TY2018 VITA Advanced Certification Test - Study Guide

Scenario 1: Smith

Issue #1 – Qualified Education Expenses, Taxable Scholarships (p4012 Tab J)

When a taxpayer has more scholarships than Qualified Educational Expenses, then the excess scholarships may be taxable if they were used to pay non-qualified expenses. ‘Qualified’ in this case means that the expenses were required of all the students in the course of study, so personal items such as travel and rent will never be valid. See page J-1 for the chart of Education Expenses.

Keep in mind that many students receive excess scholarships in one year that are used to pay tuition in the following year. How can you tell how it was spent? A thorough interview is one way. Another is to examine the student’s Account Transcript at the university, which is often attached to Form 1098-T and indicates all the debits and credits on the student’s account.

In some cases it may actually increase an Education Credit to claim the personal use of Pell Grants and other stipends! This is a valid, but complicated option.

For example, consider what would happen if Aiden had spent ALL his scholarships on room & board. In this case, he would claim all his scholarships as income and may owe some Federal tax, but his mother is claiming him as a dependent and would be able to use his Qualified Expenses ($5840) to claim the maximum benefit of the American Opportunity Credit ($2500)!

For more on this topic, see the IRS VITA Alert VTA-2015-04 at https://bit.ly/2R9wYS4

Scenario 2: Yale

Issue #1 – Filing Status (4012 Tab B)

Find the Filing Status Interview Tips on p4012 page B-6. Sean was not married on the last day of the year, so he will file as Single or as Head of Household. Being Head of Household has two requirements: the taxpayer must have kept up a house, and a qualifying person must have lived with him in the house.

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 claim a Qualifying Child as a Dependent, they are slightly different.

The EIC qualifications are on p4012 page I-2, and 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 (there are exceptions for temporary absences for school or incarceration).

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: Non-Refundable Credits (p4012 Tab C, Tab G)**

Generally, claiming a dependent on the tax return will result in a tax benefit. Most Qualifying Children will be eligible for the Child Tax Credit. See the rules in p4012 pages G-13 & G-14.

If the dependent does not meet those rules (e.g., being over age 17 or not having a valid SSN), then they may still qualify for the Credit for Other Dependents. See the rules in p4012 pages G-15 & G-16.

**Scenario 3: Baker**

**Issue #1: Child Tax Credit (CTC) vs. Credit for Other Dependents (COD) (p4012 Tab G)**

Generally, every dependent that you can claim will get you one of two possible credits; the Child Tax Credit for children under age 17 ($2000), or the Credit for Other Dependents for anyone else ($500).

See page G-12 for the full rules for the Child Tax Credit. Under the Tax Cuts and Jobs Act (TCJA), a new requirement was added: The child must have a valid SSN (the taxpayer may have an ITIN).

The Credit for Other Dependents also requires that the dependent lives in the United States, so taxpayers with ITIN dependents in Mexico or Canada will not receive a CTC or COD.

Dependent Care credits have their own rules, and are covered on p4012 page G-5 & G-6.

Keep in mind that the rules for claiming a Dependent (Tab C) do not mention anything about SSNs for the taxpayers the people they are claiming. Having an ITIN does not disqualify a taxpayer from claiming a dependent. Having an ITIN only affects specific credits, like the EIC.

**Speaking of ITINs**, take a quick look at Publication 4012 page H-15, 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, then you should not be penalized for missing it.
Issue #2: **EIC Requirements & ITINs** (p4012 Tab I)

There are a lot of rules and tests for each tax credit. The Earned Income Credit is by far the biggest, and there’s a full summary chart of the requirements at 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 a taxpayer files with an ITIN and returns later, after obtaining a Social Security Number? We see this sometimes. The law used to allow retroactive EIC claims, but in 2015 the PATH Act removed that possibility – now he can only Amend a tax return to claim the EIC if he received the SSN before the due date of that tax return (including extensions).

Scenario 4: Johnson

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

Use the Filing Status Interview Tips on page B-6, keeping in mind that Bill was still married on December 31st, and he cannot be “Considered Unmarried” this year.

What does that mean for Bill’s Education Credit? 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.

There is an old Education Benefit called the Tuition and Fees deduction, which is consistently on the verge of expiring (Congress renews it). However, it is rarely the best option for a VITA client.

**Issue #2: Additional Child Tax Credit** (p4012 Tab G)

The Child Tax Credit (CTC) is a Non-Refundable credit of $2000 for Qualifying Children under age 17 (up from $1000 in previous years). If the taxpayer has less than $2000 in Federal taxes, then the unused portion of the CTC can be claimed as a Refundable credit called the Additional Child Tax Credit.

This maximum amount of Additional CTC is $1400 per child, although in practice many taxpayers are not actually able to claim the full amount due to earned-income requirement. See page G-12.
Scenario 5: Emerson

Issue #1: Filing Status (p4012 tab B), claiming Dependents (p4012 tab C)

Use the interview on p4012 page B-6 to determine the best possible filing status. Who can Fran claim?

A taxpayer whose spouse died during the year can file a Married Joint return that year. For the next 2 years they may file as a Qualifying Widow(er) with a Dependent Child. See p4012 B-6.

Issue #2: A non-dependent may still be the taxpayer’s Qualifying Child for certain benefits (p4012 Tab I)

For any of the benefits listed, see if Howard meets all the tests.

Remember the tests found on Page I-2. Having custody of a Qualifying Child will result in EIC, even if the taxpayer cannot claim the Child as a dependent.

A disabled family member may be a Qualifying Child for EIC, even if that person provides their own support – the EIC does not consider support – as long as they meets all the other tests. This can be done without claiming the child as your dependent.

To do this, input the custodial “child” into the tax software, being careful to indicate that they are a non-dependent, and make sure they are included as a child on Schedule EIC.

Issue #3: Child and Dependent Care credit (p4012 tab G)

This credit benefits taxpayers who pay for babysitting for children under age 13 (or for other dependents that can’t care for themselves) so that the taxpayer can work or look for work.

Include the provider information on form 2441 part 1, along with the amount paid to each. In part 2, enter the amount paid per child. A credit will show on Form 2441 line 11, but it is based on a sliding income scale, so it is important to check this calculation after completing the rest of the tax return.

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

Check the table on p4012 page J-1 (what counts as Qualified Educational Expenses) against the account statement on f6744 page 67. 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 amounts that were covered by scholarships.

Issue #5: Other Income (p4012 page D-49)

Income that is not earned may not fit into 1040 lines 1-5. It fits on Schedule 1 and flows into the 1040 line 6. Schedule 1, Line 21, covers Other Income such as Gambling, Cancelled Debt, Alaska PFD, etc.

Issue #6: Early Withdrawal Penalties (p4012 page H-2)

Check the chart on p4012 page H-4 to see if Fran’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.
Scenario 6: Donnelly

Issue #1: Annuity Distributions, Roth IRA (Tab D)

Matthew has two 1099-R forms, neither of which is a traditional IRA. Check p4012 pages D-41 and D-42 for a full list of what 1099-R distribution codes represent. Matthew’s 1099-R form from Essex Bank shows distribution code Q – a Roth IRA.

The 1099-R from Pine Corporation is described in the interview as a Joint Survivor Annuity that began on April 1st. How would you be able to tell that without the interview? You can see that there is an amount in box 9b, Employee Contributions. Unlike an IRA, where all of the distributions are taxable, an Annuity contains an investment by the employee that is returned tax-free over the course of the retirement. The amount that is returned tax-free per month depends on the amount invested and the duration of the retirement as determined by the age(s) of the retiree(s) when distributions begin. Use the tax software to calculate the monthly tax-free amount with the Simplified Method.

Issue #2: Interest and Dividends (1099-B part 1)

Include all interest and dividend amounts, and do not do calculations in your head. The 1099-B form shows an early withdrawal penalty on the Interest earned, and this amount should be entered.

Interest income is very similar to gambling income, in that the full amount of interest must be entered as income (1040 page 2, line 2b), while any penalties will be accounted for as an adjustment on 1040 Schedule 1 line 30. If you entered the form into the software it should flow through Schedule B and deliver these numbers to the 1040 for you.

What about these other numbers? You’ll find that the Foreign Tax credit has moved to Schedule 2, and an additional form 1116 is not necessary for foreign taxes until they exceed $300 per individual. Non-dividend distributions are not included. The sale of stocks will be handled on Schedule D...

Issue #3: Capital Gains (1099-B part 2)

There are three items that will contribute to a correct total of Capital Gains on the Donnellys’ Sch-D. The 1099-B reporting statement from ABC Investments includes Short-Term proceeds, Long-Term proceeds, and Capital Gains Distributions (from the Dividend section, these are re-invested dividends and should have been included when you entered the Dividend information). The proceeds from asset sales during the year will be netted against their original cost (Basis) to result in a total gain or loss. The sales are separated into two sections, assets held less than one year “Short-Term” and assets held longer than one year “Long-Term.” All gains will flow together to a total on the 1040 Schedule 1 line 13.

Issue #4: ACA Penalty (p4012 page H-15).

Review the exceptions to the SRP (the penalty for being uninsured) and see if the Donnellys qualify.
Issue #5: **Social Security income (SSI) (p4012 tab D)**

SSI can be nontaxable or partially taxable income – it depends on the other income and the filing status. The tax software will do the calculations for you. Complete the tax return before you answer the test question, because the taxable portion of SSI depends on a worksheet that includes all the factors.


**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!

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, 1040 page 2, line 17.

Scenario 7: Drake

Issue #1: **Not Knowingly Preparing False Returns** (Volunteer Standards of Conduct)

Austin’s interview indicates that his business (Schedule C) had cash income in addition to the amounts shown on 1099-Misc and 1099-K. We cannot overlook the cash income once we have that information.

Issue #2: **Business Income and Expenses (p4012 Tab D, p4491 beginning on page 10-8)**

Check the charts in p4012 pages D-13 through D-19 to understand what business expenses are deductible. Most of Austin’s expenses will be shown in his Uber/Lyft app on his phone in a year-end tax statement that totals the various fees, tolls, and commissions that reduced his take-home pay in 2018.

Combining that statement with a thorough interview is essential to capturing all available deductions, as self-employed individuals may have other costs that they don’t remember without prompting (for example, an Uber driver might pay for a monthly subscription to Spotify).

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

Do not include all of the miles on Austin’s car as business miles. As a general rule, the first and last trips of the day are Commuting miles (to the main job and back from home). Everyone has to transport
themselves to work and back (commuting), and also to eat lunch at some point in between – these are not valid business expenses.

Travel during the work day is considered a business expense, even if he is driving between customers. Include the business miles on Schedule C in order to calculate their value at the standard rate. This rate accounts for gas, insurance, repairs, maintenance, depreciation, and so on.

Car washes are no longer “standard maintenance,” because services like Uber require drivers to pay for them weekly. Austin wouldn’t buy all those car washes and air fresheners if he wasn’t operating a taxi. Still, he may want to play it safe and take a percentage based on his personal use versus business use.

Issue #3: 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 7.5% tax as a payroll deduction, and the employer would pay the other 7.5%. So it stands to reason that a self-employed individual, who is paying all 15%, does not have to include the 7.5% employer half in his Federal taxable income.

How do the SE taxes appear on the 1040? In several ways; first, the software will use the Schedule C profits to calculate FICA taxes using Schedule SE and place this SE tax in Schedule 3 “Other Taxes”; this SE tax will flow out to Schedule 4, line 57, and then to the 1040 page2 line 14; meanwhile, to include the income Adjustment based on the employer half, an amount equal to half the SE tax will appear in the Adjustment section at 1040 Schedule 1, line 27, and this reduces the taxpayer’s AGI.

Issue #4: Self-Employed Health Insurance Deduction (4012 Tab E)

See page E-4 for information on entering the correct amount onto the 1040 Schedule 1 line 29.

Issue #5: Balance Due Returns (p4012 Tab K)

Check p4012 pages K-14 through K-16 for a taxpayer’s payment options.

Issue #6: Qualified Business Income Deduction (p4012 page F-11)

Under the TCJA, Austin will be able to reduce his federal taxable income with the Qualified Business Income Deduction. This is equal to 20% of his net profits from his business, or 20% of his taxable income, whichever is LESS. Check the QBI Worksheet for details, and see the amount flowing into the 1040 line 9. This does not change his Schedule C or his Schedule SE calculations, it is only a 1040 income Adjustment.
Scenario 8: Wilson

**ALERT! The IRS has released this update to Scenario 8, page 87:**

Changed from: Roberta claimed EIC for Jacob 2 years ago
Changed to: Roberta claimed EIC for Jacob on her 2015 tax return

Changed from: Roberta had wage income of $45,000 in 2018.
Changed to: Roberta had wage income of $35,000 in 2018.

Issue #1: **Itemized Deductions** (p4012 Tab F)

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

Roberta’s standard deduction depends on her filing status. Sometimes taxpayers may have enough eligible expenses to benefit from itemizing those deductions on Schedule A, but most VITA clients will not. 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 (beginning in TY2018 there is a cap of $10,000 on this category), Mortgage Interest Paid, Charity, Other / Gambling losses. Begin with the interview on page F-3.

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 #2: **Filing for EIC After Disallowance** (p4012 Tab I)

Check 4012 page I-6 for the requirements to claim the EIC when it has been disallowed previously.