TY2017 VITA Advanced Certification Test - Study Guide

Scenario 1: Tabor

Issue #1 – Claiming a **Personal Exemption** (p4012 Tab C)

A personal exemption can only be claimed if no one else **can** claim you as a dependent (whether or not they actually do claim you).

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

Issue #2 – Claiming a **Dependency Exemption** (p4012 Tab C), Education Credits (Tab J)

Consider the tests to be a Qualifying Child:

1) **Relationship** The 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) **Age** The child must be either under age 19 at the end of the year, and younger than you, 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) **Residency** The child must have lived with you for more than half of the year (with exceptions for temporary absences like college, custody agreements, etc.)

4) **Support** The child must not have provided more than half of his or her own support for the year.

5) **Joint Return Test** If the child is filing Married, it must only be to claim withholdings.

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

Check publication 4012 page J-4 and J-5 for charts on Who Can Claim the Credit.

Scenario 2: Hastings

Issue #1: Claiming a D**ependency Exemption (**p4012 page C-3)

This situation often shows up when a grandparent, parent, and grandchild all live in the same household (and the parent has minimal income). Who can the grandparent claim as dependent(s)? Whose dependent is the grandchild?

The best place to start is by determining whether or not the parent qualifies as the grandparent's dependent. If so – the answer is fairly straightforward because dependents can't have dependents. See the very top of the chart on C-3, 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, however, the parent is not the grandparent's dependent, then you have to look deeper at the rules for claiming a qualifying child. In most cases, the grandchild will be the qualifying child for either the parent or the grandparent. If that is the case they can choose who would be better off claiming the grandchild. In the case of a dispute the IRS would apply Tiebreaker rules.

This is a great scenario for understanding that "Qualifying Child" and "Qualifying Relative" are tax terms with definitions that might be different than our usual notions of "Child" and "Relative."

Issue #2: What does it mean to be a **Qualifying Child** for the **Earned Income Credit** (EIC)? (p4012 Tab I)

There are a series of tests for each child to be considered a Qualifying Child for EIC. While these tests are very similar to the tests to be a Qualifying Child for the Dependency Exemption, there's a difference.

The EIC qualifications are on p4012 page I-2, and then Qualifying Children need to pass these tests:

1) **Relationship**. Is the child related to you?

2) **Age**. Was the child under age 19 and younger than the taxpayer, OR under age 24 and a full-time student, OR any age and permanently disabled?

3) **Residency**. Did the child live with you in the United States for >half the year?

The residency requirement is non-negotiable - there are not exceptions for non-custodial parents. Notice that there is no **Support** test for the EIC like there is for a Dependency Exemption. This is because separated parents may split the various benefits for each child, but the custodial parent will always claim the EIC. If the child meets these tests to be the Qualifying Child for more than one person, then those people can choose who claims EIC and the IRS can apply Tiebreaker rules in the case of a dispute.

Issue #3: What is the best **Filing Status**? (p4012 Tab B)

There are five different ways to file. From best to worst Filing Status:

1) Married Filing Jointly (best)
2) Qualifying Widow(er) with Dependent Child (for 2 years after the spouse died)
3) Head of Household
4) Single
5) Married Filing Separately (worst)

Use the flow chart on p4012 page B-8 to determine the best available status. Keep in mind the footnotes there. The chart on B-10 can be helpful.

Scenario 3: Oberlin

Issue #1: **EIC requirements** (p4012 Tab I)

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

> What if an ITIN taxpayer comes back later after obtaining a Social Security Number(s)?
> We see this sometimes. The law used to allow retroactive EIC claims, but in 2015 the PATH Act removed that possibility – now you can only Amend a tax return to claim the EIC if you received the SSN before the due date of that tax return.

Issue #2: Taxpayers with **ITINs**, Dependency Exemptions, and other tax credits (p4012 Tab C)

At no point in the rules for claiming a Dependency Exemption do we see anything about SSNs. Having an ITIN does not disqualify a taxpayer from claiming a dependent. It only affects specific credits, like the EIC and American Opportunity Credit. Child and Dependent Care credits are covered on p4012 page G-5.

> Speaking of ITINs, take a quick look at Publication 4012 page H-14, which lists all the different types of ACA exemptions. The table lists an exemption – code C – for taxpayers who were not US citizens or not lawfully present in the United States. It stands to reason that if you are not allowed to receive Marketplace insurance, you should not be penalized for going without it.

Scenario 4: Huron

Issue #1: **Filing Status** (use the chart on p4012 page B-8)

Issue #2: Each **Education Benefit** has its own set of rules (p4012 Tab J)

There are 2 primary Education Credits: the **American Opportunity** credit and **Lifetime Learning** credit.

> There's another Education Benefit, the Tuition and Fees deduction. It is consistently on the verge of expiring and Congress renews it – however, it is rarely the best option for a VITA client.

Publication 4012 Page J-4 has a chart of rules for both credits. Consider the basic eligibility rules. For the American Opportunity credit a 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 a student only needs to take one course.

Then check p4012 page J-5 for notes on Who Can't Claim the Credit. Married Filing Separately is right at the top of the list. Publication 17 has a section on Education Related Adjustments which explains that MFS is not even allowed to take the Tuition and Fees deduction.

<u>Scenario 5: Rollins</u>

Use the tax software to prepare a tax return for Samantha Rollins.

Issue #1: **Filing Status** (p4012 tab B), claiming Dependency Exemptions (p4012 tab C)

Use the chart on p4012 page B-8 to determine the best possible filing status. Who can Samantha claim? Keep in mind that the **Residency** requirement for dependents includes an exception for temporary absences (vacation, college, incarceration, etc).

> A taxpayer whose spouse died during the tax year can file a Married joint return for that year (as long as the taxpayer hasn't remarried by the end of the year). For the next two years they may be a Qualifying Widow(er) with a Dependent Child if they meet all the tests. After that, they are once again Single or Head of Household depending on their situation. See p4012 page B-8.

Issue #2: A non-dependent may still be the taxpayer's **Qualifying Child** for certain benefits.

Does Howard meet all the tests for any of the benefits listed? Check each requirement separately.

> Remember the tests found on Page I-2. A disabled family member may be considered a Qualifying Child for the taxpayer for EIC, even if the Child supports themselves (as long as they meet all the other EIC tests). **This can be done without claiming the child's exemption.**

Issue #3: The **child and dependent care credit** benefits taxpayers with children under 13 the taxpayer pays for care while working or looking for work (p4012 tab G)

The taxpayer must have the name, address, and identifying number for the provider. This information is entered on form 2441 part 1, along with the amount paid to each provider. In part 2 enter the amount paid for each child. A credit will show on Form 2441 Line 11 based on a sliding income scale, so it is important to check this only after having completed the rest of the tax return.

Issue #4: What are **Qualified Education Expenses**? (p4012 Tab J)

Check the table on p4012 page J-1 for what counts as Qualified Educational Expenses. It is generally sufficient to ask the question, "Were all of the students in this course of study required to pay for X?" Do not include any amounts that were covered by scholarships.

Issue #5: **Self-Employment** (SE)

Complete a Schedule CEZ to calculate Samatha's net business income for translation services. The resulting profits will appear on 1040 line 12, and the SE taxes will appear on the 1040 page 2.

Issue #6: **Other Income** (p4012 page D-53)

Income that is not earned and that does not fit into 1040 lines 7-20 can appear on line 21 as Other income. This includes items like Gambling Winnings, cancelled debts, Alaska PFD, etc.

Issue #7: **Early Withdrawal Penalties** (p4012 page H-2)

Check the chart on p4012 page H-2 to see if Samantha's IRA distribution can avoid the 10% tax. If so, add form 5329 to the tax return and indicate how much of the distribution qualifies for an exception.

<u>Scenario 6: Pike</u>

Issue #1: **Interest and Dividends**

This question often catches new volunteers who did not complete an Interest statement in the tax software for the tax form 1099-Int included in the ABC Investments report. The tax form shows interest income, and a small early withdrawal penalty.

Interest income is very similar to gambling income, in that the full amount of interest must be entered as income (line 8), while any penalties will be accounted for as an adjustment on line 30. If you entered the form into the software it should flow through a Schedule B and deliver these numbers to the 1040 on line 8 and line 30 for you.

Issue #2: **Roth IRA Distributions**

Check p4012 pages D-41 and D-42 for a full list of what 1099-R distribution codes represent.

Issue #3: **Capital Gains**

If you have a printed copy of the test booklet (f6744) make sure that you have the replacement page 92. It indicates a Long-Term Capital Loss Carryover of $450 from TY2016 that will be included in TY2017.

There are many items that will contribute to a correct total of Capital Gains for the Pikes. The ABC Investments reporting statement has three different items. Two of these items are the Short-Term and Long-Term transaction totals from form 1099-B. The proceeds from asset sales minus the cost of the assets will result in a total gain or loss. The third item is from the Dividend section, which includes Capital Gain Distributions. These should have been included when you enter the Dividend information, and they will all flow together to a total on the 1040 line 13.

Issue #4: **Annuities**

Unlike an IRA, where all of the distributions are taxable, an Annuity contains a post-tax investment that is returned tax-free. The amount that is returned tax free per month depends on how much is invested (Employee Contributions), and the age at which the retiree begins taking distributions. If the retirement company does not know the taxable amount and the monthly tax-free amount, then use the tax software to calculate this with the Simplified Method.

Issue #5: **Social Security income** (SSI) (p4012 tab D)

SSI can be nontaxable or partially taxable income – it depends on the other income on the tax return and the filing status. The great thing about preparing tax returns in tax software is that the calculations are done for you. But make sure that you have completed the tax return before you answer the test question – the taxable portion of SSI depends on a worksheet that considers all the various income.

Interested in the taxable SSI worksheet? You can find it at:
https://apps.irs.gov/app/vita/content/globalmedia/social_security_benefits_worksheet_1040i.pdf

Also keep an eye on box 6 of the SSA-1099 Social Security statement. Most seniors don't choose to have withholding taken out of their SSI, but some do and it is important to include it in the software.

Issue #6: **EIC** (p4012 tab I)

Review the rules for claiming the EIC with a Qualifying Child. Does Lucas meet all the tests to be taken for this credit? Keep in mind that these rules are different from the Dependency Exemption rules. Once you have completed the tax return you can check for EIC in the Payments section of the 1040 page 2.

Issue #7: **Withholding**

It is important to keep a close eye on tax forms and include any withholding at both the Federal and State level. These amounts should flow through the tax software to appear together in the Payments section of the 1040 or the appropriate line on the state tax return. Money may have been taken out of places that you might not think of, like gambling winnings, pensions, even SSI (SSA-1099 box 6).

<u>Scenario 7: Drake</u>

Issue #1: **Accuracy**

Austin's interview indicates that his gym businesses (Schedule C) had cash income in addition to the 1099-Misc. We cannot overlook the cash income once we have that information.

Issue #2: **Business Miles** (p4012 Tab F)

Check the chart on p4012 page F-12 to understand what transportation expenses are deductible. As a general rule, the first and last trips of the day are Commuting miles (to the main job and back from home). Other travel during the work day may be considered a business expense.

Include the business miles on Schedule C in order to calculate their value at the standard rate. This rate accounts for gas, insurance, maintenance, depreciation, and so on.

Issue #3: **Business Expenses** (p4012 pages D18-D21)

The rule of thumb when claiming a business expense is to ask whether that expense was **Ordinary** for this type of business activity <u>and</u> **Necessary** for the actual work performed.

Issue #4: **Self Employment Taxes**

Self-Employment taxes (Social Security and Medicare taxes or FICA) are generally 15% of the net profit from the Schedule C. An employee would normally have paid half of that tax as a payroll deduction and the employer would pay the other half. So it stands to reason that a self-employed individual, who is paying all 15%, should be able to avoid Federal taxes on half.

The tax software will calculate the SE taxes using Schedule SE, and place the tax on 1040 line 57. The Schedule SE will also calculate the Adjustment entry to include on 1040 line 27.

Issue #5: **Student Loan Interest** (p4012 page E-8)

After including Austin's 1098-E information in the software, check the entry that appears on line 33. Review the rules in p4012 page E-8 for the maximum yearly benefits.

Issue #6: **Itemized Deductions**

Taxpayers may choose to itemize their deductions instead of claiming the standard deduction. Sometimes taxpayers may have enough eligible expenses to benefit from itemizing those deductions on Schedule A. Taxpayers that do will generally own their own home and have paid mortgage interest and real estate taxes throughout the year.

Itemized deductions are listed on Schedule A. Each type of deduction has its own section on the Schedule A: Medical (what was paid – not what was billed), Taxes paid, Interest paid, Charity, Unreimbursed Job Expenses / Miscellany, Other / Gambling losses, Theft / Casualty. Qualifying medical expenses include unreimbursed medical expenses – doctor or hospital bills, eyeglasses, prescription drugs, etc. – but not optional items like over-the-counter medications or supplements. Mortgage interest and any mortgage insurance premiums count (but not homeowner's insurance). Real estate taxes paid on the principle residence counts. Charitable donations (cash or noncash) made to registered 501(c)(3) organizations can be included, but not donations to individuals or political campaigns.

Issue #7: **Other Credits** (p4012 Tab G-1)

Make sure that the W-2 was entered completely. Box 12 has an entry with code D for Deferred compensation (retirement plan), which should flow into Form 8880. Make sure to answer any questions for Form 8880 to see if Austin qualifies for this credit.

Issue #8: **Balance Due Returns** (p4012 page K-14)

Check p4012 page K-14 for a taxpayer's payment options.

Scenario 8: Wharton

Issue #1: **Split Refunds**

Tax refunds can be split up in a huge variety of ways. Portions of the refund can be sent to up to 3 different bank accounts, to purchase Savings Bonds for the taxpayer(s) or as gifts for others, and a remainder can even be issued as a paper check. Check Publication 4012 page K-3 for examples.

Issue #2: **ITINs** and the **ACA** (p4012 Tab H)

Check the chart on p4012 page H-14 and see if Robert qualifies for exemption C.

Publication 17 is a great resource to have as a reference for tax matters. Find it here:
https://www.irs.gov/pub/irs-pdf/p17.pdf