1:40	Continue Lesson 11	
	2:40	Break	
	3:00	Lesson 12, Pub 678M: Sale of Home	
	3:30	Lesson 13, Pub 678M: Pensions	
	4:30	Dismiss	
	2	8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 3, Pub 678M: Adjustments
9:00		Lesson 4, Pub 678M: Standard and Itemized Deductions	
9:30		Break	
9:45		Lesson 5, Pub 678M: Miscellaneous Credits	
10:30		Lesson 7, Pub 678M: Child Care Credit	
11:30		Lunch	
12:30		Lesson 8, Pub 678M: Education Credits	
1:30		Break	
1:45		Lesson 9, Pub 678M: Earned income credit	
2:45		Break	
3:00		Lesson 10, Pub 678M: Child Tax Credit	
4:30		Dismiss	
3		8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 6, Pub 678M: Finishing the Return	
	10:15	Break	
	10:30	Work military comprehensive problems	
	11:30	Wrap-up	
	Noon	Dismiss	



## Suggested Class Schedule 7

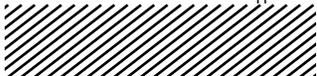
<b>Student experience level:</b>	Prior tax training
<b>Prior VITA/TCE experience:</b>	Prior experience
<b>Types of returns:</b>	<b><i>International Military Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

<b>Day</b>	<b>Time</b>	<b>Topic</b>	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 17, Pub 678M: Aliens	
	10:45	Lesson 2, Pub 678M: Income	
	11:30	Lunch	
	12:30	Lesson 16, Pub 678M: Combat Zone Provisions	
	1:30	Break	
	1:45	Lesson 15, Pub 678M: Foreign Earned Income Exclusion	
	2:45	Break	
	3:00	Lesson 11, Pub 678M: Sale of Stock	
	4:30	Dismiss	
	2	8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 12, Pub 678M: Sale of Home
9:00		Lesson 13, Pub 678M: Pensions	
9:30		Break	
9:45		Continue lesson 13	
10:45		Break	
11:00		Lesson 3, Pub 678M: Adjustments	
12:00		Lunch	
1:00		Lesson 4, Pub 678M: Standard and Itemized Deductions	
1:45		Break	
2:00		Lesson 5, Pub 678M: Miscellaneous Credits	
3:15		Break	
3:30		Lesson 7, Pub 678M: Child Care Credits	
4:30		Dismiss	
3	8:00	Review key points from yesterday and answer any questions	
	8:30	Lesson 8, Pub 678M: Education Credits	
	9:30	Break	
	9:45	Lesson 9, Pub 678M: Earned Income Credit	
	10:45	Break	
	11:00	Lesson 10, Pub 678M: Child tax Credit	
	12:00	Lunch	
	1:00	Continue Lesson 10	
2:00	Break		



	2:15	Lesson 6, Pub 678M: Finishing the Return
	3:15	Break
	3:45	Work on comprehensive problems or test
	4:30	Dismiss



## Suggested Class Schedule 8

<b>Student experience level:</b>	Prior tax training
<b>Prior VITA/TCE experience:</b>	Prior experience
<b>Types of returns:</b>	<b><i>US Taxpayers Abroad (Non-military)</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

Day	Time	Topic	
1	8:30	Registration and Introductions	
	9:00	Lesson 1, Pub 678M: Getting Started	
	10:00	Break	
	10:15	Lesson 17, Pub 678M: Aliens	
	11:30	Lunch	
	12:30	Lesson 2, Pub 678M: Income	
	1:30	Break	
	1:45	Lesson 16, Pub 678M: Combat Zone Provisions	
	2:15	Break	
	2:30	Lesson 18, Pub 678M: Home Leave Provisions	
	3:00	Lesson 15, Pub 678M: Foreign Earned Income Exclusion	
	4:00	Dismiss	
	2	8:00	Review key points from yesterday and answer any questions
		8:30	Lesson 11, Pub 678M: Sale of Stock
9:30		Break	
9:45		Continue Lesson 11	
10:45		Break	
11:00		Lesson 12, Pub 678M: Sale of Home	
11:30		Lunch	
12:30		Lesson 13, Pub 678M: Pensions	
1:30		Break	
1:45		Lesson 3, Pub 678M: Adjustments	
2:30		Break	
2:45		Lesson 4, Pub 678M: Standard and Itemized Deductions	
4:30		Dismiss	
3		8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 5, Pub 678M: Miscellaneous Credits	
	9:30	Break	
	9:45	Lesson 7, Pub 678M: Child Care Credits	
	10:45	Break	
	11:00	Lesson 8, Pub 678M: Education Credits	
	12:00	Lunch	



	1:00	Lesson 9, Pub 678M: Earned Income Credit
	2:00	Break
	2:15	Continue Lesson 9
	3:00	Break
	3:15	Lesson 10, Pub 678M: Child tax Credit
	4:30	Dismiss
4	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 6, Pub 678M: Finishing the Return
	9:30	Break
	9:45	Work comprehensive problems
	10:45	Break
	11:00	Wrap up and review
	Noon	Dismiss

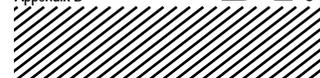


## Suggested Class Schedule 9

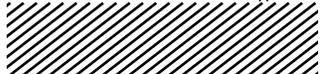
<b>Student experience level:</b>	Mixed level of experience
<b>Prior VITA/TCE experience:</b>	Mixed level of experience
<b>Types of returns:</b>	<b><i>Domestic Military Basic Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

Day	Time	Topic
		<b>Days One and Two are Designed for New Volunteers; Experienced Volunteers are Invited to Attend All of the Class, but May Choose To Only Attend the after-noon of Day Three and all of Day Four</b>
1	8:30	Registration and Introductions
	9:00	Lesson 1, Pub 678M: Getting Started (Suggestion: Ask students to record key concepts as you go through days one and two. These key concepts could then be used on days three and four when you review the lessons with the experienced volunteers.)
	10:00	Break
	10:15	Lesson 2, Pub 678M: Income
	11:30	Lunch
	12:30	Continue Lesson 2
	1:30	Short break
	1:40	Lesson 11, Pub 678M: Sale of Stock (Note: This lesson will be covered again on day 3 to allow the experienced volunteers to review the new rules.)
	2:40	Break
	3:00	Lesson 3, Pub 678M: Adjustments
	4:30	Dismiss
2	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 4, Pub 678M: Standard and Itemized Deductions
	9:00	Break
	9:15	Continue lesson 4
	10:00	Break
	10:15	Lesson 5, Pub 678M: Miscellaneous Credits
	11:30	Lunch
	12:30	Lesson 7, Pub 678M: Child Care Credit
	1:30	Break
	1:45	Lesson 8, Pub 678M: Education Credits
	2:45	Break
	3:00	Lesson 9, Pub 678M: Earned income Credit
	4:30	Dismiss



3	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 10, Pub 678M: Child Tax Credit
	9:15	Break
	9:30	Continue Lesson 10
	10:00	Break
	10:15	Lesson 6, Pub 678M: Finishing the Return
	11:30	Lunch
	12:30	Welcome experienced students, answer any questions and review administrative procedures
	1:00	Review Lesson 11, Stock Sales
	2:00	Break
	2:15	Review Lessons 1-3
	3:00	Break
	3:15	Review Lessons 4, 5, and 7
	4:15	Dismiss
4	8:00	Review key points from yesterday and answer any questions
	8:30	Review Lessons 8 and 9
	9:30	Break
	9:45	Review Lesson 10
	11:30	Lunch
	12:30	Review Lesson 6 and administrative procedures
	1:30	Break
	1:45	Work on comprehensive problems
	2:30	Break
	2:45	Review and final questions
	3:30	Wrap-up
	4:00	Dismiss



## Suggested Class Schedule 10

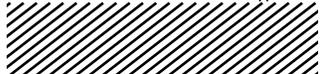
<b>Student experience level:</b>	Mixture of experience levels
<b>Prior VITA/TCE experience:</b>	Mixture of experience
<b>Types of returns:</b>	<b><i>Domestic Military Advanced Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

Day	Time	Topic
		<b>Days One and Two are Designed for New Volunteers; Experienced Volunteers are Invited to Attend All of the Class, but May Choose To Only Attend The Afternoon of Day Three and all of Day 4</b>
1	8:30	Registration and Introductions
	9:00	Lesson 1, Pub 678M: Getting Started (Suggestion: Ask students to record key concepts as you go through days one and two. These key concepts could then be used on days three and four when you review the lessons with the experienced volunteers.)
	10:00	Break
	10:15	Lesson 2, Pub 678M: Income
	11:30	Lunch
	12:30	Continue Lesson 2
	1:30	Break
	1:40	Lesson 11, Pub 678M: Sale of Stock (Note: This lesson will be covered again on day 3 to allow the experienced volunteers to review the new rules.)
	2:40	Break
	3:00	Lesson 12, Pub 678M: Sale of Home
	3:30	Break
	3:45	Work on comprehensive problems or test
	4:30	Dismiss
2	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 13, Pub 678M: Pensions
	10:00	Break
	10:15	Lesson 3, Pub 678M: Adjustments
	11:30	Lunch
	12:30	Lesson 4, Pub 678M: Standard and Itemized Deductions
	1:30	Break
	1:45	Lesson 5, Pub 678M: Miscellaneous Credits
	2:45	Break
	3:00	Lesson 7, Pub 678M: Child Care Credit



	4:00	Wrap-up and review
	4:30	Dismiss
3	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 8, Pub 678M: Education Credits
	9:30	Break
	9:45	Lesson 9, Pub 678M: Earned Income Credit
	10:30	Break
	10:45	Continue Lesson 9
	11:30	Lunch
	12:30	Welcome experienced students and review administrative procedures
	1:00	Review Lessons 1, 2, and 12
	1:45	Break
	2:00	Review Lesson 11 (Sale of Stock)
	3:00	Break
	3:15	Review Lesson 13 (Pensions)
	4:00	Dismiss
4	8:00	Review key points from yesterday and answer any questions
	8:30	Review Lessons 3, 4, and 5
	9:45	Break
	10:00	Review Lessons 7, 8, and 9 (You should allow a short "stretch-break" sometime during this review.)
	11:30	Lunch
	12:30	Lesson 10, Pub 678M: Child Tax Credit
	2:00	Break
	2:15	Lesson 6, Pub 678M: Finishing the Return
	3:00	Break
	3:15	Review and final questions
	3:45	Wrap-up
	4:30	Dismiss

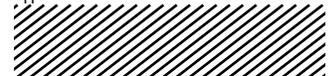


## Suggested Class Schedule 11

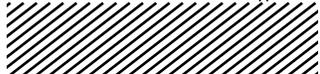
<b>Student experience level:</b>	Mixture of experience levels
<b>Prior VITA/TCE experience:</b>	Mixture of experience
<b>Types of returns:</b>	<b><i>International Military Returns</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

Day	Time	Topic
		<b>Days One and Two are Designed for New Volunteers; Experienced Volunteers are Invited to Attend All of the Class, but May Choose To Only Attend The Afternoon of Day Three and all of Day 4</b>
1	8:30	Registration and Introductions
	9:00	Lesson 1, Pub 678M: Getting Started (Suggestion: Ask students to record key concepts as you go through days one and two. These key concepts could then be used on days three and four when you review the lessons with the experienced volunteers.)
	10:00	Break
	10:15	Lesson 17, Pub 678M: Aliens
	11:30	Lunch
	12:30	Lesson 2, Pub 678M: Income
	1:30	Break
	1:45	Lesson 16, Pub 678M: Combat Zone Provisions
	2:30	Break
	2:45	Lesson 15, Pub 678M: Foreign Earned Income Exclusion
	4:00	Dismiss
2	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 11, Pub 678M: Sale of Stock (Note: This subject will be continued when the experienced volunteers join the class.)
	9:30	Break
	9:45	Lesson 12, Pub 678M: Sale of Home
	10:30	Break
	10:45	Lesson 13, Pub 678M: Pensions
	12:00	Lunch
	1:00	Lesson 3, Pub 678M: Adjustments
	1:45	Break
	2:00	Lesson 4, Pub 678M: Standard and Itemized Deductions
	3:15	Break
	3:30	Lesson 5, Pub 678M: Miscellaneous Credits
	4:30	Dismiss
3	8:00	Review key points from yesterday and answer any questions



	8:30	Lesson 7, Pub 678M: Child Care Credits
	9:30	Break
	9:45	Lesson 8, Pub 678M: Education Credits
	10:45	Break
	11:00	Lesson 9, Pub 678M: Earned Income Credit
	12:00	Lunch
	1:00	Welcome experienced volunteers and answer any questions
	1:30	Review lessons 1 and 17
	2:00	Break
	2:15	Review lessons 2, 16, and 15
	3:15	Break
	3:45	Review and continue lesson 11 (Sale of Stock)
	4:30	Dismiss
4	8:00	Review key points from yesterday and answer any questions
	8:30	Review Lessons 12 and 13
	9:30	Break
	9:45	Review Lessons 3,4,and 5
	10:45	Break
	11:00	Review Lessons 7, 8, and 9
	Noon	Lunch
	1:00	Lesson 10, Pub 678M: Child Tax Credit
	2:00	Break
	2:15	Continue lesson 10
	3:30	Lesson 6, Pub 678M: Finishing the Return
	4:00	Wrap-up
	4:30	Dismiss

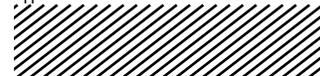


## Suggested Class Schedule 12

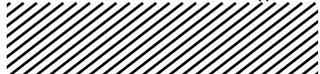
<b>Student experience level:</b>	Mixture of experience levels
<b>Prior VITA/TCE experience:</b>	Mixture of experience
<b>Types of returns:</b>	<b><i>US Taxpayers Abroad (Non-military)</i></b>
<b>Test:</b>	Done outside of class

*The following schedule lists suggested teaching times. You may need to adjust the times to meet the needs of your class.*

Day	Time	Topic
		<b>Days One and Two are Designed for New Volunteers; Experienced Volunteers are Invited to Attend All of the Class, but May Choose To Only Attend The Afternoon of Day Three and all of Day 4</b>
1	8:30	Registration and Introductions
	9:00	Lesson 1, Pub 678M: Getting Started (Suggestion: Ask students to record key concepts as you go through days one and two. These key concepts could then be used on days three and four when you review the lessons with the experienced volunteers.)
	10:00	Break
	10:15	Lesson 17, Pub 678M: Aliens
	11:30	Lunch
	12:30	Lesson 2, Pub 678M: Income
	1:30	Break
	1:45	Lesson 16, Pub 678M: Combat Zone Provisions
	2:45	Break
	3:00	Lesson 18, Pub 678M: Home Leave Provisions
	3:30	Short Break
	3:40	Lesson 15, Pub 678M: Foreign Earned Income Exclusion
	4:30	Dismiss
2	8:00	Review key points from yesterday and answer any questions
	8:30	Lesson 11, Pub 678M: Sale of Stock
	9:30	Break
	9:45	Lesson 12, Pub 678M: Sale of Home
	10:15	Break
	10:30	Lesson 13, Pub 678M: Pensions
	12:00	Lunch
	1:00	Lesson 3, Pub 678M: Adjustments
	1:30	Break
	1:45	Lesson 4, Pub 678M: Standard and Itemized Deductions
	3:00	Break
	3:15	Lesson 5, Pub 678M: Miscellaneous Credits
	4:30	Dismiss
3	8:00	Review key points from yesterday and answer any questions



	8:30	Lesson 7, Pub 678M: Child Care Credits
	9:30	Break
	9:45	Lesson 8, Pub 678M: Education Credits
	10:45	Break
	11:00	Lesson 9, Pub 678M: Earned Income Credit
	12:00	Lunch
	1:00	Welcome experienced volunteers and answer any questions
	1:30	Review Lessons 1, 17, and 2
	2:00	Break
	2:15	Review Lessons 16, 18, and 15
	3:00	Break
	3:15	Review Lesson 11
	4:00	Review Lessons 12 and 13
	4:30	Dismiss
4	8:00	Review key points from yesterday and answer any questions
	8:30	Review Lesson 3, 4, and 5
	9:15	Break
	9:30	Review Lessons 7, 8 and 9
	10:45	Break
	11:00	Lesson 10, Pub 678M: Child tax Credit
	Noon	Lunch
	1:00	Continue Lesson 10
	2:00	Break
	2:15	Lesson 6, Pub 678M: Finishing the Return
	3:30	Wrap-up
	4:00	Dismiss



## Suggested Class Schedule 13

### Tax Law Refresher

This one-day class schedule should be used only with experienced volunteers who are willing to spend time self-studying the training material.

8:30	Welcome students and ask them to share an experience from last tax season (this will help you assess their experience level)
9:15	Review Lesson 1 – Getting Started and Administrative Guidelines
9:45	Break
10:00	Review Lesson 2 – Income (No major changes) Review Lesson 11 – Stock Sales (Major changes to applicable tax rates)
11:00	Review Lesson 12 – Sale of Home (No major changes) Review Lesson 13 – Pensions (No major changes)
Noon	Lunch
1:00	Review Lesson 3 – Adjustments (No major changes) Review Lesson 4 – Itemized Deductions (No major changes) Review Lesson 5 – Miscellaneous Credits (No major changes)
1:45	Break
2:00	Review Lesson 7 – Child and Dependent Care Credit (Changes to dollar limits) Review Lesson 8 – Education Credits (Changes to dollar limits) Review Lesson 9 – Earned Income Credit (One of the top 10 errors on returns)
3:00	Break
3:15	Review Lesson 10 – Child Tax Credit (Major changes including the advanced CTC checks mailed in 2003.)
3:45	Review Lesson 14 – Credit for the Elderly and Disabled (No major changes) Review Lesson 6 – Finishing the return
4:30	Dismiss



**STUDENT NOTES**

Lined writing area for student notes.



## 2003 Earned Income Credit (EIC) Table

**Caution.** This is not a tax table.

1. To find your credit, read down the "At least - But less than" columns and find the line that includes the amount you were told to look up from your EIC Worksheet.

2. Then, go to the column that includes your filing status and the number of qualifying children you have. Enter the credit from that column on your EIC Worksheet.

**Example.** If your filing status is single, you have one qualifying child, and the amount you are looking up from your EIC Worksheet is \$2,455, you would enter \$842.

If the amount you are looking up from the worksheet is—		And your filing status is—		
		No children	One child	Two children
At least	But less than	Your credit is—		
2,400	2,450	186	825	970
2,450	2,500	189	842	990

If the amount you are looking up from the worksheet is—		And your filing status is—						If the amount you are looking up from the worksheet is—		And your filing status is—					
		Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—					Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—		
At least	But less than	No children	One child	Two children	No children	One child	Two children	At least	But less than	No children	One child	Two children	No children	One child	Two children
\$1	\$50	\$2	\$9	\$10	\$2	\$9	\$10	3,000	3,050	231	1,029	1,210	231	1,029	1,210
50	100	6	26	30	6	26	30	3,050	3,100	235	1,046	1,230	235	1,046	1,230
100	150	10	43	50	10	43	50	3,100	3,150	239	1,063	1,250	239	1,063	1,250
150	200	13	60	70	13	60	70	3,150	3,200	243	1,080	1,270	243	1,080	1,270
200	250	17	77	90	17	77	90	3,200	3,250	247	1,097	1,290	247	1,097	1,290
250	300	21	94	110	21	94	110	3,250	3,300	251	1,114	1,310	251	1,114	1,310
300	350	25	111	130	25	111	130	3,300	3,350	254	1,131	1,330	254	1,131	1,330
350	400	29	128	150	29	128	150	3,350	3,400	258	1,148	1,350	258	1,148	1,350
400	450	33	145	170	33	145	170	3,400	3,450	262	1,165	1,370	262	1,165	1,370
450	500	36	162	190	36	162	190	3,450	3,500	266	1,182	1,390	266	1,182	1,390
500	550	40	179	210	40	179	210	3,500	3,550	270	1,199	1,410	270	1,199	1,410
550	600	44	196	230	44	196	230	3,550	3,600	273	1,216	1,430	273	1,216	1,430
600	650	48	213	250	48	213	250	3,600	3,650	277	1,233	1,450	277	1,233	1,450
650	700	52	230	270	52	230	270	3,650	3,700	281	1,250	1,470	281	1,250	1,470
700	750	55	247	290	55	247	290	3,700	3,750	285	1,267	1,490	285	1,267	1,490
750	800	59	264	310	59	264	310	3,750	3,800	289	1,284	1,510	289	1,284	1,510
800	850	63	281	330	63	281	330	3,800	3,850	293	1,301	1,530	293	1,301	1,530
850	900	67	298	350	67	298	350	3,850	3,900	296	1,318	1,550	296	1,318	1,550
900	950	71	315	370	71	315	370	3,900	3,950	300	1,335	1,570	300	1,335	1,570
950	1,000	75	332	390	75	332	390	3,950	4,000	304	1,352	1,590	304	1,352	1,590
1,000	1,050	78	349	410	78	349	410	4,000	4,050	308	1,369	1,610	308	1,369	1,610
1,050	1,100	82	366	430	82	366	430	4,050	4,100	312	1,386	1,630	312	1,386	1,630
1,100	1,150	86	383	450	86	383	450	4,100	4,150	316	1,403	1,650	316	1,403	1,650
1,150	1,200	90	400	470	90	400	470	4,150	4,200	319	1,420	1,670	319	1,420	1,670
1,200	1,250	94	417	490	94	417	490	4,200	4,250	323	1,437	1,690	323	1,437	1,690
1,250	1,300	98	434	510	98	434	510	4,250	4,300	327	1,454	1,710	327	1,454	1,710
1,300	1,350	101	451	530	101	451	530	4,300	4,350	331	1,471	1,730	331	1,471	1,730
1,350	1,400	105	468	550	105	468	550	4,350	4,400	335	1,488	1,750	335	1,488	1,750
1,400	1,450	109	485	570	109	485	570	4,400	4,450	339	1,505	1,770	339	1,505	1,770
1,450	1,500	113	502	590	113	502	590	4,450	4,500	342	1,522	1,790	342	1,522	1,790
1,500	1,550	117	519	610	117	519	610	4,500	4,550	346	1,539	1,810	346	1,539	1,810
1,550	1,600	120	536	630	120	536	630	4,550	4,600	350	1,556	1,830	350	1,556	1,830
1,600	1,650	124	553	650	124	553	650	4,600	4,650	354	1,573	1,850	354	1,573	1,850
1,650	1,700	128	570	670	128	570	670	4,650	4,700	358	1,590	1,870	358	1,590	1,870
1,700	1,750	132	587	690	132	587	690	4,700	4,750	361	1,607	1,890	361	1,607	1,890
1,750	1,800	136	604	710	136	604	710	4,750	4,800	365	1,624	1,910	365	1,624	1,910
1,800	1,850	140	621	730	140	621	730	4,800	4,850	369	1,641	1,930	369	1,641	1,930
1,850	1,900	143	638	750	143	638	750	4,850	4,900	373	1,658	1,950	373	1,658	1,950
1,900	1,950	147	655	770	147	655	770	4,900	4,950	377	1,675	1,970	377	1,675	1,970
1,950	2,000	151	672	790	151	672	790	4,950	5,000	382	1,692	1,990	382	1,692	1,990
2,000	2,050	155	689	810	155	689	810	5,000	5,050	382	1,709	2,010	382	1,709	2,010
2,050	2,100	159	706	830	159	706	830	5,050	5,100	382	1,726	2,030	382	1,726	2,030
2,100	2,150	163	723	850	163	723	850	5,100	5,150	382	1,743	2,050	382	1,743	2,050
2,150	2,200	166	740	870	166	740	870	5,150	5,200	382	1,760	2,070	382	1,760	2,070
2,200	2,250	170	757	890	170	757	890	5,200	5,250	382	1,777	2,090	382	1,777	2,090
2,250	2,300	174	774	910	174	774	910	5,250	5,300	382	1,794	2,110	382	1,794	2,110
2,300	2,350	178	791	930	178	791	930	5,300	5,350	382	1,811	2,130	382	1,811	2,130
2,350	2,400	182	808	950	182	808	950	5,350	5,400	382	1,828	2,150	382	1,828	2,150
2,400	2,450	186	825	970	186	825	970	5,400	5,450	382	1,845	2,170	382	1,845	2,170
2,450	2,500	189	842	990	189	842	990	5,450	5,500	382	1,862	2,190	382	1,862	2,190
2,500	2,550	193	859	1,010	193	859	1,010	5,500	5,550	382	1,879	2,210	382	1,879	2,210
2,550	2,600	197	876	1,030	197	876	1,030	5,550	5,600	382	1,896	2,230	382	1,896	2,230
2,600	2,650	201	893	1,050	201	893	1,050	5,600	5,650	382	1,913	2,250	382	1,913	2,250
2,650	2,700	205	910	1,070	205	910	1,070	5,650	5,700	382	1,930	2,270	382	1,930	2,270
2,700	2,750	208	927	1,090	208	927	1,090	5,700	5,750	382	1,947	2,290	382	1,947	2,290
2,750	2,800	212	944	1,110	212	944	1,110	5,750	5,800	382	1,964	2,310	382	1,964	2,310
2,800	2,850	216	961	1,130	216	961	1,130	5,800	5,850	382	1,981	2,330	382	1,981	2,330
2,850	2,900	220	978	1,150	220	978	1,150	5,850	5,900	382	1,998	2,350	382	1,998	2,350
2,900	2,950	224	995	1,170	224	995	1,170	5,900	5,950	382	2,015	2,370	382	2,015	2,370
2,950	3,000	228	1,012	1,190	228	1,012	1,190	5,950	6,000	382	2,032	2,390	382	2,032	2,390

(Continued on page 51)

2003 Earned Income Credit (EIC) Table—Continued

(Caution. This is not a tax table.)

If the amount you are looking up from the worksheet is—		And your filing status is—						If the amount you are looking up from the worksheet is—		And your filing status is—					
		Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—					Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—		
		No children	One child	Two children	No children	One child	Two children			No children	One child	Two children	No children	One child	Two children
At least	But less than	Your credit is—			Your credit is—			At least	But less than	Your credit is—			Your credit is—		
6,000	6,050	382	2,049	2,410	382	2,049	2,410	9,500	9,550	130	2,547	3,810	207	2,547	3,810
6,050	6,100	382	2,066	2,430	382	2,066	2,430	9,550	9,600	127	2,547	3,830	203	2,547	3,830
6,100	6,150	382	2,083	2,450	382	2,083	2,450	9,600	9,650	123	2,547	3,850	199	2,547	3,850
6,150	6,200	382	2,100	2,470	382	2,100	2,470	9,650	9,700	119	2,547	3,870	195	2,547	3,870
6,200	6,250	382	2,117	2,490	382	2,117	2,490	9,700	9,750	115	2,547	3,890	192	2,547	3,890
6,250	6,300	379	2,134	2,510	382	2,134	2,510	9,750	9,800	111	2,547	3,910	188	2,547	3,910
6,300	6,350	375	2,151	2,530	382	2,151	2,530	9,800	9,850	107	2,547	3,930	184	2,547	3,930
6,350	6,400	371	2,168	2,550	382	2,168	2,550	9,850	9,900	104	2,547	3,950	180	2,547	3,950
6,400	6,450	368	2,185	2,570	382	2,185	2,570	9,900	9,950	100	2,547	3,970	176	2,547	3,970
6,450	6,500	364	2,202	2,590	382	2,202	2,590	9,950	10,000	96	2,547	3,990	173	2,547	3,990
6,500	6,550	360	2,219	2,610	382	2,219	2,610	10,000	10,050	92	2,547	4,010	169	2,547	4,010
6,550	6,600	356	2,236	2,630	382	2,236	2,630	10,050	10,100	88	2,547	4,030	165	2,547	4,030
6,600	6,650	352	2,253	2,650	382	2,253	2,650	10,100	10,150	85	2,547	4,050	161	2,547	4,050
6,650	6,700	348	2,270	2,670	382	2,270	2,670	10,150	10,200	81	2,547	4,070	157	2,547	4,070
6,700	6,750	345	2,287	2,690	382	2,287	2,690	10,200	10,250	77	2,547	4,090	153	2,547	4,090
6,750	6,800	341	2,304	2,710	382	2,304	2,710	10,250	10,300	73	2,547	4,110	150	2,547	4,110
6,800	6,850	337	2,321	2,730	382	2,321	2,730	10,300	10,350	69	2,547	4,130	146	2,547	4,130
6,850	6,900	333	2,338	2,750	382	2,338	2,750	10,350	10,400	65	2,547	4,150	142	2,547	4,150
6,900	6,950	329	2,355	2,770	382	2,355	2,770	10,400	10,450	62	2,547	4,170	138	2,547	4,170
6,950	7,000	326	2,372	2,790	382	2,372	2,790	10,450	10,500	58	2,547	4,190	134	2,547	4,190
7,000	7,050	322	2,389	2,810	382	2,389	2,810	10,500	10,550	54	2,547	4,204	130	2,547	4,204
7,050	7,100	318	2,406	2,830	382	2,406	2,830	10,550	10,600	50	2,547	4,204	127	2,547	4,204
7,100	7,150	314	2,423	2,850	382	2,423	2,850	10,600	10,650	46	2,547	4,204	123	2,547	4,204
7,150	7,200	310	2,440	2,870	382	2,440	2,870	10,650	10,700	42	2,547	4,204	119	2,547	4,204
7,200	7,250	306	2,457	2,890	382	2,457	2,890	10,700	10,750	39	2,547	4,204	115	2,547	4,204
7,250	7,300	303	2,474	2,910	379	2,474	2,910	10,750	10,800	35	2,547	4,204	111	2,547	4,204
7,300	7,350	299	2,491	2,930	375	2,491	2,930	10,800	10,850	31	2,547	4,204	107	2,547	4,204
7,350	7,400	295	2,508	2,950	371	2,508	2,950	10,850	10,900	27	2,547	4,204	104	2,547	4,204
7,400	7,450	291	2,525	2,970	368	2,525	2,970	10,900	10,950	23	2,547	4,204	100	2,547	4,204
7,450	7,500	287	2,542	2,990	364	2,542	2,990	10,950	11,000	20	2,547	4,204	96	2,547	4,204
7,500	7,550	283	2,547	3,010	360	2,547	3,010	11,000	11,050	16	2,547	4,204	92	2,547	4,204
7,550	7,600	280	2,547	3,030	356	2,547	3,030	11,050	11,100	12	2,547	4,204	88	2,547	4,204
7,600	7,650	276	2,547	3,050	352	2,547	3,050	11,100	11,150	8	2,547	4,204	85	2,547	4,204
7,650	7,700	272	2,547	3,070	348	2,547	3,070	11,150	11,200	4	2,547	4,204	81	2,547	4,204
7,700	7,750	268	2,547	3,090	345	2,547	3,090	11,200	11,250	*	2,547	4,204	77	2,547	4,204
7,750	7,800	264	2,547	3,110	341	2,547	3,110	11,250	11,300	0	2,547	4,204	73	2,547	4,204
7,800	7,850	260	2,547	3,130	337	2,547	3,130	11,300	11,350	0	2,547	4,204	69	2,547	4,204
7,850	7,900	257	2,547	3,150	333	2,547	3,150	11,350	11,400	0	2,547	4,204	65	2,547	4,204
7,900	7,950	253	2,547	3,170	329	2,547	3,170	11,400	11,450	0	2,547	4,204	62	2,547	4,204
7,950	8,000	249	2,547	3,190	326	2,547	3,190	11,450	11,500	0	2,547	4,204	58	2,547	4,204
8,000	8,050	245	2,547	3,210	322	2,547	3,210	11,500	11,550	0	2,547	4,204	54	2,547	4,204
8,050	8,100	241	2,547	3,230	318	2,547	3,230	11,550	11,600	0	2,547	4,204	50	2,547	4,204
8,100	8,150	238	2,547	3,250	314	2,547	3,250	11,600	11,650	0	2,547	4,204	46	2,547	4,204
8,150	8,200	234	2,547	3,270	310	2,547	3,270	11,650	11,700	0	2,547	4,204	42	2,547	4,204
8,200	8,250	230	2,547	3,290	306	2,547	3,290	11,700	11,750	0	2,547	4,204	39	2,547	4,204
8,250	8,300	226	2,547	3,310	303	2,547	3,310	11,750	11,800	0	2,547	4,204	35	2,547	4,204
8,300	8,350	222	2,547	3,330	299	2,547	3,330	11,800	11,850	0	2,547	4,204	31	2,547	4,204
8,350	8,400	218	2,547	3,350	295	2,547	3,350	11,850	11,900	0	2,547	4,204	27	2,547	4,204
8,400	8,450	215	2,547	3,370	291	2,547	3,370	11,900	11,950	0	2,547	4,204	23	2,547	4,204
8,450	8,500	211	2,547	3,390	287	2,547	3,390	11,950	12,000	0	2,547	4,204	20	2,547	4,204
8,500	8,550	207	2,547	3,410	283	2,547	3,410	12,000	12,050	0	2,547	4,204	16	2,547	4,204
8,550	8,600	203	2,547	3,430	280	2,547	3,430	12,050	12,100	0	2,547	4,204	12	2,547	4,204
8,600	8,650	199	2,547	3,450	276	2,547	3,450	12,100	12,150	0	2,547	4,204	8	2,547	4,204
8,650	8,700	195	2,547	3,470	272	2,547	3,470	12,150	12,200	0	2,547	4,204	4	2,547	4,204
8,700	8,750	192	2,547	3,490	268	2,547	3,490	12,200	12,250	0	2,547	4,204	*	2,547	4,204
8,750	8,800	188	2,547	3,510	264	2,547	3,510	12,250	13,750	0	2,547	4,204	0	2,547	4,204
8,800	8,850	184	2,547	3,530	260	2,547	3,530	13,750	13,800	0	2,539	4,195	0	2,547	4,204
8,850	8,900	180	2,547	3,550	257	2,547	3,550	13,800	13,850	0	2,531	4,184	0	2,547	4,204
8,900	8,950	176	2,547	3,570	253	2,547	3,570	13,850	13,900	0	2,523	4,173	0	2,547	4,204
8,950	9,000	173	2,547	3,590	249	2,547	3,590	13,900	13,950	0	2,515	4,163	0	2,547	4,204
9,000	9,050	169	2,547	3,610	245	2,547	3,610	13,950	14,000	0	2,507	4,152	0	2,547	4,204
9,050	9,100	165	2,547	3,630	241	2,547	3,630	14,000	14,050	0	2,499	4,142	0	2,547	4,204
9,100	9,150	161	2,547	3,650	238	2,547	3,650	14,050	14,100	0	2,491	4,131	0	2,547	4,204
9,150	9,200	157	2,547	3,670	234	2,547	3,670	14,100	14,150	0	2,483	4,121	0	2,547	4,204
9,200	9,250	153	2,547	3,690	230	2,547	3,690	14,150	14,200	0	2,475	4,110	0	2,547	4,204
9,250	9,300	150	2,547	3,710	226	2,547	3,710	14,200	14,250	0	2,467	4,100	0	2,547	4,204
9,300	9,350	146	2,547	3,730	222	2,547	3,730	14,250	14,300	0	2,460	4,089	0	2,547	4,204
9,350	9,400	142	2,547	3,750	218	2,547	3,750	14,300	14,350	0	2,452	4,079	0	2,547	4,204
9,400															

2003 Earned Income Credit (EIC) Table—Continued

(Caution. This is not a tax table.)

If the amount you are looking up from the worksheet is—		And your filing status is—						If the amount you are looking up from the worksheet is—		And your filing status is—					
		Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—					Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—		
		No children	One child	Two children	No children	One child	Two children			No children	One child	Two children	No children	One child	Two children
At least	But less than	Your credit is—			Your credit is—			At least	But less than	Your credit is—			Your credit is—		
14,450	14,500	0	2,428	4,047	0	2,547	4,204	17,950	18,000	0	1,868	3,310	0	2,028	3,521
14,500	14,550	0	2,420	4,037	0	2,547	4,204	18,000	18,050	0	1,860	3,299	0	2,020	3,510
14,550	14,600	0	2,412	4,026	0	2,547	4,204	18,050	18,100	0	1,852	3,289	0	2,012	3,500
14,600	14,650	0	2,404	4,016	0	2,547	4,204	18,100	18,150	0	1,844	3,278	0	2,004	3,489
14,650	14,700	0	2,396	4,005	0	2,547	4,204	18,150	18,200	0	1,836	3,268	0	1,996	3,478
14,700	14,750	0	2,388	3,994	0	2,547	4,204	18,200	18,250	0	1,828	3,257	0	1,988	3,468
14,750	14,800	0	2,380	3,984	0	2,539	4,195	18,250	18,300	0	1,820	3,247	0	1,980	3,457
14,800	14,850	0	2,372	3,973	0	2,531	4,184	18,300	18,350	0	1,812	3,236	0	1,972	3,447
14,850	14,900	0	2,364	3,963	0	2,523	4,173	18,350	18,400	0	1,804	3,226	0	1,964	3,436
14,900	14,950	0	2,356	3,952	0	2,515	4,163	18,400	18,450	0	1,796	3,215	0	1,956	3,426
14,950	15,000	0	2,348	3,942	0	2,507	4,152	18,450	18,500	0	1,788	3,205	0	1,948	3,415
15,000	15,050	0	2,340	3,931	0	2,499	4,142	18,500	18,550	0	1,780	3,194	0	1,940	3,405
15,050	15,100	0	2,332	3,921	0	2,491	4,131	18,550	18,600	0	1,772	3,184	0	1,932	3,394
15,100	15,150	0	2,324	3,910	0	2,483	4,121	18,600	18,650	0	1,764	3,173	0	1,924	3,384
15,150	15,200	0	2,316	3,900	0	2,475	4,110	18,650	18,700	0	1,756	3,163	0	1,916	3,373
15,200	15,250	0	2,308	3,889	0	2,467	4,100	18,700	18,750	0	1,748	3,152	0	1,908	3,363
15,250	15,300	0	2,300	3,879	0	2,460	4,089	18,750	18,800	0	1,740	3,142	0	1,900	3,352
15,300	15,350	0	2,292	3,868	0	2,452	4,079	18,800	18,850	0	1,732	3,131	0	1,892	3,342
15,350	15,400	0	2,284	3,858	0	2,444	4,068	18,850	18,900	0	1,724	3,120	0	1,884	3,331
15,400	15,450	0	2,276	3,847	0	2,436	4,058	18,900	18,950	0	1,716	3,110	0	1,876	3,321
15,450	15,500	0	2,268	3,837	0	2,428	4,047	18,950	19,000	0	1,708	3,099	0	1,868	3,310
15,500	15,550	0	2,260	3,826	0	2,420	4,037	19,000	19,050	0	1,700	3,089	0	1,860	3,299
15,550	15,600	0	2,252	3,815	0	2,412	4,026	19,050	19,100	0	1,692	3,078	0	1,852	3,289
15,600	15,650	0	2,244	3,805	0	2,404	4,016	19,100	19,150	0	1,684	3,068	0	1,844	3,278
15,650	15,700	0	2,236	3,794	0	2,396	4,005	19,150	19,200	0	1,676	3,057	0	1,836	3,268
15,700	15,750	0	2,228	3,784	0	2,388	3,994	19,200	19,250	0	1,668	3,047	0	1,828	3,257
15,750	15,800	0	2,220	3,773	0	2,380	3,984	19,250	19,300	0	1,661	3,036	0	1,820	3,247
15,800	15,850	0	2,212	3,763	0	2,372	3,973	19,300	19,350	0	1,653	3,026	0	1,812	3,236
15,850	15,900	0	2,204	3,752	0	2,364	3,963	19,350	19,400	0	1,645	3,015	0	1,804	3,226
15,900	15,950	0	2,196	3,742	0	2,356	3,952	19,400	19,450	0	1,637	3,005	0	1,796	3,215
15,950	16,000	0	2,188	3,731	0	2,348	3,942	19,450	19,500	0	1,629	2,994	0	1,788	3,205
16,000	16,050	0	2,180	3,721	0	2,340	3,931	19,500	19,550	0	1,621	2,984	0	1,780	3,194
16,050	16,100	0	2,172	3,710	0	2,332	3,921	19,550	19,600	0	1,613	2,973	0	1,772	3,184
16,100	16,150	0	2,164	3,700	0	2,324	3,910	19,600	19,650	0	1,605	2,963	0	1,764	3,173
16,150	16,200	0	2,156	3,689	0	2,316	3,900	19,650	19,700	0	1,597	2,952	0	1,756	3,163
16,200	16,250	0	2,148	3,679	0	2,308	3,889	19,700	19,750	0	1,589	2,941	0	1,748	3,152
16,250	16,300	0	2,140	3,668	0	2,300	3,879	19,750	19,800	0	1,581	2,931	0	1,740	3,142
16,300	16,350	0	2,132	3,657	0	2,292	3,868	19,800	19,850	0	1,573	2,920	0	1,732	3,131
16,350	16,400	0	2,124	3,647	0	2,284	3,858	19,850	19,900	0	1,565	2,910	0	1,724	3,120
16,400	16,450	0	2,116	3,636	0	2,276	3,847	19,900	19,950	0	1,557	2,899	0	1,716	3,110
16,450	16,500	0	2,108	3,626	0	2,268	3,837	19,950	20,000	0	1,549	2,889	0	1,708	3,099
16,500	16,550	0	2,100	3,615	0	2,260	3,826	20,000	20,050	0	1,541	2,878	0	1,700	3,089
16,550	16,600	0	2,092	3,605	0	2,252	3,815	20,050	20,100	0	1,533	2,868	0	1,692	3,078
16,600	16,650	0	2,084	3,594	0	2,244	3,805	20,100	20,150	0	1,525	2,857	0	1,684	3,068
16,650	16,700	0	2,076	3,584	0	2,236	3,794	20,150	20,200	0	1,517	2,847	0	1,676	3,057
16,700	16,750	0	2,068	3,573	0	2,228	3,784	20,200	20,250	0	1,509	2,836	0	1,668	3,047
16,750	16,800	0	2,060	3,563	0	2,220	3,773	20,250	20,300	0	1,501	2,826	0	1,661	3,036
16,800	16,850	0	2,052	3,552	0	2,212	3,763	20,300	20,350	0	1,493	2,815	0	1,653	3,026
16,850	16,900	0	2,044	3,542	0	2,204	3,752	20,350	20,400	0	1,485	2,805	0	1,645	3,015
16,900	16,950	0	2,036	3,531	0	2,196	3,742	20,400	20,450	0	1,477	2,794	0	1,637	3,005
16,950	17,000	0	2,028	3,521	0	2,188	3,731	20,450	20,500	0	1,469	2,784	0	1,629	2,994
17,000	17,050	0	2,020	3,510	0	2,180	3,721	20,500	20,550	0	1,461	2,773	0	1,621	2,984
17,050	17,100	0	2,012	3,500	0	2,172	3,710	20,550	20,600	0	1,453	2,762	0	1,613	2,973
17,100	17,150	0	2,004	3,489	0	2,164	3,700	20,600	20,650	0	1,445	2,752	0	1,605	2,963
17,150	17,200	0	1,996	3,478	0	2,156	3,689	20,650	20,700	0	1,437	2,741	0	1,597	2,952
17,200	17,250	0	1,988	3,468	0	2,148	3,679	20,700	20,750	0	1,429	2,731	0	1,589	2,941
17,250	17,300	0	1,980	3,457	0	2,140	3,668	20,750	20,800	0	1,421	2,720	0	1,581	2,931
17,300	17,350	0	1,972	3,447	0	2,132	3,657	20,800	20,850	0	1,413	2,710	0	1,573	2,920
17,350	17,400	0	1,964	3,436	0	2,124	3,647	20,850	20,900	0	1,405	2,699	0	1,565	2,910
17,400	17,450	0	1,956	3,426	0	2,116	3,636	20,900	20,950	0	1,397	2,689	0	1,557	2,899
17,450	17,500	0	1,948	3,415	0	2,108	3,626	20,950	21,000	0	1,389	2,678	0	1,549	2,889
17,500	17,550	0	1,940	3,405	0	2,100	3,615	21,000	21,050	0	1,381	2,668	0	1,541	2,878
17,550	17,600	0	1,932	3,394	0	2,092	3,605	21,050	21,100	0	1,373	2,657	0	1,533	2,868
17,600	17,650	0	1,924	3,384	0	2,084	3,594	21,100	21,150	0	1,365	2,647	0	1,525	2,857
17,650	17,700	0	1,916	3,373	0	2,076	3,584	21,150	21,200	0	1,357	2,636	0	1,517	2,847
17,700	17,750	0	1,908	3,363	0	2,068	3,573	21,200	21,250	0	1,349	2,626	0	1,509	2,836
17,750	17,800	0	1,900	3,352	0	2,060	3,563	21,250	21,300	0	1,341	2,615	0	1,501	2,826
17,800	17,850	0	1,892	3,342	0	2,052	3,552	21,300	21,350	0	1,333	2,604	0	1,493	2,815
17,850	17,900	0	1,884	3,331	0	2,044	3,542	21,350	21,400	0	1,325	2,594	0	1,485	2,805
17,900	17,950	0	1,876	3,321	0	2,036									

**2003 Earned Income Credit (EIC) Table—Continued**

**(Caution. This is not a tax table.)**

If the amount you are looking up from the worksheet is—		And your filing status is—						If the amount you are looking up from the worksheet is—		And your filing status is—					
		Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—					Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—		
		No children	One child	Two children	No children	One child	Two children			No children	One child	Two children	No children	One child	Two children
At least	But less than	Your credit is—			Your credit is—			At least	But less than	Your credit is—			Your credit is—		
21,450	21,500	0	1,309	2,573	0	1,469	2,784	24,950	25,000	0	750	1,836	0	909	2,046
21,500	21,550	0	1,301	2,562	0	1,461	2,773	25,000	25,050	0	742	1,825	0	901	2,036
21,550	21,600	0	1,293	2,552	0	1,453	2,762	25,050	25,100	0	734	1,815	0	893	2,025
21,600	21,650	0	1,285	2,541	0	1,445	2,752	25,100	25,150	0	726	1,804	0	885	2,015
21,650	21,700	0	1,277	2,531	0	1,437	2,741	25,150	25,200	0	718	1,794	0	877	2,004
21,700	21,750	0	1,269	2,520	0	1,429	2,731	25,200	25,250	0	710	1,783	0	869	1,994
21,750	21,800	0	1,261	2,510	0	1,421	2,720	25,250	25,300	0	702	1,773	0	862	1,983
21,800	21,850	0	1,253	2,499	0	1,413	2,710	25,300	25,350	0	694	1,762	0	854	1,973
21,850	21,900	0	1,245	2,489	0	1,405	2,699	25,350	25,400	0	686	1,752	0	846	1,962
21,900	21,950	0	1,237	2,478	0	1,397	2,689	25,400	25,450	0	678	1,741	0	838	1,952
21,950	22,000	0	1,229	2,468	0	1,389	2,678	25,450	25,500	0	670	1,731	0	830	1,941
22,000	22,050	0	1,221	2,457	0	1,381	2,668	25,500	25,550	0	662	1,720	0	822	1,931
22,050	22,100	0	1,213	2,447	0	1,373	2,657	25,550	25,600	0	654	1,709	0	814	1,920
22,100	22,150	0	1,205	2,436	0	1,365	2,647	25,600	25,650	0	646	1,699	0	806	1,910
22,150	22,200	0	1,197	2,425	0	1,357	2,636	25,650	25,700	0	638	1,688	0	798	1,899
22,200	22,250	0	1,189	2,415	0	1,349	2,626	25,700	25,750	0	630	1,678	0	790	1,888
22,250	22,300	0	1,181	2,404	0	1,341	2,615	25,750	25,800	0	622	1,667	0	782	1,878
22,300	22,350	0	1,173	2,394	0	1,333	2,604	25,800	25,850	0	614	1,657	0	774	1,867
22,350	22,400	0	1,165	2,383	0	1,325	2,594	25,850	25,900	0	606	1,646	0	766	1,857
22,400	22,450	0	1,157	2,373	0	1,317	2,583	25,900	25,950	0	598	1,636	0	758	1,846
22,450	22,500	0	1,149	2,362	0	1,309	2,573	25,950	26,000	0	590	1,625	0	750	1,836
22,500	22,550	0	1,141	2,352	0	1,301	2,562	26,000	26,050	0	582	1,615	0	742	1,825
22,550	22,600	0	1,133	2,341	0	1,293	2,552	26,050	26,100	0	574	1,604	0	734	1,815
22,600	22,650	0	1,125	2,331	0	1,285	2,541	26,100	26,150	0	566	1,594	0	726	1,804
22,650	22,700	0	1,117	2,320	0	1,277	2,531	26,150	26,200	0	558	1,583	0	718	1,794
22,700	22,750	0	1,109	2,310	0	1,269	2,520	26,200	26,250	0	550	1,573	0	710	1,783
22,750	22,800	0	1,101	2,299	0	1,261	2,510	26,250	26,300	0	542	1,562	0	702	1,773
22,800	22,850	0	1,093	2,289	0	1,253	2,499	26,300	26,350	0	534	1,551	0	694	1,762
22,850	22,900	0	1,085	2,278	0	1,245	2,489	26,350	26,400	0	526	1,541	0	686	1,752
22,900	22,950	0	1,077	2,268	0	1,237	2,478	26,400	26,450	0	518	1,530	0	678	1,741
22,950	23,000	0	1,069	2,257	0	1,229	2,468	26,450	26,500	0	510	1,520	0	670	1,731
23,000	23,050	0	1,061	2,246	0	1,221	2,457	26,500	26,550	0	502	1,509	0	662	1,720
23,050	23,100	0	1,053	2,236	0	1,213	2,447	26,550	26,600	0	494	1,499	0	654	1,709
23,100	23,150	0	1,045	2,225	0	1,205	2,436	26,600	26,650	0	486	1,488	0	646	1,699
23,150	23,200	0	1,037	2,215	0	1,197	2,425	26,650	26,700	0	478	1,478	0	638	1,688
23,200	23,250	0	1,029	2,204	0	1,189	2,415	26,700	26,750	0	470	1,467	0	630	1,678
23,250	23,300	0	1,021	2,194	0	1,181	2,404	26,750	26,800	0	462	1,457	0	622	1,667
23,300	23,350	0	1,013	2,183	0	1,173	2,394	26,800	26,850	0	454	1,446	0	614	1,657
23,350	23,400	0	1,005	2,173	0	1,165	2,383	26,850	26,900	0	446	1,436	0	606	1,646
23,400	23,450	0	997	2,162	0	1,157	2,373	26,900	26,950	0	438	1,425	0	598	1,636
23,450	23,500	0	989	2,152	0	1,149	2,362	26,950	27,000	0	430	1,415	0	590	1,625
23,500	23,550	0	981	2,141	0	1,141	2,352	27,000	27,050	0	422	1,404	0	582	1,615
23,550	23,600	0	973	2,131	0	1,133	2,341	27,050	27,100	0	414	1,394	0	574	1,604
23,600	23,650	0	965	2,120	0	1,125	2,331	27,100	27,150	0	406	1,383	0	566	1,594
23,650	23,700	0	957	2,110	0	1,117	2,320	27,150	27,200	0	398	1,372	0	558	1,583
23,700	23,750	0	949	2,099	0	1,109	2,310	27,200	27,250	0	390	1,362	0	550	1,573
23,750	23,800	0	941	2,089	0	1,101	2,299	27,250	27,300	0	382	1,351	0	542	1,562
23,800	23,850	0	933	2,078	0	1,093	2,289	27,300	27,350	0	374	1,341	0	534	1,551
23,850	23,900	0	925	2,067	0	1,085	2,278	27,350	27,400	0	366	1,330	0	526	1,541
23,900	23,950	0	917	2,057	0	1,077	2,268	27,400	27,450	0	358	1,320	0	518	1,530
23,950	24,000	0	909	2,046	0	1,069	2,257	27,450	27,500	0	350	1,309	0	510	1,520
24,000	24,050	0	901	2,036	0	1,061	2,246	27,500	27,550	0	342	1,299	0	502	1,509
24,050	24,100	0	893	2,025	0	1,053	2,236	27,550	27,600	0	334	1,288	0	494	1,499
24,100	24,150	0	885	2,015	0	1,045	2,225	27,600	27,650	0	326	1,278	0	486	1,488
24,150	24,200	0	877	2,004	0	1,037	2,215	27,650	27,700	0	318	1,267	0	478	1,478
24,200	24,250	0	869	1,994	0	1,029	2,204	27,700	27,750	0	310	1,257	0	470	1,467
24,250	24,300	0	862	1,983	0	1,021	2,194	27,750	27,800	0	302	1,246	0	462	1,457
24,300	24,350	0	854	1,973	0	1,013	2,183	27,800	27,850	0	294	1,236	0	454	1,446
24,350	24,400	0	846	1,962	0	1,005	2,173	27,850	27,900	0	286	1,225	0	446	1,436
24,400	24,450	0	838	1,952	0	997	2,162	27,900	27,950	0	278	1,215	0	438	1,425
24,450	24,500	0	830	1,941	0	989	2,152	27,950	28,000	0	270	1,204	0	430	1,415
24,500	24,550	0	822	1,931	0	981	2,141	28,000	28,050	0	262	1,193	0	422	1,404
24,550	24,600	0	814	1,920	0	973	2,131	28,050	28,100	0	254	1,183	0	414	1,394
24,600	24,650	0	806	1,910	0	965	2,120	28,100	28,150	0	246	1,172	0	406	1,383
24,650	24,700	0	798	1,899	0	957	2,110	28,150	28,200	0	238	1,162	0	398	1,372
24,700	24,750	0	790	1,888	0	949	2,099	28,200	28,250	0	230	1,151	0	390	1,362
24,750	24,800	0	782	1,878	0	941	2,089	28,250	28,300	0	222	1,141	0	382	1,351
24,800	24,850	0	774	1,867	0	933	2,078	28,300	28,350	0	214	1,130	0	374	1,341
24,850	24,900	0	766	1,857	0	925	2,067	28,350	28,400	0	206	1,120	0	366	1,330
24,900	24,950	0	758	1,846	0	917	2,057	28,400	28,450	0	198	1,109	0	358	1,320

(Continued on page 54)

**2003 Earned Income Credit (EIC) Table—Continued (Caution. This is not a tax table.)**

If the amount you are looking up from the worksheet is—		And your filing status is—						If the amount you are looking up from the worksheet is—		And your filing status is—					
		Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—					Single, head of household, or qualifying widow(er) and you have—			Married filing jointly and you have—		
		No children	One child	Two children	No children	One child	Two children			No children	One child	Two children	No children	One child	Two children
At least	But less than	Your credit is—			Your credit is—			At least	But less than	Your credit is—			Your credit is—		
28,450	28,500	0	190	1,099	0	350	1,309	31,950	32,000	0	0	362	0	0	572
28,500	28,550	0	182	1,088	0	342	1,299	32,000	32,050	0	0	351	0	0	562
28,550	28,600	0	174	1,078	0	334	1,288	32,050	32,100	0	0	341	0	0	551
28,600	28,650	0	166	1,067	0	326	1,278	32,100	32,150	0	0	330	0	0	541
28,650	28,700	0	158	1,057	0	318	1,267	32,150	32,200	0	0	319	0	0	530
28,700	28,750	0	150	1,046	0	310	1,257	32,200	32,250	0	0	309	0	0	520
28,750	28,800	0	142	1,036	0	302	1,246	32,250	32,300	0	0	298	0	0	509
28,800	28,850	0	134	1,025	0	294	1,236	32,300	32,350	0	0	288	0	0	498
28,850	28,900	0	126	1,014	0	286	1,225	32,350	32,400	0	0	277	0	0	488
28,900	28,950	0	118	1,004	0	278	1,215	32,400	32,450	0	0	267	0	0	477
28,950	29,000	0	110	993	0	270	1,204	32,450	32,500	0	0	256	0	0	467
29,000	29,050	0	102	983	0	262	1,193	32,500	32,550	0	0	246	0	0	456
29,050	29,100	0	94	972	0	254	1,183	32,550	32,600	0	0	235	0	0	446
29,100	29,150	0	86	962	0	246	1,172	32,600	32,650	0	0	225	0	0	435
29,150	29,200	0	78	951	0	238	1,162	32,650	32,700	0	0	214	0	0	425
29,200	29,250	0	70	941	0	230	1,151	32,700	32,750	0	0	204	0	0	414
29,250	29,300	0	63	930	0	222	1,141	32,750	32,800	0	0	193	0	0	404
29,300	29,350	0	55	920	0	214	1,130	32,800	32,850	0	0	183	0	0	393
29,350	29,400	0	47	909	0	206	1,120	32,850	32,900	0	0	172	0	0	383
29,400	29,450	0	39	899	0	198	1,109	32,900	32,950	0	0	162	0	0	372
29,450	29,500	0	31	888	0	190	1,099	32,950	33,000	0	0	151	0	0	362
29,500	29,550	0	23	878	0	182	1,088	33,000	33,050	0	0	140	0	0	351
29,550	29,600	0	15	867	0	174	1,078	33,050	33,100	0	0	130	0	0	341
29,600	29,650	0	7	857	0	166	1,067	33,100	33,150	0	0	119	0	0	330
29,650	29,700	0	**	846	0	158	1,057	33,150	33,200	0	0	109	0	0	319
29,700	29,750	0	0	835	0	150	1,046	33,200	33,250	0	0	98	0	0	309
29,750	29,800	0	0	825	0	142	1,036	33,250	33,300	0	0	88	0	0	298
29,800	29,850	0	0	814	0	134	1,025	33,300	33,350	0	0	77	0	0	288
29,850	29,900	0	0	804	0	126	1,014	33,350	33,400	0	0	67	0	0	277
29,900	29,950	0	0	793	0	118	1,004	33,400	33,450	0	0	56	0	0	267
29,950	30,000	0	0	783	0	110	993	33,450	33,500	0	0	46	0	0	256
30,000	30,050	0	0	772	0	102	983	33,500	33,550	0	0	35	0	0	246
30,050	30,100	0	0	762	0	94	972	33,550	33,600	0	0	25	0	0	235
30,100	30,150	0	0	751	0	86	962	33,600	33,650	0	0	14	0	0	225
30,150	30,200	0	0	741	0	78	951	33,650	33,700	0	0	***	0	0	214
30,200	30,250	0	0	730	0	70	941	33,700	33,750	0	0	0	0	0	204
30,250	30,300	0	0	720	0	63	930	33,750	33,800	0	0	0	0	0	193
30,300	30,350	0	0	709	0	55	920	33,800	33,850	0	0	0	0	0	183
30,350	30,400	0	0	699	0	47	909	33,850	33,900	0	0	0	0	0	172
30,400	30,450	0	0	688	0	39	899	33,900	33,950	0	0	0	0	0	162
30,450	30,500	0	0	678	0	31	888	33,950	34,000	0	0	0	0	0	151
30,500	30,550	0	0	667	0	23	878	34,000	34,050	0	0	0	0	0	140
30,550	30,600	0	0	656	0	15	867	34,050	34,100	0	0	0	0	0	130
30,600	30,650	0	0	646	0	7	857	34,100	34,150	0	0	0	0	0	119
30,650	30,700	0	0	635	0	**	846	34,150	34,200	0	0	0	0	0	109
30,700	30,750	0	0	625	0	0	835	34,200	34,250	0	0	0	0	0	98
30,750	30,800	0	0	614	0	0	825	34,250	34,300	0	0	0	0	0	88
30,800	30,850	0	0	604	0	0	814	34,300	34,350	0	0	0	0	0	77
30,850	30,900	0	0	593	0	0	804	34,350	34,400	0	0	0	0	0	67
30,900	30,950	0	0	583	0	0	793	34,400	34,450	0	0	0	0	0	56
30,950	31,000	0	0	572	0	0	783	34,450	34,500	0	0	0	0	0	46
31,000	31,050	0	0	562	0	0	772	34,500	34,550	0	0	0	0	0	35
31,050	31,100	0	0	551	0	0	762	34,550	34,600	0	0	0	0	0	25
31,100	31,150	0	0	541	0	0	751	34,600	34,650	0	0	0	0	0	14
31,150	31,200	0	0	530	0	0	741	34,650	34,692	0	0	0	0	0	4
31,200	31,250	0	0	520	0	0	730	34,692 or more		0	0	0	0	0	0
31,250	31,300	0	0	509	0	0	720								
31,300	31,350	0	0	498	0	0	709								
31,350	31,400	0	0	488	0	0	699								
31,400	31,450	0	0	477	0	0	688								
31,450	31,500	0	0	467	0	0	678								
31,500	31,550	0	0	456	0	0	667								
31,550	31,600	0	0	446	0	0	656								
31,600	31,650	0	0	435	0	0	646								
31,650	31,700	0	0	425	0	0	635								
31,700	31,750	0	0	414	0	0	625								
31,750	31,800	0	0	404	0	0	614								
31,800	31,850	0	0	393	0	0	604								
31,850	31,900	0	0	383	0	0	593								
31,900	31,950	0	0	372	0	0	583								

\*\*If the amount you are looking up from the worksheet is at least \$29,650 (\$30,650 if married filing jointly) but less than \$29,666 (\$30,666 if married filing jointly), your credit is \$1. Otherwise, you cannot take the credit.

\*\*\*If the amount you are looking up from the worksheet is at least \$33,650 but less than \$33,692, your credit is \$4. Otherwise, you cannot take the credit.

**STUDENT NOTES**

## 2003 Tax Table

Use if your taxable income is less than \$100,000.  
If \$100,000 or more, use the Tax Rate Schedules.

**Example.** Mr. and Mrs. Brown are filing a joint return. Their taxable income on line 40 of Form 1040 is \$25,300. First, they find the \$25,300–25,350 income line. Next, they find the column for married filing jointly and read down the column. The amount shown where the income line and filing status column meet is \$3,099. This is the tax amount they should enter on line 41 of their Form 1040.

Sample Table

At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
<b>Your tax is—</b>					
25,200	25,250	3,434	3,084	3,434	3,284
25,250	25,300	3,441	3,091	3,441	3,291
25,300	25,350	3,449	3,099	3,449	3,299
25,350	25,400	3,456	3,106	3,456	3,306

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		<b>Your tax is—</b>						<b>Your tax is—</b>						<b>Your tax is—</b>			
0	5	0	0	0	0	1,300	1,325	131	131	131	131	2,700	2,725	271	271	271	271
5	15	1	1	1	1	1,325	1,350	134	134	134	134	2,725	2,750	274	274	274	274
15	25	2	2	2	2	1,350	1,375	136	136	136	136	2,750	2,775	276	276	276	276
25	50	4	4	4	4	1,375	1,400	139	139	139	139	2,775	2,800	279	279	279	279
50	75	6	6	6	6	1,400	1,425	141	141	141	141	2,800	2,825	281	281	281	281
75	100	9	9	9	9	1,425	1,450	144	144	144	144	2,825	2,850	284	284	284	284
100	125	11	11	11	11	1,450	1,475	146	146	146	146	2,850	2,875	286	286	286	286
125	150	14	14	14	14	1,475	1,500	149	149	149	149	2,875	2,900	289	289	289	289
150	175	16	16	16	16	1,500	1,525	151	151	151	151	2,900	2,925	291	291	291	291
175	200	19	19	19	19	1,525	1,550	154	154	154	154	2,925	2,950	294	294	294	294
200	225	21	21	21	21	1,550	1,575	156	156	156	156	2,950	2,975	296	296	296	296
225	250	24	24	24	24	1,575	1,600	159	159	159	159	2,975	3,000	299	299	299	299
250	275	26	26	26	26	1,600	1,625	161	161	161	161	<b>3,000</b>					
275	300	29	29	29	29	1,625	1,650	164	164	164	164	3,000	3,050	303	303	303	303
300	325	31	31	31	31	1,650	1,675	166	166	166	166	3,050	3,100	308	308	308	308
325	350	34	34	34	34	1,675	1,700	169	169	169	169	3,100	3,150	313	313	313	313
350	375	36	36	36	36	1,700	1,725	171	171	171	171	3,150	3,200	318	318	318	318
375	400	39	39	39	39	1,725	1,750	174	174	174	174	3,200	3,250	323	323	323	323
400	425	41	41	41	41	1,750	1,775	176	176	176	176	3,250	3,300	328	328	328	328
425	450	44	44	44	44	1,775	1,800	179	179	179	179	3,300	3,350	333	333	333	333
450	475	46	46	46	46	1,800	1,825	181	181	181	181	3,350	3,400	338	338	338	338
475	500	49	49	49	49	1,825	1,850	184	184	184	184	3,400	3,450	343	343	343	343
500	525	51	51	51	51	1,850	1,875	186	186	186	186	3,450	3,500	348	348	348	348
525	550	54	54	54	54	1,875	1,900	189	189	189	189	3,500	3,550	353	353	353	353
550	575	56	56	56	56	1,900	1,925	191	191	191	191	3,550	3,600	358	358	358	358
575	600	59	59	59	59	1,925	1,950	194	194	194	194	3,600	3,650	363	363	363	363
600	625	61	61	61	61	1,950	1,975	196	196	196	196	3,650	3,700	368	368	368	368
625	650	64	64	64	64	1,975	2,000	199	199	199	199	3,700	3,750	373	373	373	373
650	675	66	66	66	66	<b>2,000</b>						3,750	3,800	378	378	378	378
675	700	69	69	69	69	2,000	2,025	201	201	201	201	3,800	3,850	383	383	383	383
700	725	71	71	71	71	2,025	2,050	204	204	204	204	3,850	3,900	388	388	388	388
725	750	74	74	74	74	2,050	2,075	206	206	206	206	3,900	3,950	393	393	393	393
750	775	76	76	76	76	2,075	2,100	209	209	209	209	3,950	4,000	398	398	398	398
775	800	79	79	79	79	2,100	2,125	211	211	211	211	<b>4,000</b>					
800	825	81	81	81	81	2,125	2,150	214	214	214	214	4,000	4,050	403	403	403	403
825	850	84	84	84	84	2,150	2,175	216	216	216	216	4,050	4,100	408	408	408	408
850	875	86	86	86	86	2,175	2,200	219	219	219	219	4,100	4,150	413	413	413	413
875	900	89	89	89	89	2,200	2,225	221	221	221	221	4,150	4,200	418	418	418	418
900	925	91	91	91	91	2,225	2,250	224	224	224	224	4,200	4,250	423	423	423	423
925	950	94	94	94	94	2,250	2,275	226	226	226	226	4,250	4,300	428	428	428	428
950	975	96	96	96	96	2,275	2,300	229	229	229	229	4,300	4,350	433	433	433	433
975	1,000	99	99	99	99	2,300	2,325	231	231	231	231	4,350	4,400	438	438	438	438
<b>1,000</b>						2,325	2,350	234	234	234	234	4,400	4,450	443	443	443	443
1,000	1,025	101	101	101	101	2,350	2,375	236	236	236	236	4,450	4,500	448	448	448	448
1,025	1,050	104	104	104	104	2,375	2,400	239	239	239	239	4,500	4,550	453	453	453	453
1,050	1,075	106	106	106	106	2,400	2,425	241	241	241	241	4,550	4,600	458	458	458	458
1,075	1,100	109	109	109	109	2,425	2,450	244	244	244	244	4,600	4,650	463	463	463	463
1,100	1,125	111	111	111	111	2,450	2,475	246	246	246	246	4,650	4,700	468	468	468	468
1,125	1,150	114	114	114	114	2,475	2,500	249	249	249	249	4,700	4,750	473	473	473	473
1,150	1,175	116	116	116	116	2,500	2,525	251	251	251	251	4,750	4,800	478	478	478	478
1,175	1,200	119	119	119	119	2,525	2,550	254	254	254	254	4,800	4,850	483	483	483	483
1,200	1,225	121	121	121	121	2,550	2,575	256	256	256	256	4,850	4,900	488	488	488	488
1,225	1,250	124	124	124	124	2,575	2,600	259	259	259	259	4,900	4,950	493	493	493	493
1,250	1,275	126	126	126	126	2,600	2,625	261	261	261	261	4,950	5,000	498	498	498	498
1,275	1,300	129	129	129	129	2,625	2,650	264	264	264	264						
						2,650	2,675	266	266	266	266						
						2,675	2,700	269	269	269	269						

(Continued on page 64)

\* This column must also be used by a qualifying widow(er).

2003 Tax Table—Continued

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
<b>5,000</b>						<b>8,000</b>						<b>11,000</b>					
5,000	5,050	503	503	503	503	8,000	8,050	854	803	854	803	11,000	11,050	1,304	1,103	1,304	1,154
5,050	5,100	508	508	508	508	8,050	8,100	861	808	861	808	11,050	11,100	1,311	1,108	1,311	1,161
5,100	5,150	513	513	513	513	8,100	8,150	869	813	869	813	11,100	11,150	1,319	1,113	1,319	1,169
5,150	5,200	518	518	518	518	8,150	8,200	876	818	876	818	11,150	11,200	1,326	1,118	1,326	1,176
5,200	5,250	523	523	523	523	8,200	8,250	884	823	884	823	11,200	11,250	1,334	1,123	1,334	1,184
5,250	5,300	528	528	528	528	8,250	8,300	891	828	891	828	11,250	11,300	1,341	1,128	1,341	1,191
5,300	5,350	533	533	533	533	8,300	8,350	899	833	899	833	11,300	11,350	1,349	1,133	1,349	1,199
5,350	5,400	538	538	538	538	8,350	8,400	906	838	906	838	11,350	11,400	1,356	1,138	1,356	1,206
5,400	5,450	543	543	543	543	8,400	8,450	914	843	914	843	11,400	11,450	1,364	1,143	1,364	1,214
5,450	5,500	548	548	548	548	8,450	8,500	921	848	921	848	11,450	11,500	1,371	1,148	1,371	1,221
5,500	5,550	553	553	553	553	8,500	8,550	929	853	929	853	11,500	11,550	1,379	1,153	1,379	1,229
5,550	5,600	558	558	558	558	8,550	8,600	936	858	936	858	11,550	11,600	1,386	1,158	1,386	1,236
5,600	5,650	563	563	563	563	8,600	8,650	944	863	944	863	11,600	11,650	1,394	1,163	1,394	1,244
5,650	5,700	568	568	568	568	8,650	8,700	951	868	951	868	11,650	11,700	1,401	1,168	1,401	1,251
5,700	5,750	573	573	573	573	8,700	8,750	959	873	959	873	11,700	11,750	1,409	1,173	1,409	1,259
5,750	5,800	578	578	578	578	8,750	8,800	966	878	966	878	11,750	11,800	1,416	1,178	1,416	1,266
5,800	5,850	583	583	583	583	8,800	8,850	974	883	974	883	11,800	11,850	1,424	1,183	1,424	1,274
5,850	5,900	588	588	588	588	8,850	8,900	981	888	981	888	11,850	11,900	1,431	1,188	1,431	1,281
5,900	5,950	593	593	593	593	8,900	8,950	989	893	989	893	11,900	11,950	1,439	1,193	1,439	1,289
5,950	6,000	598	598	598	598	8,950	9,000	996	898	996	898	11,950	12,000	1,446	1,198	1,446	1,296
<b>6,000</b>						<b>9,000</b>						<b>12,000</b>					
6,000	6,050	603	603	603	603	9,000	9,050	1,004	903	1,004	903	12,000	12,050	1,454	1,203	1,454	1,304
6,050	6,100	608	608	608	608	9,050	9,100	1,011	908	1,011	908	12,050	12,100	1,461	1,208	1,461	1,311
6,100	6,150	613	613	613	613	9,100	9,150	1,019	913	1,019	913	12,100	12,150	1,469	1,213	1,469	1,319
6,150	6,200	618	618	618	618	9,150	9,200	1,026	918	1,026	918	12,150	12,200	1,476	1,218	1,476	1,326
6,200	6,250	623	623	623	623	9,200	9,250	1,034	923	1,034	923	12,200	12,250	1,484	1,223	1,484	1,334
6,250	6,300	628	628	628	628	9,250	9,300	1,041	928	1,041	928	12,250	12,300	1,491	1,228	1,491	1,341
6,300	6,350	633	633	633	633	9,300	9,350	1,049	933	1,049	933	12,300	12,350	1,499	1,233	1,499	1,349
6,350	6,400	638	638	638	638	9,350	9,400	1,056	938	1,056	938	12,350	12,400	1,506	1,238	1,506	1,356
6,400	6,450	643	643	643	643	9,400	9,450	1,064	943	1,064	943	12,400	12,450	1,514	1,243	1,514	1,364
6,450	6,500	648	648	648	648	9,450	9,500	1,071	948	1,071	948	12,450	12,500	1,521	1,248	1,521	1,371
6,500	6,550	653	653	653	653	9,500	9,550	1,079	953	1,079	953	12,500	12,550	1,529	1,253	1,529	1,379
6,550	6,600	658	658	658	658	9,550	9,600	1,086	958	1,086	958	12,550	12,600	1,536	1,258	1,536	1,386
6,600	6,650	663	663	663	663	9,600	9,650	1,094	963	1,094	963	12,600	12,650	1,544	1,263	1,544	1,394
6,650	6,700	668	668	668	668	9,650	9,700	1,101	968	1,101	968	12,650	12,700	1,551	1,268	1,551	1,401
6,700	6,750	673	673	673	673	9,700	9,750	1,109	973	1,109	973	12,700	12,750	1,559	1,273	1,559	1,409
6,750	6,800	678	678	678	678	9,750	9,800	1,116	978	1,116	978	12,750	12,800	1,566	1,278	1,566	1,416
6,800	6,850	683	683	683	683	9,800	9,850	1,124	983	1,124	983	12,800	12,850	1,574	1,283	1,574	1,424
6,850	6,900	688	688	688	688	9,850	9,900	1,131	988	1,131	988	12,850	12,900	1,581	1,288	1,581	1,431
6,900	6,950	693	693	693	693	9,900	9,950	1,139	993	1,139	993	12,900	12,950	1,589	1,293	1,589	1,439
6,950	7,000	698	698	698	698	9,950	10,000	1,146	998	1,146	998	12,950	13,000	1,596	1,298	1,596	1,446
<b>7,000</b>						<b>10,000</b>						<b>13,000</b>					
7,000	7,050	704	703	704	703	10,000	10,050	1,154	1,003	1,154	1,004	13,000	13,050	1,604	1,303	1,604	1,454
7,050	7,100	711	708	711	708	10,050	10,100	1,161	1,008	1,161	1,011	13,050	13,100	1,611	1,308	1,611	1,461
7,100	7,150	719	713	719	713	10,100	10,150	1,169	1,013	1,169	1,019	13,100	13,150	1,619	1,313	1,619	1,469
7,150	7,200	726	718	726	718	10,150	10,200	1,176	1,018	1,176	1,026	13,150	13,200	1,626	1,318	1,626	1,476
7,200	7,250	734	723	734	723	10,200	10,250	1,184	1,023	1,184	1,034	13,200	13,250	1,634	1,323	1,634	1,484
7,250	7,300	741	728	741	728	10,250	10,300	1,191	1,028	1,191	1,041	13,250	13,300	1,641	1,328	1,641	1,491
7,300	7,350	749	733	749	733	10,300	10,350	1,199	1,033	1,199	1,049	13,300	13,350	1,649	1,333	1,649	1,499
7,350	7,400	756	738	756	738	10,350	10,400	1,206	1,038	1,206	1,056	13,350	13,400	1,656	1,338	1,656	1,506
7,400	7,450	764	743	764	743	10,400	10,450	1,214	1,043	1,214	1,064	13,400	13,450	1,664	1,343	1,664	1,514
7,450	7,500	771	748	771	748	10,450	10,500	1,221	1,048	1,221	1,071	13,450	13,500	1,671	1,348	1,671	1,521
7,500	7,550	779	753	779	753	10,500	10,550	1,229	1,053	1,229	1,079	13,500	13,550	1,679	1,353	1,679	1,529
7,550	7,600	786	758	786	758	10,550	10,600	1,236	1,058	1,236	1,086	13,550	13,600	1,686	1,358	1,686	1,536
7,600	7,650	794	763	794	763	10,600	10,650	1,244	1,063	1,244	1,094	13,600	13,650	1,694	1,363	1,694	1,544
7,650	7,700	801	768	801	768	10,650	10,700	1,251	1,068	1,251	1,101	13,650	13,700	1,701	1,368	1,701	1,551
7,700	7,750	809	773	809	773	10,700	10,750	1,259	1,073	1,259	1,109	13,700	13,750	1,709	1,373	1,709	1,559
7,750	7,800	816	778	816	778	10,750	10,800	1,266	1,078	1,266	1,116	13,750	13,800	1,716	1,378	1,716	1,566
7,800	7,850	824	783	824	783	10,800	10,850	1,274	1,083	1,274	1,124	13,800	13,850	1,724	1,383	1,724	1,574
7,850	7,900	831	788	831	788	10,850	10,900	1,281	1,088	1,281	1,131	13,850	13,900	1,731	1,388	1,731	1,581
7,900	7,950	839	793	839	793	10,900	10,950	1,289	1,093	1,289	1,139	13,900	13,950	1,739	1,393	1,739	1,589
7,950	8,000	846	798	846	798	10,950	11,000	1,296	1,098	1,296	1,146	13,950	14,000	1,746	1,398	1,746	1,596

\* This column must also be used by a qualifying widow(er).

(Continued on page 65)

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
<b>14,000</b>						<b>17,000</b>						<b>20,000</b>					
14,000	14,050	1,754	1,404	1,754	1,604	17,000	17,050	2,204	1,854	2,204	2,054	20,000	20,050	2,654	2,304	2,654	2,504
14,050	14,100	1,761	1,411	1,761	1,611	17,050	17,100	2,211	1,861	2,211	2,061	20,050	20,100	2,661	2,311	2,661	2,511
14,100	14,150	1,769	1,419	1,769	1,619	17,100	17,150	2,219	1,869	2,219	2,069	20,100	20,150	2,669	2,319	2,669	2,519
14,150	14,200	1,776	1,426	1,776	1,626	17,150	17,200	2,226	1,876	2,226	2,076	20,150	20,200	2,676	2,326	2,676	2,526
14,200	14,250	1,784	1,434	1,784	1,634	17,200	17,250	2,234	1,884	2,234	2,084	20,200	20,250	2,684	2,334	2,684	2,534
14,250	14,300	1,791	1,441	1,791	1,641	17,250	17,300	2,241	1,891	2,241	2,091	20,250	20,300	2,691	2,341	2,691	2,541
14,300	14,350	1,799	1,449	1,799	1,649	17,300	17,350	2,249	1,899	2,249	2,099	20,300	20,350	2,699	2,349	2,699	2,549
14,350	14,400	1,806	1,456	1,806	1,656	17,350	17,400	2,256	1,906	2,256	2,106	20,350	20,400	2,706	2,356	2,706	2,556
14,400	14,450	1,814	1,464	1,814	1,664	17,400	17,450	2,264	1,914	2,264	2,114	20,400	20,450	2,714	2,364	2,714	2,564
14,450	14,500	1,821	1,471	1,821	1,671	17,450	17,500	2,271	1,921	2,271	2,121	20,450	20,500	2,721	2,371	2,721	2,571
14,500	14,550	1,829	1,479	1,829	1,679	17,500	17,550	2,279	1,929	2,279	2,129	20,500	20,550	2,729	2,379	2,729	2,579
14,550	14,600	1,836	1,486	1,836	1,686	17,550	17,600	2,286	1,936	2,286	2,136	20,550	20,600	2,736	2,386	2,736	2,586
14,600	14,650	1,844	1,494	1,844	1,694	17,600	17,650	2,294	1,944	2,294	2,144	20,600	20,650	2,744	2,394	2,744	2,594
14,650	14,700	1,851	1,501	1,851	1,701	17,650	17,700	2,301	1,951	2,301	2,151	20,650	20,700	2,751	2,401	2,751	2,601
14,700	14,750	1,859	1,509	1,859	1,709	17,700	17,750	2,309	1,959	2,309	2,159	20,700	20,750	2,759	2,409	2,759	2,609
14,750	14,800	1,866	1,516	1,866	1,716	17,750	17,800	2,316	1,966	2,316	2,166	20,750	20,800	2,766	2,416	2,766	2,616
14,800	14,850	1,874	1,524	1,874	1,724	17,800	17,850	2,324	1,974	2,324	2,174	20,800	20,850	2,774	2,424	2,774	2,624
14,850	14,900	1,881	1,531	1,881	1,731	17,850	17,900	2,331	1,981	2,331	2,181	20,850	20,900	2,781	2,431	2,781	2,631
14,900	14,950	1,889	1,539	1,889	1,739	17,900	17,950	2,339	1,989	2,339	2,189	20,900	20,950	2,789	2,439	2,789	2,639
14,950	15,000	1,896	1,546	1,896	1,746	17,950	18,000	2,346	1,996	2,346	2,196	20,950	21,000	2,796	2,446	2,796	2,646
<b>15,000</b>						<b>18,000</b>						<b>21,000</b>					
15,000	15,050	1,904	1,554	1,904	1,754	18,000	18,050	2,354	2,004	2,354	2,204	21,000	21,050	2,804	2,454	2,804	2,654
15,050	15,100	1,911	1,561	1,911	1,761	18,050	18,100	2,361	2,011	2,361	2,211	21,050	21,100	2,811	2,461	2,811	2,661
15,100	15,150	1,919	1,569	1,919	1,769	18,100	18,150	2,369	2,019	2,369	2,219	21,100	21,150	2,819	2,469	2,819	2,669
15,150	15,200	1,926	1,576	1,926	1,776	18,150	18,200	2,376	2,026	2,376	2,226	21,150	21,200	2,826	2,476	2,826	2,676
15,200	15,250	1,934	1,584	1,934	1,784	18,200	18,250	2,384	2,034	2,384	2,234	21,200	21,250	2,834	2,484	2,834	2,684
15,250	15,300	1,941	1,591	1,941	1,791	18,250	18,300	2,391	2,041	2,391	2,241	21,250	21,300	2,841	2,491	2,841	2,691
15,300	15,350	1,949	1,599	1,949	1,799	18,300	18,350	2,399	2,049	2,399	2,249	21,300	21,350	2,849	2,499	2,849	2,699
15,350	15,400	1,956	1,606	1,956	1,806	18,350	18,400	2,406	2,056	2,406	2,256	21,350	21,400	2,856	2,506	2,856	2,706
15,400	15,450	1,964	1,614	1,964	1,814	18,400	18,450	2,414	2,064	2,414	2,264	21,400	21,450	2,864	2,514	2,864	2,714
15,450	15,500	1,971	1,621	1,971	1,821	18,450	18,500	2,421	2,071	2,421	2,271	21,450	21,500	2,871	2,521	2,871	2,721
15,500	15,550	1,979	1,629	1,979	1,829	18,500	18,550	2,429	2,079	2,429	2,279	21,500	21,550	2,879	2,529	2,879	2,729
15,550	15,600	1,986	1,636	1,986	1,836	18,550	18,600	2,436	2,086	2,436	2,286	21,550	21,600	2,886	2,536	2,886	2,736
15,600	15,650	1,994	1,644	1,994	1,844	18,600	18,650	2,444	2,094	2,444	2,294	21,600	21,650	2,894	2,544	2,894	2,744
15,650	15,700	2,001	1,651	2,001	1,851	18,650	18,700	2,451	2,101	2,451	2,301	21,650	21,700	2,901	2,551	2,901	2,751
15,700	15,750	2,009	1,659	2,009	1,859	18,700	18,750	2,459	2,109	2,459	2,309	21,700	21,750	2,909	2,559	2,909	2,759
15,750	15,800	2,016	1,666	2,016	1,866	18,750	18,800	2,466	2,116	2,466	2,316	21,750	21,800	2,916	2,566	2,916	2,766
15,800	15,850	2,024	1,674	2,024	1,874	18,800	18,850	2,474	2,124	2,474	2,324	21,800	21,850	2,924	2,574	2,924	2,774
15,850	15,900	2,031	1,681	2,031	1,881	18,850	18,900	2,481	2,131	2,481	2,331	21,850	21,900	2,931	2,581	2,931	2,781
15,900	15,950	2,039	1,689	2,039	1,889	18,900	18,950	2,489	2,139	2,489	2,339	21,900	21,950	2,939	2,589	2,939	2,789
15,950	16,000	2,046	1,696	2,046	1,896	18,950	19,000	2,496	2,146	2,496	2,346	21,950	22,000	2,946	2,596	2,946	2,796
<b>16,000</b>						<b>19,000</b>						<b>22,000</b>					
16,000	16,050	2,054	1,704	2,054	1,904	19,000	19,050	2,504	2,154	2,504	2,354	22,000	22,050	2,954	2,604	2,954	2,804
16,050	16,100	2,061	1,711	2,061	1,911	19,050	19,100	2,511	2,161	2,511	2,361	22,050	22,100	2,961	2,611	2,961	2,811
16,100	16,150	2,069	1,719	2,069	1,919	19,100	19,150	2,519	2,169	2,519	2,369	22,100	22,150	2,969	2,619	2,969	2,819
16,150	16,200	2,076	1,726	2,076	1,926	19,150	19,200	2,526	2,176	2,526	2,376	22,150	22,200	2,976	2,626	2,976	2,826
16,200	16,250	2,084	1,734	2,084	1,934	19,200	19,250	2,534	2,184	2,534	2,384	22,200	22,250	2,984	2,634	2,984	2,834
16,250	16,300	2,091	1,741	2,091	1,941	19,250	19,300	2,541	2,191	2,541	2,391	22,250	22,300	2,991	2,641	2,991	2,841
16,300	16,350	2,099	1,749	2,099	1,949	19,300	19,350	2,549	2,199	2,549	2,399	22,300	22,350	2,999	2,649	2,999	2,849
16,350	16,400	2,106	1,756	2,106	1,956	19,350	19,400	2,556	2,206	2,556	2,406	22,350	22,400	3,006	2,656	3,006	2,856
16,400	16,450	2,114	1,764	2,114	1,964	19,400	19,450	2,564	2,214	2,564	2,414	22,400	22,450	3,014	2,664	3,014	2,864
16,450	16,500	2,121	1,771	2,121	1,971	19,450	19,500	2,571	2,221	2,571	2,421	22,450	22,500	3,021	2,671	3,021	2,871
16,500	16,550	2,129	1,779	2,129	1,979	19,500	19,550	2,579	2,229	2,579	2,429	22,500	22,550	3,029	2,679	3,029	2,879
16,550	16,600	2,136	1,786	2,136	1,986	19,550	19,600	2,586	2,236	2,586	2,436	22,550	22,600	3,036	2,686	3,036	2,886
16,600	16,650	2,144	1,794	2,144	1,994	19,600	19,650	2,594	2,244	2,594	2,444	22,600	22,650	3,044	2,694	3,044	2,894
16,650	16,700	2,151	1,801	2,151	2,001	19,650	19,700	2,601	2,251	2,601	2,451	22,650	22,700	3,051	2,701	3,051	2,901
16,700	16,750	2,159	1,809	2,159	2,009	19,700	19,750	2,609	2,259	2,609	2,459	22,700	22,750	3,059	2,709	3,059	2,909
16,750	16,800	2,166	1,816	2,166	2,016	19,750	19,800	2,616	2,266	2,616	2,466	22,750	22,800	3,066	2,716	3,066	2,916
16,800	16,850	2,174	1,824	2,174	2,024	19,800	19,850	2,624	2,274	2,624	2,474	22,800	22,850	3,074	2,724	3,074	2,924
16,850	16,900	2,181	1,831	2,181	2,031	19,850	19,900	2,631	2,281	2,631	2,481	22,850	22,900	3,081	2,731	3,081	2,931
16,900	16,950	2,189	1,839	2,189	2,039	19,900	19,950	2,639	2,289	2,639	2,489	22,900	22,950	3,089	2,739	3,089	2,939
16,950	17,000	2,196	1,846	2,196	2,046	19,950	20,000										

2003 Tax Table—Continued

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
<b>23,000</b>						<b>26,000</b>						<b>29,000</b>					
23,000	23,050	3,104	2,754	3,104	2,954	26,000	26,050	3,554	3,204	3,554	3,404	29,000	29,050	4,066	3,654	4,066	3,854
23,050	23,100	3,111	2,761	3,111	2,961	26,050	26,100	3,561	3,211	3,561	3,411	29,050	29,100	4,079	3,661	4,079	3,861
23,100	23,150	3,119	2,769	3,119	2,969	26,100	26,150	3,569	3,219	3,569	3,419	29,100	29,150	4,091	3,669	4,091	3,869
23,150	23,200	3,126	2,776	3,126	2,976	26,150	26,200	3,576	3,226	3,576	3,426	29,150	29,200	4,104	3,676	4,104	3,876
23,200	23,250	3,134	2,784	3,134	2,984	26,200	26,250	3,584	3,234	3,584	3,434	29,200	29,250	4,116	3,684	4,116	3,884
23,250	23,300	3,141	2,791	3,141	2,991	26,250	26,300	3,591	3,241	3,591	3,441	29,250	29,300	4,129	3,691	4,129	3,891
23,300	23,350	3,149	2,799	3,149	2,999	26,300	26,350	3,599	3,249	3,599	3,449	29,300	29,350	4,141	3,699	4,141	3,899
23,350	23,400	3,156	2,806	3,156	3,006	26,350	26,400	3,606	3,256	3,606	3,456	29,350	29,400	4,154	3,706	4,154	3,906
23,400	23,450	3,164	2,814	3,164	3,014	26,400	26,450	3,614	3,264	3,614	3,464	29,400	29,450	4,166	3,714	4,166	3,914
23,450	23,500	3,171	2,821	3,171	3,021	26,450	26,500	3,621	3,271	3,621	3,471	29,450	29,500	4,179	3,721	4,179	3,921
23,500	23,550	3,179	2,829	3,179	3,029	26,500	26,550	3,629	3,279	3,629	3,479	29,500	29,550	4,191	3,729	4,191	3,929
23,550	23,600	3,186	2,836	3,186	3,036	26,550	26,600	3,636	3,286	3,636	3,486	29,550	29,600	4,204	3,736	4,204	3,936
23,600	23,650	3,194	2,844	3,194	3,044	26,600	26,650	3,644	3,294	3,644	3,494	29,600	29,650	4,216	3,744	4,216	3,944
23,650	23,700	3,201	2,851	3,201	3,051	26,650	26,700	3,651	3,301	3,651	3,501	29,650	29,700	4,229	3,751	4,229	3,951
23,700	23,750	3,209	2,859	3,209	3,059	26,700	26,750	3,659	3,309	3,659	3,509	29,700	29,750	4,241	3,759	4,241	3,959
23,750	23,800	3,216	2,866	3,216	3,066	26,750	26,800	3,666	3,316	3,666	3,516	29,750	29,800	4,254	3,766	4,254	3,966
23,800	23,850	3,224	2,874	3,224	3,074	26,800	26,850	3,674	3,324	3,674	3,524	29,800	29,850	4,266	3,774	4,266	3,974
23,850	23,900	3,231	2,881	3,231	3,081	26,850	26,900	3,681	3,331	3,681	3,531	29,850	29,900	4,279	3,781	4,279	3,981
23,900	23,950	3,239	2,889	3,239	3,089	26,900	26,950	3,689	3,339	3,689	3,539	29,900	29,950	4,291	3,789	4,291	3,989
23,950	24,000	3,246	2,896	3,246	3,096	26,950	27,000	3,696	3,346	3,696	3,546	29,950	30,000	4,304	3,796	4,304	3,996
<b>24,000</b>						<b>27,000</b>						<b>30,000</b>					
24,000	24,050	3,254	2,904	3,254	3,104	27,000	27,050	3,704	3,354	3,704	3,554	30,000	30,050	4,316	3,804	4,316	4,004
24,050	24,100	3,261	2,911	3,261	3,111	27,050	27,100	3,711	3,361	3,711	3,561	30,050	30,100	4,329	3,811	4,329	4,011
24,100	24,150	3,269	2,919	3,269	3,119	27,100	27,150	3,719	3,369	3,719	3,569	30,100	30,150	4,341	3,819	4,341	4,019
24,150	24,200	3,276	2,926	3,276	3,126	27,150	27,200	3,726	3,376	3,726	3,576	30,150	30,200	4,354	3,826	4,354	4,026
24,200	24,250	3,284	2,934	3,284	3,134	27,200	27,250	3,734	3,384	3,734	3,584	30,200	30,250	4,366	3,834	4,366	4,034
24,250	24,300	3,291	2,941	3,291	3,141	27,250	27,300	3,741	3,391	3,741	3,591	30,250	30,300	4,379	3,841	4,379	4,041
24,300	24,350	3,299	2,949	3,299	3,149	27,300	27,350	3,749	3,399	3,749	3,599	30,300	30,350	4,391	3,849	4,391	4,049
24,350	24,400	3,306	2,956	3,306	3,156	27,350	27,400	3,756	3,406	3,756	3,606	30,350	30,400	4,404	3,856	4,404	4,056
24,400	24,450	3,314	2,964	3,314	3,164	27,400	27,450	3,764	3,414	3,764	3,614	30,400	30,450	4,416	3,864	4,416	4,064
24,450	24,500	3,321	2,971	3,321	3,171	27,450	27,500	3,771	3,421	3,771	3,621	30,450	30,500	4,429	3,871	4,429	4,071
24,500	24,550	3,329	2,979	3,329	3,179	27,500	27,550	3,779	3,429	3,779	3,629	30,500	30,550	4,441	3,879	4,441	4,079
24,550	24,600	3,336	2,986	3,336	3,186	27,550	27,600	3,786	3,436	3,786	3,636	30,550	30,600	4,454	3,886	4,454	4,086
24,600	24,650	3,344	2,994	3,344	3,194	27,600	27,650	3,794	3,444	3,794	3,644	30,600	30,650	4,466	3,894	4,466	4,094
24,650	24,700	3,351	3,001	3,351	3,201	27,650	27,700	3,801	3,451	3,801	3,651	30,650	30,700	4,479	3,901	4,479	4,101
24,700	24,750	3,359	3,009	3,359	3,209	27,700	27,750	3,809	3,459	3,809	3,659	30,700	30,750	4,491	3,909	4,491	4,109
24,750	24,800	3,366	3,016	3,366	3,216	27,750	27,800	3,816	3,466	3,816	3,666	30,750	30,800	4,504	3,916	4,504	4,116
24,800	24,850	3,374	3,024	3,374	3,224	27,800	27,850	3,824	3,474	3,824	3,674	30,800	30,850	4,516	3,924	4,516	4,124
24,850	24,900	3,381	3,031	3,381	3,231	27,850	27,900	3,831	3,481	3,831	3,681	30,850	30,900	4,529	3,931	4,529	4,131
24,900	24,950	3,389	3,039	3,389	3,239	27,900	27,950	3,839	3,489	3,839	3,689	30,900	30,950	4,541	3,939	4,541	4,139
24,950	25,000	3,396	3,046	3,396	3,246	27,950	28,000	3,846	3,496	3,846	3,696	30,950	31,000	4,554	3,946	4,554	4,146
<b>25,000</b>						<b>28,000</b>						<b>31,000</b>					
25,000	25,050	3,404	3,054	3,404	3,254	28,000	28,050	3,854	3,504	3,854	3,704	31,000	31,050	4,566	3,954	4,566	4,154
25,050	25,100	3,411	3,061	3,411	3,261	28,050	28,100	3,861	3,511	3,861	3,711	31,050	31,100	4,579	3,961	4,579	4,161
25,100	25,150	3,419	3,069	3,419	3,269	28,100	28,150	3,869	3,519	3,869	3,719	31,100	31,150	4,591	3,969	4,591	4,169
25,150	25,200	3,426	3,076	3,426	3,276	28,150	28,200	3,876	3,526	3,876	3,726	31,150	31,200	4,604	3,976	4,604	4,176
25,200	25,250	3,434	3,084	3,434	3,284	28,200	28,250	3,884	3,534	3,884	3,734	31,200	31,250	4,616	3,984	4,616	4,184
25,250	25,300	3,441	3,091	3,441	3,291	28,250	28,300	3,891	3,541	3,891	3,741	31,250	31,300	4,629	3,991	4,629	4,191
25,300	25,350	3,449	3,099	3,449	3,299	28,300	28,350	3,899	3,549	3,899	3,749	31,300	31,350	4,641	3,999	4,641	4,199
25,350	25,400	3,456	3,106	3,456	3,306	28,350	28,400	3,906	3,556	3,906	3,756	31,350	31,400	4,654	4,006	4,654	4,206
25,400	25,450	3,464	3,114	3,464	3,314	28,400	28,450	3,916	3,564	3,916	3,764	31,400	31,450	4,666	4,014	4,666	4,214
25,450	25,500	3,471	3,121	3,471	3,321	28,450	28,500	3,929	3,571	3,929	3,771	31,450	31,500	4,679	4,021	4,679	4,221
25,500	25,550	3,479	3,129	3,479	3,329	28,500	28,550	3,941	3,579	3,941	3,779	31,500	31,550	4,691	4,029	4,691	4,229
25,550	25,600	3,486	3,136	3,486	3,336	28,550	28,600	3,954	3,586	3,954	3,786	31,550	31,600	4,704	4,036	4,704	4,236
25,600	25,650	3,494	3,144	3,494	3,344	28,600	28,650	3,966	3,594	3,966	3,794	31,600	31,650	4,716	4,044	4,716	4,244
25,650	25,700	3,501	3,151	3,501	3,351	28,650	28,700	3,979	3,601	3,979	3,801	31,650	31,700	4,729	4,051	4,729	4,251
25,700	25,750	3,509	3,159	3,509	3,359	28,700	28,750	3,991	3,609	3,991	3,809	31,700	31,750	4,741	4,059	4,741	4,259
25,750	25,800	3,516	3,166	3,516	3,366	28,750	28,800	4,004	3,616	4,004	3,816	31,750	31,800	4,754	4,066	4,754	4,266
25,800	25,850	3,524	3,174	3,524	3,374	28,800	28,850	4,016	3,624	4,016	3,824	31,800	31,850	4,766	4,074	4,766	4,274
25,850	25,900	3,531	3,181	3,531	3,381	28,850	28,900	4,029	3,631	4,029	3,831	31,850	31,900	4,779	4,081	4,779	4,281
25,900	25,950	3,539	3,189	3,539	3,389	28,900	28,950	4,041	3,639	4,041	3,839	31,900	31,950	4,791	4,089	4,791	4,289
25,950	26,000	3,546	3,196	3,546	3,396	28,950	29,000	4,054	3,646	4,054							

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
		Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household
At least	But less than	Your tax is—				At least	But less than	Your tax is—				At least	But less than	Your tax is—			
<b>32,000</b>						<b>35,000</b>						<b>38,000</b>					
32,000	32,050	4,816	4,104	4,816	4,304	35,000	35,050	5,566	4,554	5,566	4,754	38,000	38,050	6,316	5,004	6,316	5,204
32,050	32,100	4,829	4,111	4,829	4,311	35,050	35,100	5,579	4,561	5,579	4,761	38,050	38,100	6,329	5,011	6,329	5,214
32,100	32,150	4,841	4,119	4,841	4,319	35,100	35,150	5,591	4,569	5,591	4,769	38,100	38,150	6,341	5,019	6,341	5,226
32,150	32,200	4,854	4,126	4,854	4,326	35,150	35,200	5,604	4,576	5,604	4,776	38,150	38,200	6,354	5,026	6,354	5,239
32,200	32,250	4,866	4,134	4,866	4,334	35,200	35,250	5,616	4,584	5,616	4,784	38,200	38,250	6,366	5,034	6,366	5,251
32,250	32,300	4,879	4,141	4,879	4,341	35,250	35,300	5,629	4,591	5,629	4,791	38,250	38,300	6,379	5,041	6,379	5,264
32,300	32,350	4,891	4,149	4,891	4,349	35,300	35,350	5,641	4,599	5,641	4,799	38,300	38,350	6,391	5,049	6,391	5,276
32,350	32,400	4,904	4,156	4,904	4,356	35,350	35,400	5,654	4,606	5,654	4,806	38,350	38,400	6,404	5,056	6,404	5,289
32,400	32,450	4,916	4,164	4,916	4,364	35,400	35,450	5,666	4,614	5,666	4,814	38,400	38,450	6,416	5,064	6,416	5,301
32,450	32,500	4,929	4,171	4,929	4,371	35,450	35,500	5,679	4,621	5,679	4,821	38,450	38,500	6,429	5,071	6,429	5,314
32,500	32,550	4,941	4,179	4,941	4,379	35,500	35,550	5,691	4,629	5,691	4,829	38,500	38,550	6,441	5,079	6,441	5,326
32,550	32,600	4,954	4,186	4,954	4,386	35,550	35,600	5,704	4,636	5,704	4,836	38,550	38,600	6,454	5,086	6,454	5,339
32,600	32,650	4,966	4,194	4,966	4,394	35,600	35,650	5,716	4,644	5,716	4,844	38,600	38,650	6,466	5,094	6,466	5,351
32,650	32,700	4,979	4,201	4,979	4,401	35,650	35,700	5,729	4,651	5,729	4,851	38,650	38,700	6,479	5,101	6,479	5,364
32,700	32,750	4,991	4,209	4,991	4,409	35,700	35,750	5,741	4,659	5,741	4,859	38,700	38,750	6,491	5,109	6,491	5,376
32,750	32,800	5,004	4,216	5,004	4,416	35,750	35,800	5,754	4,666	5,754	4,866	38,750	38,800	6,504	5,116	6,504	5,389
32,800	32,850	5,016	4,224	5,016	4,424	35,800	35,850	5,766	4,674	5,766	4,874	38,800	38,850	6,516	5,124	6,516	5,401
32,850	32,900	5,029	4,231	5,029	4,431	35,850	35,900	5,779	4,681	5,779	4,881	38,850	38,900	6,529	5,131	6,529	5,414
32,900	32,950	5,041	4,239	5,041	4,439	35,900	35,950	5,791	4,689	5,791	4,889	38,900	38,950	6,541	5,139	6,541	5,426
32,950	33,000	5,054	4,246	5,054	4,446	35,950	36,000	5,804	4,696	5,804	4,896	38,950	39,000	6,554	5,146	6,554	5,439
<b>33,000</b>						<b>36,000</b>						<b>39,000</b>					
33,000	33,050	5,066	4,254	5,066	4,454	36,000	36,050	5,816	4,704	5,816	4,904	39,000	39,050	6,566	5,154	6,566	5,451
33,050	33,100	5,079	4,261	5,079	4,461	36,050	36,100	5,829	4,711	5,829	4,911	39,050	39,100	6,579	5,161	6,579	5,464
33,100	33,150	5,091	4,269	5,091	4,469	36,100	36,150	5,841	4,719	5,841	4,919	39,100	39,150	6,591	5,169	6,591	5,476
33,150	33,200	5,104	4,276	5,104	4,476	36,150	36,200	5,854	4,726	5,854	4,926	39,150	39,200	6,604	5,176	6,604	5,489
33,200	33,250	5,116	4,284	5,116	4,484	36,200	36,250	5,866	4,734	5,866	4,934	39,200	39,250	6,616	5,184	6,616	5,501
33,250	33,300	5,129	4,291	5,129	4,491	36,250	36,300	5,879	4,741	5,879	4,941	39,250	39,300	6,629	5,191	6,629	5,514
33,300	33,350	5,141	4,299	5,141	4,499	36,300	36,350	5,891	4,749	5,891	4,949	39,300	39,350	6,641	5,199	6,641	5,526
33,350	33,400	5,154	4,306	5,154	4,506	36,350	36,400	5,904	4,756	5,904	4,956	39,350	39,400	6,654	5,206	6,654	5,539
33,400	33,450	5,166	4,314	5,166	4,514	36,400	36,450	5,916	4,764	5,916	4,964	39,400	39,450	6,666	5,214	6,666	5,551
33,450	33,500	5,179	4,321	5,179	4,521	36,450	36,500	5,929	4,771	5,929	4,971	39,450	39,500	6,679	5,221	6,679	5,564
33,500	33,550	5,191	4,329	5,191	4,529	36,500	36,550	5,941	4,779	5,941	4,979	39,500	39,550	6,691	5,229	6,691	5,576
33,550	33,600	5,204	4,336	5,204	4,536	36,550	36,600	5,954	4,786	5,954	4,986	39,550	39,600	6,704	5,236	6,704	5,589
33,600	33,650	5,216	4,344	5,216	4,544	36,600	36,650	5,966	4,794	5,966	4,994	39,600	39,650	6,716	5,244	6,716	5,601
33,650	33,700	5,229	4,351	5,229	4,551	36,650	36,700	5,979	4,801	5,979	5,001	39,650	39,700	6,729	5,251	6,729	5,614
33,700	33,750	5,241	4,359	5,241	4,559	36,700	36,750	5,991	4,809	5,991	5,009	39,700	39,750	6,741	5,259	6,741	5,626
33,750	33,800	5,254	4,366	5,254	4,566	36,750	36,800	6,004	4,816	6,004	5,016	39,750	39,800	6,754	5,266	6,754	5,639
33,800	33,850	5,266	4,374	5,266	4,574	36,800	36,850	6,016	4,824	6,016	5,024	39,800	39,850	6,766	5,274	6,766	5,651
33,850	33,900	5,279	4,381	5,279	4,581	36,850	36,900	6,029	4,831	6,029	5,031	39,850	39,900	6,779	5,281	6,779	5,664
33,900	33,950	5,291	4,389	5,291	4,589	36,900	36,950	6,041	4,839	6,041	5,039	39,900	39,950	6,791	5,289	6,791	5,676
33,950	34,000	5,304	4,396	5,304	4,596	36,950	37,000	6,054	4,846	6,054	5,046	39,950	40,000	6,804	5,296	6,804	5,689
<b>34,000</b>						<b>37,000</b>						<b>40,000</b>					
34,000	34,050	5,316	4,404	5,316	4,604	37,000	37,050	6,066	4,854	6,066	5,054	40,000	40,050	6,816	5,304	6,816	5,701
34,050	34,100	5,329	4,411	5,329	4,611	37,050	37,100	6,079	4,861	6,079	5,061	40,050	40,100	6,829	5,311	6,829	5,714
34,100	34,150	5,341	4,419	5,341	4,619	37,100	37,150	6,091	4,869	6,091	5,069	40,100	40,150	6,841	5,319	6,841	5,726
34,150	34,200	5,354	4,426	5,354	4,626	37,150	37,200	6,104	4,876	6,104	5,076	40,150	40,200	6,854	5,326	6,854	5,739
34,200	34,250	5,366	4,434	5,366	4,634	37,200	37,250	6,116	4,884	6,116	5,084	40,200	40,250	6,866	5,334	6,866	5,751
34,250	34,300	5,379	4,441	5,379	4,641	37,250	37,300	6,129	4,891	6,129	5,091	40,250	40,300	6,879	5,341	6,879	5,764
34,300	34,350	5,391	4,449	5,391	4,649	37,300	37,350	6,141	4,899	6,141	5,099	40,300	40,350	6,891	5,349	6,891	5,776
34,350	34,400	5,404	4,456	5,404	4,656	37,350	37,400	6,154	4,906	6,154	5,106	40,350	40,400	6,904	5,356	6,904	5,789
34,400	34,450	5,416	4,464	5,416	4,664	37,400	37,450	6,166	4,914	6,166	5,114	40,400	40,450	6,916	5,364	6,916	5,801
34,450	34,500	5,429	4,471	5,429	4,671	37,450	37,500	6,179	4,921	6,179	5,121	40,450	40,500	6,929	5,371	6,929	5,814
34,500	34,550	5,441	4,479	5,441	4,679	37,500	37,550	6,191	4,929	6,191	5,129	40,500	40,550	6,941	5,379	6,941	5,826
34,550	34,600	5,454	4,486	5,454	4,686	37,550	37,600	6,204	4,936	6,204	5,136	40,550	40,600	6,954	5,386	6,954	5,839
34,600	34,650	5,466	4,494	5,466	4,694	37,600	37,650	6,216	4,944	6,216	5,144	40,600	40,650	6,966	5,394	6,966	5,851
34,650	34,700	5,479	4,501	5,479	4,701	37,650	37,700	6,229	4,951	6,229	5,151	40,650	40,700	6,979	5,401	6,979	5,864
34,700	34,750	5,491	4,509	5,491	4,709	37,700	37,750	6,241	4,959	6,241	5,159	40,700	40,750	6,991	5,409	6,991	5,876
34,750	34,800	5,504	4,516	5,504	4,716	37,750	37										

2003 Tax Table—Continued

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
		Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household
At least	But less than	Your tax is—				At least	But less than	Your tax is—				At least	But less than	Your tax is—			
<b>41,000</b>						<b>44,000</b>						<b>47,000</b>					
41,000	41,050	7,066	5,454	7,066	5,951	44,000	44,050	7,816	5,904	7,816	6,701	47,000	47,050	8,566	6,354	8,566	7,451
41,050	41,100	7,079	5,461	7,079	5,964	44,050	44,100	7,829	5,911	7,829	6,714	47,050	47,100	8,579	6,361	8,579	7,464
41,100	41,150	7,091	5,469	7,091	5,976	44,100	44,150	7,841	5,919	7,841	6,726	47,100	47,150	8,591	6,369	8,591	7,476
41,150	41,200	7,104	5,476	7,104	5,989	44,150	44,200	7,854	5,926	7,854	6,739	47,150	47,200	8,604	6,376	8,604	7,489
41,200	41,250	7,116	5,484	7,116	6,001	44,200	44,250	7,866	5,934	7,866	6,751	47,200	47,250	8,616	6,384	8,616	7,501
41,250	41,300	7,129	5,491	7,129	6,014	44,250	44,300	7,879	5,941	7,879	6,764	47,250	47,300	8,629	6,391	8,629	7,514
41,300	41,350	7,141	5,499	7,141	6,026	44,300	44,350	7,891	5,949	7,891	6,776	47,300	47,350	8,641	6,399	8,641	7,526
41,350	41,400	7,154	5,506	7,154	6,039	44,350	44,400	7,904	5,956	7,904	6,789	47,350	47,400	8,654	6,406	8,654	7,539
41,400	41,450	7,166	5,514	7,166	6,051	44,400	44,450	7,916	5,964	7,916	6,801	47,400	47,450	8,666	6,414	8,666	7,551
41,450	41,500	7,179	5,521	7,179	6,064	44,450	44,500	7,929	5,971	7,929	6,814	47,450	47,500	8,679	6,421	8,679	7,564
41,500	41,550	7,191	5,529	7,191	6,076	44,500	44,550	7,941	5,979	7,941	6,826	47,500	47,550	8,691	6,429	8,691	7,576
41,550	41,600	7,204	5,536	7,204	6,089	44,550	44,600	7,954	5,986	7,954	6,839	47,550	47,600	8,704	6,436	8,704	7,589
41,600	41,650	7,216	5,544	7,216	6,101	44,600	44,650	7,966	5,994	7,966	6,851	47,600	47,650	8,716	6,444	8,716	7,601
41,650	41,700	7,229	5,551	7,229	6,114	44,650	44,700	7,979	6,001	7,979	6,864	47,650	47,700	8,729	6,451	8,729	7,614
41,700	41,750	7,241	5,559	7,241	6,126	44,700	44,750	7,991	6,009	7,991	6,876	47,700	47,750	8,741	6,459	8,741	7,626
41,750	41,800	7,254	5,566	7,254	6,139	44,750	44,800	8,004	6,016	8,004	6,889	47,750	47,800	8,754	6,466	8,754	7,639
41,800	41,850	7,266	5,574	7,266	6,151	44,800	44,850	8,016	6,024	8,016	6,901	47,800	47,850	8,766	6,474	8,766	7,651
41,850	41,900	7,279	5,581	7,279	6,164	44,850	44,900	8,029	6,031	8,029	6,914	47,850	47,900	8,779	6,481	8,779	7,664
41,900	41,950	7,291	5,589	7,291	6,176	44,900	44,950	8,041	6,039	8,041	6,926	47,900	47,950	8,791	6,489	8,791	7,676
41,950	42,000	7,304	5,596	7,304	6,189	44,950	45,000	8,054	6,046	8,054	6,939	47,950	48,000	8,804	6,496	8,804	7,689
<b>42,000</b>						<b>45,000</b>						<b>48,000</b>					
42,000	42,050	7,316	5,604	7,316	6,201	45,000	45,050	8,066	6,054	8,066	6,951	48,000	48,050	8,816	6,504	8,816	7,701
42,050	42,100	7,329	5,611	7,329	6,214	45,050	45,100	8,079	6,061	8,079	6,964	48,050	48,100	8,829	6,511	8,829	7,714
42,100	42,150	7,341	5,619	7,341	6,226	45,100	45,150	8,091	6,069	8,091	6,976	48,100	48,150	8,841	6,519	8,841	7,726
42,150	42,200	7,354	5,626	7,354	6,239	45,150	45,200	8,104	6,076	8,104	6,989	48,150	48,200	8,854	6,526	8,854	7,739
42,200	42,250	7,366	5,634	7,366	6,251	45,200	45,250	8,116	6,084	8,116	7,001	48,200	48,250	8,866	6,534	8,866	7,751
42,250	42,300	7,379	5,641	7,379	6,264	45,250	45,300	8,129	6,091	8,129	7,014	48,250	48,300	8,879	6,541	8,879	7,764
42,300	42,350	7,391	5,649	7,391	6,276	45,300	45,350	8,141	6,099	8,141	7,026	48,300	48,350	8,891	6,549	8,891	7,776
42,350	42,400	7,404	5,656	7,404	6,289	45,350	45,400	8,154	6,106	8,154	7,039	48,350	48,400	8,904	6,556	8,904	7,789
42,400	42,450	7,416	5,664	7,416	6,301	45,400	45,450	8,166	6,114	8,166	7,051	48,400	48,450	8,916	6,564	8,916	7,801
42,450	42,500	7,429	5,671	7,429	6,314	45,450	45,500	8,179	6,121	8,179	7,064	48,450	48,500	8,929	6,571	8,929	7,814
42,500	42,550	7,441	5,679	7,441	6,326	45,500	45,550	8,191	6,129	8,191	7,076	48,500	48,550	8,941	6,579	8,941	7,826
42,550	42,600	7,454	5,686	7,454	6,339	45,550	45,600	8,204	6,136	8,204	7,089	48,550	48,600	8,954	6,586	8,954	7,839
42,600	42,650	7,466	5,694	7,466	6,351	45,600	45,650	8,216	6,144	8,216	7,101	48,600	48,650	8,966	6,594	8,966	7,851
42,650	42,700	7,479	5,701	7,479	6,364	45,650	45,700	8,229	6,151	8,229	7,114	48,650	48,700	8,979	6,601	8,979	7,864
42,700	42,750	7,491	5,709	7,491	6,376	45,700	45,750	8,241	6,159	8,241	7,126	48,700	48,750	8,991	6,609	8,991	7,876
42,750	42,800	7,504	5,716	7,504	6,389	45,750	45,800	8,254	6,166	8,254	7,139	48,750	48,800	9,004	6,616	9,004	7,889
42,800	42,850	7,516	5,724	7,516	6,401	45,800	45,850	8,266	6,174	8,266	7,151	48,800	48,850	9,016	6,624	9,016	7,901
42,850	42,900	7,529	5,731	7,529	6,414	45,850	45,900	8,279	6,181	8,279	7,164	48,850	48,900	9,029	6,631	9,029	7,914
42,900	42,950	7,541	5,739	7,541	6,426	45,900	45,950	8,291	6,189	8,291	7,176	48,900	48,950	9,041	6,639	9,041	7,926
42,950	43,000	7,554	5,746	7,554	6,439	45,950	46,000	8,304	6,196	8,304	7,189	48,950	49,000	9,054	6,646	9,054	7,939
<b>43,000</b>						<b>46,000</b>						<b>49,000</b>					
43,000	43,050	7,566	5,754	7,566	6,451	46,000	46,050	8,316	6,204	8,316	7,201	49,000	49,050	9,066	6,654	9,066	7,951
43,050	43,100	7,579	5,761	7,579	6,464	46,050	46,100	8,329	6,211	8,329	7,214	49,050	49,100	9,079	6,661	9,079	7,964
43,100	43,150	7,591	5,769	7,591	6,476	46,100	46,150	8,341	6,219	8,341	7,226	49,100	49,150	9,091	6,669	9,091	7,976
43,150	43,200	7,604	5,776	7,604	6,489	46,150	46,200	8,354	6,226	8,354	7,239	49,150	49,200	9,104	6,676	9,104	7,989
43,200	43,250	7,616	5,784	7,616	6,501	46,200	46,250	8,366	6,234	8,366	7,251	49,200	49,250	9,116	6,684	9,116	8,001
43,250	43,300	7,629	5,791	7,629	6,514	46,250	46,300	8,379	6,241	8,379	7,264	49,250	49,300	9,129	6,691	9,129	8,014
43,300	43,350	7,641	5,799	7,641	6,526	46,300	46,350	8,391	6,249	8,391	7,276	49,300	49,350	9,141	6,699	9,141	8,026
43,350	43,400	7,654	5,806	7,654	6,539	46,350	46,400	8,404	6,256	8,404	7,289	49,350	49,400	9,154	6,706	9,154	8,039
43,400	43,450	7,666	5,814	7,666	6,551	46,400	46,450	8,416	6,264	8,416	7,301	49,400	49,450	9,166	6,714	9,166	8,051
43,450	43,500	7,679	5,821	7,679	6,564	46,450	46,500	8,429	6,271	8,429	7,314	49,450	49,500	9,179	6,721	9,179	8,064
43,500	43,550	7,691	5,829	7,691	6,576	46,500	46,550	8,441	6,279	8,441	7,326	49,500	49,550	9,191	6,729	9,191	8,076
43,550	43,600	7,704	5,836	7,704	6,589	46,550	46,600	8,454	6,286	8,454	7,339	49,550	49,600	9,204	6,736	9,204	8,089
43,600	43,650	7,716	5,844	7,716	6,601	46,600	46,650	8,466	6,294	8,466	7,351	49,600	49,650	9,216	6,744	9,216	8,101
43,650	43,700	7,729	5,851	7,729	6,614	46,650	46,700	8,479	6,301	8,479	7,364	49,650	49,700	9,229	6,751	9,229	8,114
43,700	43,750	7,741	5,859	7,741	6,626	46,700	46,750	8,491	6,309	8,491	7,376	49,700	49,750	9,241	6,759	9,241	8,126
43,750	43,800	7,754	5,866	7,754	6,639	46,750	46,800	8,504	6,316	8,504	7,389	49,750	49,800	9,254	6,766	9,254	8,139
43,800	43,850	7,766	5,874	7,766	6,651	46,800	46,850	8,516	6,324	8,516	7,401	49,800	49,850	9,266	6,774	9,266	8,151
43,850	43,900	7,779	5,881	7,779	6,664	46,850	46,900	8,529	6,331	8,529	7,414	49,850	49,900	9,279	6,781	9,279	8,164
43,900	43,950	7,791	5,889	7,791	6,676	46,900	46,950	8,541	6,339	8,541	7,426	49,900	49,950	9,291	6,789	9,291	8,176
43,950	44,000	7,804	5,896	7,804	6,689	46,950	47,000	8,554	6,346	8,554	7,439						

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
		Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household
At least	But less than	Your tax is—				At least	But less than	Your tax is—				At least	But less than	Your tax is—			
<b>50,000</b>						<b>53,000</b>						<b>56,000</b>					
50,000	50,050	9,316	6,804	9,316	8,201	53,000	53,050	10,066	7,254	10,066	8,951	56,000	56,050	10,816	7,704	10,816	9,701
50,050	50,100	9,329	6,811	9,329	8,214	53,050	53,100	10,079	7,261	10,079	8,964	56,050	56,100	10,829	7,711	10,829	9,714
50,100	50,150	9,341	6,819	9,341	8,226	53,100	53,150	10,091	7,269	10,091	8,976	56,100	56,150	10,841	7,719	10,841	9,726
50,150	50,200	9,354	6,826	9,354	8,239	53,150	53,200	10,104	7,276	10,104	8,989	56,150	56,200	10,854	7,726	10,854	9,739
50,200	50,250	9,366	6,834	9,366	8,251	53,200	53,250	10,116	7,284	10,116	9,001	56,200	56,250	10,866	7,734	10,866	9,751
50,250	50,300	9,379	6,841	9,379	8,264	53,250	53,300	10,129	7,291	10,129	9,014	56,250	56,300	10,879	7,741	10,879	9,764
50,300	50,350	9,391	6,849	9,391	8,276	53,300	53,350	10,141	7,299	10,141	9,026	56,300	56,350	10,891	7,749	10,891	9,776
50,350	50,400	9,404	6,856	9,404	8,289	53,350	53,400	10,154	7,306	10,154	9,039	56,350	56,400	10,904	7,756	10,904	9,789
50,400	50,450	9,416	6,864	9,416	8,301	53,400	53,450	10,166	7,314	10,166	9,051	56,400	56,450	10,916	7,764	10,916	9,801
50,450	50,500	9,429	6,871	9,429	8,314	53,450	53,500	10,179	7,321	10,179	9,064	56,450	56,500	10,929	7,771	10,929	9,814
50,500	50,550	9,441	6,879	9,441	8,326	53,500	53,550	10,191	7,329	10,191	9,076	56,500	56,550	10,941	7,779	10,941	9,826
50,550	50,600	9,454	6,886	9,454	8,339	53,550	53,600	10,204	7,336	10,204	9,089	56,550	56,600	10,954	7,786	10,954	9,839
50,600	50,650	9,466	6,894	9,466	8,351	53,600	53,650	10,216	7,344	10,216	9,101	56,600	56,650	10,966	7,794	10,966	9,851
50,650	50,700	9,479	6,901	9,479	8,364	53,650	53,700	10,229	7,351	10,229	9,114	56,650	56,700	10,979	7,801	10,979	9,864
50,700	50,750	9,491	6,909	9,491	8,376	53,700	53,750	10,241	7,359	10,241	9,126	56,700	56,750	10,991	7,809	10,991	9,876
50,750	50,800	9,504	6,916	9,504	8,389	53,750	53,800	10,254	7,366	10,254	9,139	56,750	56,800	11,004	7,816	11,004	9,889
50,800	50,850	9,516	6,924	9,516	8,401	53,800	53,850	10,266	7,374	10,266	9,151	56,800	56,850	11,016	7,826	11,016	9,901
50,850	50,900	9,529	6,931	9,529	8,414	53,850	53,900	10,279	7,381	10,279	9,164	56,850	56,900	11,029	7,833	11,029	9,914
50,900	50,950	9,541	6,939	9,541	8,426	53,900	53,950	10,291	7,389	10,291	9,176	56,900	56,950	11,041	7,851	11,041	9,926
50,950	51,000	9,554	6,946	9,554	8,439	53,950	54,000	10,304	7,396	10,304	9,189	56,950	57,000	11,054	7,864	11,054	9,939
<b>51,000</b>						<b>54,000</b>						<b>57,000</b>					
51,000	51,050	9,566	6,954	9,566	8,451	54,000	54,050	10,316	7,404	10,316	9,201	57,000	57,050	11,066	7,876	11,066	9,951
51,050	51,100	9,579	6,961	9,579	8,464	54,050	54,100	10,329	7,411	10,329	9,214	57,050	57,100	11,079	7,889	11,079	9,964
51,100	51,150	9,591	6,969	9,591	8,476	54,100	54,150	10,341	7,419	10,341	9,226	57,100	57,150	11,091	7,901	11,091	9,976
51,150	51,200	9,604	6,976	9,604	8,489	54,150	54,200	10,354	7,426	10,354	9,239	57,150	57,200	11,104	7,914	11,104	9,989
51,200	51,250	9,616	6,984	9,616	8,501	54,200	54,250	10,366	7,434	10,366	9,251	57,200	57,250	11,116	7,926	11,116	10,001
51,250	51,300	9,629	6,991	9,629	8,514	54,250	54,300	10,379	7,441	10,379	9,264	57,250	57,300	11,129	7,939	11,129	10,014
51,300	51,350	9,641	6,999	9,641	8,526	54,300	54,350	10,391	7,449	10,391	9,276	57,300	57,350	11,141	7,951	11,141	10,026
51,350	51,400	9,654	7,006	9,654	8,539	54,350	54,400	10,404	7,456	10,404	9,289	57,350	57,400	11,154	7,964	11,154	10,039
51,400	51,450	9,666	7,014	9,666	8,551	54,400	54,450	10,416	7,464	10,416	9,301	57,400	57,450	11,166	7,976	11,166	10,051
51,450	51,500	9,679	7,021	9,679	8,564	54,450	54,500	10,429	7,471	10,429	9,314	57,450	57,500	11,179	7,989	11,179	10,064
51,500	51,550	9,691	7,029	9,691	8,576	54,500	54,550	10,441	7,479	10,441	9,326	57,500	57,550	11,191	8,001	11,191	10,076
51,550	51,600	9,704	7,036	9,704	8,589	54,550	54,600	10,454	7,486	10,454	9,339	57,550	57,600	11,204	8,014	11,211	10,089
51,600	51,650	9,716	7,044	9,716	8,601	54,600	54,650	10,466	7,494	10,466	9,351	57,600	57,650	11,216	8,026	11,225	10,101
51,650	51,700	9,729	7,051	9,729	8,614	54,650	54,700	10,479	7,501	10,479	9,364	57,650	57,700	11,229	8,039	11,239	10,114
51,700	51,750	9,741	7,059	9,741	8,626	54,700	54,750	10,491	7,509	10,491	9,376	57,700	57,750	11,241	8,051	11,253	10,126
51,750	51,800	9,754	7,066	9,754	8,639	54,750	54,800	10,504	7,516	10,504	9,389	57,750	57,800	11,254	8,064	11,267	10,139
51,800	51,850	9,766	7,074	9,766	8,651	54,800	54,850	10,516	7,524	10,516	9,401	57,800	57,850	11,266	8,076	11,281	10,151
51,850	51,900	9,779	7,081	9,779	8,664	54,850	54,900	10,529	7,531	10,529	9,414	57,850	57,900	11,279	8,089	11,295	10,164
51,900	51,950	9,791	7,089	9,791	8,676	54,900	54,950	10,541	7,539	10,541	9,426	57,900	57,950	11,291	8,101	11,309	10,176
51,950	52,000	9,804	7,096	9,804	8,689	54,950	55,000	10,554	7,546	10,554	9,439	57,950	58,000	11,304	8,114	11,323	10,189
<b>52,000</b>						<b>55,000</b>						<b>58,000</b>					
52,000	52,050	9,816	7,104	9,816	8,701	55,000	55,050	10,566	7,554	10,566	9,451	58,000	58,050	11,316	8,126	11,337	10,201
52,050	52,100	9,829	7,111	9,829	8,714	55,050	55,100	10,579	7,561	10,579	9,464	58,050	58,100	11,329	8,139	11,351	10,214
52,100	52,150	9,841	7,119	9,841	8,726	55,100	55,150	10,591	7,569	10,591	9,476	58,100	58,150	11,341	8,151	11,365	10,226
52,150	52,200	9,854	7,126	9,854	8,739	55,150	55,200	10,604	7,576	10,604	9,489	58,150	58,200	11,354	8,164	11,379	10,239
52,200	52,250	9,866	7,134	9,866	8,751	55,200	55,250	10,616	7,584	10,616	9,501	58,200	58,250	11,366	8,176	11,393	10,251
52,250	52,300	9,879	7,141	9,879	8,764	55,250	55,300	10,629	7,591	10,629	9,514	58,250	58,300	11,379	8,189	11,407	10,264
52,300	52,350	9,891	7,149	9,891	8,776	55,300	55,350	10,641	7,599	10,641	9,526	58,300	58,350	11,391	8,201	11,421	10,276
52,350	52,400	9,904	7,156	9,904	8,789	55,350	55,400	10,654	7,606	10,654	9,539	58,350	58,400	11,404	8,214	11,435	10,289
52,400	52,450	9,916	7,164	9,916	8,801	55,400	55,450	10,666	7,614	10,666	9,551	58,400	58,450	11,416	8,226	11,449	10,301
52,450	52,500	9,929	7,171	9,929	8,814	55,450	55,500	10,679	7,621	10,679	9,564	58,450	58,500	11,429	8,239	11,463	10,314
52,500	52,550	9,941	7,179	9,941	8,826	55,500	55,550	10,691	7,629	10,691	9,576	58,500	58,550	11,441	8,251	11,477	10,326
52,550	52,600	9,954	7,186	9,954	8,839	55,550	55,600	10,704	7,636	10,704	9,589	58,550	58,600	11,454	8,264	11,491	10,339
52,600	52,650	9,966	7,194	9,966	8,851	55,600	55,650	10,716	7,644	10,716	9,601	58,600	58,650	11,466	8,276	11,505	10,351
52,650	52,700	9,979	7,201	9,979	8,864	55,650	55,700	10,729	7,651	10,729	9,614	58,650	58,700	11,479	8,289	11,519	10,364
52,700	52,750	9,991	7,209	9													

2003 Tax Table—Continued

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
		Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
<b>59,000</b>						<b>62,000</b>						<b>65,000</b>					
59,000	59,050	11,566	8,376	11,617	10,451	62,000	62,050	12,316	9,126	12,457	11,201	65,000	65,050	13,066	9,876	13,297	11,951
59,050	59,100	11,579	8,389	11,631	10,464	62,050	62,100	12,329	9,139	12,471	11,214	65,050	65,100	13,079	9,889	13,311	11,964
59,100	59,150	11,591	8,401	11,645	10,476	62,100	62,150	12,341	9,151	12,485	11,226	65,100	65,150	13,091	9,901	13,325	11,976
59,150	59,200	11,604	8,414	11,659	10,489	62,150	62,200	12,354	9,164	12,499	11,239	65,150	65,200	13,104	9,914	13,339	11,989
59,200	59,250	11,616	8,426	11,673	10,501	62,200	62,250	12,366	9,176	12,513	11,251	65,200	65,250	13,116	9,926	13,353	12,001
59,250	59,300	11,629	8,439	11,687	10,514	62,250	62,300	12,379	9,189	12,527	11,264	65,250	65,300	13,129	9,939	13,367	12,014
59,300	59,350	11,641	8,451	11,701	10,526	62,300	62,350	12,391	9,201	12,541	11,276	65,300	65,350	13,141	9,951	13,381	12,026
59,350	59,400	11,654	8,464	11,715	10,539	62,350	62,400	12,404	9,214	12,555	11,289	65,350	65,400	13,154	9,964	13,395	12,039
59,400	59,450	11,666	8,476	11,729	10,551	62,400	62,450	12,416	9,226	12,569	11,301	65,400	65,450	13,166	9,976	13,409	12,051
59,450	59,500	11,679	8,489	11,743	10,564	62,450	62,500	12,429	9,239	12,583	11,314	65,450	65,500	13,179	9,989	13,423	12,064
59,500	59,550	11,691	8,501	11,757	10,576	62,500	62,550	12,441	9,251	12,597	11,326	65,500	65,550	13,191	10,001	13,437	12,076
59,550	59,600	11,704	8,514	11,771	10,589	62,550	62,600	12,454	9,264	12,611	11,339	65,550	65,600	13,204	10,014	13,451	12,089
59,600	59,650	11,716	8,526	11,785	10,601	62,600	62,650	12,466	9,276	12,625	11,351	65,600	65,650	13,216	10,026	13,465	12,101
59,650	59,700	11,729	8,539	11,799	10,614	62,650	62,700	12,479	9,289	12,639	11,364	65,650	65,700	13,229	10,039	13,479	12,114
59,700	59,750	11,741	8,551	11,813	10,626	62,700	62,750	12,491	9,301	12,653	11,376	65,700	65,750	13,241	10,051	13,493	12,126
59,750	59,800	11,754	8,564	11,827	10,639	62,750	62,800	12,504	9,314	12,667	11,389	65,750	65,800	13,254	10,064	13,507	12,139
59,800	59,850	11,766	8,576	11,841	10,651	62,800	62,850	12,516	9,326	12,681	11,401	65,800	65,850	13,266	10,076	13,521	12,151
59,850	59,900	11,779	8,589	11,855	10,664	62,850	62,900	12,529	9,339	12,695	11,414	65,850	65,900	13,279	10,089	13,535	12,164
59,900	59,950	11,791	8,601	11,869	10,676	62,900	62,950	12,541	9,351	12,709	11,426	65,900	65,950	13,291	10,101	13,549	12,176
59,950	60,000	11,804	8,614	11,883	10,689	62,950	63,000	12,554	9,364	12,723	11,439	65,950	66,000	13,304	10,114	13,563	12,189
<b>60,000</b>						<b>63,000</b>						<b>66,000</b>					
60,000	60,050	11,816	8,626	11,897	10,701	63,000	63,050	12,566	9,376	12,737	11,451	66,000	66,050	13,316	10,126	13,577	12,201
60,050	60,100	11,829	8,639	11,911	10,714	63,050	63,100	12,579	9,389	12,751	11,464	66,050	66,100	13,329	10,139	13,591	12,214
60,100	60,150	11,841	8,651	11,925	10,726	63,100	63,150	12,591	9,401	12,765	11,476	66,100	66,150	13,341	10,151	13,605	12,226
60,150	60,200	11,854	8,664	11,939	10,739	63,150	63,200	12,604	9,414	12,779	11,489	66,150	66,200	13,354	10,164	13,619	12,239
60,200	60,250	11,866	8,676	11,953	10,751	63,200	63,250	12,616	9,426	12,793	11,501	66,200	66,250	13,366	10,176	13,633	12,251
60,250	60,300	11,879	8,689	11,967	10,764	63,250	63,300	12,629	9,439	12,807	11,514	66,250	66,300	13,379	10,189	13,647	12,264
60,300	60,350	11,891	8,701	11,981	10,776	63,300	63,350	12,641	9,451	12,821	11,526	66,300	66,350	13,391	10,201	13,661	12,276
60,350	60,400	11,904	8,714	11,995	10,789	63,350	63,400	12,654	9,464	12,835	11,539	66,350	66,400	13,404	10,214	13,675	12,289
60,400	60,450	11,916	8,726	12,009	10,801	63,400	63,450	12,666	9,476	12,849	11,551	66,400	66,450	13,416	10,226	13,689	12,301
60,450	60,500	11,929	8,739	12,023	10,814	63,450	63,500	12,679	9,489	12,863	11,564	66,450	66,500	13,429	10,239	13,703	12,314
60,500	60,550	11,941	8,751	12,037	10,826	63,500	63,550	12,691	9,501	12,877	11,576	66,500	66,550	13,441	10,251	13,717	12,326
60,550	60,600	11,954	8,764	12,051	10,839	63,550	63,600	12,704	9,514	12,891	11,589	66,550	66,600	13,454	10,264	13,731	12,339
60,600	60,650	11,966	8,776	12,065	10,851	63,600	63,650	12,716	9,526	12,905	11,601	66,600	66,650	13,466	10,276	13,745	12,351
60,650	60,700	11,979	8,789	12,079	10,864	63,650	63,700	12,729	9,539	12,919	11,614	66,650	66,700	13,479	10,289	13,759	12,364
60,700	60,750	11,991	8,801	12,093	10,876	63,700	63,750	12,741	9,551	12,933	11,626	66,700	66,750	13,491	10,301	13,773	12,376
60,750	60,800	12,004	8,814	12,107	10,889	63,750	63,800	12,754	9,564	12,947	11,639	66,750	66,800	13,504	10,314	13,787	12,389
60,800	60,850	12,016	8,826	12,121	10,901	63,800	63,850	12,766	9,576	12,961	11,651	66,800	66,850	13,516	10,326	13,801	12,401
60,850	60,900	12,029	8,839	12,135	10,914	63,850	63,900	12,779	9,589	12,975	11,664	66,850	66,900	13,529	10,339	13,815	12,414
60,900	60,950	12,041	8,851	12,149	10,926	63,900	63,950	12,791	9,601	12,989	11,676	66,900	66,950	13,541	10,351	13,829	12,426
60,950	61,000	12,054	8,864	12,163	10,939	63,950	64,000	12,804	9,614	13,003	11,689	66,950	67,000	13,554	10,364	13,843	12,439
<b>61,000</b>						<b>64,000</b>						<b>67,000</b>					
61,000	61,050	12,066	8,876	12,177	10,951	64,000	64,050	12,816	9,626	13,017	11,701	67,000	67,050	13,566	10,376	13,857	12,451
61,050	61,100	12,079	8,889	12,191	10,964	64,050	64,100	12,829	9,639	13,031	11,714	67,050	67,100	13,579	10,389	13,871	12,464
61,100	61,150	12,091	8,901	12,205	10,976	64,100	64,150	12,841	9,651	13,045	11,726	67,100	67,150	13,591	10,401	13,885	12,476
61,150	61,200	12,104	8,914	12,219	10,989	64,150	64,200	12,854	9,664	13,059	11,739	67,150	67,200	13,604	10,414	13,899	12,489
61,200	61,250	12,116	8,926	12,233	11,001	64,200	64,250	12,866	9,676	13,073	11,751	67,200	67,250	13,616	10,426	13,913	12,501
61,250	61,300	12,129	8,939	12,247	11,014	64,250	64,300	12,879	9,689	13,087	11,764	67,250	67,300	13,629	10,439	13,927	12,514
61,300	61,350	12,141	8,951	12,261	11,026	64,300	64,350	12,891	9,701	13,101	11,776	67,300	67,350	13,641	10,451	13,941	12,526
61,350	61,400	12,154	8,964	12,275	11,039	64,350	64,400	12,904	9,714	13,115	11,789	67,350	67,400	13,654	10,464	13,955	12,539
61,400	61,450	12,166	8,976	12,289	11,051	64,400	64,450	12,916	9,726	13,129	11,801	67,400	67,450	13,666	10,476	13,969	12,551
61,450	61,500	12,179	8,989	12,303	11,064	64,450	64,500	12,929	9,739	13,143	11,814	67,450	67,500	13,679	10,489	13,983	12,564
61,500	61,550	12,191	9,001	12,317	11,076	64,500	64,550	12,941	9,751	13,157	11,826	67,500	67,550	13,691	10,501	13,997	12,576
61,550	61,600	12,204	9,014	12,331	11,089	64,550	64,600	12,954	9,764	13,171	11,839	67,550	67,600	13,704	10,514	14,011	12,589
61,600	61,650	12,216	9,026	12,345	11,101	64,600	64,650	12,966	9,776	13,185	11,851	67,600	67,650	13,716	10,526	14,025	12,601
61,650	61,700	12,229	9,039	12,359	11,114	64,650	64,700	12,979	9,789	13,199	11,864	67,650	67,700	13,729	10,539	14,039	12,614
61,700	61,750	12,241	9,051	12,373	11,126	64,700	64,750	12,991	9,801	13,213	11,876	67,700	67,750	13,741	10,551	14,053	12,626
61,750	61,800	12,254	9,064	12,387	11,139	64,750	64,800	13,004	9,814	13,227	11,889	67,750	67,800	13,754	10,564	14,067	12,639
61,800	61,850	12,266	9,076	12,401	11,151	64,800	64,850	13,016	9,826	13,241	11,901	67,800	67,850	13,766	10,576	14,081	12,

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
		Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household
At least	But less than	Your tax is—				At least	But less than	Your tax is—				At least	But less than	Your tax is—			
<b>68,000</b>						<b>71,000</b>						<b>74,000</b>					
68,000	68,050	13,816	10,626	14,137	12,701	71,000	71,050	14,633	11,376	14,977	13,451	74,000	74,050	15,473	12,126	15,817	14,201
68,050	68,100	13,829	10,639	14,151	12,714	71,050	71,100	14,647	11,389	14,991	13,464	74,050	74,100	15,487	12,139	15,831	14,214
68,100	68,150	13,841	10,651	14,165	12,726	71,100	71,150	14,661	11,401	15,005	13,476	74,100	74,150	15,501	12,151	15,845	14,226
68,150	68,200	13,854	10,664	14,179	12,739	71,150	71,200	14,675	11,414	15,019	13,489	74,150	74,200	15,515	12,164	15,859	14,239
68,200	68,250	13,866	10,676	14,193	12,751	71,200	71,250	14,689	11,426	15,033	13,501	74,200	74,250	15,529	12,176	15,873	14,251
68,250	68,300	13,879	10,689	14,207	12,764	71,250	71,300	14,703	11,439	15,047	13,514	74,250	74,300	15,543	12,189	15,887	14,264
68,300	68,350	13,891	10,701	14,221	12,776	71,300	71,350	14,717	11,451	15,061	13,526	74,300	74,350	15,557	12,201	15,901	14,276
68,350	68,400	13,904	10,714	14,235	12,789	71,350	71,400	14,731	11,464	15,075	13,539	74,350	74,400	15,571	12,214	15,915	14,289
68,400	68,450	13,916	10,726	14,249	12,801	71,400	71,450	14,745	11,476	15,089	13,551	74,400	74,450	15,585	12,226	15,929	14,301
68,450	68,500	13,929	10,739	14,263	12,814	71,450	71,500	14,759	11,489	15,103	13,564	74,450	74,500	15,599	12,239	15,943	14,314
68,500	68,550	13,941	10,751	14,277	12,826	71,500	71,550	14,773	11,501	15,117	13,576	74,500	74,550	15,613	12,251	15,957	14,326
68,550	68,600	13,954	10,764	14,291	12,839	71,550	71,600	14,787	11,514	15,131	13,589	74,550	74,600	15,627	12,264	15,971	14,339
68,600	68,650	13,966	10,776	14,305	12,851	71,600	71,650	14,801	11,526	15,145	13,601	74,600	74,650	15,641	12,276	15,985	14,351
68,650	68,700	13,979	10,789	14,319	12,864	71,650	71,700	14,815	11,539	15,159	13,614	74,650	74,700	15,655	12,289	15,999	14,364
68,700	68,750	13,991	10,801	14,333	12,876	71,700	71,750	14,829	11,551	15,173	13,626	74,700	74,750	15,669	12,301	16,013	14,376
68,750	68,800	14,004	10,814	14,347	12,889	71,750	71,800	14,843	11,564	15,187	13,639	74,750	74,800	15,683	12,314	16,027	14,389
68,800	68,850	14,017	10,826	14,361	12,901	71,800	71,850	14,857	11,576	15,201	13,651	74,800	74,850	15,697	12,326	16,041	14,401
68,850	68,900	14,031	10,839	14,375	12,914	71,850	71,900	14,871	11,589	15,215	13,664	74,850	74,900	15,711	12,339	16,055	14,414
68,900	68,950	14,045	10,851	14,389	12,926	71,900	71,950	14,885	11,601	15,229	13,676	74,900	74,950	15,725	12,351	16,069	14,426
68,950	69,000	14,059	10,864	14,403	12,939	71,950	72,000	14,899	11,614	15,243	13,689	74,950	75,000	15,739	12,364	16,083	14,439
<b>69,000</b>						<b>72,000</b>						<b>75,000</b>					
69,000	69,050	14,073	10,876	14,417	12,951	72,000	72,050	14,913	11,626	15,257	13,701	75,000	75,050	15,753	12,376	16,097	14,451
69,050	69,100	14,087	10,889	14,431	12,964	72,050	72,100	14,927	11,639	15,271	13,714	75,050	75,100	15,767	12,389	16,111	14,464
69,100	69,150	14,101	10,901	14,445	12,976	72,100	72,150	14,941	11,651	15,285	13,726	75,100	75,150	15,781	12,401	16,125	14,476
69,150	69,200	14,115	10,914	14,459	12,989	72,150	72,200	14,955	11,664	15,299	13,739	75,150	75,200	15,795	12,414	16,139	14,489
69,200	69,250	14,129	10,926	14,473	13,001	72,200	72,250	14,969	11,676	15,313	13,751	75,200	75,250	15,809	12,426	16,153	14,501
69,250	69,300	14,143	10,939	14,487	13,014	72,250	72,300	14,983	11,689	15,327	13,764	75,250	75,300	15,823	12,439	16,167	14,514
69,300	69,350	14,157	10,951	14,501	13,026	72,300	72,350	14,997	11,701	15,341	13,776	75,300	75,350	15,837	12,451	16,181	14,526
69,350	69,400	14,171	10,964	14,515	13,039	72,350	72,400	15,011	11,714	15,355	13,789	75,350	75,400	15,851	12,464	16,195	14,539
69,400	69,450	14,185	10,976	14,529	13,051	72,400	72,450	15,025	11,726	15,369	13,801	75,400	75,450	15,865	12,476	16,209	14,551
69,450	69,500	14,199	10,989	14,543	13,064	72,450	72,500	15,039	11,739	15,383	13,814	75,450	75,500	15,879	12,489	16,223	14,564
69,500	69,550	14,213	11,001	14,557	13,076	72,500	72,550	15,053	11,751	15,397	13,826	75,500	75,550	15,893	12,501	16,237	14,576
69,550	69,600	14,227	11,014	14,571	13,089	72,550	72,600	15,067	11,764	15,411	13,839	75,550	75,600	15,907	12,514	16,251	14,589
69,600	69,650	14,241	11,026	14,585	13,101	72,600	72,650	15,081	11,776	15,425	13,851	75,600	75,650	15,921	12,526	16,265	14,601
69,650	69,700	14,255	11,039	14,599	13,114	72,650	72,700	15,095	11,789	15,439	13,864	75,650	75,700	15,935	12,539	16,279	14,614
69,700	69,750	14,269	11,051	14,613	13,126	72,700	72,750	15,109	11,801	15,453	13,876	75,700	75,750	15,949	12,551	16,293	14,626
69,750	69,800	14,283	11,064	14,627	13,139	72,750	72,800	15,123	11,814	15,467	13,889	75,750	75,800	15,963	12,564	16,307	14,639
69,800	69,850	14,297	11,076	14,641	13,151	72,800	72,850	15,137	11,826	15,481	13,901	75,800	75,850	15,977	12,576	16,321	14,651
69,850	69,900	14,311	11,089	14,655	13,164	72,850	72,900	15,151	11,839	15,495	13,914	75,850	75,900	15,991	12,589	16,335	14,664
69,900	69,950	14,325	11,101	14,669	13,176	72,900	72,950	15,165	11,851	15,509	13,926	75,900	75,950	16,005	12,601	16,349	14,676
69,950	70,000	14,339	11,114	14,683	13,189	72,950	73,000	15,179	11,864	15,523	13,939	75,950	76,000	16,019	12,614	16,363	14,689
<b>70,000</b>						<b>73,000</b>						<b>76,000</b>					
70,000	70,050	14,353	11,126	14,697	13,201	73,000	73,050	15,193	11,876	15,537	13,951	76,000	76,050	16,033	12,626	16,377	14,701
70,050	70,100	14,367	11,139	14,711	13,214	73,050	73,100	15,207	11,889	15,551	13,964	76,050	76,100	16,047	12,639	16,391	14,714
70,100	70,150	14,381	11,151	14,725	13,226	73,100	73,150	15,221	11,901	15,565	13,976	76,100	76,150	16,061	12,651	16,405	14,726
70,150	70,200	14,395	11,164	14,739	13,239	73,150	73,200	15,235	11,914	15,579	13,989	76,150	76,200	16,075	12,664	16,419	14,739
70,200	70,250	14,409	11,176	14,753	13,251	73,200	73,250	15,249	11,926	15,593	14,001	76,200	76,250	16,089	12,676	16,433	14,751
70,250	70,300	14,423	11,189	14,767	13,264	73,250	73,300	15,263	11,939	15,607	14,014	76,250	76,300	16,103	12,689	16,447	14,764
70,300	70,350	14,437	11,201	14,781	13,276	73,300	73,350	15,277	11,951	15,621	14,026	76,300	76,350	16,117	12,701	16,461	14,776
70,350	70,400	14,451	11,214	14,795	13,289	73,350	73,400	15,291	11,964	15,635	14,039	76,350	76,400	16,131	12,714	16,475	14,789
70,400	70,450	14,465	11,226	14,809	13,301	73,400	73,450	15,305	11,976	15,649	14,051	76,400	76,450	16,145	12,726	16,489	14,801
70,450	70,500	14,479	11,239	14,823	13,314	73,450	73,500	15,319	11,989	15,663	14,064	76,450	76,500	16,159	12,739	16,503	14,814
70,500	70,550	14,493	11,251	14,837	13,326	73,500	73,550	15,333	12,001	15,677	14,076	76,500	76,550	16,173	12,751	16,517	14,826
70,550	70,600	14,507	11,264	14,851	13,339	73,550	73,600	15,347	12,014	15,691	14,089	76,550	76,600	16,187	12,764	16,531	14,839
70,600	70,650	14,521	11,276	14,865	13,351	73,600	73,650	15,361	12,026	15,705	14,101	76,600	76,650	16,201	12,776	16,545	14,851
70,650	70,700	14,535	11,289	14,879	13,364	73,650	73,700	15,375	12,039	15,719	14,114	76,650	76,700	16,215	12,789	16,559	14,864
70,700	70,750	14,549	11,301	14,893	13,376	73,700	73,750	15,389	12,051	15,733	14,126	76,700	76,750	16,229	12,801	16,573	14,876
70,750	70,800	14,563	11,314	14,907	13,389	73,750	73,800	15,403	12,064	15,747	14,139	76,750	76,800	16,243	12,814	16,587	14,889
70,800	70,850	14,577	11,326														

2003 Tax Table—Continued

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
<b>77,000</b>						<b>80,000</b>						<b>83,000</b>					
77,000	77,050	16,313	12,876	16,657	14,951	80,000	80,050	17,153	13,626	17,497	15,701	83,000	83,050	17,993	14,376	18,337	16,451
77,050	77,100	16,327	12,889	16,671	14,964	80,050	80,100	17,167	13,639	17,511	15,714	83,050	83,100	18,007	14,389	18,351	16,464
77,100	77,150	16,341	12,901	16,685	14,976	80,100	80,150	17,181	13,651	17,525	15,726	83,100	83,150	18,021	14,401	18,365	16,476
77,150	77,200	16,355	12,914	16,699	14,989	80,150	80,200	17,195	13,664	17,539	15,739	83,150	83,200	18,035	14,414	18,379	16,489
77,200	77,250	16,369	12,926	16,713	15,001	80,200	80,250	17,209	13,676	17,553	15,751	83,200	83,250	18,049	14,426	18,393	16,501
77,250	77,300	16,383	12,939	16,727	15,014	80,250	80,300	17,223	13,689	17,567	15,764	83,250	83,300	18,063	14,439	18,407	16,514
77,300	77,350	16,397	12,951	16,741	15,026	80,300	80,350	17,237	13,701	17,581	15,776	83,300	83,350	18,077	14,451	18,421	16,526
77,350	77,400	16,411	12,964	16,755	15,039	80,350	80,400	17,251	13,714	17,595	15,789	83,350	83,400	18,091	14,464	18,435	16,539
77,400	77,450	16,425	12,976	16,769	15,051	80,400	80,450	17,265	13,726	17,609	15,801	83,400	83,450	18,105	14,476	18,449	16,551
77,450	77,500	16,439	12,989	16,783	15,064	80,450	80,500	17,279	13,739	17,623	15,814	83,450	83,500	18,119	14,489	18,463	16,564
77,500	77,550	16,453	13,001	16,797	15,076	80,500	80,550	17,293	13,751	17,637	15,826	83,500	83,550	18,133	14,501	18,477	16,576
77,550	77,600	16,467	13,014	16,811	15,089	80,550	80,600	17,307	13,764	17,651	15,839	83,550	83,600	18,147	14,514	18,491	16,589
77,600	77,650	16,481	13,026	16,825	15,101	80,600	80,650	17,321	13,776	17,665	15,851	83,600	83,650	18,161	14,526	18,505	16,601
77,650	77,700	16,495	13,039	16,839	15,114	80,650	80,700	17,335	13,789	17,679	15,864	83,650	83,700	18,175	14,539	18,519	16,614
77,700	77,750	16,509	13,051	16,853	15,126	80,700	80,750	17,349	13,801	17,693	15,876	83,700	83,750	18,189	14,551	18,533	16,626
77,750	77,800	16,523	13,064	16,867	15,139	80,750	80,800	17,363	13,814	17,707	15,889	83,750	83,800	18,203	14,564	18,547	16,639
77,800	77,850	16,537	13,076	16,881	15,151	80,800	80,850	17,377	13,826	17,721	15,901	83,800	83,850	18,217	14,576	18,561	16,651
77,850	77,900	16,551	13,089	16,895	15,164	80,850	80,900	17,391	13,839	17,735	15,914	83,850	83,900	18,231	14,589	18,575	16,664
77,900	77,950	16,565	13,101	16,909	15,176	80,900	80,950	17,405	13,851	17,749	15,926	83,900	83,950	18,245	14,601	18,589	16,676
77,950	78,000	16,579	13,114	16,923	15,189	80,950	81,000	17,419	13,864	17,763	15,939	83,950	84,000	18,259	14,614	18,603	16,689
<b>78,000</b>						<b>81,000</b>						<b>84,000</b>					
78,000	78,050	16,593	13,126	16,937	15,201	81,000	81,050	17,433	13,876	17,777	15,951	84,000	84,050	18,273	14,626	18,617	16,701
78,050	78,100	16,607	13,139	16,951	15,214	81,050	81,100	17,447	13,889	17,791	15,964	84,050	84,100	18,287	14,639	18,631	16,714
78,100	78,150	16,621	13,151	16,965	15,226	81,100	81,150	17,461	13,901	17,805	15,976	84,100	84,150	18,301	14,651	18,645	16,726
78,150	78,200	16,635	13,164	16,979	15,239	81,150	81,200	17,475	13,914	17,819	15,989	84,150	84,200	18,315	14,664	18,659	16,739
78,200	78,250	16,649	13,176	16,993	15,251	81,200	81,250	17,489	13,926	17,833	16,001	84,200	84,250	18,329	14,676	18,673	16,751
78,250	78,300	16,663	13,189	17,007	15,264	81,250	81,300	17,503	13,939	17,847	16,014	84,250	84,300	18,343	14,689	18,687	16,764
78,300	78,350	16,677	13,201	17,021	15,276	81,300	81,350	17,517	13,951	17,861	16,026	84,300	84,350	18,357	14,701	18,701	16,776
78,350	78,400	16,691	13,214	17,035	15,289	81,350	81,400	17,531	13,964	17,875	16,039	84,350	84,400	18,371	14,714	18,715	16,789
78,400	78,450	16,705	13,226	17,049	15,301	81,400	81,450	17,545	13,976	17,889	16,051	84,400	84,450	18,385	14,726	18,729	16,801
78,450	78,500	16,719	13,239	17,063	15,314	81,450	81,500	17,559	13,989	17,903	16,064	84,450	84,500	18,399	14,739	18,743	16,814
78,500	78,550	16,733	13,251	17,077	15,326	81,500	81,550	17,573	14,001	17,917	16,076	84,500	84,550	18,413	14,751	18,757	16,826
78,550	78,600	16,747	13,264	17,091	15,339	81,550	81,600	17,587	14,014	17,931	16,089	84,550	84,600	18,427	14,764	18,771	16,839
78,600	78,650	16,761	13,276	17,105	15,351	81,600	81,650	17,601	14,026	17,945	16,101	84,600	84,650	18,441	14,776	18,785	16,851
78,650	78,700	16,775	13,289	17,119	15,364	81,650	81,700	17,615	14,039	17,959	16,114	84,650	84,700	18,455	14,789	18,799	16,864
78,700	78,750	16,789	13,301	17,133	15,376	81,700	81,750	17,629	14,051	17,973	16,126	84,700	84,750	18,469	14,801	18,813	16,876
78,750	78,800	16,803	13,314	17,147	15,389	81,750	81,800	17,643	14,064	17,987	16,139	84,750	84,800	18,483	14,814	18,827	16,889
78,800	78,850	16,817	13,326	17,161	15,401	81,800	81,850	17,657	14,076	18,001	16,151	84,800	84,850	18,497	14,826	18,841	16,901
78,850	78,900	16,831	13,339	17,175	15,414	81,850	81,900	17,671	14,089	18,015	16,164	84,850	84,900	18,511	14,839	18,855	16,914
78,900	78,950	16,845	13,351	17,189	15,426	81,900	81,950	17,685	14,101	18,029	16,176	84,900	84,950	18,525	14,851	18,869	16,926
78,950	79,000	16,859	13,364	17,203	15,439	81,950	82,000	17,699	14,114	18,043	16,189	84,950	85,000	18,539	14,864	18,883	16,939
<b>79,000</b>						<b>82,000</b>						<b>85,000</b>					
79,000	79,050	16,873	13,376	17,217	15,451	82,000	82,050	17,713	14,126	18,057	16,201	85,000	85,050	18,553	14,876	18,897	16,951
79,050	79,100	16,887	13,389	17,231	15,464	82,050	82,100	17,727	14,139	18,071	16,214	85,050	85,100	18,567	14,889	18,911	16,964
79,100	79,150	16,901	13,401	17,245	15,476	82,100	82,150	17,741	14,151	18,085	16,226	85,100	85,150	18,581	14,901	18,925	16,976
79,150	79,200	16,915	13,414	17,259	15,489	82,150	82,200	17,755	14,164	18,099	16,239	85,150	85,200	18,595	14,914	18,939	16,989
79,200	79,250	16,929	13,426	17,273	15,501	82,200	82,250	17,769	14,176	18,113	16,251	85,200	85,250	18,609	14,926	18,953	17,001
79,250	79,300	16,943	13,439	17,287	15,514	82,250	82,300	17,783	14,189	18,127	16,264	85,250	85,300	18,623	14,939	18,967	17,014
79,300	79,350	16,957	13,451	17,301	15,526	82,300	82,350	17,797	14,201	18,141	16,276	85,300	85,350	18,637	14,951	18,981	17,026
79,350	79,400	16,971	13,464	17,315	15,539	82,350	82,400	17,811	14,214	18,155	16,289	85,350	85,400	18,651	14,964	18,995	17,039
79,400	79,450	16,985	13,476	17,329	15,551	82,400	82,450	17,825	14,226	18,169	16,301	85,400	85,450	18,665	14,976	19,009	17,051
79,450	79,500	16,999	13,489	17,343	15,564	82,450	82,500	17,839	14,239	18,183	16,314	85,450	85,500	18,679	14,989	19,023	17,064
79,500	79,550	17,013	13,501	17,357	15,576	82,500	82,550	17,853	14,251	18,197	16,326	85,500	85,550	18,693	15,001	19,037	17,076
79,550	79,600	17,027	13,514	17,371	15,589	82,550	82,600	17,867	14,264	18,211	16,339	85,550	85,600	18,707	15,014	19,051	17,089
79,600	79,650	17,041	13,526	17,385	15,601	82,600	82,650	17,881	14,276	18,225	16,351	85,600	85,650	18,721	15,026	19,065	17,101
79,650	79,700	17,055	13,539	17,399	15,614	82,650	82,700	17,895	14,289	18,239	16,364	85,650	85,700	18,735	15,039	19,079	17,114
79,700	79,750	17,069	13,551	17,413	15,626	82,700	82,750	17,909	14,301	18,253	16,376	85,700	85,750	18,749	15,051	19,093	17,126
79,750	79,800	17,083	13,564	17,427	15,639	82,750	82,800	17,923	14,314	18,267	16,389	85,750	85,800	18,763	15,064	19,107	17,139
79,800	79,850	17,097</															

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
<b>86,000</b>						<b>89,000</b>						<b>92,000</b>					
86,000	86,050	18,833	15,126	19,177	17,201	89,000	89,050	19,673	15,876	20,101	17,951	92,000	92,050	20,513	16,626	21,091	18,701
86,050	86,100	18,847	15,139	19,191	17,214	89,050	89,100	19,687	15,889	20,118	17,964	92,050	92,100	20,527	16,639	21,108	18,714
86,100	86,150	18,861	15,151	19,205	17,226	89,100	89,150	19,701	15,901	20,134	17,976	92,100	92,150	20,541	16,651	21,124	18,726
86,150	86,200	18,875	15,164	19,219	17,239	89,150	89,200	19,715	15,914	20,151	17,989	92,150	92,200	20,555	16,664	21,141	18,739
86,200	86,250	18,889	15,176	19,233	17,251	89,200	89,250	19,729	15,926	20,167	18,001	92,200	92,250	20,569	16,676	21,157	18,751
86,250	86,300	18,903	15,189	19,247	17,264	89,250	89,300	19,743	15,939	20,184	18,014	92,250	92,300	20,583	16,689	21,174	18,764
86,300	86,350	18,917	15,201	19,261	17,276	89,300	89,350	19,757	15,951	20,200	18,026	92,300	92,350	20,597	16,701	21,190	18,776
86,350	86,400	18,931	15,214	19,275	17,289	89,350	89,400	19,771	15,964	20,217	18,039	92,350	92,400	20,611	16,714	21,207	18,789
86,400	86,450	18,945	15,226	19,289	17,301	89,400	89,450	19,785	15,976	20,233	18,051	92,400	92,450	20,625	16,726	21,223	18,801
86,450	86,500	18,959	15,239	19,303	17,314	89,450	89,500	19,799	15,989	20,250	18,064	92,450	92,500	20,639	16,739	21,240	18,814
86,500	86,550	18,973	15,251	19,317	17,326	89,500	89,550	19,813	16,001	20,266	18,076	92,500	92,550	20,653	16,751	21,256	18,826
86,550	86,600	18,987	15,264	19,331	17,339	89,550	89,600	19,827	16,014	20,283	18,089	92,550	92,600	20,667	16,764	21,273	18,839
86,600	86,650	19,001	15,276	19,345	17,351	89,600	89,650	19,841	16,026	20,299	18,101	92,600	92,650	20,681	16,776	21,289	18,851
86,650	86,700	19,015	15,289	19,359	17,364	89,650	89,700	19,855	16,039	20,316	18,114	92,650	92,700	20,695	16,789	21,306	18,864
86,700	86,750	19,029	15,301	19,373	17,376	89,700	89,750	19,869	16,051	20,332	18,126	92,700	92,750	20,709	16,801	21,322	18,876
86,750	86,800	19,043	15,314	19,387	17,389	89,750	89,800	19,883	16,064	20,349	18,139	92,750	92,800	20,723	16,814	21,339	18,889
86,800	86,850	19,057	15,326	19,401	17,401	89,800	89,850	19,897	16,076	20,365	18,151	92,800	92,850	20,737	16,826	21,355	18,901
86,850	86,900	19,071	15,339	19,415	17,414	89,850	89,900	19,911	16,089	20,382	18,164	92,850	92,900	20,751	16,839	21,372	18,914
86,900	86,950	19,085	15,351	19,429	17,426	89,900	89,950	19,925	16,101	20,398	18,176	92,900	92,950	20,765	16,851	21,388	18,926
86,950	87,000	19,099	15,364	19,443	17,439	89,950	90,000	19,939	16,114	20,415	18,189	92,950	93,000	20,779	16,864	21,405	18,939
<b>87,000</b>						<b>90,000</b>						<b>93,000</b>					
87,000	87,050	19,113	15,376	19,457	17,451	90,000	90,050	19,953	16,126	20,431	18,201	93,000	93,050	20,793	16,876	21,421	18,951
87,050	87,100	19,127	15,389	19,471	17,464	90,050	90,100	19,967	16,139	20,448	18,214	93,050	93,100	20,807	16,889	21,438	18,964
87,100	87,150	19,141	15,401	19,485	17,476	90,100	90,150	19,981	16,151	20,464	18,226	93,100	93,150	20,821	16,901	21,454	18,976
87,150	87,200	19,155	15,414	19,499	17,489	90,150	90,200	19,995	16,164	20,481	18,239	93,150	93,200	20,835	16,914	21,471	18,989
87,200	87,250	19,169	15,426	19,513	17,501	90,200	90,250	20,009	16,176	20,497	18,251	93,200	93,250	20,849	16,926	21,487	19,001
87,250	87,300	19,183	15,439	19,527	17,514	90,250	90,300	20,023	16,189	20,514	18,264	93,250	93,300	20,863	16,939	21,504	19,014
87,300	87,350	19,197	15,451	19,541	17,526	90,300	90,350	20,037	16,201	20,530	18,276	93,300	93,350	20,877	16,951	21,520	19,026
87,350	87,400	19,211	15,464	19,555	17,539	90,350	90,400	20,051	16,214	20,547	18,289	93,350	93,400	20,891	16,964	21,537	19,039
87,400	87,450	19,225	15,476	19,573	17,551	90,400	90,450	20,065	16,226	20,563	18,301	93,400	93,450	20,905	16,976	21,553	19,051
87,450	87,500	19,239	15,489	19,590	17,564	90,450	90,500	20,079	16,239	20,580	18,314	93,450	93,500	20,919	16,989	21,570	19,064
87,500	87,550	19,253	15,501	19,606	17,576	90,500	90,550	20,093	16,251	20,596	18,326	93,500	93,550	20,933	17,001	21,586	19,076
87,550	87,600	19,267	15,514	19,623	17,589	90,550	90,600	20,107	16,264	20,613	18,339	93,550	93,600	20,947	17,014	21,603	19,089
87,600	87,650	19,281	15,526	19,639	17,601	90,600	90,650	20,121	16,276	20,629	18,351	93,600	93,650	20,961	17,026	21,619	19,101
87,650	87,700	19,295	15,539	19,656	17,614	90,650	90,700	20,135	16,289	20,646	18,364	93,650	93,700	20,975	17,039	21,636	19,114
87,700	87,750	19,309	15,551	19,672	17,626	90,700	90,750	20,149	16,301	20,662	18,376	93,700	93,750	20,989	17,051	21,652	19,126
87,750	87,800	19,323	15,564	19,689	17,639	90,750	90,800	20,163	16,314	20,679	18,389	93,750	93,800	21,003	17,064	21,669	19,139
87,800	87,850	19,337	15,576	19,705	17,651	90,800	90,850	20,177	16,326	20,695	18,401	93,800	93,850	21,017	17,076	21,685	19,151
87,850	87,900	19,351	15,589	19,722	17,664	90,850	90,900	20,191	16,339	20,712	18,414	93,850	93,900	21,031	17,089	21,702	19,164
87,900	87,950	19,365	15,601	19,738	17,676	90,900	90,950	20,205	16,351	20,728	18,426	93,900	93,950	21,045	17,101	21,718	19,176
87,950	88,000	19,379	15,614	19,755	17,689	90,950	91,000	20,219	16,364	20,745	18,439	93,950	94,000	21,059	17,114	21,735	19,189
<b>88,000</b>						<b>91,000</b>						<b>94,000</b>					
88,000	88,050	19,393	15,626	19,771	17,701	91,000	91,050	20,233	16,376	20,761	18,451	94,000	94,050	21,073	17,126	21,751	19,201
88,050	88,100	19,407	15,639	19,788	17,714	91,050	91,100	20,247	16,389	20,778	18,464	94,050	94,100	21,087	17,139	21,768	19,214
88,100	88,150	19,421	15,651	19,804	17,726	91,100	91,150	20,261	16,401	20,794	18,476	94,100	94,150	21,101	17,151	21,784	19,226
88,150	88,200	19,435	15,664	19,821	17,739	91,150	91,200	20,275	16,414	20,811	18,489	94,150	94,200	21,115	17,164	21,801	19,239
88,200	88,250	19,449	15,676	19,837	17,751	91,200	91,250	20,289	16,426	20,827	18,501	94,200	94,250	21,129	17,176	21,817	19,251
88,250	88,300	19,463	15,689	19,854	17,764	91,250	91,300	20,303	16,439	20,844	18,514	94,250	94,300	21,143	17,189	21,834	19,264
88,300	88,350	19,477	15,701	19,870	17,776	91,300	91,350	20,317	16,451	20,860	18,526	94,300	94,350	21,157	17,201	21,850	19,276
88,350	88,400	19,491	15,714	19,887	17,789	91,350	91,400	20,331	16,464	20,877	18,539	94,350	94,400	21,171	17,214	21,867	19,289
88,400	88,450	19,505	15,726	19,903	17,801	91,400	91,450	20,345	16,476	20,893	18,551	94,400	94,450	21,185	17,226	21,883	19,301
88,450	88,500	19,519	15,739	19,920	17,814	91,450	91,500	20,359	16,489	20,910	18,564	94,450	94,500	21,199	17,239	21,900	19,314
88,500	88,550	19,533	15,751	19,936	17,826	91,500	91,550	20,373	16,501	20,926	18,576	94,500	94,550	21,213	17,251	21,916	19,326
88,550	88,600	19,547	15,764	19,953	17,839	91,550	91,600	20,387	16,514	20,943	18,589	94,550	94,600	21,227	17,264	21,933	19,339
88,600	88,650	19,561	15,776	19,969	17,851	91,600	91,650	20,401	16,526	20,959	18,601	94,600	94,650	21,241	17,276	21,949	19,351
88,650	88,700	19,575	15,789	19,986	17,864	91,650	91,700	20,415	16,539	20,976	18,614	94,650	94,700	21,255	17,289	21,966	19,364
88,700	88,750	19,589	15,801	20,002	17,876	91,700	91,750	20,429	16,551	20,992	18,626	94,700	94,750	21,269	17,301	21,982	19,376
88,750	88,800	19,603	15,814	20,019	17,889	91,750	91,800	20,443	16,564	21,009	18,639	94,750	94,800	21,283	17,314	21,999	19,389
88,800	88,850	19,61															

2003 Tax Table—Continued

If line 40 (taxable income) is—		And you are—				If line 40 (taxable income) is—		And you are—			
		Single	Married filing jointly *	Married filing separately	Head of a household			Single	Married filing jointly *	Married filing separately	Head of a household
At least	But less than	Your tax is—				At least	But less than	Your tax is—			
<b>95,000</b>						<b>98,000</b>					
95,000	95,050	21,353	17,376	22,081	19,451	98,000	98,050	22,193	18,126	23,071	20,201
95,050	95,100	21,367	17,389	22,098	19,464	98,050	98,100	22,207	18,139	23,088	20,214
95,100	95,150	21,381	17,401	22,114	19,476	98,100	98,150	22,221	18,151	23,104	20,226
95,150	95,200	21,395	17,414	22,131	19,489	98,150	98,200	22,235	18,164	23,121	20,239
95,200	95,250	21,409	17,426	22,147	19,501	98,200	98,250	22,249	18,176	23,137	20,251
95,250	95,300	21,423	17,439	22,164	19,514	98,250	98,300	22,263	18,189	23,154	20,265
95,300	95,350	21,437	17,451	22,180	19,526	98,300	98,350	22,277	18,201	23,170	20,279
95,350	95,400	21,451	17,464	22,197	19,539	98,350	98,400	22,291	18,214	23,187	20,293
95,400	95,450	21,465	17,476	22,213	19,551	98,400	98,450	22,305	18,226	23,203	20,307
95,450	95,500	21,479	17,489	22,230	19,564	98,450	98,500	22,319	18,239	23,220	20,321
95,500	95,550	21,493	17,501	22,246	19,576	98,500	98,550	22,333	18,251	23,236	20,335
95,550	95,600	21,507	17,514	22,263	19,589	98,550	98,600	22,347	18,264	23,253	20,349
95,600	95,650	21,521	17,526	22,279	19,601	98,600	98,650	22,361	18,276	23,269	20,363
95,650	95,700	21,535	17,539	22,296	19,614	98,650	98,700	22,375	18,289	23,286	20,377
95,700	95,750	21,549	17,551	22,312	19,626	98,700	98,750	22,389	18,301	23,302	20,391
95,750	95,800	21,563	17,564	22,329	19,639	98,750	98,800	22,403	18,314	23,319	20,405
95,800	95,850	21,577	17,576	22,345	19,651	98,800	98,850	22,417	18,326	23,335	20,419
95,850	95,900	21,591	17,589	22,362	19,664	98,850	98,900	22,431	18,339	23,352	20,433
95,900	95,950	21,605	17,601	22,378	19,676	98,900	98,950	22,445	18,351	23,368	20,447
95,950	96,000	21,619	17,614	22,395	19,689	98,950	99,000	22,459	18,364	23,385	20,461
<b>96,000</b>						<b>99,000</b>					
96,000	96,050	21,633	17,626	22,411	19,701	99,000	99,050	22,473	18,376	23,401	20,475
96,050	96,100	21,647	17,639	22,428	19,714	99,050	99,100	22,487	18,389	23,418	20,489
96,100	96,150	21,661	17,651	22,444	19,726	99,100	99,150	22,501	18,401	23,434	20,503
96,150	96,200	21,675	17,664	22,461	19,739	99,150	99,200	22,515	18,414	23,451	20,517
96,200	96,250	21,689	17,676	22,477	19,751	99,200	99,250	22,529	18,426	23,467	20,531
96,250	96,300	21,703	17,689	22,494	19,764	99,250	99,300	22,543	18,439	23,484	20,545
96,300	96,350	21,717	17,701	22,510	19,776	99,300	99,350	22,557	18,451	23,500	20,559
96,350	96,400	21,731	17,714	22,527	19,789	99,350	99,400	22,571	18,464	23,517	20,573
96,400	96,450	21,745	17,726	22,543	19,801	99,400	99,450	22,585	18,476	23,533	20,587
96,450	96,500	21,759	17,739	22,560	19,814	99,450	99,500	22,599	18,489	23,550	20,601
96,500	96,550	21,773	17,751	22,576	19,826	99,500	99,550	22,613	18,501	23,566	20,615
96,550	96,600	21,787	17,764	22,593	19,839	99,550	99,600	22,627	18,514	23,583	20,629
96,600	96,650	21,801	17,776	22,609	19,851	99,600	99,650	22,641	18,526	23,599	20,643
96,650	96,700	21,815	17,789	22,626	19,864	99,650	99,700	22,655	18,539	23,616	20,657
96,700	96,750	21,829	17,801	22,642	19,876	99,700	99,750	22,669	18,551	23,632	20,671
96,750	96,800	21,843	17,814	22,659	19,889	99,750	99,800	22,683	18,564	23,649	20,685
96,800	96,850	21,857	17,826	22,675	19,901	99,800	99,850	22,697	18,576	23,665	20,699
96,850	96,900	21,871	17,839	22,692	19,914	99,850	99,900	22,711	18,589	23,682	20,713
96,900	96,950	21,885	17,851	22,708	19,926	99,900	99,950	22,725	18,601	23,698	20,727
96,950	97,000	21,899	17,864	22,725	19,939	99,950	100,000	22,739	18,614	23,715	20,741
<b>97,000</b>						<div style="border: 1px solid black; border-radius: 50%; padding: 20px; width: fit-content; margin: 0 auto;"> <p><b>\$100,000</b> or over — use the Tax Rate Schedules on page 75</p> </div>					
97,000	97,050	21,913	17,876	22,741	19,951						
97,050	97,100	21,927	17,889	22,758	19,964						
97,100	97,150	21,941	17,901	22,774	19,976						
97,150	97,200	21,955	17,914	22,791	19,989						
97,200	97,250	21,969	17,926	22,807	20,001						
97,250	97,300	21,983	17,939	22,824	20,014						
97,300	97,350	21,997	17,951	22,840	20,026						
97,350	97,400	22,011	17,964	22,857	20,039						
97,400	97,450	22,025	17,976	22,873	20,051						
97,450	97,500	22,039	17,989	22,890	20,064						
97,500	97,550	22,053	18,001	22,906	20,076						
97,550	97,600	22,067	18,014	22,923	20,089						
97,600	97,650	22,081	18,026	22,939	20,101						
97,650	97,700	22,095	18,039	22,956	20,114						
97,700	97,750	22,109	18,051	22,972	20,126						
97,750	97,800	22,123	18,064	22,989	20,139						
97,800	97,850	22,137	18,076	23,005	20,151						
97,850	97,900	22,151	18,089	23,022	20,164						
97,900	97,950	22,165	18,101	23,038	20,176						
97,950	98,000	22,179	18,114	23,055	20,189						

\* This column must also be used by a qualifying widow(er).

# 2003 Tax Rate Schedules



Use **only** if your taxable income (Form 1040, line 40) is \$100,000 or more. If less, use the **Tax Table**. Even though you cannot use the Tax Rate Schedules below if your taxable income is less than \$100,000, all levels of taxable income are shown so taxpayers can see the tax rate that applies to each level.

## Schedule X—Use if your filing status is **Single**

If the amount on Form 1040, line 40, is: Over—	But not over—	Enter on Form 1040, line 41	of the amount over—
\$0	\$7,000	..... 10%	\$0
7,000	28,400	<b>\$700.00 + 15%</b>	<b>7,000</b>
28,400	68,800	<b>3,910.00 + 25%</b>	<b>28,400</b>
68,800	143,500	<b>14,010.00 + 28%</b>	<b>68,800</b>
143,500	311,950	<b>34,926.00 + 33%</b>	<b>143,500</b>
311,950	.....	<b>90,514.50 + 35%</b>	<b>311,950</b>

## Schedule Y-1—Use if your filing status is **Married filing jointly** or **Qualifying widow(er)**

If the amount on Form 1040, line 40, is: Over—	But not over—	Enter on Form 1040, line 41	of the amount over—
\$0	\$14,000	..... 10%	\$0
14,000	56,800	<b>\$1,400.00 + 15%</b>	<b>14,000</b>
56,800	114,650	<b>7,820.00 + 25%</b>	<b>56,800</b>
114,650	174,700	<b>22,282.50 + 28%</b>	<b>114,650</b>
174,700	311,950	<b>39,096.50 + 33%</b>	<b>174,700</b>
311,950	.....	<b>84,389.00 + 35%</b>	<b>311,950</b>

## Schedule Y-2—Use if your filing status is **Married filing separately**

If the amount on Form 1040, line 40, is: Over—	But not over—	Enter on Form 1040, line 41	of the amount over—
\$0	\$7,000	..... 10%	\$0
7,000	28,400	<b>\$700.00 + 15%</b>	<b>7,000</b>
28,400	57,325	<b>3,910.00 + 25%</b>	<b>28,400</b>
57,325	87,350	<b>11,141.25 + 28%</b>	<b>57,325</b>
87,350	155,975	<b>19,548.25 + 33%</b>	<b>87,350</b>
155,975	.....	<b>42,194.50 + 35%</b>	<b>155,975</b>

## Schedule Z—Use if your filing status is **Head of household**

If the amount on Form 1040, line 40, is: Over—	But not over—	Enter on Form 1040, line 41	of the amount over—
\$0	\$10,000	..... 10%	\$0
10,000	38,050	<b>\$1,000.00 + 15%</b>	<b>10,000</b>
38,050	98,250	<b>5,207.50 + 25%</b>	<b>38,050</b>
98,250	159,100	<b>20,257.50 + 28%</b>	<b>98,250</b>
159,100	311,950	<b>37,295.50 + 33%</b>	<b>159,100</b>
311,950	.....	<b>87,736.00 + 35%</b>	<b>311,950</b>

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