

Publication 4491

VITA/TCE Training Guide

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

Volume 4 of 16

2023 RETURNS



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Publication 4491 (Rev. 10-2023) Catalog Number 74182D
Department of the Treasury **Internal Revenue Service** www.irs.gov



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Special Rule for Children of Divorced or Separated Parents or Parents Who Live Apart

In most cases, the child is the qualifying child of the custodial parent. However, a child will be treated as the qualifying child or qualifying relative of his or her noncustodial parent if all the following conditions apply:



This rule does not apply for Head of Household filing status, the credit for child and dependent care expenses, or the earned income credit. For these benefits, the child must meet the residency test. The custodial parent may still qualify for these provisions even though the noncustodial parent can claim the dependent for other tax benefits.

1. The parents
 - are divorced or legally separated under divorce or separate

maintenance decrees or written separation agreements, or

- lived apart at all times during the last six months of the year whether or not they are or were married

2. The child received over half of his or her support for the year from the parents. (Multiple Support Agreement rules do not apply.)
3. The child was in the custody of one or both parents for more than half the year.
4. The custodial parent signs a written declaration (Form 8332 or a similar statement) that he or she will not claim the child as a dependent for the year and the noncustodial parent attaches this declaration to his or her return. If the decree or agreement went into effect after 1984 and before 2009, the noncustodial parent may be

able to attach certain pages from the decree or agreement instead of Form 8332. For a pre-1985 decree or agreement, see Publication 17.

This special rule is the exception to:

- The residency test for qualifying child
- The support test for qualifying relative

Custodial and Noncustodial Parent

The custodial parent is the parent with whom the child lived for the greater number of nights during the year. The other parent is the noncustodial parent.

If the parents divorced or separated during the year and the child lived with both parents before the separation, the custodial parent is the one with whom the child lived for the greater number of nights during the rest of the year.

A child is treated as living with a parent for a night if the child sleeps:

- At that parent's home, whether or not the parent is present, or
- In the company of the parent, when the child does not sleep at a parent's home (for example, the parent and child are on vacation together).



Chloe has one child, Timmy, and is divorced. During the tax year, Timmy lived with Chloe 210 nights and with his father 155 nights. Chloe is the custodial parent because Timmy lived with her more nights during the year.

If the child lived with each parent for an equal number of nights during the year, the custodial parent is the parent with the higher adjusted gross income.

Question 3: Ted is divorced and has a daughter who lived with him and his ex-spouse for an equal number of nights. Ted's

adjusted gross income is \$45,000 and his ex-spouse's adjusted gross income is \$30,000.

Who is considered the custodial parent?

If a child is emancipated under state law, the child is treated as not living with either parent. See more examples and additional information in Publication 17.



When Troy turned age 18 in May, he became emancipated under the law of the state in which he lives. As a result, he is not considered in the custody of his parents for more than half of the year. The special rule for children of divorced or separated parents does not apply.

Revocation of Release of Claim to an Exemption

Custodial parents can revoke a release of claim to exemption they previously provided to the noncustodial parent on Form 8332 or a

similar statement. The custodial parent must provide, or make a reasonable effort to provide, the noncustodial parent with written notice of the revocation in the calendar year prior to the tax year in which the revocation is to take effect. Part III of Form 8332 can be used for this purpose. Attach a copy of the revocation to the return for each tax year the child is claimed as a dependent as a result of the revocation.



The tax software determines the taxpayer's dependents based on the Dependents/Qualifying Person information entered in the Basic Information section.

Be sure to complete and review all the family and dependent information on the taxpayer's intake and interview sheet before entering the data into the tax software.

For detailed instructions on entering a dependent's information, refer to the

Volunteer Resource Guide, Tab B, Starting a Return and Filing Status.

This table summarizes the benefits that remain with the custodial parent, even after they have released the claim to the dependent to the noncustodial parent.

Who May Claim	Custodial Parent	Noncustodial Parent with Form 8332
Dependent		✓
Head of Household	✓	
Earned Income Credit (EIC)	✓	
Child Tax Credit or Credit for Other Dependents		✓

Dependent Care Credit	✓	
Education credits		✓
Premium Tax Credit		✓

Be sure to add the child to the custodial parent's return, even though you will indicate that they are not a dependent. The software will then have the information needed for an accurate return.

Tax Law Application

Elaine Smith has one Form W-2 from her clerk job of 36 years, showing wages of \$37,000. She has been divorced from her husband for over 20 years. She pays all the costs of keeping up her home and is the main provider for her seven-year-old granddaughter, Lisa and her 30-year-old son, Todd. Lisa is Todd's niece. Both her son and granddaughter lived with Elaine all year. Her

son worked part time and earned \$9,000. He is not disabled. She would like to file a tax return and claim her son and granddaughter as dependents.

How do I apply the dependency tests to Elaine's son?

Use the tables in the Volunteer Resource Guide, Tab C, Dependents, to apply the test to Elaine's son.

How do I apply the dependency tests to Elaine's granddaughter?

Use the tables in the Volunteer Resource Guide, Tab C, Dependents, to apply the test to Elaine's granddaughter. You will find that Lisa is a qualifying child of both Elaine and Todd. However, under the tie-breaker rules, Elaine is entitled to claim Lisa as a dependent because she has the higher AGI.

Dependent/Nondependent Determinations

Elaine can claim her granddaughter as a dependent, but cannot claim her adult son because he does not meet the gross income test to be Elaine's qualifying relative.

Summary

For a taxpayer to claim a dependent, the following conditions must be met:

- The taxpayer may not claim a dependent if the taxpayer may be claimed as a dependent on another taxpayer's return.
- The taxpayer may not claim a dependent who files a joint return unless the joint return is filed only to claim a refund and no tax liability would exist for either spouse on separate returns.
- A person cannot be claimed as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national,

or a resident of Canada or Mexico, for some part of the year. (There is an exception for certain adopted children.)

- A dependent must be either a *qualifying child* or *qualifying relative*.



EXERCISE Answers

Answer 1: No, since Eva has a filing requirement and her children meet the tests to be Eva's qualifying children, Todd cannot claim the children as qualifying relatives.

Answer 2: No one is entitled to claim the grandmother as a dependent. The individuals who provided more than half of the grandmother's support are not eligible to claim her because they are not related to her and did not live in the same household all year.

Answer 3: Ted is his daughter's custodial parent because he had a higher adjusted gross income.

Unique Filing Situations



Introduction

This lesson will assist you in addressing some filing status issues you may encounter when helping taxpayers who are not U.S. citizens.

This lesson also covers dependent issues related to taxpayers who may have nonresident alien stepchildren (children of a nonresident spouse who is married to U.S. citizen or resident alien).

This lesson does not cover the preparation of returns for taxpayers who are in the U.S. on an F, J, M, or Q visa. Refer taxpayers with one of these visas to a volunteer who is certified to prepare tax returns for foreign students or to a professional tax preparer.

The Foreign Student and Scholar course and certification test are part of Link & Learn Taxes, which is available on

<https://apps.irs.gov/app/vita/>

Objectives

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

- Determine whether an individual is a resident or nonresident alien
- Apply the support test and citizen or resident test to determine whether an individual can be claimed as a dependent
- Apply special rules for Head of Household status when the spouse is a nonresident alien

What do I need?

- Form 13614-C
- Publication 4012
- Publication 17

- Publication 519

Optional:

- Publication 3
- Publication 54
- Form 1040-NR

How do I apply tax law to nonresident aliens?

Nonresident aliens can include students, teachers, trainees, or undocumented immigrants. Your role is to determine if the nonresident alien can be treated as a resident alien for tax purposes; most tax rules that apply to a U.S. citizen will also apply to the resident alien, including filing status and dependent issues. Resident aliens and U.S. citizens must report worldwide income on their Form 1040. A person who appears to be resident may be treated as nonresident alien under certain circumstances as discussed later.

Keep in mind that a person is considered married no matter where in the world they were married. It does not matter if one spouse is living in another country. The person who is the resident alien or citizen still must follow the tax rules for married persons.

Filing a tax return as a resident alien does not affect the person's immigration status in any way.

Who is a resident alien or nonresident alien?

Let's begin by looking at the intake and interview sheet. Locate the part of the form where taxpayers and their spouses indicate whether they are U.S. citizens. In another part of the form, taxpayers indicate citizenship or residency of family members and dependents.

If the taxpayer has checked "No" for U.S. citizen on the intake and interview sheet, you must determine if the person can be treated

as a resident alien for tax purposes before continuing. An individual must meet **one** of the following tests to be considered a resident alien for tax purposes:

- Green card test
- Substantial presence test

What is the green card test?

Individuals who were lawful permanent residents of the U.S. at any time during the tax year are resident aliens. They were given the privilege, according to immigration laws, of residing permanently in the U.S. They receive alien registration cards, commonly known as a "green cards," attesting to this status. Green cards are approximately the size of driver licenses. They are no longer green in color but still hold the name. Most green card holders have valid Social Security numbers and must follow the same tax laws as U.S. citizens, including the requirement to report worldwide income on their tax returns.

What is the substantial presence test?

This test is based on a formula of days and years a person is physically present in the United States. Individuals who do not have green cards may still be considered resident aliens if they meet the requirements of the substantial presence test for the calendar year.

Use the Resident or Nonresident Alien Decision Chart in the Volunteer Resource Guide, Tab L, Resident/NR Aliens, or on the next page, to determine an individual's residency status for tax purposes. Information can also be found in Publication 519, U.S. Tax Guide for Aliens.



On their intake sheet, Gloria indicated that her husband, Dante, is not a U.S. citizen. During the interview, you learn that Dante does not have a tax

home in another country. He was physically present in the U.S. for 150 days during the current tax year and both of the two prior years. Using the Nonresident Alien or Resident Alien? – Decision Chart on the following page, determine if Dante is a resident alien under the substantial presence test for the tax year.

The decision chart indicates that Dante does meet the substantial presence test and is considered a resident alien for tax purposes. You can assist Gloria and Dante in filing their joint return.

Current tax year: 150 days Prior year: $\frac{1}{3}$ of 150 = 50 days Two years prior: $\frac{1}{6}$ of 150 days = 25 days Total = 225 days

Resident or Nonresident Alien Decision Chart

Determine residency status for federal income tax purposes.

Step	Probe	Action
1	Were you a lawful permanent resident of the United States (had a "green card") at any time during the current tax year?	YES – RESIDENT Alien for U.S. tax purposes ^{1, 2} NO – Go to Step 2
2	Were you physically present in the United States on at least 31 days during the current tax year? ³	YES – Go to Step 3 NO – NONRESIDENT Alien for U.S. tax purposes ³

3	<p>Were you physically present in the United States on at least 183 days during the 3-year period consisting of the current tax year and the preceding 2 years,</p> <ul style="list-style-type: none"> • counting all days of presence in the current tax year, • 1/3 of the days of presence in the first preceding year, and • 1/6 of the days of presence in the second preceding year?³ 	<p>YES – Go to Step 4</p> <p>NO – NONRESIDENT Alien for U.S. tax purposes⁴</p>
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4	Were you physically present in the United States on at least 183 days during the current tax year? ³	<p>YES – RESIDENT Alien for U.S. tax purposes^{1, 2}</p> <p>NO – Go to Step 5</p>
5	Can you show that for the current tax year you have a tax home in a foreign country and have a closer connection to that country than to the United States? (*Out of Scope, Form 8840, Closer Connection Exception Statement for Aliens required)	<p>YES– NONRESIDENT Alien for U.S. tax purposes⁵</p> <p>NO – RESIDENT Alien for U.S. tax purposes^{1, 2}</p>

Footnotes

- 1** If this is your first year of residency, you may have a dual status for the year. See

Dual Status Aliens in Pub 519, U.S. Tax Guide for Aliens. (Out of Scope)

- 2** In some circumstances you may still be considered a nonresident alien and eligible for benefits under an income tax treaty between the U.S. and your country. Check the provision of the treaty carefully. (Out of Scope)
- 3** See Days of Presence in the United States in Pub 519 for days that do not count as days of presence in the U.S. (Exempt individuals such as students, scholars, and others temporarily in the U.S. under an F, J, M, or Q visa's immigration status do not count their days of presence in the U.S. for specified periods of time.)
- 4** If you meet the substantial presence test for the following year, you may be able to choose treatment as a U.S. resident alien for part of the current tax year. See Substantial Presence Test under Resident

Aliens and First Year Choice under Dual Status Aliens in Pub. 519. (Out of Scope)

- 5** Nonresident students from Barbados, Hungary, and Jamaica, as well as trainees from Jamaica, may qualify for an election to be treated as a U.S. Resident for tax purposes under their tax treaty provisions with the U.S. A formal, signed, election statement must be attached to the Form 1040 (preparation of the statement is Out of Scope). (It continues until formally revoked.)



Taxpayers should be referred to a professional tax preparer if they:

- Are dual-status aliens, or
- Wish to claim a special treaty provision or tax topic not specifically addressed as within the scope of the Foreign Student and Scholar training, or

- Wish to claim resident status for a prior year based on days present in the U.S. after that year (first-year choice), or
- Wish to claim a closer connection exception on Form 8840

What counts as days of presence?

Count any day a person is physically present in the United States at any time during the day as a day of presence. There are exceptions to this rule. For example, do not count days a person regularly commutes to work in the United States from their home in Canada or Mexico or days the person is an exempt individual. The full list of exceptions and an explanation of each can be found in Publication 519, U.S. Tax Guide for Aliens.

Who is an exempt individual?

Generally, an exempt individual is a:

- Foreign government-related individual

- Teacher or trainee who is temporarily present under a J or Q visa
- Student who is temporarily present under an F, J, M, or Q visa
- Professional athlete who is temporarily in the United States to compete in a charitable sports event

Do not count the days present in the U.S. for purposes of the substantial presence test for an exempt individual. In general, they will be considered nonresident aliens for tax purposes and should file a Form 1040-NR if required. Exempt individuals must file Form 8843, Statement for Exempt Individuals and Individuals with a Medical Condition, to exclude days present in the U.S. from the substantial presence test. Refer these individuals to a VITA site that prepares tax returns for foreign students or to a professional tax preparer.

Publication 519 has detailed information on determining who is a resident or nonresident alien.



If a person's visa has expired or the person is not complying with the requirements of the visa, then that person is not an exempt individual and cannot exclude those days he or she is physically present in the U.S.

What if a nonresident alien meets the substantial presence test?

Nonresident aliens who meet the substantial presence test are treated as resident aliens for tax purposes.

No paperwork or documentation is needed to indicate that a person is a nonresident alien filing as a resident alien under the substantial presence test.

All persons listed on the return must have either a valid Social Security number or an individual tax identification number (ITIN).

ITINs are discussed in the Filing Basics lesson.



*A return with an ITIN can be e-filed.
A return missing an ITIN cannot be e-filed.*

What if a nonresident alien does not meet the green card or substantial presence test?

If an unmarried nonresident alien does not meet the green card or substantial presence test, refer the taxpayer to a VITA site that handles Foreign Students/Scholars, if appropriate, or a professional tax preparer to file Form 1040-NR.

If a U.S. citizen or resident alien is married to a spouse who is not a resident alien using the green card or substantial presence test, you may be able to provide assistance. Their options are discussed next.



Paul, a U.S. citizen, is married to Gabriella, who does not have a green card or a valid visa. They have no children and are not supporting anyone else.

Gabriella lived in the U.S. for 120 days during the current tax year. She was also in the U.S. for 120 days in each of the prior two years. Gabriella does not have a tax home in another country. Does Gabriella meet the substantial presence test?

Following the decision tree, you find that Gabriella does not meet the substantial presence test. For tax purposes, she is considered a nonresident alien.

Current tax year: 120 days Prior year: $\frac{1}{3}$ of 120 days = 40 days Two years prior: $\frac{1}{6}$ of 120 days = 20 days Total = 180 days



Individuals can be both a nonresident alien and a resident alien during the same tax year. This

usually occurs in the year of arrival in or departure from the United States. This is referred to as a dual-status tax year.

Individuals with a dual-status for the tax year are out of scope. Refer these individuals to a professional tax preparer. This does not apply to an individual who is married and chooses to be treated as a U.S. resident for the entire year.

What are the filing status options?

A U.S. citizen or resident alien who is married to a nonresident alien spouse who does not meet either the green card or substantial presence test generally has three filing status options:

- The taxpayer may choose to file as Married Filing Separately
- The couple may choose to file as Married Filing Jointly

- The taxpayer may qualify for Head of Household under the regular rules for a married person who is “considered unmarried” even while living with the nonresident alien spouse

What happens when a U.S. citizen and nonresident alien spouse file separate returns?

The U.S. citizen can file a Married Filing Separately return. The nonresident alien spouse, if required to file a return, would file Form 1040 NR. In this situation, the volunteer can assist in the preparation of Form 1040 for the U.S. citizen but must refer the spouse to a professional tax preparer.

When can nonresident aliens file a joint return?

A married couple may elect to treat a nonresident alien spouse as a resident alien for tax purposes and file a joint return. If taxpayers make this choice, both spouses are

treated for income tax purposes as residents for the entire tax year. Neither spouse can claim under any tax treaty not to be a U.S. resident. Both spouses are taxed on worldwide income.

How does a married couple elect to treat the nonresident alien spouse as a resident alien?

If the nonresident alien spouse agrees to file a joint return, worldwide income of both spouses must be reported. To make this election, Publication 519 requires a declaration signed by both spouses and attached to their joint return. The statement should include:

- One spouse was a nonresident alien and the other spouse was a U.S. citizen or resident alien on the last day of the tax year
- They choose to be treated as U.S. residents for the entire year, and

- The name, address, and SSN or ITIN of each spouse



Preparation of the required statement outlined in Publication 519 is out of scope.

How does this election affect the filing status in future years?

The election continues in future years, but the spouses can file separately after the first year, if they so choose. The election to treat the spouse as a resident is terminated by revocation, the death of either spouse, their legal separation, or the IRS may terminate it for failure to keep adequate records. Consult Publication 519 for more details on this option.



In the previous example, you determined that Gabriella, Paul's nonresident alien wife, does not meet either the green card or the substantial presence

tests to be considered a resident alien. However, Paul and Gabriella choose to treat Gabriella as a resident alien. They must attach a signed statement to their return that indicates this choice. You can assist Paul and Gabriella in preparing their joint return. They must report their worldwide income for the year and for all later years unless the choice is ended or suspended. Although Paul and Gabriella must file a joint return for the year they make the choice, they may file either joint or separate returns for later years.

When can a citizen or resident alien, who lives with a nonresident alien spouse, file as Head of Household?

There is an exception that allows U.S. citizens and resident aliens who have a nonresident alien spouse to file as Head of Household. All of the following requirements must be met:

- The taxpayer is a U.S. citizen, or resident alien for the entire year.

- The nonresident alien spouse chooses **not** to file a joint return.
- The taxpayer meets the other requirements for this filing status.
- The spouse is **not a qualifying person** for head of household purposes. The taxpayer must have a qualifying person in order to be eligible for this filing status.



EXERCISES

Answers are at the end of the lesson summary.

Question 1: Gloria's husband, Dante, meets the substantial presence test for the entire tax year. Gloria is a U.S. citizen. They do not have any children and do not support anyone else. Dante is applying for an ITIN. Gloria has an SSN. They live together.

What filing status options do Gloria and Dante have?

Question 2: Raul is a U.S. citizen and serving in the U.S. Army in Japan. His wife and his 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 for tax purposes. She does not want to file a joint return with him.

Raul meets all of the other qualifications for Head of Household. Even though he is married and living with his spouse, can he claim Head of Household status?

- a. Yes
- b. No



In the Volunteer Resource Guide, Tab B, Starting a Return and Filing Status, note that if a spouse is a nonresident alien, the living apart rule does not apply to the taxpayer. This information is found in Publication 519.

Can a taxpayer with a nonresident alien spouse claim the earned income credit?

A taxpayer who was a nonresident alien for any part of the year can't claim the EIC unless their filing status is married filing jointly. They can use that filing status only if their spouse is a U.S. citizen or resident alien and the nonresident spouse chooses to be treated as a U.S. resident. If they make this choice, both spouses are taxed on their worldwide income. If a taxpayer was a nonresident alien for any part of the year and their filing status isn't married filing jointly, they are not eligible for the EIC. See Publication 596, Earned Income Credit, for more information.

Which family members can be claimed as dependents?

Can a taxpayer claim a nonresident alien spouse as a dependent?

A taxpayer's spouse does not meet the relationship test for either qualifying child or qualifying relative. Thus, taxpayers cannot claim a spouse as their dependent.

Can a child born overseas be claimed as a dependent?

A child born overseas to U.S. citizen parents is considered a U.S. citizen for tax purposes. A child can be claimed as a dependent as long as all the other rules for qualifying child or qualifying relative are met.

The birth of a child abroad should be reported as soon as possible to establish an official record of the child's claim to U.S. citizenship. Form FS-240, Consular Report of Birth

Abroad, establishes official evidence that the child is a U.S. citizen.



Patricia, a U.S. citizen, is married to Gilberto, a nonresident alien from Spain. Their daughter, Eva, was born while they were living in Spain.

Eva is entitled to U.S. citizenship. Eva will need a Social Security number to be claimed as a dependent on her mother's tax return.



While applying for the Consular Report of Birth Abroad, parents should also apply for a Social Security number and passport for their child. Without a Social Security number, the parents will not be able to claim the child as a dependent or take advantage of credits, such as the earned income credit or the child tax credit, even if all of the other prerequisites are met.

Can a foreign-born stepchild be claimed as a dependent?

Before determining if a foreign-born stepchild is a dependent, it is necessary to determine the child's U.S. residency status for tax purposes by answering the questions in the Nonresident Alien or Resident Alien decision chart. If the foreign-born child is a nonresident alien for tax purposes, the child must be a resident of Canada or Mexico to be claimed as a dependent.



Terry, a U.S. citizen, is married to a German citizen whose three children are German citizens and do not have green cards. Terry has not adopted the children. They all live in Germany. The children were not physically present in the U.S. during the tax year. Since the children are not U.S. citizens and are not residents of the U.S., Canada, or Mexico, Terry cannot claim the children as dependents.

Question 3: Terry moved his family to the U.S. in January of the tax year. His stepchildren are not U.S. citizens and they do not have green cards. They meet the other dependency tests. If he can claim them, he will apply for ITINs for them. Can he claim the stepchildren as dependents on his tax return?

- a. Yes
- b. No

Question 4: John, a U.S. citizen, lives in Germany. His wife is a German citizen who has never lived in the U.S. Their two-year-old son was born in Germany. John's 12-year-old stepdaughter, a German citizen whom John has not adopted, also lives with them. John and his wife provide all the support for the two children. How many dependents can John claim?

- a. One
- b. Two

- c. Three
- d. Zero

Can a taxpayer claim an adopted foreign-born child as a dependent?

A U.S. citizen or national can claim a legally adopted child who is not a U.S. citizen, U.S. resident alien, or U.S. national provided the child is a member of the taxpayer's household all year. All the other rules for a qualifying child or qualifying relative must be met, and the child must have an SSN, ITIN, or ATIN to be claimed as a dependent.

An Adoption Taxpayer Identification Number (ATIN) can be obtained when a domestic adoption is pending and other rules are met. An ATIN can be obtained in a foreign adoption when the child already possesses a green card or a certificate of citizenship, which identifies a child born overseas as a U.S. citizen.

See Publication 519 for more information about the citizen or resident test, including who is considered a U.S. national.



An adopted nonresident alien child must live with the taxpayer all year to pass the citizen or resident test.

Summary

Resident aliens follow the same tax laws as U.S. citizens.

To determine the residency status of a noncitizen, use the Nonresident Alien or Resident Alien decision chart in the Volunteer Resource Guide, Tab L, Resident/NR Alien.

If a citizen or resident alien is married to a person who does not meet the green card or substantial presence test, the couple can elect to treat the nonresident spouse as a resident alien for tax purposes and file a joint return.

A U.S. citizen's child is usually a U.S. citizen by birth, even if the child is born in another country.

A nonresident alien stepchild generally will not pass the citizenship or resident test and therefore cannot be claimed as a dependent, unless the child is a resident of Canada or Mexico.

An adopted nonresident alien child can usually be claimed as a dependent if the child lives with the taxpayer the entire year.

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

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

- Taxpayers with F, J, M, or Q visas, unless there is a volunteer and quality reviewer at your site with Foreign Student certification

- Nonresident aliens who do not meet the green card or substantial presence test and are not married to a
- U.S. citizen or resident alien
- Individuals having a dual status for the tax year
- Nonresidents who are married to U.S. citizens or resident aliens can make an election to file a joint return for tax purposes and file as Married Filing Jointly. Preparation of the required statement is out of scope.



EXERCISE Answers

Answer 1: Since Dante meets the substantial presence test, he is considered a U.S. resident alien for tax purposes and must follow U.S. tax laws. Dante and Gloria can use either the Married Filing Jointly or Married Filing Separately filing status.

Answer 2: a, Yes. Raul can claim Head of Household status because his children are his qualifying persons. If Raul did not have a qualifying person, he would have to use the Married Filing Separately filing status since his wife chose not to file a joint return.

Answer 3: a, Yes. The children meet the substantial presence test because they were in the United States more than 183 days. Terry's stepchildren are considered resident aliens for tax purposes. As long as the other

requirements for qualifying child or qualifying relative are met, Terry can claim the stepchildren as dependents on his tax return. They have to obtain SSNs or ITINs.

Answer 4: a. John can claim his son as a dependent. The son qualifies as a U.S. citizen because his father is a U.S. citizen. The stepdaughter does not meet the U.S. citizen or resident test. A spouse is never considered a dependent.

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Income – Wages, Interest, Etc.

Introduction

This is the first of nine lessons covering the Income section of the taxpayer's return. A critical component of completing the taxpayer's return is distinguishing between taxable and nontaxable income and knowing where to report the different types of income on Form 1040.

Objectives

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

- Distinguish between taxable and nontaxable income
- Distinguish between earned and unearned income
- Report income correctly on Form 1040

The following chart will help you select the appropriate topic for your certification course.

	Certification Course			
	 Basic	 Advanced	 Military	 International
Wages & Reported Tips	Yes	Yes		
Unreported Tip Income		Yes		
Scholarship and Fellowship Income	Yes	Yes		
Interest Income	Yes	Yes		

Dividend Income	Yes	Yes		
Taxable Refunds	Yes	Yes		
Alimony Received	Yes	Yes		
Business Income		Yes		
Capital Gain/Loss		Yes		
Other Gains/Losses	N/A	N/A	N/A	N/A
IRA Distributions*	Yes	Yes		
Pensions/Annuities*	Yes	Yes		

Rental Income			Yes	
Schedule K-1 Distributions		Yes		
Farm Income	N/A	N/A	N/A	N/A
Unemployment Compensation	Yes	Yes		
Social Security Benefits	Yes	Yes		
Other Income	Yes	Yes		
Foreign Earned Income				Yes
Military Income			Yes	

*Basic only if the taxable amount is shown in Box 2a and does not require adjustment.

What do I need?

- Form 13614-C
- Publication 4012
- Publication 17

Optional:

- Form 1040 Instructions
- Form 1099-PATR
- Schedule B
- Publication 531
- Publication 550
- Publication 926
- Publication 970

How do I determine taxable and nontaxable income?

The Income Quick Reference Guide in the Volunteer Resource Guide, Tab D, Income, includes examples of taxable and nontaxable income.

Gross income is all income received in the form of money, goods, property, and services that is not exempt from tax. It includes income from sources outside the U.S. or from the sale of a primary residence, even if part or all of that income can be excluded. Gross income may include part of Social Security benefits received and certain scholarship and fellowship grants.

- Income that is taxable must be reported on a taxpayer's return and is subject to tax.
- Income that is nontaxable may have to be shown on a taxpayer's return but is exempt from tax.

What are types of taxable income?

Form 1040 and its associated schedules are used to report earned and unearned taxable income.

- Earned income – any income received for work, such as wages or business/self-employment income
- Unearned income – any income not earned from work, such as unemployment income or income produced by investments, such as interest on savings, dividends on stocks, or rental income

What are examples of nontaxable or exempt income?

Some nontaxable income such as gifts and inheritances are excludable and not shown on the return.

Exempt income includes such things as interest income produced from certain types of investments. There are some instances

when exempt income is shown on the return but not included in the income tax computation, for example, tax-exempt municipal bond interest income.

Under the Victims of Terrorism Tax Relief Act of 2001, the following amounts are not included in income:

- Certain disability payments received in tax years ending after September 10, 2001, for injuries sustained in a terrorist attack
- Payments from the September 11th Victim Compensation Fund of 2001
- Qualified disaster relief payments made after September 10, 2001, to cover personal, family, living, or funeral expenses incurred because of a terrorist attack
- Death benefits paid by an employer to the survivor of an employee if the benefits are paid because the employee died as a result of a terrorist attack

The Act also provides that the federal income tax liability of those who died as a result of the following attacks is forgiven for certain tax years:

- The September 11, 2001 attacks on the World Trade Center, the Pentagon, and United Airlines Flight 93 in Somerset County, Pennsylvania
- Terrorist attacks involving anthrax occurring after September 10, 2001, and before January 1, 2002
- The April 19, 1995 attack on the Alfred P. Murrah Federal Building

For additional details, see Publication 3920, Tax Relief for Victims of Terrorist Attacks.

How do I get started?

To determine a taxpayer's income, discuss and review the Income section of the intake and interview sheet with the taxpayer.

Income is reported on a variety of forms depending on its source. Ask taxpayers to show you all Forms W-2, Forms 1099, and other statements reporting income. Also ask taxpayers if they received income that was not reported on a tax form, such as odd jobs or tips from customers. (Do not confuse Form 1099 with Form 1098.

Generally, Form 1098 reports expenses the taxpayers have paid, not income they have received.)



After you have collected all the income statements, review the pages on income documents and How/Where to Enter Income in the Volunteer Resource Guide, Tab D, Income. These pages will show you where to correctly report income items.



*Taxpayers who can check **No** to the digital asset question on Form 1040 are in scope. Taxpayers are instructed to check **No** if they held no digital*

assets (such as virtual currency or a non-fungible token) for the year or if the taxpayer's only transactions involving digital assets during the year were a cash purchase, inheritance, bona fide gift, or a transfer between two wallets the taxpayer owns. Identify these situations as early in the interview as possible.

How do I report wages, salaries, tips, etc.?

What is Form W-2?

Employers must report wages and other employee compensation on Form W-2. Employers are not required to mail Forms W-2, but they must make them available to employees by January 31. Employees may need to pick up Form W-2 from their employers or obtain it electronically. Most employers issue a standardized version of Form W-2, Wage and Tax Statement. Go to www.irs.gov to view Form W-2.



Additional Medicare Tax applies to an individual's wages, Railroad Retirement Tax Act compensation, and self-employment income that exceeds a threshold amount based on the individual's filing status. This topic is out of scope for the VITA/TCE programs. Taxpayers affected by the Additional Medicare Tax should be referred to a professional tax preparer. Additional information can be found on www.irs.gov



A Form W-2 with code Q in Box 12, indicating combat pay, requires Military certification to complete the return.



Refer to the Volunteer Resource Guide, Tab D, Income, for instructions on entering income. Once you enter all Forms W-2 into the software, it carries the total to Form 1040 and transfers necessary information for

credits, deductions, withholding, etc., to other sections of the tax return.

What if the taxpayer does not receive Form W-2 by January 31?

Taxpayers who do not receive Form W-2 by January 31 should first contact the employer and find out if, or when, the form was mailed, or if it can be picked up or accessed online. Also, taxpayers may order transcripts from IRS.gov and receive the information by mail.

If Form W-2 is still not received after allowing a reasonable amount of time for the employer to issue or reissue it, then the taxpayer should contact the IRS for assistance after February 15.

If taxpayers do not receive Form W-2 before the filing deadline, they should file their tax return with Form 4852, Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans,

IRAs, Insurance Contracts, etc. Taxpayers will need to provide the information required to complete Form 4852, such as the last paycheck stub. Taxpayers should keep a copy of Form 4852 for their records. Your coordinator may need to determine whether Form 4852 can be filed with a state return as well.



If the taxpayer eventually receives the employer's Form W-2, and the numbers differ from those on Form 4852, the taxpayer will need to amend the return to report the correct amounts.

If the earnings reported on Form 4852 are not reflected on the taxpayer's Social Security Statement, the taxpayer should contact the Social Security Administration at the number shown on the statement. See Publication 5396-A: Job Aid for VITA/TCE Volunteers: Using Form 4852 when Missing the Form W-2 or 1099-R (PDF) for help completing the form.



During the tax year, Tina earned income from both a full-time and a part-time job. She received two Forms W-2, each listing different employers. Her return will list her wages as the total of the amounts in Box 1, but each Form W-2 must be entered into the tax software separately.

What if the taxpayer has an ITIN, but a Form W-2 is showing a different SSN?

Use the taxpayer's ITIN when starting the return. Enter the Social Security number as shown on the Form W-2 when prompted by the tax software. Refer to the Volunteer Resource Guide, Tab D, Income, for instructions.

What is Box 10, Dependent Care Benefits?

Box 10 is used by employers to report dependent care benefits paid to the taxpayer or incurred on behalf of the taxpayer.

Complete Form 2441, Child and Dependent Care Expenses, to determine if any part of this benefit is taxable to the taxpayer and the allowable amount of dependent care credit. Some employer plans provide a carryover or forfeiture of benefits that are not used by year end. This may require part III of Form 2441 to be completed.

What do Box 12 codes mean?

There are numerous code letters that the employer can use to designate certain items, such as employee contributions to the company retirement plan. Refer to the list of codes in the Volunteer Resource Guide, Tab D, Income.

The tax software will automatically transfer qualified voluntary retirement contributions to Form 8880, Credit for Qualified Retirement Savings Contributions, for the retirement savings credit. Refer to the Volunteer Resource Guide, Tab G, Nonrefundable Credits, for instructions on how to enter these

amounts. Also see the Miscellaneous Credits lesson.



Code FF in Box 12 of a Form W-2 indicates a Qualified Small Employer Health Reimbursement

Arrangement (QSEHRA) and is out of scope for the VITA/TCE programs. Codes R and T are also out of scope. Code Q is in scope for volunteers with Military certification only.

What do Box 13 checkmarks mean?

There are three checkboxes in Box 13:

- Statutory employees receive Form W-2 for their pay and have taxes withheld; however, statutory employees may report their income and deduct their expenses on Schedule C. See the Business Income lesson for more information.
- Retirement plan indicates that the employee participated in the employer's retirement plan. If the taxpayer or spouse (if MFJ) makes IRA contributions, their

deduction may be limited. See the Adjustments lesson for more information.

- Third-party sick pay is reported on Form W-2 by the insurance company when it is taxable.

What do Box 14 codes mean?

This box may be used for other information, such as state disability insurance taxes withheld, union dues, uniform payments, health insurance premiums deducted, nontaxable income, educational assistance payments, or a minister's parsonage allowance and utilities. In addition, the following may be entered in Box 14: contributions to a pension plan: (a) nonelective employer contributions made on behalf of an employee, (b) voluntary after-tax contributions (but not designated Roth contributions) that are deducted from an employee's pay, (c) required employee contributions, and (d) employer matching contributions.

Other Wage Income

Can a disability pension be treated as wages?

An individual who has not reached their employer's minimum retirement age and is receiving a disability pension may report the disability pension as wages for tax purposes, such as the earned income credit. This is discussed in the Retirement Income lesson.

What about income received by household employees?

The term "household employee" refers to an individual who works in someone's home performing household duties such as caring for children, cleaning, or cooking. Generally, an employer is not required to provide Form W-2 to a household employee who earns less than the threshold amount for that year. In this situation, neither the employer nor the employee will owe Social Security or Medicare tax on those wages. However, employers who

withhold federal income taxes from their employee's wages must issue Form W-2. Regardless of whether Form W-2 is issued, the income must be included on Form 1040.



For further information and a definition of who is a household employee, see Publication 926, Household Employer's Tax Guide.

What about Qualified Medicaid Waiver Payments?

Qualified Medicaid waiver payments, as defined in IRS Notice 2014-7, may be excluded from gross income. Qualified Medicaid waiver payments may be excluded from gross income only when the care provider and the care recipient reside in the same home. When the care provider and the care recipient do not live together in the same home, the Medicaid waiver payments may not be excluded from gross income.

A taxpayer may choose to include qualified Medicaid waiver payments in the calculation of earned income for the Earned Income Credit (EIC) and Additional Child Tax Credit (ACTC). The taxpayer may include qualified Medicaid waiver payments in earned income even if the taxpayer chooses to exclude those payments from gross income.

- A taxpayer may not choose to include or exclude only a portion of qualified Medicaid waiver payments. Either include all or none of the qualified Medicaid waiver payments for the taxable year in earned income.
- If the taxpayer chooses to include qualified Medicaid waiver payments in earned income, that amount will be included in the calculation for both the EIC and the ACTC.
- A taxpayer and spouse can each make separate elections to include or not

include their respective Medicaid waiver payments in earned income.

Taxpayers who excluded qualified Medicaid waiver payments from gross income in prior tax years may amend a return for any open tax years to include Medicaid waiver payments in earned income for the EIC and ACTC.

For more information, refer to the Volunteer Resource Guide, Tab D, Income, Entering Medicaid Waiver Payments and

www.irs.gov/individuals/certain-medicaid-waiver-payments-may-be-excludable-from-income.

Tip Income

If taxpayers have jobs for which they get a W-2 and in which tips are normally received (e.g., waiter/waitress, bellhop, or motel/hotel housekeeper), be sure to ask about any tips they may have received. All tip income is

taxable, whether or not it is reported to the employer.

If individuals receive more than \$20 per month in tips at one job and report their tip income to their employer, the tips will be included in Boxes 1 and 7 on Form W-2.



Self-employed taxpayers who receive tips, such as hair stylists and manicurists, should include their tips in gross receipts on Schedule C.

What are allocated tips?

To ensure that everyone reports their fair share of income from tips, some employers have tip allocation programs. These programs are approved by the IRS. If an employee reports tips to the employer that were less than the designated share based on the employer's formula, the employer reports the difference as "allocated tips" and includes it on the employee's Form W-2.

Allocated tips are shown separately in Form W-2, Box 8. Social Security and Medicare taxes are not withheld on allocated tips. Allocated tips are not included in the amount in Form W-2, Box 1. Explain to the taxpayers that unless they kept a written and reliable record of tips actually received at that job, the allocated tips must be included in Form 1040 as wages.



When allocated tips are reported on Form W-2, the software automatically adds them to Form 1040 and also completes Form 4137, Social Security and Medicare Tax on Unreported Tip Income. Refer to the Volunteer Resource Guide for instructions to enter the taxpayer's actual amount of tips according to their tip log



What about unreported tips?

An individual is not required to report tip income to their employer if it is \$20 or less per month. Since these tips are subject to federal income tax, ask taxpayers if they have any tip income that was not reported to their employer.

Other Tips

- Noncash tips (e.g., tickets or passes) do not have to be reported to the employer, but must be included as taxable income at their fair market value.
- Tips of less than \$20 per month or noncash tips are not subject to Social Security and Medicare taxes.
- If tips of more than \$20 a month were not reported to the employer, the taxpayer must also pay Social Security and Medicare taxes. Complete Form 4137 if

the taxpayer received tips that were not reported to the employer. This form calculates the appropriate income, Social Security, and Medicare taxes.



If the taxpayer has unreported tip income, enter the income on Form W-2, unreported tip income box. This will initiate Form 4137. Refer to the Volunteer Resource Guide, Tab D, Income, for instructions on how to enter tip income.



For more information about tip income, see Publication 531, Reporting Tip Income.

What is penal income (or prisoner income)?

An individual may be compensated while in a penal institution, a work-release program, or in a halfway house. The compensation will be reported on Form W-2 but it is not treated as earned income for most tax benefits, such as

the earned income credit. The amount is reported as wages on Form 1040, Schedule 1. Refer to the Volunteer Resource Guide, Tab D, Income, for instructions on how to identify and enter penal income, also known as prisoner income.



Under the PATH Act, a wrongfully incarcerated individual does not include in income any civil damages, restitution, or other monetary award received that relates to his or her incarceration.



Scholarship and Fellowship Income (Form W-2 and Form 1098-T)

Are scholarships and fellowships taxable income?

Scholarships and fellowships may be fully or partially taxable, or nontaxable. Taxable amounts include:

- Payment for services
- Money used for personal living expenses, such as room and board

If the taxpayer received Form W-2 for the scholarship or fellowship it is considered earned income. Include the amount on Form 1040 as wages just as you would any other Form W-2.

Form 1098-T reports scholarships and grants received as well as qualified tuition and related expenses paid to the school. Verify that these amounts are correct by reviewing the student's detailed financial account transcript which lists scholarship and grant money the student received. If scholarships or grants exceed the qualified educational costs, some of the grant or scholarship may be taxable to the student (not the taxpayer claiming the student as a dependent).

In certain situations, the student may choose to include all or part of certain scholarships or

grants in income in order to increase an education credit. This is explained in the education credits lesson, and examples can be found in the Form 8863 Instructions and Publication 970, Tax Benefits for Education. Taxable scholarship income is treated as earned income when:

- determining whether the student has a filing requirement and
- computing their standard deduction amount.

Taxable scholarship income is treated as unearned income for other purposes, such as the kiddie tax, earned income credit, or additional child tax credit.



Taxable scholarships are entered into the software in the Income>Less Common Income>Other compensation> Scholarships and Grants section, but are shown on Form 1040, Schedule 1. Refer to

the Volunteer Resource Guide for specific entries.

What about higher education emergency financial aid grants?

Emergency financial aid grants under the CARES Act for unexpected expenses, unmet financial need, or expenses related to the disruption of campus operations due to the COVID-19 pandemic, such as unexpected expenses for food, housing, course materials, technology, health care, or childcare, are qualified disaster relief payments under section 139 of the Internal Revenue Code. This grant is not includible in gross income and it does not reduce qualified education expenses that can be used for an education credit or deduction.

What about loan repayment assistance programs (LRAPs) for health care professionals?

Education loan repayments are not taxable if they are made to taxpayers by:

- The National Health Service Corps Loan Repayment Program
- A state education loan repayment program eligible for funds under the Public Health Service Act, or
- Any other state loan repayment or loan forgiveness program that promotes increased availability of health professionals/services in underserved areas

The taxpayer should not receive a tax form because the amount is not taxable. If there is any question, the taxpayer should contact the repayment agency.

What about ministers or other members of the clergy?

The ministry profession presents unique issues, such as the parsonage/housing allowance, whether earnings are covered under FICA or SECA (self employment tax), and the rules for being exempt. Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers, covers this topic. This information is provided for awareness only and is out of scope for the VITA/TCE programs. Taxpayers who have these issues should be referred to a professional tax preparer.

What interest is taxable?

Common sources of taxable interest income are checking and savings accounts, certificates of deposit (CDs), savings certificates, U.S. government bonds, interest on insurance proceeds, and loans that the taxpayer makes to others. Some savings and

loans, credit unions, and banks call their distributions “dividends.” These distributions are really interest and are reported correctly as interest on Form 1099-INT.



If a taxpayer received less than \$10 in interest, the financial institution might not issue Form 1099INT. Even if the taxpayer did not receive Form 1099-INT, they must still report all of their taxable interest income, including any interest paid by the IRS. The interest amount for the year will typically be shown on the December statement.



Taxpayers may have additional Foreign Bank and Financial Accounts (FBAR) filing requirements if they:

- *Have financial accounts or signature authority over a financial account in a foreign country (generally with a value of \$10,000 or more at any time during the year).*

- *Received a distribution from, or were the grantor of, or transferor to, a foreign trust.*

If the FATCA (Foreign Account Tax Compliance Act) filing requirement box is checked on Forms 1099-INT, 1099-DIV, or any other income reporting document, the taxpayer may have a FATCA filing requirement. Refer these taxpayers to a professional tax preparer.

Where do I get interest income information?

There are many sources of information about interest income. Ask the taxpayer to supply all Form(s) 1099INT from institutions that pay interest. Some institutions issue a year-end summary statement with the title "In lieu of Form 1099-INT or Form 1099-DIV" rather than preparing multiple documents for each account.

Original Issue Discount (OID) is a form of interest income. A debt instrument generally has OID when issued for an amount that is less than its stated redemption price at maturity. The issuer of the debt instrument will report the amount of OID that is currently taxable on Form 1099-OID, Original Issue Discount, or a similar statement.



Entries in Boxes 10,11,12 and 13 of Form 1099-INT, and Boxes 5 and 10 of Form 1099-OID are in scope.

Enter the information just as it appears on the information reporting documents (type what you see) and TaxSlayer software will complete the calculations.

If the amount reported in Box 11 exceeds the amount reported in Box 1, the return is out of scope.

If the amount reported in Box 12 exceeds the amount reported in Box 3, or if the amount reported in Box 13 exceeds the amount

reported in Box 8, the return is also out of scope.

If the taxpayers cashed in Series EE or Series I bonds, they should have received a Form 1099-INT. Most taxpayers report the total interest when they cash in the bonds. Few taxpayers elect to report savings bond interest as it accrues each year. This accrual method is out of scope for the volunteer program and taxpayers should be referred to a professional tax preparer.



Interest on qualified U.S. Series EE and Series I savings bonds that are used to pay for higher education expenses may be eligible for exclusion from income using Form 8815, Exclusion of Interest From Series EE and Series I U.S. Savings Bonds Issued After 1989. Form 8815 is out of scope for the VITA/TCE programs.



A Net Investment Income Tax applies to individuals, estates and trusts that have certain investment income above certain threshold amounts. This topic is out of scope for the VITA/TCE programs. Taxpayers affected by the Net Investment Income Tax should be referred to a professional tax preparer. Additional information can be found in Publication 17 or on www.irs.gov

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 the interest from the redemption of a bond, see Publication 17, Interest Income.

- Ask the taxpayer for all tax statements reporting the interest received.
- Ask if the taxpayer holds any loans or seller-financed mortgages.
- Ask if the taxpayer received any interest that was not reported on tax statement.

The taxpayer will likely not receive a tax form for interest received from a private borrower. The name, Social Security number, and address of the payer (the buyer) of interest on a seller-financed mortgage is required to e-file a return.



Bob holds a promissory note for a cash loan that he made to his brother-in-law, Stan. Stan pays Bob principal and interest each month. Even though Bob does

not receive a Form 1099-INT, he reports that interest on Schedule B of his tax return.



Hazel has four savings accounts in four different banks. The total amount of interest earned from the accounts is \$3,000. Hazel will receive four Forms 1099-INT. She will list each payer and amount on Schedule B and file it with her tax return.



The manner of reporting interest income on Series E, Series EE, or Series I U.S. savings bonds, after the death of the owner (decedent), depends on the accounting and income-reporting methods previously used by the decedent. See Publication 550, Investment Income and Expenses, for additional information.



Interest from U.S. government obligations is not taxable by any state. Refer to the Volunteer Resource Guide, Tab D, Income, for the

entries needed to identify the interest that is not taxable for state purposes.

What interest income is tax-exempt?

Certain types of interest are exempt from federal income tax. However, they may be taxable on the state tax return, and sometimes the reverse is true; the interest may be taxable on the federal return and exempt from state income tax.

Interest from bonds issued by the following are exempt from federal income tax:

- State and political subdivisions (county or city)
- District of Columbia
- U.S. territories and political subdivisions
- 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 tax-exempt dividends

Read the taxpayer's Form(s) 1099-INT carefully; both taxable and tax-exempt interest may be listed. Specific software entries are needed based on the source of the municipal interest income. Consult with your Coordinator if you have any questions.

Municipal mutual funds report the exempt interest as dividends on Form 1099-DIV. This income is interest income and while you may enter the amounts as "exempt interest dividends" in the software, they will appear on the interest income line of Form 1040.

Interest from Private Activity Bonds (PAB) may be shown on the interest statement. It is a subset of tax-exempt interest and may affect the Alternative Minimum Tax.

Taxpayers who are subject to the Alternative Minimum Tax should be referred to a professional tax preparer. Although tax-exempt interest is not taxable, it must be reported on Form 1040. Tax-exempt interest is used in calculating the taxability of some income items, such as Social Security benefits.

What if a bond is sold between interest payment dates?

If a bond is sold between interest payment dates, part of the sales price represents interest accrued to the date of the sale. This amount is taxable to the seller and must be reported as interest income for that tax year, even if the seller does not receive a Form 1099-INT. The buyers of the bond may receive a 1099-INT reflecting the accrued interest and will treat this amount as a return of capital investment, reducing their basis in the bond. Payers and brokers will report the correct amount of interest on the Form 1099-

INT/OID for all covered securities. Taxpayers who sell noncovered bonds between interest payment dates should be referred to a professional tax preparer. If taxpayers would like additional information, refer them to Publication 550, Investment Income and Expenses.



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

What about the interest on an IRA?

Generally, interest on a Roth IRA is not taxable. However, if the criteria for a qualified distribution are not followed, the interest may be taxable.

Interest on a traditional IRA is tax-deferred. Do not include that interest in taxable income until the taxpayer receives distributions from the IRA, which will be reported on Form 1099-R. See the Retirement Income lesson,

Publication 17, and Publication 590-B, Distributions from Individual Retirement Arrangements, for more information on IRA distributions.



Mike makes contributions to a traditional IRA each year. Throughout the year, he gets statements listing the interest earned. Because it is tax-deferred, he does not report any of the interest income from his traditional IRA on his tax return.

How do I report interest income?

Interest income is entered on Form 1040. Amounts labeled Interest income and Interest on U.S. Savings Bonds and Treasury obligations on Form 1099-INT are reported as taxable interest. Be sure to enter any tax-exempt interest as directed in the software.

If the taxpayer receives Form 1099-OID, ensure that all the amounts included on

Forms 1099-INT and 1099OID are entered in the correct places in the software and on Form 1040. These will be discussed in later lessons. For example, amounts shown in the early withdrawal penalty box will appear in the Adjustments section and any federal income tax withheld is shown in the Payments section. Entries shown in the foreign tax paid and foreign country boxes will be discussed in the Foreign Tax Credit lesson.

If taxpayers indicate there are adjustments needed for any of the amounts listed on Form 1099-OID, or if they have income from original issue discount but did not receive a Form 1099-OID, refer them to a professional tax preparer to ensure the correct amount is reported.



Refer to the Volunteer Resource Guide, Tab D, Income, for instructions on entering interest income. The software will file Schedule B if required.

Taxpayer Interview and Tax Law Application

Barbara Smith is a clerk with the United States Postal Service. She has one Form W-2.

Sample Interview

Volunteer Says...	Barbara Responds...
Now we will complete the income section of your return. I believe you told me that you work at the post office?	Yes. Here is my W-2.
Are you employed by anyone else?	No way, they keep me busy enough at the post office!
Did you have any disability income?	No, I'm not disabled.

Now, let's go on to interest income. Did you earn any interest on checking accounts, savings accounts, or a certificate of deposit?	Yes, I have a savings account that earns interest. Here is the 1099INT.
What about U.S. savings bonds? I know that a lot of postal employees buy them at work	Yes, I do, every pay period.
Are they for educational purposes, or just an investment?	No, they aren't educational. I don't have any information about my bonds with me. Why would I need that?
Some people report the interest as it accrues every year.	Oh, no, never.

<p>You have to make this decision in the first year after you buy the bonds. Have you ever declared accrued interest from your savings bonds on your federal tax return?</p>	
<p>Well, did you redeem any bonds, or did any of them mature during this tax year?</p>	<p>No to both questions. I've been buying them for 15 years and they don't become fully mature for 30 years.</p>
<p>Okay, then it sounds like your only interest income is from the savings account.</p>	



How do I handle dividends?

The corporate distributions that volunteer tax preparers may handle are:

- Ordinary dividends
- Section 199A dividends
- Qualified dividends
- Capital gain distributions
- Nondividend distributions

These are all reported on Form 1099-DIV.

What are ordinary dividends?

Ordinary dividends are corporate distributions paid out of the earnings and profits of a corporation. Any dividend received on common or preferred stock is an ordinary dividend unless the paying corporation states otherwise. Ordinary dividends are reported on Form 1099-DIV.



Olivia held both common stock and preferred stock in several U.S. corporations. Several of them paid dividends during the tax year. The following January she received Forms 1099-DIV listing these as ordinary dividends.

What are Section 199A dividends?

A subset of ordinary dividends is called Section 199A dividends, which are eligible for the qualified business income deduction. See the Standard Deduction lesson for this deduction and the Volunteer Resource Guide, Tab D, Income, for software entries.