Advanced Certification Test: Study Guide

Scenario 1: Bill Flagler

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: Julia Hillsdale

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.

Make sure, if the child(ren) qualifies, that you check the EIC box next to the child on the Main Information Sheet in TaxWise, and complete the required questions on the Sch EIC Wkt.

Issue 3: If a dependent does not have minimum essential coverage, the taxpayer must pay the shared responsibility payment on their behalf.

See Publication 4012, Page ACA-14. The taxpayer is responsible for reporting coverage, the exemption, or making the shared responsibility payment for everyone in the tax household.

Scenario 3: George and Maria Newton

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!

Scenario 4: **Chad Forsyth**

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 5: Matthew Clark

Issue 1: Taxpayers who buy health insurance through the Marketplace receive a Form 1095-A that must be entered as part of the tax return.

Taxpayers who buy insurance online through www.healthcare.gov may also receive assistance with paying their monthly premiums. Because of that, the information from the Form 1095-A must be entered as part of the tax return, on Form 8962. Form 8962 calculates the amount of the Premium Tax Credit, and reconciles that with any amounts received in advance to help pay for insurance. Some taxpayers may be eligible to receive some additional Premium Tax Credit, while others, particularly if they underestimated their income or if any other situations changed, may need to repay some of the Advanced Premium Tax Credit they received throughout the year.

In TaxWise, you'll want to choose the box on the ACA worksheet that indicates the taxpayer purchased insurance through the Marketplace, as well as complete the necessary information about months of coverage.   You'll then need to complete Form 8962 by answering the questions that are flagged in red, and entering all of the information from the Form 1095-A. Be sure to enter every box so that the Premium Tax Credit computes correctly. For more information, see Publication 4012, Pages ACA 15-16.

Issue 2: Sometimes the taxpayer has to repay some of the Premium Tax Credit received in advance.

If a taxpayer purchases insurance through the Marketplace, they may receive the Advanced Premium Tax Credit – PTC paid in advance to help cover the cost of insurance throughout the year. It's important for taxpayers to inform the Marketplace of any changes to their situation – income, members of the household, marital status, etc – because those chances will affect the amount of credit they qualify for. If they don't, they may end up having to repay

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Be careful when dealing with 1098-Ts. Sometimes they list charges that have been billed, but not yet paid! An example would be spring semester tuition that's billed in December. Those expenses don't qualify until they're actually paid. Look carefully at the student's statement of account to see what was actually paid and to where.

Issue 4: In most cases, cancelled consumer debt is considered income to the taxpayer.

Sometimes you'll see a taxpayer with a 1099-C for cancellation of debt. Usually, this is for a credit card or some other type of consumer debt that the taxpayer no longer has to repay. In most cases, the taxpayer could have repaid the debt, but was able to work out a settlement option with the credit card company. In cases where a taxpayer is truly unable to repay the debt, the taxpayer may be considered *insolvent* and the debt does not have to be reported. Insolvency is complicated, however, and does not apply in most cases.

Cancelled debt is entered on the tax return on Line 21, Other Income. You'll link from the field to Worksheet 7 and enter the income there.

Issue 5: Some early distributions from retirement accounts qualify for an exception to the 10% penalty.

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.

Exceptions include distributions taken to pay for educational expenses, distributions due to permanent and total disability or death, distributions made to unemployed individuals to pay for health insurance, and distributions to help with down payment on a first home, among others.

In TaxWise, you'll need to complete the top of Form 5329 in order to claim the exception. When you enter the Form 1099-R, you'll see a small box that says "Check to Force Form 5329." Check that box, or add the 5329 using the "Add Form" feature. At the top of the form, on line 2

– you'll enter the amount of distribution that's subject to the exception, as well as a numerical code that corresponds to that exception. You can search TaxWise help for the list of exception codes.

Scenario 6: Kelly Floyd

Issue 1: 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 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.

Make sure, if the child(ren) qualifies, that you check the EIC box next to the child on the Main Information Sheet in TaxWise, and complete the required questions on the Sch EIC Wkt.

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 may incur a penalty for doing so.

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 7:

Issue 1: Sometimes not all interest is taxable.

Be careful when entering interest information on the Interest worksheet. Box 1 and 3 get entered in the first column. However – interest from US Savings bonds and Treasury obligations are exempt from state taxes. To indicate that, you must enter a "-" and the amount in the State Adjust column. If interest is listed as fully tax-exempt, in box 8 of the 1099-INT, then you enter that amount only in the NAEOB amount column with an "E" in the letter column that precedes it. You should also pay close attention for any early withdrawal penalties in Box 2, which must be entered in the Early Penalty column.

Issue 2: When taxpayers roll over an IRA, they receive a tax statement, but the amount is usually not taxable.

If a taxpayer rolls over an IRA, the transaction must still be reported to the IRS. However, the code on the 1099-R indicates the rollover and exempts the amount from tax. Be careful when entering 1099-Rs and enter the appropriate code.

Issue 3: There are several pieces of information that feed into the total Capital Gains or Losses reported on the tax return.

First, taxpayers must report sales of stock, whether they had a gain or a loss on the transaction. They will receive a Form 1099-B, Proceeds from Broker and Barter Exchange Transactions. Most current statements list both the sales price and the cost basis. The best place to enter this information is on the Capital Gain or Loss Transactions Worksheets. This information will transfer to the Form 8949, Schedule D and back to the 1040. For more information, see Publication 4012, page D-16.

Second, some dividend information transfers to the Schedule D. Be careful when entering information from the 1099-DIV. Total ordinary dividends, qualified dividends, and total capital gain distributions are all taxed at different rates – be sure to enter each amount in the right column on the Dividend Worksheet. Sometimes there will be an amount listed as "Foreign Tax Paid". Generally, if the amount is under $300, only from interest or dividends, and were reported on a statement like a 1099, you can enter the amount of foreign tax paid directly on Line 48 of the 1040, on Page 2.

Third, some taxpayers will have what's called a capital loss carryover. If they sold stock the year before, but did not take the full loss on the tax return, they may have something to enter on this year's tax return. To enter a capital loss carryover, enter the amount on Schedule D, line 6 or 14. See Publication 4012, Page D-19 for more information.

Issue 4: Sometimes not all of a taxpayer's retirement distribution is taxable.

Taxpayers who receive a Form 1099-R for retirement distributions, who are taking normal distributions after retirement age, may have some of that income excluded from the tax return.

If the 1099-R does not have a figure in Box 2, Taxable Amount, or the "Taxable Amount not determined" box in 2B is checked, then you likely will need to complete the Simplified Method worksheet at the bottom of the TaxWise screen.

For full instructions on completing the Simplified Method Worksheet, see Publication 4012, Page D-24.

Issue 5: 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 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.

Issue 7: Taxpayers may qualify for the Earned Income Credit.

To ensure whether or not a taxpayer is eligible for the Earned Income Credit, be sure that all forms of income have been entered on the tax return. If there are qualifying children, be sure to check the EIC box on the Main Information Sheet. If, after entering income, the taxpayer qualifies, TaxWise will bring up the Sch EIC Wkt – a worksheet with questions to answer about the qualifying child(ren) and/or taxpayer that will confirm qualification.

Scenario 8: Enrique Clayton

Issue 1: Cash income is always reported on the tax return, regardless of whether there are written records or statements.

Income is income. Income received in exchange for services provided is considered self-employment income and reported on either Schedule C-EZ or Schedule C. In TaxWise, the income is reported in Part 1, Line 1. If someone receives both cash inform and a 1099-MISC, you can link from the line to the 1099 and to a scratch pad to enter the cash income.

Issue 2: Mileage can be claimed for some business travel.

In general, mileage can be claimed only between jobs. Mileage from home to a first job site, and from the last job site to home is considered commuting. Mileage is entered on the Schedule C, Page 2, and the box under line A must be checked in order to carry the expense amount to the Schedule C.

Issue 3: Business expenses can be tricky!

In general, the IRS expects to see business expenses that are reasonable and ordinary for the type of business. Things like advertising, insurance, licenses, travel, and supplies – can all easily be connected to the business. Something like haircuts are much harder to justify – is the haircut specific to the type of work? Required? Anything that is generally more of a personal expense – grooming products, vitamins, etc. are generally not deductible.

Issue 4: Self-employment tax is partially deductible on the tax return.

Self-employment tax is, essentially, the Social Security and Medicare taxes due on the income. For someone who works for an employer, the employer withholds these taxes. For someone who is self-employed, this is reconciled on the tax return. The total tax appears as an “other tax” on Page 2 of the 1040.

Since the taxpayer is paying the additional, normally employer-paid Social Security and Medicare tax, one-half of the total tax is deducted on Page 1 of the Form 1040.

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.

Issue 6: 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 7: 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 8: Taxpayers who can't pay their full balance due have options.

Taxpayers can pay using a credit card. They can also contact the IRS for a 120-day agreement to pay the full balance. If they need more time, they can also submit a Form 9465, Installment Agreement Request.