Basic Certification Test: Study Guide

Scenario 1:

Issue #1: If a dependent **can** be claimed by someone else – they cannot claim their own exemption, even if the other person does not actually claim them.

The tax law states that "Taxpayers who **can be** claimed as a dependent on someone else's return cannot claim any exemption for themselves." Notice it doesn't say **"**who **are** claimed" – it says "who **can be** claimed." (See Publication 4012, page C-1)

Think about the tests to be a qualifying child:

1) Child must be the taxpayer's son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of these.
2) The child must be either under age 19 at the end of the year, and younger than you (or your spouse, if filing jointly), OR under age 24 at the end of the year, a full-time student, and younger than you (or your spouse if filing jointly), OR any age if permanently and totally disabled.
3) The child must have lived with you for more than half of the year (exceptions for temporary absences like college, custody agreements, etc.)
4) The child must not have provided more than half of his or her own support for the year.
5) The child is not filing a joint return for the year (unless that joint return is filed only to claim a refund of income tax withheld or estimated tax paid).

Remember - the tax law states that "Taxpayers who **can be** claimed as a dependent on someone else's return cannot claim any exemption for themselves." Notice it doesn't say **"**who **are** claimed" – it says "who **can be** claimed."

Issue #2: When is a dependent required to file a tax return?

Let's take a look at the filing requirements table in Publication 4012, Page A-2. This is Chart B, for people who can be claimed as a dependent. The rules are pretty straightforward, and depend on age, marital status, and whether or not the person in question is blind. There are three different levels that may mean that someone has to file a tax return. If their unearned income is over a certain level; if earned income was over a certain level; or if total gross income is over a certain level.

Scenario 2:

Issue 1: A taxpayer can use the Head of Household filing status when their qualifying person is a parent who does not live with them.

To be a qualifying person for head of household, a parent must also qualify as the taxpayer's dependent. For a parent to be a dependent, they must pass the qualifying relative tests.

1) Is the person a qualifying child for the taxpayer or anyone else?
2) Was the person your son, daughter, etc, OR brother, sister, etc., OR your father, mother, etc., OR your stepbrother/sister/mother/father, OR your son-in-law, daughter-in-law, etc? (If yes, test #3 can be skipped.)
3) Was the person any other person (other than your spouse) who lived with you all year as a member of your household? (This test does not apply if #2 is answered "Yes.")
4) Did the person have gross income of less than $4,000 in 2015?
5) Did you provide more than half the person's total support for the year?

If the person is, in fact, the taxpayer's dependent, then you can start looking at Head of Household.

The rule that qualifies someone as Head of Household is that the taxpayer paid more than half the cost of keeping up a home for you and for a qualifying person for the year. The first qualifying person test, shown on page B-3 of Publication 4012, is as follows:

1) Is the person a qualifying child, qualifying relative who is a parent, or another qualified relative?

Keeping in mind that we are specifically discussing a parent, the second question is whether or not you can claim their exemption. If yes – the parent is a qualifying person that enables the taxpayer to use Head of Household filing status.

Issue 2: What types of insurance qualify as "minimum essential coverage"?

Take a look at Publication 4012, Page ACA-4. This chart lists all the main types of minimal essential coverage.

Scenario 3:

Issue #1: Someone who qualifies as a taxpayer's dependent cannot, themselves, claim a dependent.

This situation usually shows up when a grandparent, parent, and grandchild all live in the same household, and the parent has very little income. The question becomes – who can the grandparent claim as a dependent, and whose dependent is the grandchild?

The simplest place to start is by determining whether or not the parent qualifies as the grandparent's dependent. If so – the answer is fairly straightforward, according to the very top of the chart, where it reads: "You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer."

If the parent is **not** the grandparent's dependent, then you have to look deeper at the rules for qualifying child. In most cases, the grandchild will be the qualifying child for either the parent or the grandparent, and you'll have to help them figure out who would be better off claiming the grandchild.

Issue 2: When are dependents also qualifying children for the earned income credit?

There are a series of tests one must pass in order to be a qualifying child for the EIC.

1) Does your qualifying child have an SSN that allows him or her to work?
2) Is the child related to you in one of the listed ways?
3) Was the child under age 19 and younger than the taxpayer, or under age 24 and a full-time student?
4) Did the child file a joint return for the year?
5) Did the child live with you in the United States for more than half of the tax year?
6) Is the child a qualifying child of another person?

So, again, look at the rules for the people in question. If looking at a multiple-adult household, like the grandparent/parent/grandchild above, remember that whoever claims the dependency exemption would also claim the other tax benefits for that person – child tax credit, earned income credit, etc. – the benefits cannot be split.

Scenario 4:

Issue #1: Taxpayers who have Individual Taxpayer Identification Numbers (ITINs) qualify for an exemption from Affordable Care Act provisions.

Let's take a look in Publication 4012, at page ACA-6, which lists all the different types of exemptions. The table lists an exemption – coded C - for taxpayers who were not US citizens, and not lawfully present in the United States.

Issue #2: Taxpayers who have Individual Taxpayer Identification Numbers (ITINs) do not qualify for the Earned Income Credit.

There are a lot of rules and tests to see if a taxpayer qualifies for the Earned Income Credit. There's a full summary in Publication 4012, on Page I-2. One of those rules is that the taxpayer, and any qualifying children, must have Social Security numbers. Another rule is that everyone must be a US citizen or resident alien all year.

What if a taxpayer comes back next year, and she went through the process to obtain Social Security Numbers that allows her to work in the US?

We see this sometimes at the sites. When former ITIN holders obtain SSNs, they not only become eligible to claim the EIC – but they can amend the last three years of tax returns to retroactively claim the EIC and any other benefit they may not have received in the past!

Issue #3: Taxpayers who have Individual Taxpayer Identification Numbers (ITINs) qualify to claim dependency exemptions following the same rules as any other taxpayer.

Having an ITIN does not disqualify a taxpayer from claiming dependency exemptions. As long as the person they want to claim passes the tests for Qualifying Child or Qualifying Relative, the exemption can be claimed.

Scenario 5:

Issue 1: When two adults live in the same house, and are both the parents of children living in the house, filing status can get a little tricky!

Often times, in a household with multiple adults and children, the taxpayers will decide to split up the children so that each adult claims one or more children. That's perfectly fine – but what about filing status? In a single household, only one taxpayer can file as head of household, no matter who is claiming which children. The key is to look at who paid more than half of the household's expenses. If neither adult did – or both paid exactly half, then both would be required to file as single. Otherwise – whoever paid more than half of the household expenses would qualify to file as head of households.

Issue 2: When multiple adults live in a household and the kids that live with them are qualifying children for more than one adult, the adults can choose to divide up the children on tax returns in a way that's advantageous for the household. Sometimes you'll have to prepare returns in several different ways to see what results in the best outcome! The only trick is that two different taxpayers cannot claim the same child.

Scenario 6:

Issue 1: Be mindful of the different qualifications for the education credit! Each credit has its own set of rules, and not everyone qualifies for both!

Let's think about the education credits. There's two primary credits, right? There's the American opportunity credit and the lifetime learning credit. (Note: At the time this guide was written, a third potential benefit, the tuition and fees deduction, had expired and was not considered).

There are lots of rules for both credits, but let's think about the basic eligibility. To claim the American opportunity credit, the student must be enrolled at least half time for at least one academic period, and they must be pursuing a program leading to a degree or other recognized credential. For the lifetime learning credit, they only need to take one course, and they don't have to be pursuing a degree or credential.

Issue 2: There are also lots of rules about qualifying expenses – be careful to avoid the pitfalls!

In general, qualifying expenses include tuition and fees paid for the course – regardless of the source of those funds. Even if the tuition was paid with the proceeds from a loan – they're still considered qualifying expenses. For the American opportunity credit **only**, qualified expenses also include the cost of books, supplies and equipment needed for a course of study – regardless of where they're purchased from or if they're absolutely required.

Scenario 7:

Issue 1: Taxpayers who have been the victim of identity theft may be given an Identity Protection Personal Identification Number.

If the IRS is aware of an identity theft issue, they may issue the taxpayer an ID theft PIN. They will have sent the taxpayer a letter with a six-digit PIN that they will need to enter on their tax return.

There is a question on the first page of the IRS Intake Sheet, Form 13614-C that asks if they've been the victim of identity theft. That will be your cue to inquire about a PIN.

Issue 2: Interest income is always taxable, whether or not the bank issues a statement that lists the amount.

Sometimes banks won't bother sending a statement to a taxpayer if they only earned a small amount of interest – usually under $10. Taxpayers often think that means they don't have to report it, but that's not the case. If it was interest received, it's considered taxable income! See Publication 4012, Page D-9 for help on entering interest income in TaxWise.

Issue 3: Social Security retirement income is sometimes taxable income to a taxpayer.

Social Security income can be both nontaxable and taxable income – it depends on the taxpayer's other income and their filing status. The great thing about preparing tax returns in TaxWise is that the software does the calculations for you! Make sure you finish the tax return in its entirety – enter **all** income, complete all worksheets, etc. before answering this question. For tips on entering Social Security income in TaxWise, see Pub 4012, page D-26.

Issue 4: The standard deduction may change if a taxpayer is over the age of 65 or blind.

The IRS gives most taxpayers a standard deduction – a specific amount of income that will not be taxed – based primarily on filing status. However, there are provisions that increase the amount of the standard deduction if the taxpayer is over 65 or considered legally blind. See Pub 4012, Page F-2 for specifics.

Issue 5: Taxpayers have many options for trying to prevent a balance due in the following tax year.

They can choose to make estimated payments, using Form 1040-ES. They can adjust the withholding in their paychecks by revising their Form W-4 with their employer. If they are retired, they can give Form W-4P to their retirement plan administrator. If they are receiving Social Security benefits, they can complete form W-4V to have taxes withheld.

Issue 6: Taxpayers who do not have minimum essential coverage (health insurance), and don't qualify for an exemption, may have to pay a Shared Responsibility Payment for the year.

Unfortunately, taxpayers who do not obtain minimum coverage and don't qualify for one of the many exemptions listed in Pub 4012 on page ACA-6, will have to pay an additional tax called the Shared Responsibility Payment. This is often referred to as the penalty or the fee for not having insurance. Make sure to pay close attention to the ACA worksheets in TaxWise. If a taxpayer has to pay a Shared Responsibility Payment, it will show up on the 1040, Page 2, Line 61.

Scenario 8:

Issue 1: Filing status for a person whose spouse has passed away may not be so straightforward.

A taxpayer whose spouse died during the tax year is likely eligible to file a joint return for one last year. As long as the taxpayer has not remarried by the end of the tax year, they can still choose to file a joint return with their deceased spouse.

Issue 2: A child who is not the taxpayer's dependent may still be their qualifying child for EIC purposes.

The rules for being a qualifying child for Earned Income Credit do not include a support test – the main difference between rules for dependency and rules for EIC. So a child who is not a dependent solely because they provided more than half of their own support may still be considered a qualifying child for the Earned Income Credit.

Remember the tests found on Page I-4. The qualifying child must have an SSN, be related to the taxpayer in one of the ways listed, be under age 19 OR under age 24 and a full-time student OR any age if permanently and totally disabled, not file a joint return, and live with the taxpayer in the US for more than half the year.

Issue 3: Federal tax withholding may come from a variety of sources.

Make sure that you double check all boxes on income statements. Many taxpayers have tax withheld on unemployment, retirement distributions, and even gambling winnings. Make sure

to enter **all** withholding so that it calculates the client's refund or balance due correctly. You can see the total withholding on the 1040, Page 2, Line 64.

Issue 4: The child and dependent care credit may benefit taxpayers with children under 13 if the kids attend child care while the taxpayer works.

If the taxpayer has qualifying children under the age of 13, they may be able to claim a tax credit for the amounts paid to the childcare provider. In order to do so, the taxpayer must have the name, address, and identifying number for the provider, as well as the total amount paid to the provider.

In TaxWise, you'll need to check the "DC" box next to the qualifying child's name on the Main Information Sheet. That will bring up Form 2441 in your Forms tree. You'll enter the provider information in Section 1, and then the amounts paid for each child in Part 2, section A. Make sure you've entered everything else in the tax return before checking to see if the child care credit applied. If it did, the amount of the credit will show on Form 2441, Line 11.

Issue 5: Taxpayers who are without insurance for only a short period of time may qualify for an exemption.

If a taxpayer was without insurance for only two months, they may qualify for what's called a short coverage gap exemption. They can only use the exemption once, so if there was another gap in coverage during the same year, they will have to pay the Shared Responsibility Payment for the other gap unless they qualified for another exemption. Remember, the exemption information shows up on Form 8965. Be careful when completing the forms in TaxWise!

Issue 6: Taxpayers who take early withdrawals from their 401(k) or IRA plans.

If a taxpayer takes an early withdrawal from an IRA or 401(k), it's likely that they will have to pay an additional 10% penalty. That's in addition to the income being taxed at the normal income tax rate.

Generally, the penalty applies if the taxpayer is under age 59 ½ years old at the time of distribution. There are exceptions if distributions are taken for specific reasons, but if no exception applies – the 10% penalty is assessed in the "Other Taxes" section of Form 1040, Page 2. TaxWise will calculate the penalty automatically, but if an exception is warranted, you'll need to complete a separate form in order to take that penalty out of the tax return.

Scenario 9

Issue 1: Taxpayers may choose to itemize their deductions instead of claiming the standard deduction.

Sometimes taxpayers may have enough eligible expenses that they would benefit from itemizing those deductions on Schedule A. In most cases, they will be taxpayers who own their own home and have paid mortgage interest and real estate taxes throughout the year.

Itemized deductions are listed on Schedule A, and each type of deduction has its own line or section on the Schedule A. Qualifying expenses include unreimbursed medical expenses – doctor or hospital bills, eyeglasses, prescription drugs – but not over the counter medications or supplements. Mortgage interest, and any mortgage insurance premiums (note: this is not homeowner's insurance), as well as real estate taxes paid on the principle residence counts. Charitable donations made to registered 501(c)(3) organizations or churches can also be listed. Donations to individuals or political campaigns are not generally deductible.

Certain categories only count if they are over a specific percentage of the taxpayers Adjusted Gross Income. The general rule of thumb is to enter all qualifying expenses and let TaxWise do the math.

Issue 2: Taxpayers with a qualifying child may benefit from filing as Head of Household.

Refer to the decision trees and charts on Pages B-2 and B-3 of the Publication 4012 to help determine if a taxpayer qualifies for this filing status.

Issue 3: Only specific expenses qualify to claim the American opportunity credit.

To compute the American opportunity credit, taxpayers can claim amounts paid for tuition, fees, and course related books (regardless of where they were purchased) – unless the amounts were paid by a scholarship. Look at the 1098-T and the student's account statement from the college carefully to be sure of what expenses qualify. Amounts paid for room and board do not count as qualifying expenses.

Issue 4: Taxpayers who contribute to a retirement account during the tax year may qualify for a Retirement Savings Contribution Credit.

Taxpayers who pay into a 401(k) or IRA may qualify for a tax credit based on the amount contributed. Look at their W-2s carefully and make sure to enter any amounts listed in Box 12 and 14. Typically, retirement contributions show on in Box 12 with code D or G, though other

codes are sometimes utilized. TaxWise will determine basic eligibility for the credit and generate Form 8880 if the taxpayer seems to qualify.

Issue 5: Student loan interest paid is generally deductible as an adjustment to income.

Taxpayers who are repaying student loans may be able to deduct all or some of the interest paid on the loan. They will usually receive a Form 1098-E from the bank or loan originator that lists the amount of interest paid. To enter this type of income, you'll link from Line 33 on Page 1 of the 1040 to the 1040 Worksheet 2. You'll enter the amount paid, and TaxWise will compute the adjustment for you. The deduction is limited to $2500.