TY2017 VITA Basic Certification Test - Study Guide

Scenario 1: Albright

Issue #1 – **Minimum Essential Coverage** (MEC) (p4012 Tab H)

See p4012's ACA tab for a list of what counts as MEC

Issue #2 – Penalties for not having MEC

Each month without coverage will result in a penalty, which is called a **Shared Responsibility Payment** (SRP). Many exceptions can be taken to avoid this penalty. Check the list of exceptions on p4012 page H-14 to see if any of them apply here.

Scenario 2: Glendale

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).
To put it simply: Dependents can't have their own dependents.

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.”

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, which indicate that there are many exceptions, such as an exception to the Residency requirements for temporary absences like vacation or college. The chart on B-10 can be helpful.

<u>Scenario 3: Hillsdale</u>

Issue #1: Claiming a D**ependency Exemption**. (Same issue as Scenario 2, see 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. 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 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 the people can choose who claims EIC and the IRS can apply Tiebreaker rules in the case of a dispute.

<u>Scenario 4: Brescia</u>

Issue #1: 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.

Issue #2: **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.

<u>Scenario 5: Crowder/Kent</u>

Issue #1: Adults living together with kids can be tricky! **Who claims the kids?** (p4012 Tab C)

Often times, households with multiple adults and multiple children will decide to split up the children. That may be perfectly fine *if* they meet all the tests: **Relationship**, **Age**, **Residency**, **Support**.

Issue #2: What about **Filing Status**? (p4012 Tab B)

First, use tab C to see who can potentially claim the children as dependents. Then review the chart on n p4012 page B-10 to determine who, if anyone, can be Head of Household. Keep in mind that, for Marsha, these children are not Step-Children because she has never been married to their father.

<u>Scenario 6: Findlay</u>

Issue #1: What counts as **income**? (p4012 Tab D)

The most important thing to keep in mind is that we must prepare correct tax returns. This means including all the items we have knowledge about. Once the client tells us about unreported income, we must establish the nature and amount of the income, then include it (even if there isn't a tax form).

Gambling Income sucks! All winnings must be listed on the 1040 income line 21, while losses are reported on Schedule A (up to the amount of the winnings). Unlike business expenses, which reduce the net business income on line 12, gambling losses cannot reduce the income on line 21 (p4012 page D-53).

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 <u>rarely</u> 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 allowed to take the Student Loan Interest adjustment nor the Tuition and Fees deduction.

<u>Scenario 7: Ferris</u>

Issue #1: **Filing Status** (p4012 tab B)

Issue #2: **Interest income** (p4012 tab D)

Accuracy is required. Once we know about income it must be included, whether a tax form exists or not.

Issue #3: **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 worksheet? You can find it at:
https://apps.irs.gov/app/vita/content/globalmedia/social_security_benefits_worksheet_1040i.pdf

Issue #4: **Standard Deductions** (p4012 Tab F)

The IRS gives most taxpayers a standard deduction – a specific amount of income that will not be taxed – based primarily on filing status. However, taxpayers over 65 and/or legally blind get a bonus. See Publication 4012, page F-2 for details.

Issue #5: **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, retirements, even SSI (SSA-1099 box 6).

Issue #6: **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.

<u>Scenario 8: Sinclair</u>

Issue #1: **Filing Status** and **Head of Household** requirements (p4012 Tab B)

Check the chart on p4012 page B-10 and review the rules for claiming a dependent (p4012 page C-3).

> 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 Ethan meet all the tests for any of the credits listed? Check each credit requirements 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 as a dependent.

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

If you haven't overlooked any withholding entries, you will see the total withholding on the 1040 line64.

Issue #4: 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 #5: **Student Loan Interest** deduction (p4012 Tab J)

This might seem a bit sticky. Keep in mind how Publication 17 defines a Qualified Student Loan:

"This is a loan you took out solely to pay qualified education expenses (defined later) that were: For you, your spouse, or a person who was your dependent (defined in chapter 3) when you took out the loan"

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

Issue #6: **Early Distributions** from retirement accounts (p4012 Tab H)

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 (by 'additional' we mean in addition to normal federal income taxes).

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. See the chart on p4012 page H-2.

If no exception applies – the 10% penalty is assessed in the "Other Taxes" section of Form 1040 page 2. The tax software will calculate the penalty automatically, but if an exception is warranted, you'll need to complete form 5329 in order to take that penalty off of the tax return.

Scenario 9: Reedley/Washington

Issue #1: 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 non-cash) made to registered 501(c)(3) organizations can be included, but not donations to individuals or political campaigns.

Issue #2: **State Tax Refunds**

Income or not? Publication 4012 page D-1 has a footnote (#2) which indicates that state tax refunds are taxable income if the client itemized their deductions for the tax year from which the refund originated.

Issue #3: 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?"

Issue #4: How much **EIC**?

While the tax software will calculate the EIC, many different elements can affect the amount of the credit. It is best to check this total once the tax return is complete, including all the items discussed in the interview (such as Jenna's educator expenses, which should be an Adjustment to her income).

Issue #5: What are **Adjustments** to income?

The idea of Adjustments is that some of the money you receive during the year goes right back out the door. The biggest adjustments are:

- Student Loan interest (for the taxpayer or a dependent, up to $2500 per year)
- IRA Contributions (not ones that are already included on a W-2)
- Moving Expenses (moving over 50 miles for a full-time job)
- Tax Treaties

There are many other adjustments. See p4012 pages E-1 and E-2.

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

Remember how you entered the full amount of gambling income in Scenario 6? Interest income is very similar. 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.