

# Part Six.

## Figuring Your Taxes and Credits

The eight chapters in this part explain how to figure your tax and how to figure the tax of certain children who have more than \$1,700 of investment income. They also discuss tax credits that, unlike deductions are subtracted directly from your tax and reduce your tax, dollar for dollar. Chapter 36 discusses the earned income credit and how you may be able to get part of the credit paid to you in advance throughout the year.

### 30.

## How To Figure Your Tax

### Introduction

After you have figured your income and deductions as explained in *Parts One through Five*, your next step is to figure your tax. This chapter discusses:

- The general steps you take to figure your tax,
- An additional tax you may have to pay called the alternative minimum tax, and
- The conditions you must meet if you want the IRS to figure your tax.

### Figuring Your Tax

Your income tax is based on your taxable income. After you figure your income tax and any alternative minimum tax, subtract your tax credits and add any other taxes you may owe. The result is your total tax. Compare your total tax with your total payments to determine whether you are entitled to a refund or owe additional tax.

This section provides a general outline of how to figure your tax. You can find step-by-step directions in the instructions for Forms 1040EZ, 1040A, and 1040. If you are unsure of which tax form you should file, see *Which Form Should I Use?* in chapter 1.

**Tax.** Most taxpayers use either the Tax Table or the Tax Computation Worksheet to figure their income tax. However, there are special methods if your income includes any of the following items.

- A net capital gain. (See chapter 16.)
- Qualified dividends taxed at the same rates as a net capital gain. (See chapters 8 and 16.)
- Lump-sum distributions. (See chapter 10.)
- Farming or fishing income. (See Schedule J (Form 1040), Income Averaging for Farmers and Fishermen.)
- Investment income over \$1,700 for children under age 18. (See chapter 31.)

- Foreign earned income exclusion or the housing exclusion. (See Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.)

**Credits.** After you figure your income tax and any alternative minimum tax (discussed later), determine your tax credits. This chapter does not explain whether you are eligible for these credits. You can find that information in chapters 32 through 37 and your form instructions. See the following table for credits you may be able to subtract from your income tax.

CREDITS	
For information on:	See chapter:
Adoption . . . . .	37
Alternative motor vehicle . . . . .	37
Alternative fuel vehicle refueling property . . . . .	37
Child and dependent care . . . . .	32
Child tax credit . . . . .	34
Clean renewable energy bond . . . . .	37
Education . . . . .	35
Elderly or disabled . . . . .	33
Foreign tax . . . . .	37
Gulf tax credit bonds . . . . .	37
Mortgage interest . . . . .	37
Prior year minimum tax . . . . .	37
Qualified electric vehicle . . . . .	37
Qualified retirement savings contributions . . . . .	37
Residential energy improvements . . . . .	37

Some credits (such as the earned income credit) are not listed above because they are treated as payments. See *Payments*, later.

There are other credits that are not discussed in this publication. These include the following items.

- General business credit, which is made up of several separate business-related credits. These generally are reported on Form 3800, General Business Credit, and are discussed in chapter 4 of Publication 334, Tax Guide for Small Business.
- Empowerment zone and renewal community employment credit, which is for certain employers who are engaged in a business in an empowerment zone or a renewal community. See Publication 954, Tax Incentives for Distressed Communities. Also see the instructions for Form 8844, Empowerment Zone and Renewal Community Employment Credit.
- Credit for alcohol used as fuel. See Form 6478.
- Renewable electricity, refined coal, and Indian coal production credit for electricity

and refined coal produced at facilities placed in service after October 22, 2004, and Indian coal produced at facilities placed in service after August 8, 2005. See Form 8835, Section B.

**Other taxes.** After you subtract your tax credits, determine whether there are any other taxes you must pay. This chapter does not explain these other taxes. You can find that information in other chapters of this publication and your form instructions. See the following table for other taxes you may need to add to your income tax.

OTHER TAXES	
For information on:	See chapter:
Additional taxes on qualified retirement plans and IRAs . . . . .	10, 17
Advance earned income credit payments . . . . .	36
Household employment taxes . . . . .	32
Recapture of an education credit . . . . .	35
Social security and Medicare tax on unreported tips . . . . .	6
Uncollected social security and Medicare tax on tips . . . . .	6

Another tax you may have to pay, the alternative minimum tax, is discussed later in this chapter.

There are other taxes that are not discussed in this publication. These include the following items.

1. **Self-employment tax.** You must figure this tax if either of the following applies to you (or your spouse if you file a joint return).
  - a. Your net earnings from self-employment from other than church employee income were \$400 or more. The term "net earnings from self-employment" may include certain nonemployee compensation and other amounts reported to you on Form 1099-MISC, Miscellaneous Income. If you received a Form 1099-MISC, see the *Instructions for Recipients* on the back. Also see the instructions for Schedule SE (Form 1040), Self-Employment Tax; and Publication 334, Tax Guide for Small Business.
  - b. You had church employee income of \$108.28 or more.
2. **Recapture taxes.** You may have to pay these taxes if you previously claimed an investment credit, a low-income housing credit, a mortgage interest credit, a new markets credit, a qualified electric vehicle

credit, a credit for employer-provided child care facilities, or an Indian employment credit. For more information, see the instructions for Form 1040, line 63.

3. **Section 72(m)(5) excess benefits tax.** If you are (or were) a 5% owner of a business and you received a distribution that exceeds the benefits provided for you under the qualified pension or annuity plan formula, you may have to pay this additional tax. See *Tax on Excess Benefits* in chapter 4 of Publication 560, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*.
4. **Uncollected social security and Medicare tax on group-term life insurance.** If your former employer provides you with more than \$50,000 of group-term life insurance coverage, you must pay the employee part of social security and Medicare taxes on those premiums. The amount should be shown in box 12 of your Form W-2 with codes M and N.
5. **Tax on golden parachute payments.** This tax applies if you received an "excess parachute payment" (EPP) due to a change in a corporation's ownership or control. See the instructions for Form 1040, line 63.
6. **Tax on accumulation distribution of trusts.** This applies if you are the beneficiary of a trust that accumulated its income instead of distributing it currently. See the instructions for Form 4970, *Tax on Accumulation Distribution of Trusts*.
7. **Additional tax on HSAs or MSAs.** If amounts contributed to, or distributed from, your health savings account or medical savings account do not meet the rules for these accounts, you may have to pay additional taxes. See Publication 969, *Health Savings Accounts and Other Tax-Favored Health Plans*; Form 8853, *Archer MSAs and Long-Term Care Insurance Contracts*; Form 8889, *Health Savings Accounts (HSAs)*; and Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*.
8. **Additional tax on Coverdell ESAs.** This applies if amounts contributed to, or distributed from, your Coverdell ESA do not meet the rules for these accounts. See Publication 970, *Tax Benefits for Education*, and Form 5329.
9. **Additional tax on qualified tuition programs.** This applies to amounts distributed from qualified tuition programs that do not meet the rules for these accounts. See Publication 970 and Form 5329.
10. **Tax on insider stock compensation from an expatriated corporation.** You may owe a 15% excise tax on the value of nonstatutory stock options and certain other stock-based compensation held by you or a member of your family from an expatriated corporation or its expanded affiliated group in which you were an officer, director, or more-than-10% owner. For more information, see the instructions for Form 1040, line 63.
11. **Additional tax on income you received from a nonqualified deferred compensation plan that fails to meet certain requirements.** This income should be shown in Form W-2, box 12, with code Z, or in Form

1099-MISC, box 15b. For more information, see the instructions for Form 1040, line 63.

12. **Interest on the tax due on installment income from the sale of certain residential lots and timeshares.** For more information, see the instructions for Form 1040, line 63.
13. **Interest on the deferred tax on gain from certain installment sales with a sales price over \$150,000.** For more information, see the instructions for Form 1040, line 63.

**Payments.** After you determine your total tax, figure the total payments you have already made for the year. Include credits that are treated as payments. This chapter does not explain these payments and credits. You can find that information in other chapters of this publication and your form instructions. See the following table for amounts you can include in your total payments.

#### PAYMENTS

For information on:	See chapter:
Child tax credit (additional) . . . . .	34
Credit for federal telephone excise tax paid . . . . .	37
Earned income credit . . . . .	36
Estimated tax paid . . . . .	4
Excess social security and RRTA tax withheld . . . . .	37
Federal income tax withheld . . . . .	4
Health coverage tax credit . . . . .	37
Regulated investment company credit . . . . .	37
Tax paid with extension . . . . .	1

Another credit that is treated as a payment is the credit for federal excise tax paid on fuels. This credit is for persons who have a nontaxable use of certain fuels, such as diesel fuel and kerosene. It is claimed on Form 1040, line 70. See Form 4136, *Credit for Federal Tax Paid on Fuels*.

**Refund or balance due.** To determine whether you are entitled to a refund or owe additional tax, compare your total payments with your total tax. If you are entitled to a refund, see your form instructions for information on having it directly deposited into one or more of your accounts instead of receiving a paper check.

## Alternative Minimum Tax

This section briefly discusses an additional tax you may have to pay.

The tax law gives special treatment to some kinds of income and allows special deductions and credits for some kinds of expenses. Taxpayers who benefit from the law in these ways may have to pay at least a minimum amount of tax through an additional tax. This additional tax is called the alternative minimum tax (AMT).

You may have to pay the alternative minimum tax if your taxable income for regular tax purposes, combined with certain adjustments and tax preference items, is more than:

- \$62,550 if your filing status is married filing a joint return (or qualifying widow(er) with dependent child),

- \$42,500 if your filing status is single or head of household, or
- \$31,275 if your filing status is married filing a separate return.

#### Adjustments and tax preference items.

The more common adjustments and tax preference items include:

- Addition of personal exemptions,
- Addition of the standard deduction (if claimed),
- Addition of itemized deductions claimed for state and local taxes, certain interest, most miscellaneous deductions, and part of medical expenses,
- Subtraction of any refund of state and local taxes included in gross income,
- Changes to accelerated depreciation of certain property,
- Difference between gain or loss on the sale of property reported for regular tax purposes and AMT purposes,
- Addition of certain income from incentive stock options,
- Change in certain passive activity loss deductions,
- Addition of certain depletion that is more than the adjusted basis of the property,
- Addition of part of the deduction for certain intangible drilling costs, and
- Addition of tax-exempt interest on certain private activity bonds.

**More information.** For more information about the alternative minimum tax, see the instructions for Form 1040, line 45, and Form 6251, *Alternative Minimum Tax—Individuals*.

## Tax Figured by IRS

If you file by April 16, 2007, (April 17, 2007, if you live in Maine, Maryland, Massachusetts, New Hampshire, New York, Vermont, or the District of Columbia), you can have the IRS figure your tax for you on Form 1040EZ, Form 1040A, or Form 1040.

If the IRS figures your tax and you paid too much, you will receive a refund. If you did not pay enough, you will receive a bill for the balance. To avoid interest or the penalty for late payment, you must pay the bill within 30 days of the date of the bill or by the due date for your return, whichever is later.

**When the IRS cannot figure your tax.** The IRS cannot figure your tax for you if any of the following apply.

1. You want your refund directly deposited into your accounts.
2. You want any part of your refund applied to your 2007 estimated tax.
3. You had income for the year from sources other than wages, salaries, tips, interest, dividends, taxable social security benefits, unemployment compensation, IRA distributions, pensions, and annuities.
4. Your taxable income is \$100,000 or more.
5. You itemize deductions.
6. You file any of the following forms.

- a. Form 2555, Foreign Earned Income.
- b. Form 2555-EZ, Foreign Earned Income Exclusion.
- c. Form 4137, Social Security and Medicare Tax on Unreported Tip Income.
- d. Form 4970, Tax on Accumulation Distribution of Trusts.
- e. Form 4972, Tax on Lump-Sum Distributions.
- f. Form 6198, At-Risk Limitations.
- g. Form 6251, Alternative Minimum Tax—Individuals.
- h. Form 8606, Nondeductible IRAs.
- i. Form 8615, Tax for Children Under Age 18 With Investment Income of More Than \$1,700.
- j. Form 8814, Parents' Election To Report Child's Interest and Dividends.
- k. Form 8839, Qualified Adoption Expenses.
- l. Form 8853, Archer MSAs and Long-Term Care Insurance Contracts.
- m. Form 8889, Health Savings Accounts (HSAs).
- n. Form 8915, Qualified Hurricane Retirement Plan Distributions and Repayments.

## Filing the Return

After you complete the line entries for the tax form you are filing, as discussed next, attach the peel-off label. If you do not have a peel-off label, fill in your name and address. Enter your social security number in the space provided. If you are married, enter the social security numbers of you and your spouse even if you file separately. Complete the "Third Party Designee" area of the return if you would like another person to discuss your return with the IRS. Sign and date your return and enter your occupation(s). If you are filing a joint return, both you and your spouse must sign it. Enter your daytime phone number in the space provided.

Attach a copy of each of your Forms W-2 to your return. Also attach any Form 1099-R you received that has withholding tax in box 4.

Mail your return to the Internal Revenue Service Center for the area where you live. A list of Service Center addresses is shown near the end of this publication.

### Form 1040EZ Line Entries

Read lines 1 through 9 and fill in the lines that apply to you. Do not complete lines 10 through 13. If you are filing a joint return, use the space to the left of line 6 to separately show your taxable income and your spouse's taxable income.

**Earned income credit.** If you can take this credit, as discussed in chapter 36, the IRS can figure it for you. Enter "EIC" in the space to the left of line 8a. Enter the nontaxable combat pay you elect to include in earned income on line 8b.

If your credit for any year after 1996 was reduced or disallowed by the IRS, you may also have to file Form 8862, Information To Claim Earned Income Credit After Disallowance, with

your return. For details, see the Form 1040EZ instructions.

**Credit for federal telephone excise tax paid.** If you can take this credit, as discussed in chapter 37, enter the amount of the credit on line 9. The IRS will not figure this credit.

### Form 1040A Line Entries

Read lines 1 through 27 and fill in the lines that apply to you. If you are filing a joint return, use the space to the left of line 27 to separately show your taxable income and your spouse's taxable income. Do not complete line 28. Complete lines 29 through 33, 36, and 38 through 42 if they apply to you. Do not fill in lines 30 and 40a if you want the IRS to figure the credits shown on those lines. Also, enter any write-in information that applies to you in the space to the left of line 43. Do not complete lines 34, 35, 37, and 43 through 48.

**Credit for child and dependent care expenses.** If you can take this credit, as discussed in chapter 32, complete Schedule 2 (Form 1040A), Child and Dependent Care Expenses for Form 1040A Filers, and attach it to your return. Enter the amount of the credit on line 29. The IRS will not figure this credit.

**Credit for the elderly or the disabled.** If you can take this credit, as discussed in chapter 33, attach Schedule 3 (Form 1040A), Credit for the Elderly or the Disabled for Form 1040A Filers. Enter "CFE" next to line 30. The IRS will figure this credit for you. On Schedule 3, check the box in Part I for your filing status and age. Complete Part II and Part III, lines 11 and 13, if they apply.

**Earned income credit.** If you can take this credit, as discussed in chapter 36, the IRS will figure it for you. Enter "EIC" to the left of the entry space for line 40a. Enter the nontaxable combat pay you elect to include in earned income on line 40b. If you have a qualifying child, you must fill in Schedule EIC, Earned Income Credit, and attach it to your return.

If your credit for any year after 1996 was reduced or disallowed by the IRS, you may also have to file Form 8862, Information To Claim Earned Income Credit After Disallowance, with your return. For details, see the Form 1040A instructions.

**Credit for federal telephone excise tax paid.** If you can take this credit, as discussed in chapter 37, enter the amount of the credit on line 42. The IRS will not figure this credit.

### Form 1040 Line Entries

Read lines 1 through 43 and fill in the lines that apply to you. Do not complete line 44.

If you are filing a joint return, use the space under the words "Adjusted Gross Income" on the front of your return to separately show your taxable income and your spouse's taxable income.

Read lines 45 through 71. Fill in the lines that apply to you, but do not fill in lines 56, 63, and 72. Also, do not complete line 57 and lines 73 through 77. Do not fill in lines 49 and 66a if you want the IRS to figure the credits shown on those lines.

Fill in any forms or schedules asked for on the lines you completed, and attach them to your return.

**Credit for child and dependent care expenses.** If you can take this credit, as discussed in chapter 32, complete Form 2441, Child and Dependent Care Expenses, and attach it to your return. Enter the amount of the credit on line 48. The IRS will not figure this credit.

**Credit for the elderly or the disabled.** If you can take this credit, as discussed in chapter 33, attach Schedule R, Credit for the Elderly or the Disabled. Enter "CFE" on the dotted line next to Form 1040, line 49. The IRS will figure the credit for you. On Schedule R check the box in Part I for your filing status and age. Complete Part II and Part III, lines 11 and 13, if they apply.

**Earned income credit.** If you can take this credit, as discussed in chapter 36, the IRS will figure it for you. Enter "EIC" on the dotted line next to Form 1040, line 66a. Enter the nontaxable combat pay you elect to include in earned income on line 66b. If you have a qualifying child, you must fill in Schedule EIC and attach it to your return.

If your credit for any year after 1996 was reduced or disallowed by the IRS, you may also have to file Form 8862, Information To Claim Earned Income Credit After Disallowance, with your return. For details, see the Form 1040 instructions.

**Credit for federal telephone excise tax paid.** If you can take this credit, as discussed in chapter 37, enter the amount of the credit on line 71. The IRS will not figure this credit.

## 31.

# Tax on Investment Income of Certain Minor Children

## What's New

**Investment income of child under age 18.** A child's investment income may be subject to tax at the parent's tax rate if the child is under age 18 (previously under age 14) at the end of the year. The amount of taxable investment income the child can have without it being subject to tax at the parent's rate has increased to \$1,700 (previously \$1,600).

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## Introduction

This chapter discusses the following two rules that may affect the tax on certain investment income of a child under age 18.

1. If the child's interest and dividend income (including capital gain distributions) total less than \$8,500, the child's parent may be able to choose to include that income on the parent's return rather than file a return for the child. (See *Parent's Election To Report Child's Interest and Dividends*, later.)
2. If the child's interest, dividends, and other investment income total more than \$1,700, part of that income may be taxed at the parent's tax rate instead of the child's tax rate. (See *Tax for Children Under Age 18 Who Have Investment Income of More Than \$1,700*, later.)

For these rules, the term "child" includes a legally adopted child and a stepchild. These rules apply whether or not the child is a dependent.

These rules do not apply if:

- The child is not required to file a tax return,
- Neither of the child's parents were living at the end of the tax year, or
- The child files a joint return for the year.

## Useful Items

You may want to see:

### Publication

- 929** Tax Rules for Children and Dependents

### Form (and Instructions)

- 8615** Tax for Children Under Age 18 With Investment Income of More Than \$1,700
- 8814** Parents' Election To Report Child's Interest and Dividends

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## Which Parent's Return To Use

If a child's parents are married to each other and file a joint return, use the joint return to figure the tax on the investment income of a child under age 18. The tax rate and other return information from that return are used to figure the child's tax as explained later under *Tax for Children Under Age 18 Who Have Investment Income of More Than \$1,700*.

## Parents Who Do Not File a Joint Return

For parents who do not file a joint return, the following discussions explain which parent's tax return must be used to figure the tax.

Only the parent whose tax return is used can make the election described under *Parent's Election To Report Child's Interest and Dividends*.

**Parents are married.** If the child's parents file separate returns, use the return of the parent with the greater taxable income.

**Parents not living together.** If the child's parents are married to each other but not living together, and the parent with whom the child lives (the custodial parent) is considered unmarried, use the return of the custodial parent. If the custodial parent is not considered unmarried, use the return of the parent with the greater taxable income.

For an explanation of when a married person living apart from his or her spouse is considered unmarried, see *Head of Household* in chapter 2.

**Parents are divorced.** If the child's parents are divorced or legally separated, and the parent who had custody of the child for the greater part of the year (the custodial parent) has not remarried, use the return of the custodial parent.

**Custodial parent remarried.** If the custodial parent has remarried, the stepparent (rather than the noncustodial parent) is treated as the child's other parent. Therefore, if the custodial parent and the stepparent file a joint return, use that joint return. Do not use the return of the noncustodial parent.

If the custodial parent and the stepparent are married, but file separate returns, use the return of the one with the greater taxable income. If the custodial parent and the stepparent are married but not living together, the earlier discussion under *Parents not living together* applies.

**Parents never married.** If a child's parents did not marry each other, but lived together all year, use the return of the parent with the greater taxable income. If the parents did not live together all year, the rules explained earlier under *Parents are divorced* apply.

**Widowed parent remarried.** If a widow or widower remarries, the new spouse is treated as the child's other parent. The rules explained earlier under *Custodial parent remarried* apply.

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## Parent's Election To Report Child's Interest and Dividends

You may be able to elect to include your child's interest and dividend income (including capital gain distributions) on your tax return. If you do, your child will not have to file a return.

You can make this election for 2006 only if all the following conditions are met.

- Your child was under age 18 at the end of 2006. (A child born on January 1, 1989, is considered to be age 18 at the end of 2006. You cannot make the election for this child.)
- Your child had income only from interest and dividends (including capital gain distributions and Alaska Permanent Fund dividends).
- Your child is required to file a return for 2006, unless you make this election.
- The child does not file a joint return for 2006.

- The dividend and interest income was less than \$8,500.
- No estimated tax payment was made for 2006 and no 2005 overpayment was applied to 2006 under your child's name and social security number.
- No federal income tax was taken out of your child's income under the backup withholding rules.
- You are the parent whose return must be used when applying the special tax rules for children under age 18. (See *Which Parent's Return To Use*, earlier.)

These conditions are also shown in Figure 31-A.

**How to make the election.** Make the election by attaching Form 8814 to your Form 1040 or Form 1040NR. (If you make this election, you cannot file Form 1040A or Form 1040EZ.) Attach a separate Form 8814 for each child for whom you make the election. You can make the election for one or more children and not for others.

## Effect of Making the Election

The federal income tax on your child's income may be more if you make the Form 8814 election.

**Rate may be higher.** If your child received qualified dividends or capital gain distributions, you may pay up to \$42.50 more tax if you make this election instead of filing a separate tax return for the child. This is because the tax rate on the child's income between \$850 and \$1,700 is 10% if you make this election. However, if you file a separate return for the child, the tax rate may be as low as 5% because of the preferential tax rates for qualified dividends and capital gain distributions.

**Deductions you cannot take.** By making the Form 8814 election, you cannot take any of the following deductions that the child would be entitled to on his or her return.

- The higher standard deduction for a blind child.
- The deduction for a penalty on an early withdrawal of your child's savings.
- Itemized deductions (such as your child's investment expenses or charitable contributions).

**Reduced deductions or credits.** If you use Form 8814, your increased adjusted gross income may reduce certain deductions or credits on your return including the following.

- Deduction for contributions to a traditional individual retirement arrangement (IRA).
- Deduction for student loan interest.
- Itemized deductions for medical expenses, casualty and theft losses, and certain miscellaneous expenses.
- Total itemized deductions.
- Personal exemptions.
- Credit for child and dependent care expenses.
- Child tax credit.
- Education tax credits.
- Earned income credit.

**Penalty for underpayment of estimated tax.** If you make this election for 2006 and did not have enough tax withheld or pay enough estimated tax to cover the tax you owe, you may be subject to a penalty. If you plan to make this election for 2007, you may need to increase your federal income tax withholding or your estimated tax payments to avoid the penalty. See chapter 4 for more information.

## Figuring Child's Income

Use Form 8814, Part I, to figure your child's interest and dividend income to report on your return. Only the amount over \$1,700 is added to your income. The amount over \$1,700 is shown on Form 8814, line 6. Unless the child's income includes qualified dividends or capital gain distributions (discussed next), the same amount is shown on Form 8814, line 12. Include the amount from Form 8814, line 12, on Form 1040 or Form 1040NR, line 21. Enter "Form 8814" in the space next to line 21. If you file more than one Form 8814, include the total amounts from line 12 of all your Forms 8814 on Form 1040 or Form 1040NR, line 21.

**Capital gain distributions and qualified dividends.** If your child's dividend income included any capital gain distributions, see *Capital gain distributions* under *Figuring Child's Income* in Part 2 of Publication 929. If your child's dividend income included any qualified dividends, see *Qualified dividends* under *Figuring Child's Income* in Part 2 of Publication 929.

## Figuring Additional Tax

Use Form 8814, Part II, to figure the tax on the \$1,700 of your child's interest and dividends that you do not include in your income. This tax is added to the tax figured on your income.

This additional tax is the smaller of:

1.  $10\% \times (\text{your child's gross income} - \$850)$ , or
2. \$85.

Include the amount from line 15 of all your Forms 8814 in the total on Form 1040, line 44, or Form 1040NR, line 41. Check box a on Form 1040, line 44, or Form 1040NR, line 41.

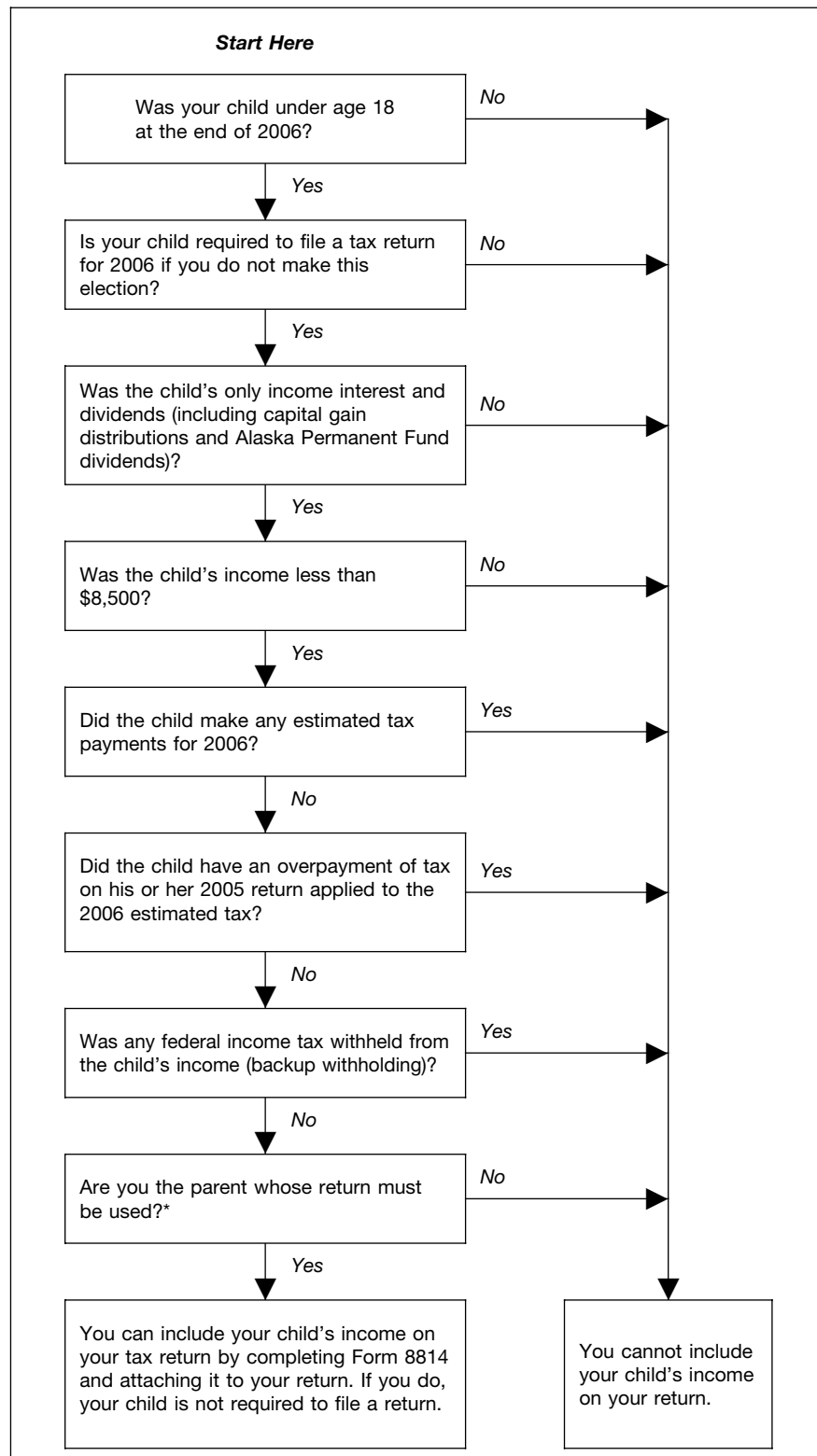
## Illustrated Example

David and Linda Parks are married and will file separate tax returns for 2006. Their only child, Philip, is 8. Philip received a Form 1099-INT showing \$1,650 taxable interest income and a Form 1099-DIV showing \$1,150 ordinary dividends. All the dividends were qualified dividends. His parents decide to include that income on one of their returns so they will not have to file a return for Philip.

First, David and Linda each figure their taxable income (Form 1040, line 43) without regard to Philip's income. David's taxable income is \$56,700 and Linda's is \$74,300. Because her taxable income is greater, Linda can elect to include Philip's income on her return. See *Which Parent's Return To Use*, earlier.

On Form 8814 (see illustrated form), Linda enters her name and social security number, then Philip's name and social security number. She enters Philip's taxable interest income,

Figure 31-A. Can You Include Your Child's Income On Your Tax Return?

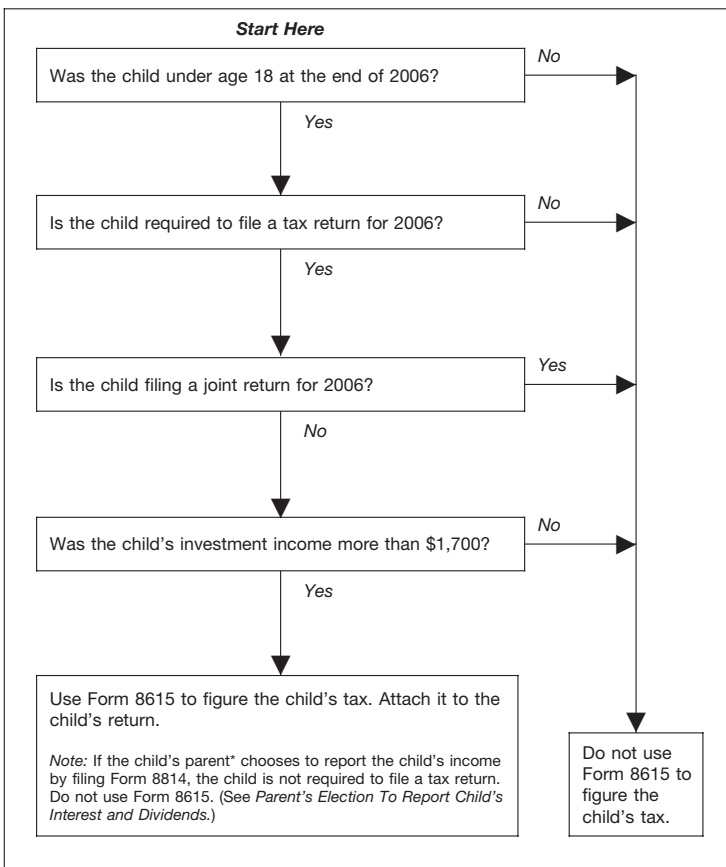


\*See *Which Parent's Return To Use*

\$1,650, on line 1a. Philip had no tax-exempt interest income, so she leaves line 1b blank. She enters Philip's ordinary dividends, \$1,150, on line 2a. All of Philip's ordinary dividends were qualified dividends, so Linda also enters \$1,150 on line 2b. Philip did not have any capital gain distributions, so she leaves line 3 blank.

Linda adds lines 1a and 2a and enters the result, \$2,800, on line 4. Because Philip had qualified dividends, Linda must complete lines 7 through 11 of Form 8814. She includes the amount from line 9 of Form 8814 (\$452) on lines 9a and 9b of her Form 1040. On the dotted lines

Figure 31-B. Do You Have To Use Form 8615 To Figure Your Child's Tax?



\*See Which Parent's Return To Use

the completed form to the child's Form 1040, Form 1040A, or Form 1040NR.

The following discussions explain the parental information needed for Form 8615 and the steps to follow in figuring the child's tax. Form 8615 is illustrated later.

## Providing Parental Information (Form 8615, lines A–C)

On Form 8615, lines A and B, enter the parent's name and social security number. (If the parents filed a joint return, enter the name and social security number listed first on the joint return.) On line C, check the box for the parent's filing status.

See *Which Parent's Return To Use* at the beginning of this chapter for information on which parent's return information must be used on Form 8615.

**Parent with different tax year.** If the parent and the child do not have the same tax year, complete Form 8615 using the information on the parent's return for the tax year that ends in the child's tax year.

**Parent's return information not known timely.** If the information needed from the parent's return is not known by the time the child's return is due (usually April 15), you can file the return using estimates.

You can use any reasonable estimate. This includes using information from last year's return. If you use an estimated amount on Form 8615, enter "Estimated" on the line next to the amount.

When you get the correct information, file an amended return on Form 1040X, Amended U.S. Individual Income Tax Return.

Instead of using estimates, you can get an automatic 6-month extension of time to file if, by the date your return is due, you file Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return. Extensions are discussed in chapter 1.

## Step 1. Figuring the Child's Net Investment Income (Form 8615, Part I)

The first step in figuring a child's tax using Form 8615 is to figure the child's net investment income. To do that, use Form 8615, Part I.

**Line 1 (investment income).** If the child had no earned income, enter on this line the adjusted gross income shown on the child's return. Adjusted gross income is shown on Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36. Form 1040EZ and Form 1040NR-EZ cannot be used if Form 8615 must be filed.

If the child had earned income, figure the amount to enter on Form 8615, line 1, by using the worksheet in the instructions for the form.

However, if the child has excluded any foreign earned income or deducted either a loss from self-employment or a net operating loss from another year, use the Alternate Worksheet for Form 8615, Line 1, in Publication 929 to figure the amount to enter on Form 8615, line 1.

next to lines 9a and 9b, she enters "Form 8814—\$452."

Linda includes \$648 in the total on line 21 of her Form 1040 (not illustrated) and in the space next to that line writes "Form 8814—\$648." Adding that amount, plus the \$452 of qualified dividends, to her income increases each of the amounts on lines 22, 37, 38, 41, and 43 of her Form 1040 by \$1,100. Linda is not claiming any deductions that are affected by the increase to her income. Therefore, her revised taxable income on line 43 is \$75,400 (\$74,300 + \$452 + \$648).

On Form 8814, Linda subtracts the \$850 shown on line 13 from the \$2,800 on line 4 and enters the result, \$1,950, on line 14. Because that amount is not less than \$850, she enters \$85 on line 15. This is the tax on the first \$1,700 of Philip's income, which Linda did not have to add to her income. She must add this additional tax to the tax figured on her revised taxable income.

The tax on her \$75,400 revised taxable income, figured using the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions, is \$15,749. She adds \$85, and enters the \$15,834 total on Form 1040, line 44, and checks box a.

Linda attaches Form 8814 to her Form 1040.

## Tax for Children Under Age 18 Who Have Investment Income of More Than \$1,700

Part of a child's 2006 investment income may be subject to tax at the parent's tax rate if all of the following statements are true.

- The child was under age 18 at the end of 2006. (A child born on January 1, 1989, is considered to be age 18 at the end of 2006. This child's investment income is not taxed at the parent's rate.)
- The child's investment income was more than \$1,700.
- The child does not file a joint return for 2006.
- The child is required to file a return for 2006.

These conditions are also shown in Figure 31-B.

If neither parent was alive on December 31, 2006, do not use Form 8615. Instead, figure the child's tax in the normal manner.

If the parent does not or cannot choose to include the child's income on the parent's return, use Form 8615 to figure the child's tax. Attach

**Parents' Election To Report  
Child's Interest and Dividends**

▶ See instructions.

▶ Attach to parents' Form 1040 or Form 1040NR.

Name(s) shown on your return Linda Parks Your social security number 111 00 1111

**Caution.** The federal income tax on your child's income, including qualified dividends and capital gain distributions, may be less if you file a separate tax return for the child instead of making this election. This is because you cannot take certain tax benefits that your child could take on his or her own return. For details, see **Tax benefits you cannot take** on page 2.

**A** Child's name (first, initial, and last) Philip Parks **B** Child's social security number 000 00 0000

**c** If more than one Form 8814 is attached, check here

**Part I Child's Interest and Dividends To Report on Your Return**

<b>1a</b> Enter your child's <b>taxable</b> interest. If this amount is different from the amounts shown on the child's Forms 1099-INT and 1099-OID, see the instructions . . . . .	<b>1a</b>	1,650	
<b>b</b> Enter your child's <b>tax-exempt</b> interest. <b>Do not</b> include this amount on line 1a . . . . .	<b>1b</b>		
<b>2a</b> Enter your child's ordinary dividends, including any Alaska Permanent Fund dividends. If your child received any ordinary dividends as a nominee, see the instructions . . . . .	<b>2a</b>	1,150	
<b>b</b> Enter your child's qualified dividends included on line 2a. See the instructions . . . . .	<b>2b</b>	1,150	
<b>3</b> Enter your child's capital gain distributions. If your child received any capital gain distributions as a nominee, see the instructions . . . . .	<b>3</b>		
<b>4</b> Add lines 1a, 2a, and 3. If the total is \$1,700 or less, skip lines 5 through 12 and go to line 13. If the total is \$8,500 or more, <b>do not</b> file this form. Your child <b>must</b> file his or her own return to report the income. . . . .	<b>4</b>	2,800	
<b>5</b> Base amount . . . . .	<b>5</b>	1,700	00
<b>6</b> Subtract line 5 from line 4 . . . . .	<b>6</b>	1,100	
<b>If both lines 2b and 3 are zero or blank, skip lines 7 through 10, enter -0- on line 11, and go to line 12. Otherwise, go to line 7.</b>			
<b>7</b> Divide line 2b by line 4. Enter the result as a decimal (rounded to at least three places) . . . . .	<b>7</b>	.411	
<b>8</b> Divide line 3 by line 4. Enter the result as a decimal (rounded to at least three places) . . . . .	<b>8</b>	.	
<b>9</b> Multiply line 6 by line 7. Enter the result here. See the instructions for where to report this amount on your return . . . . .	<b>9</b>	452	
<b>10</b> Multiply line 6 by line 8. Enter the result here. See the instructions for where to report this amount on your return . . . . .	<b>10</b>		
<b>11</b> Add lines 9 and 10 . . . . .	<b>11</b>	452	
<b>12</b> Subtract line 11 from line 6. Include this amount in the total on Form 1040, line 21, or Form 1040NR, line 21. In the space next to line 21, enter "Form 8814" and show the amount. If you checked the box on line C above, see the instructions. Go to line 13 below . . . . .	<b>12</b>	648	

**Part II Tax on the First \$1,700 of Child's Interest and Dividends**

<b>13</b> Amount not taxed . . . . .	<b>13</b>	850	00
<b>14</b> Subtract line 13 from line 4. If the result is zero or less, enter -0-. . . . .	<b>14</b>	1950	
<b>15 Tax.</b> Is the amount on line 14 less than \$850? <input checked="" type="checkbox"/> <b>No.</b> Enter \$85 here and see the <b>Note</b> below. <input type="checkbox"/> <b>Yes.</b> Multiply line 14 by 10% (.10). Enter the result here and see the <b>Note</b> below.	<b>15</b>	85	

**Note.** If you checked the box on line C above, see the instructions. Otherwise, include the amount from line 15 in the tax you enter on Form 1040, line 44, or Form 1040NR, line 41. Be sure to check box **a** on Form 1040, line 44, or Form 1040NR, line 41.

**Investment income defined.** Investment income is generally all income other than salaries, wages, and other amounts received as pay for work actually done. It includes taxable interest, dividends, capital gains (including capital gain distributions), the taxable part of social security and pension payments, and certain distributions from trusts. Investment income includes amounts produced by assets the child obtained with earned income (such as interest on a savings account into which the child deposited wages).

**Nontaxable income.** For this purpose, investment income includes only amounts that the child must include in total income. Nontaxable investment income, such as tax-exempt interest and the nontaxable part of social security and pension payments, is not included.

**Income from property received as a gift.** A child's investment income includes all income produced by property belonging to the child. This is true even if the property was transferred to the child, regardless of when the property was transferred or purchased or who transferred it.

A child's investment income includes income produced by property given as a gift to the child. This includes gifts to the child from grandparents or any other person and gifts made under the Uniform Gift to Minors Act.

**Example.** Amanda Black, age 13, received the following income.

- Dividends — \$600
- Wages — \$2,100
- Taxable interest — \$1,200
- Tax-exempt interest — \$100
- Net capital gains — \$100

The dividends were qualified dividends on stock given to her by her grandparents.

Amanda's investment income is \$1,900. This is the total of the dividends (\$600), taxable interest (\$1,200), and net capital gains (\$100). Her wages are earned (not investment) income because they are received for work actually done. Her tax-exempt interest is not included because it is nontaxable.

**Trust income.** If a child is the beneficiary of a trust, distributions of taxable interest, dividends, capital gains, and other investment income from the trust are investment income to the child.

However, for purposes of completing Form 8615, a taxable distribution from a qualified disability trust is considered earned income, not investment income.

**Line 2 (deductions).** If the child does not itemize deductions on Schedule A (Form 1040 or Form 1040NR), enter \$1,700 on line 2.

If the child does itemize deductions, enter on line 2 the larger of:

1. \$850 plus the child's itemized deductions that are directly connected with the production of investment income entered on line 1, or
2. \$1,700.

**Directly connected.** Itemized deductions are directly connected with the production of

investment income if they are for expenses paid to produce or collect taxable income or to manage, conserve, or maintain property held for producing income. These expenses include custodian fees and service charges, service fees to collect taxable interest and dividends, and certain investment counsel fees.

These expenses are added to certain other miscellaneous itemized deductions on Schedule A (Form 1040). Only the amount greater than 2% of the child's adjusted gross income can be deducted. See chapter 28 for more information.

**Example 1.** Roger, age 12, has investment income of \$8,000, no other income, no adjustments to income, and itemized deductions of \$300 (net of the 2% limit) that are directly connected with his investment income. His adjusted gross income is \$8,000, which is entered on Form 1040, line 38, and on Form 8615, line 1. Line 2 is \$1,700 because that is more than the sum of \$850 and his directly-connected itemized deductions of \$300.

**Example 2.** Eleanor, age 8, has investment income of \$16,000 and an early withdrawal penalty of \$100. She has no other income. She has itemized deductions of \$1,050 (net of the 2% limit) that are directly connected with the production of her investment income. Her adjusted gross income, entered on line 1, is \$15,900 (\$16,000 – \$100). The amount on line 2 is \$1,900. This is the larger of:

1. \$850 plus the \$1,050 of directly connected itemized deductions, or
2. \$1,700.

**Line 3.** Subtract line 2 from line 1 and enter the result on this line. If zero or less, do not complete the rest of the form. However, you must still attach Form 8615 to the child's tax return. Figure the tax on the child's taxable income in the normal manner.

**Line 4 (child's taxable income).** Enter on line 4 the child's taxable income from Form 1040, line 43; Form 1040A, line 27; or Form 1040NR, line 40.

However, if the child files Form 2555 or 2555-EZ to claim the foreign earned income exclusion or housing exclusion, see the Form 8615 instructions.

**Line 5 (net investment income).** A child's net investment income cannot be more than his or her taxable income. Enter on Form 8615, line 5, the smaller of line 3 or line 4. This is the child's net investment income.

If zero or less, do not complete the rest of the form. However, you must still attach Form 8615 to the child's tax return. Figure the tax on the child's taxable income in the normal manner.

## Step 2. Figuring Tentative Tax at the Parent's Tax Rate (Form 8615, Part II)

The next step in completing Form 8615 is to figure a tentative tax on the child's net investment income at the parent's tax rate. The tentative tax at the parent's tax rate is the difference between the tax on the parent's taxable income

figured with the child's net investment income (plus the net investment income of any other child whose Form 8615 includes the tax return information of that parent) and the tax figured without it.

When figuring the tentative tax at the parent's tax rate, do not refigure any of the exclusions, deductions, or credits on the parent's return because of the child's net investment income. For example, do not refigure the medical expense deduction.

Figure the tentative tax on Form 8615, lines 6 through 13.

**Note.** If the child has any capital gains or losses, get Publication 929 for help in completing Form 8615, Part II.

**Line 7 (net investment income of other children).** If the tax return information of the parent is also used on any other child's Form 8615, enter on line 7 the total of the amounts from line 5 of all the other children's Forms 8615. Do not include the amount from line 5 of the Form 8615 being completed.

**Example.** Paul and Jane Persimmon have three children, Sharon, Jerry, and Mike, who must attach Form 8615 to their tax returns. The children's net investment income amounts on line 5 of their Forms 8615 are:

- Sharon — \$800
- Jerry — \$600
- Mike — \$1,000

Line 7 of Sharon's Form 8615 will show \$1,600, the total of the amounts on line 5 of Jerry's and Mike's Forms 8615.

Line 7 of Jerry's Form 8615 will show \$1,800 (\$800 + \$1,000).

Line 7 of Mike's Form 8615 will show \$1,400 (\$800 + \$600).

**Other children's information not available.** If the net investment income of the other children is not available when the return is due, either file the return using estimates or get an extension of time to file. See *Parent's return information not known timely*, earlier.

**Line 11 (tentative tax).** Subtract line 10 from line 9 and enter the result on this line. This is the tentative tax.

If line 7 is blank, skip lines 12a and 12b and enter the amount from line 11 on line 13. Also skip the discussion for lines 12a and 12b that follows.

**Lines 12a and 12b (dividing the tentative tax).** If an amount is entered on line 7, divide the tentative tax shown on line 11 among the children according to each child's share of the total net investment income. This is done on lines 12a, 12b, and 13. Add the amount on line 7 to the amount on line 5 and enter the total on line 12a. Divide the amount on line 5 by the amount on line 12a and enter the result as a decimal on line 12b.

**Example.** In the earlier example under *Line 7 (net investment income of other children)*, Sharon's Form 8615 shows \$1,600 on line 7. The amount entered on line 12a is \$2,400, the total of the amounts on lines 5 and 7 (\$800 +

\$1,600). The decimal on line 12b is .333, figured as follows and rounded to three places.

$$\frac{\$800}{\$2,400} = .333$$

### Step 3. Figuring the Child's Tax (Form 8615, Part III)

The final step in figuring a child's tax using Form 8615 is to determine the larger of:

1. The total of:
  - a. The child's share of the tentative tax based on the parent's tax rate, plus
  - b. The tax on the child's taxable income in excess of net investment income, figured at the child's tax rate, or
2. The tax on the child's taxable income, figured at the child's tax rate.

This is the child's tax. It is figured on Form 8615, lines 14 through 18.

**Alternative minimum tax.** A child may be subject to alternative minimum tax (AMT) if he or she has certain items given preferential treatment under the tax law. See *Alternative Minimum Tax* in chapter 30.

For more information on who is liable for AMT and how to figure it, get Form 6251, *Alternative Minimum Tax—Individuals*. For information on special limits that apply to a child who files Form 6251, see *Alternative Minimum Tax* in Publication 929.

## Illustrated Example

The following example includes a completed Form 8615. Form 1040A is not shown.

John and Laura Brown have one child, Sara. She is 13 and has \$2,800 taxable interest income and \$1,500 earned income. She does not itemize deductions. John and Laura file a joint return with John's name and social security number listed first. They claim three exemptions, including an exemption for Sara, on their return.

Because Sara is under age 18 and has more than \$1,700 investment income, part of her income may be subject to tax at her parents' rate. A completed Form 8615 must be attached to her return.

Sara's father, John, fills out Sara's return for her. He completes her Form 1040A through line 27, then begins completing her Form 8615.

John enters his name and social security number on Sara's Form 8615 because his name and number are listed first on the joint return he and Laura are filing. He checks the box for married filing jointly.

He enters Sara's investment income, \$2,800, on line 1. Sara does not itemize deductions, so John enters \$1,700 on line 2. He enters \$1,100 (\$2,800 – \$1,700) on line 3.

Sara's taxable income, as shown on her Form 1040A, line 27, is \$2,500. This is her total income (\$4,300) minus her standard deduction (\$1,800). Her standard deduction is limited to the amount of her earned income plus \$300. John enters \$2,500 on line 4.

John compares lines 3 and 4 and enters the smaller amount, \$1,100, on line 5.

John enters \$48,000 on line 6. This is the taxable income from line 43 of John and Laura's joint Form 1040 return. Sara is an only child, so line 7 is blank. He adds line 5 (\$1,100), line 6 (\$48,000), and line 7 (blank), and enters \$49,100 on line 8.

Using the column for married filing jointly in the Tax Table, John finds the tax on \$49,100. He enters the tax, \$6,614, on line 9. He enters \$6,449 on line 10. This is the tax from line 44 of John and Laura's Form 1040. He enters \$165 on line 11 (\$6,614 – \$6,449).

Because line 7 is blank, John skips lines 12a and 12b and enters \$165 on line 13.

John subtracts line 5 (\$1,100) from line 4 (\$2,500) and enters the result, \$1,400, on line 14. Using the column for single filing status in the Tax Table, John finds the tax on \$1,400 and enters this tax, \$141, on line 15. He adds lines 13 (\$165) and 15 (\$141) and enters \$306 on line 16.

Using the column for single filing status in the Tax Table, John finds the tax on \$2,500 (line 4) and enters this tax, \$251, on line 17.

John compares lines 16 and 17 and enters the larger amount, \$306, on line 18 of Sara's Form 8615. He also enters that amount on line 28 of Sara's Form 1040A.

John also completes Schedule 1 (Form 1040A) for Sara.

**Tax for Children Under Age 18**  
**With Investment Income of More Than \$1,700**  
 ► Attach only to the child's Form 1040, Form 1040A, or Form 1040NR.  
 ► See separate instructions.

Child's name shown on return <p align="center">Sara L. Brown</p>	Child's social security number <p align="center">117 : 00 : 1111</p>
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**Before you begin:** If the child, the parent, or any of the parent's other children under age 18 must use the Schedule D Tax Worksheet or has income from farming or fishing, see **Pub. 929**, Tax Rules for Children and Dependents. It explains how to figure the child's tax using the **Schedule D Tax Worksheet** or **Schedule J** (Form 1040).

A Parent's name (first, initial, and last). <b>Caution:</b> See instructions before completing. <p align="center">John J. Brown</p>	B Parent's social security number <p align="center">007 : 00 : 0001</p>
--	--

C Parent's filing status (check one):  
 Single     Married filing jointly     Married filing separately     Head of household     Qualifying widow(er)

**Part I Child's Net Investment Income**

1 Enter the child's investment income (see instructions)	<b>1</b>	2,800	
2 If the child <b>did not</b> itemize deductions on <b>Schedule A</b> (Form 1040 or Form 1040NR), enter \$1,700. Otherwise, see instructions	<b>2</b>	1,700	
3 Subtract line 2 from line 1. If zero or less, <b>stop</b> ; do not complete the rest of this form but <b>do</b> attach it to the child's return	<b>3</b>	1,100	
4 Enter the child's <b>taxable income</b> from Form 1040, line 43; Form 1040A, line 27; or Form 1040NR, line 40	<b>4</b>	2,500	
5 Enter the <b>smaller</b> of line 3 or line 4. If zero, <b>stop</b> ; do not complete the rest of this form but <b>do</b> attach it to the child's return	<b>5</b>	1,100	

**Part II Tentative Tax Based on the Tax Rate of the Parent**

6 Enter the parent's <b>taxable income</b> from Form 1040, line 43; Form 1040A, line 27; Form 1040EZ, line 6; Form 1040NR, line 40; or Form 1040NR-EZ, line 14. If zero or less, enter -0-	<b>6</b>	48,000	
7 Enter the total, if any, from Forms 8615, line 5, of <b>all other</b> children of the parent named above. <b>Do not</b> include the amount from line 5 above	<b>7</b>		
8 Add lines 5, 6, and 7 (see instructions)	<b>8</b>	49,100	
9 Enter the tax on the amount on line 8 based on the <b>parent's</b> filing status above (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here <input type="checkbox"/>	<b>9</b>	6,614	
10 Enter the parent's tax from Form 1040, line 44; Form 1040A, line 28, minus any alternative minimum tax; Form 1040EZ, line 11; Form 1040NR, line 41; or Form 1040NR-EZ, line 15. <b>Do not</b> include any tax from <b>Form 4972</b> or <b>8814</b> . If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) was used to figure the tax, check here <input type="checkbox"/>	<b>10</b>	6,449	
11 Subtract line 10 from line 9 and enter the result. If line 7 is blank, also enter this amount on line 13 and go to <b>Part III</b>	<b>11</b>	165	
12a Add lines 5 and 7	<b>12a</b>		
b Divide line 5 by line 12a. Enter the result as a decimal (rounded to at least three places)	<b>12b</b>	x .	
13 Multiply line 11 by line 12b	<b>13</b>	165	

**Part III Child's Tax**—If lines 4 and 5 above are the same, enter -0- on line 15 and go to line 16.

14 Subtract line 5 from line 4	<b>14</b>	1,400	
15 Enter the tax on the amount on line 14 based on the <b>child's</b> filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here <input type="checkbox"/>	<b>15</b>	141	
16 Add lines 13 and 15	<b>16</b>	306	
17 Enter the tax on the amount on line 4 based on the <b>child's</b> filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here <input type="checkbox"/>	<b>17</b>	251	
18 Enter the <b>larger</b> of line 16 or line 17 here and on the <b>child's</b> Form 1040, line 44; Form 1040A, line 28; or Form 1040NR, line 41	<b>18</b>	306	

## 32.

# Child and Dependent Care Credit

## Reminders

**Taxpayer identification number needed for each qualifying person.** You must include on line 2 of Form 2441 or Schedule 2 (Form 1040A) the name and taxpayer identification number (generally the social security number) of each qualifying person. See *Taxpayer identification number* under *Qualifying Person Test*, later.

**You may have to pay employment taxes.** If you pay someone to come to your home and care for your dependent or spouse, you may be a household employer who has to pay employment taxes. Usually, you are not a household employer if the person who cares for your dependent or spouse does so at his or her home or place of business. See *Employment Taxes for Household Employers*, later.

## Introduction

This chapter discusses the credit for child and dependent care expenses and covers the following topics.

- Tests you must meet to claim the credit.
- How to figure the credit.
- How to claim the credit.
- Employment taxes you may have to pay as a household employer.

You may be able to claim the credit if you pay someone to care for your dependent who is under age 13 or for your spouse or dependent who is not able to care for himself or herself. The credit can be up to 35% of your expenses. To qualify, you must pay these expenses so you can work or look for work.



*This credit should not be confused with the child tax credit discussed in chapter 34.*

**Dependent care benefits.** If you received any dependent care benefits from your employer during the year, you may be able to exclude from your income all or part of them. You must complete Part III of Form 2441 or Schedule 2 (Form 1040A) before you can figure the amount of your credit. See *Dependent Care Benefits* under *How To Figure the Credit*, later.

## Useful Items

You may want to see:

### Publication

- ❑ **501** Exemptions, Standard Deduction, and Filing Information
- ❑ **503** Child and Dependent Care Expenses
- ❑ **926** Household Employer's Tax Guide

### Form (and Instructions)

- ❑ **2441** Child and Dependent Care Expenses
- ❑ **Schedule 2 (Form 1040A)** Child and Dependent Care Expenses for Form 1040A Filers
- ❑ **Schedule H (Form 1040)** Household Employment Taxes
- ❑ **W-7** Application for IRS Individual Taxpayer Identification Number
- ❑ **W-10** Dependent Care Provider's Identification and Certification

## Tests To Claim the Credit

To be able to claim the credit for child and dependent care expenses, you must file Form 1040 or Form 1040A, not Form 1040EZ, and meet all the following tests.

1. The care must be for one or more qualifying persons who are identified on the form you use to claim the credit. (See *Qualifying Person Test*.)
  2. You (and your spouse if you are married) must have earned income during the year. (However, see *Rule for student-spouse or spouse not able to care for self* under *Earned Income Test*, later.)
  3. You must pay child and dependent care expenses so you (and your spouse if you are married) can work or look for work. (See *Work-Related Expense Test*, later.)
  4. You must make payments for child and dependent care to someone neither you nor your spouse can claim as a dependent. If you make payments to your child, he or she cannot be your dependent and must be age 19 or older by the end of the year. You cannot make payments to your spouse or to the parent of your qualifying child who is your qualifying person and is under age 13. (See *Payments to Relatives or Dependents* under *Work-Related Expense Test*, later.)
  5. Your filing status must be single, head of household, qualifying widow(er) with dependent child, or married filing jointly. You must file a joint return if you are married, unless an exception applies to you. (See *Joint Return Test*, later.)
6. You must identify the care provider on your tax return. (See *Provider Identification Test*, later.)
  7. If you exclude or deduct dependent care benefits provided by a dependent care benefits plan, the total amount you exclude or deduct must be less than the dollar limit for qualifying expenses (generally, \$3,000 if one qualifying person was cared for or \$6,000 if two or more qualifying persons were cared for). (If two or more qualifying persons were cared for, the amount you exclude or deduct will always be less than the dollar limit, since the amount you can exclude or deduct is limited to \$5,000. See *Reduced Dollar Limit* under *How To Figure the Credit*, later.)

These tests are presented in Figure 32-A and are also explained in detail in this chapter.

## Qualifying Person Test

Your child and dependent care expenses must be for the care of one or more qualifying persons.

A qualifying person is:

1. Your qualifying child who is your dependent and who was under age 13 when the care was provided (but see **Note** below),
2. Your spouse who was physically or mentally not able to care for himself or herself and lived with you for more than half the year, or
3. A person who was physically or mentally not able to care for himself or herself, lived with you for more than half the year, and either:
  - a. Was your dependent, or
  - b. Would have been your dependent except that (i) he or she received gross income of \$3,300 or more, (ii) he or she filed a joint return, or (iii) you, or your spouse if filing jointly, could be claimed as a dependent on someone else's 2006 return.

**Note.** If you are divorced or separated, see *Child of divorced or separated parents*, later, to determine which parent may treat the child as a qualifying person.

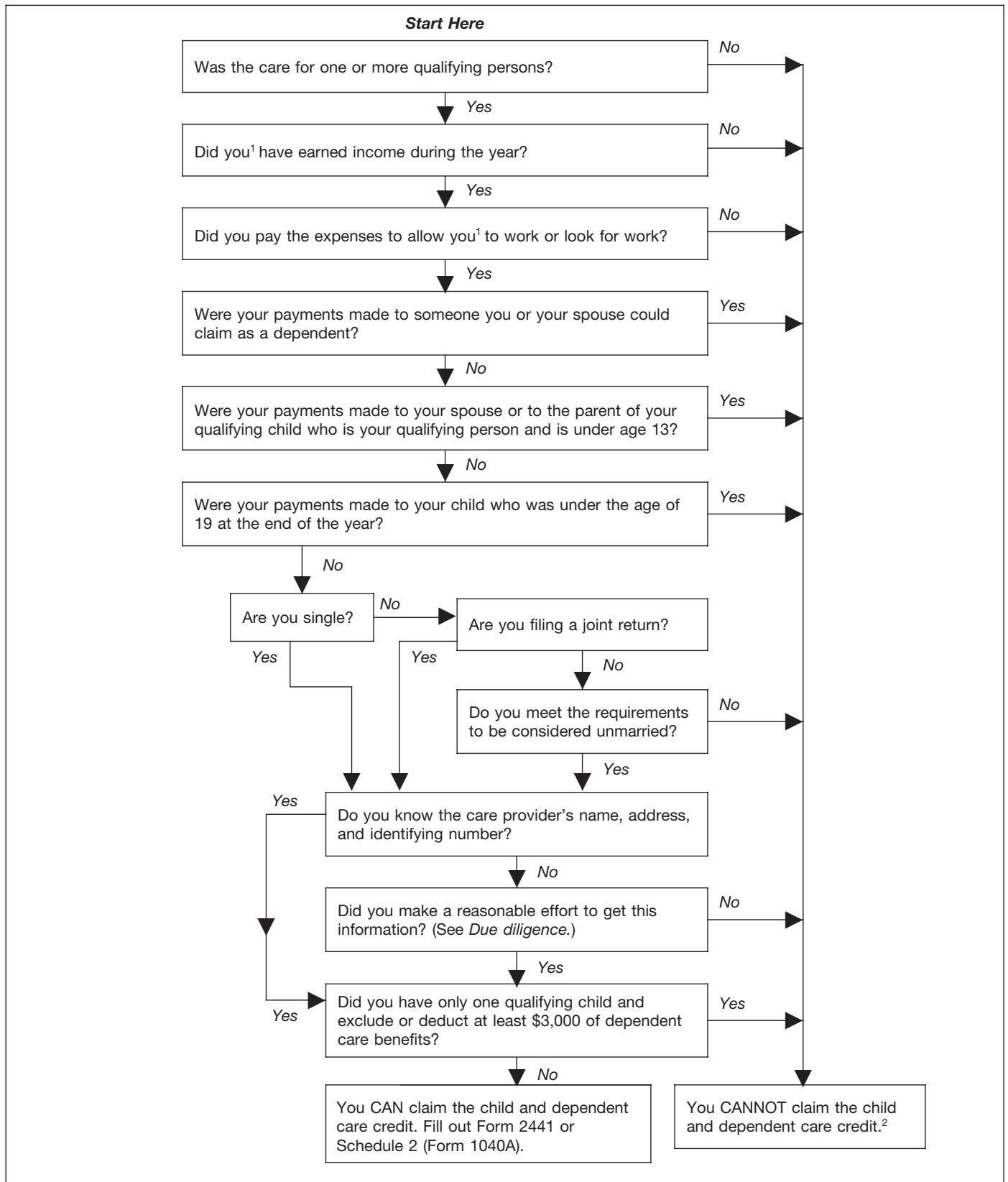
**Dependent defined.** A dependent is a person, other than you or your spouse, for whom you can claim an exemption. To be your dependent, a person must be your qualifying child (or your qualifying relative).

**Qualifying child.** To be your qualifying child, a child must live with you for more than half the year and meet other requirements.

**More information.** For more information about who is a dependent or a qualifying child, see chapter 3.

**Physically or mentally not able to care for oneself.** Persons who cannot dress, clean, or feed themselves because of physical or mental problems are considered not able to care for themselves. Also, persons who must have constant attention to prevent them from injuring

Figure 32-A. **Can You Claim the Credit?**



<sup>1</sup> This also applies to your spouse, unless your spouse was disabled or a full-time student.

<sup>2</sup> If you had expenses that met the requirements for 2005, except that you did not pay them until 2006, you may be able to claim those expenses in 2006. See *Expenses not paid until the following year* under *How To Figure the Credit*.

themselves or others are considered not able to care for themselves.

**Person qualifying for part of year.** You determine a person's qualifying status each day. For example, if the person for whom you pay child and dependent care expenses no longer qualifies on September 16, count only those expenses through September 15. Also see *Dollar Limit* under *How To Figure the Credit*, later.

**Taxpayer identification number.** You must include on your return the name and taxpayer identification number (generally the social security number) of the qualifying person(s). If the correct information is not shown, the credit may be reduced or disallowed.

**Individual taxpayer identification number (ITIN) for aliens.** If your qualifying person is a nonresident or resident alien who does not have and cannot get a social security number (SSN), use that person's ITIN. To apply for an ITIN, see Form W-7. The ITIN is entered wherever an SSN is requested on a tax return.

An ITIN is for tax use only. It does not entitle the holder to social security benefits or change the holder's employment or immigration status under U.S. law.

**Adoption taxpayer identification number (ATIN).** If your qualifying person is a child who was placed in your home for adoption and for whom you do not have an SSN, you must get an ATIN for the child. File Form W-7A, Application for Taxpayer Identification Number for Pending U.S. Adoptions.

**Child of divorced or separated parents.** Even if you cannot claim your child as a dependent, he or she is treated as your qualifying person if:

- The child was under age 13 or was physically or mentally not able to care for himself or herself, and
- You were the child's custodial parent (the parent with whom the child lived for the greater part of 2005).

The noncustodial parent cannot treat the child as a qualifying person even if that parent is entitled to claim the child as a dependent under the special rule for a child of divorced or separated parents.

## Earned Income Test

To claim the credit, you (and your spouse if you are married) must have earned income during the year.

**Earned income.** Earned income includes wages, salaries, tips, other taxable employee compensation, and net earnings from self-employment. A net loss from self-employment reduces earned income. Earned income also includes strike benefits and any disability pay you report as wages.

Earned income also includes nontaxable employee compensation such as parsonage allowances, meals and lodging furnished for the convenience of the employer, voluntary salary deferrals, military basic quarters and subsistence allowances and in-kind quarters and subsistence, and military pay earned in a combat zone.

**Members of certain religious faiths opposed to social security.** Certain income earned by persons who are members of certain religious faiths that are opposed to participation in Social Security Act programs and have an IRS-approved form that exempts certain income from social security and Medicare taxes may not be considered earned income for this purpose. See *Earned Income Test* in Publication 503.

**Not earned income.** Earned income does not include pensions or annuities, social security payments, workers' compensation, interest, dividends, or unemployment compensation. It also does not include scholarship or fellowship grants, except amounts paid to you (and reported on Form W-2) for teaching, research, or other services.

**Rule for student-spouse or spouse not able to care for self.** Your spouse is treated as having earned income for any month that he or she is:

1. A full-time student, or
2. Physically or mentally not able to care for himself or herself. (Your spouse also must live with you for more than half the year.)

Figure the earned income of the nonworking spouse described under (1) or (2) above as explained under *Earned Income Limit*, later.

This rule applies to only one spouse for any one month. If, in the same month, both you and your spouse do not work and are either full-time students or physically or mentally not able to care for yourselves, only one of you can be treated as having earned income in that month.

**Full-time student.** You are a full-time student if you are enrolled at and attend a school for the number of hours or classes that the school considers full time. You must have been a student for some part of each of 5 calendar months during the year. (The months need not be consecutive.)

If you enrolled in school before August 25, 2005, you are treated as a full-time student for any month of the enrollment period you were unable to attend classes because of Hurricane Katrina.

If you enrolled in school before September 23, 2005, you are treated as a full-time student for any month of the enrollment period you were unable to attend classes because of Hurricane Rita.

If you enrolled in school before October 23, 2005, you are treated as a full-time student for any month of the enrollment period you were unable to attend classes because of Hurricane Wilma.

**School.** The term "school" includes elementary schools, junior and senior high schools, colleges, universities, and technical, trade, and mechanical schools. A school does not include an on-the-job training course, correspondence school, or school offering courses only through the Internet.

## Work-Related Expense Test

Child and dependent care expenses must be work-related to qualify for the credit. Expenses

are considered work-related only if both of the following are true.

- They allow you (and your spouse if you are married) to work or look for work.
- They are for a qualifying person's care.

## Working or Looking for Work

To be work-related, your expenses must allow you to work or look for work. If you are married, generally both you and your spouse must work or look for work. Your spouse is treated as working during any month he or she is a full-time student or is physically or mentally not able to care for himself or herself.

Your work can be for others or in your own business or partnership. It can be either full time or part time.

Work also includes actively looking for work. However, if you do not find a job and have no earned income for the year, you cannot take this credit. See *Earned Income Test*, earlier.

Whether your expenses allow you to work or look for work depends on the facts. For example, the cost of a babysitter while you and your spouse go out to eat is not normally a work-related expense.

An expense is not considered work-related merely because you had it while you were working. The purpose of the expense must be to enable you to work.

**Volunteer work.** For this purpose, you are not considered to be working if you do unpaid volunteer work or volunteer work for a nominal salary.

**Work for part of year.** If you work or actively look for work during only part of the period covered by the expenses, then you must figure your expenses for each day. For example, if you work all year and pay care expenses of \$250 a month (\$3,000 for the year), all the expenses are work-related. However, if you work or look for work for only 2 months and 15 days during the year and pay expenses of \$250 a month, your work-related expenses are limited to \$625 (2½ months × \$250).

**Payments while you are out sick.** Do not count as work-related expenses amounts you pay for child and dependent care while you are off work because of illness. These amounts are not paid to allow you to work. This applies even if you get sick pay and are still considered an employee.

## Care of a Qualifying Person

To be work-related, your expenses must be to provide care for a qualifying person. You do not have to choose the least expensive way of providing the care.

Expenses are for the care of a qualifying person only if their main purpose is the person's well-being and protection.

Expenses for household services qualify if part of the services is for the care of qualifying persons. See *Household services*, later.

**Expenses not for care.** Expenses for care do not include amounts you pay for food, clothing, education, and entertainment. However, you can include small amounts paid for these items if

they are incident to and cannot be separated from the cost of caring for the qualifying person.

**Education.** Expenses for a child in nursery school, pre-school, or similar programs for children below the level of kindergarten are expenses for care. Expenses to attend kindergarten or a higher grade are not expenses for care. Do not use these expenses to figure your credit.

**Example 1.** You take your 3-year-old child to a nursery school that provides lunch and educational activities as a part of its preschool childcare service. You can count the total cost when you figure the credit.

**Example 2.** You place your 10-year-old child in a boarding school so you can work full time. Only the part of the boarding school expense that is for the care of your child is a work-related expense. You can count that part of the expense in figuring your credit if it can be separated from the cost of education. You cannot count any part of the amount you pay the school for your child's education.

**Care outside your home.** You can count the cost of care provided outside your home if the care is for your dependent under age 13 or any other qualifying person who regularly spends at least 8 hours each day in your home.

**Dependent care center.** You can count care provided outside your home by a dependent care center only if the center complies with all state and local regulations that apply to these centers.

A dependent care center is a place that provides care for more than six persons (other than persons who live there) and receives a fee, payment, or grant for providing services for any of those persons, even if the center is not run for profit.

**Camp.** The cost of sending your child to an overnight camp is not considered a work-related expense. The cost of sending your child to a day camp may be a work-related expense, even if the camp specializes in a particular activity, such as computers or soccer.

**Transportation.** The cost of getting a qualifying person from your home to the care location and back, or from the care location to school and back, is not considered a work-related expense. This includes the costs of bus, subway, taxi, or private car. Also, if you pay the transportation cost for the care provider to come to your home, you cannot count this cost as a work-related expense.

**Household services.** Expenses you pay for household services meet the work-related expense test if they are at least partly for the well-being and protection of a qualifying person.

Household services are ordinary and usual services done in and around your home that are necessary to run your home. They include the services of a housekeeper, maid, or cook. However, they do not include the services of a chauffeur, bartender, or gardener. See *Household Services* in Publication 503 for more information.

In this chapter, the term housekeeper refers to any household employee whose services include the care of a qualifying person.

**Taxes paid on wages.** The taxes you pay on wages for qualifying child and dependent care services are work-related expenses. See *Employment Taxes for Household Employers*, later.

## Payments to Relatives or Dependents

You can count work-related payments you make to relatives who are not your dependents, even if they live in your home. However, do not count any amounts you pay to:

1. A dependent for whom you (or your spouse if you are married) can claim an exemption,
2. Your child who was under age 19 at the end of the year, even if he or she is not your dependent,
3. Your spouse, or
4. The parent of your qualifying child who is your qualifying person and is under age 13.

## Joint Return Test

Generally, married couples must file a joint return to take the credit. However, if you are legally separated or living apart from your spouse, you may be able to file a separate return and still take the credit.

**Legally separated.** You are not considered married if you are legally separated from your spouse under a decree of divorce or separate maintenance. You are eligible to take the credit on a separate return.

**Married and living apart.** You are not considered married and are eligible to take the credit if all the following apply.

1. You file a separate return.
2. Your home is the home of a qualifying person for more than half the year.
3. You pay more than half the cost of keeping up your home for the year.
4. Your spouse does not live in your home for the last 6 months of the year.

**Costs of keeping up a home.** The costs of keeping up a home normally include property taxes, mortgage interest, rent, utility charges, home repairs, insurance on the home, and food eaten at home.

The costs of keeping up a home do not include payments for clothing, education, medical treatment, vacations, life insurance, transportation, or mortgage principal.

They also do not include the purchase, permanent improvement, or replacement of property. For example, you cannot include the cost of replacing a water heater. However, you can include the cost of repairing a water heater.

**Death of spouse.** If your spouse died during the year and you do not remarry before the end of the year, you generally must file a joint return to take the credit. If you do remarry before the end of the year, the credit can be claimed on your deceased spouse's separate return.

## Provider Identification Test

You must identify all persons or organizations that provide care for your child or dependent. Use Part I of Form 2441 or Schedule 2 (Form 1040A) to show the information.

**Information needed.** To identify the care provider, you must give the provider's:

1. Name,
2. Address, and
3. Taxpayer identification number.

If the care provider is an individual, the taxpayer identification number is his or her social security number or individual taxpayer identification number. If the care provider is an organization, then it is the employer identification number (EIN).

You do not have to show the taxpayer identification number if the care provider is one of certain tax-exempt organizations (such as a church or school). In this case, enter "Tax-Exempt" in the space where the tax form calls for the number.

If you cannot provide all of the information or if the information you provide is incorrect you must be able to show that you used due diligence (discussed later) in trying to furnish the necessary information.

**Getting the information.** You can use Form W-10 to request the required information from the care provider. If you do not use Form W-10, you can get the information from:

1. A copy of the provider's social security card,
2. A copy of the provider's driver's license (in a state where the license includes the social security number),
3. A copy of the provider's completed Form W-4 if he or she is your household employee,
4. A copy of the statement furnished by your employer if the provider is your employer's dependent care plan, or
5. A letter or invoice from the provider if it shows the information.



You should keep this information with your tax records. Do not send Form W-10 (or other document containing this information) to the Internal Revenue Service.

**Due diligence.** If the care provider information you give is incorrect or incomplete, your credit may not be allowed. However, if you can show that you used due diligence in trying to supply the information, you can still claim the credit.

You can show due diligence by getting and keeping the provider's completed Form W-10 or one of the other sources of information listed earlier. Care providers can be penalized if they do not provide this information to you or if they provide incorrect information.

**Provider refusal.** If the provider refuses to give you their identifying information, you should report whatever information you have (such as the name and address) on the form you use to

claim the credit. Enter "See page 2" in the columns calling for the information you do not have. On the bottom of page 2, explain that you requested the information from the care provider, but the provider did not give you the information. This statement will show that you used due diligence in trying to furnish the necessary information.

## How To Figure the Credit


Your credit is a percentage of your work-related expenses. Your expenses are subject to the earned income limit and the dollar limit. The percentage is based on your adjusted gross income.

## Figuring Total Work-Related Expenses

To figure the credit for 2006 work-related expenses, count only those you paid by December 31, 2006.

**Expenses prepaid in an earlier year.** If you pay for services before they are provided, you can count the prepaid expenses only in the year the care is received. Claim the expenses for the later year as if they were actually paid in that later year.

**Expenses not paid until the following year.** Do not count 2005 expenses that you paid in 2006 as work-related expenses for 2006. You may be able to claim an additional credit for them on your 2006 return, but you must figure it separately. See *Payments for previous year's expenses* under *Amount of Credit* in Publication 503.

 **TIP** *If you had expenses in 2006 that you did not pay until 2007, you cannot count them when figuring your 2006 credit. You may be able to claim a credit for them on your 2007 return.*

**Expenses reimbursed.** If a state social services agency pays you a nontaxable amount to reimburse you for some of your child and dependent care expenses, you cannot count the expenses that are reimbursed as work-related expenses.

**Example.** You paid work-related expenses of \$3,000. You are reimbursed \$2,000 by a state social services agency. You can use only \$1,000 to figure your credit.

**Medical expenses.** Some expenses for the care of qualifying persons who are not able to care for themselves may qualify as work-related expenses and also as medical expenses. You can use them either way, but you cannot use the same expenses to claim both a credit and a medical expense deduction.

If you use these expenses to figure the credit and they are more than the earned income limit or the dollar limit, discussed later, you can add the excess to your medical expenses. However, if you use your total expenses to figure your medical expense deduction, you cannot use any part of them to figure your credit.



*Amounts excluded from your income under your employer's dependent care benefits plan cannot be used to claim a medical expense deduction.*

## Dependent Care Benefits

If you receive dependent care benefits, your dollar limit for purposes of the credit may be reduced. See *Reduced Dollar Limit*, later. But, even if you cannot take the credit, you may be able to take an exclusion or deduction for the dependent care benefits.

**Dependent care benefits.** Dependent care benefits include:

1. Amounts your employer paid directly to either you or your care provider for the care of your qualifying person while you work, and
2. The fair market value of care in a daycare facility provided or sponsored by your employer.

Your salary may have been reduced to pay for these benefits. If you received benefits as an employee, they should be shown on your W-2 form. See *Statement for employee*, later. Benefits you received as a partner should be shown in box 13 of your Schedule K-1 (Form 1065) with code N. Enter the amount of these benefits on Form 2441, line 12.

**Exclusion or deduction.** If your employer provides dependent care benefits under a qualified plan, you may be able to exclude these benefits from your income. Your employer can tell you whether your benefit plan qualifies. To claim the exclusion, you must complete Part III of either Form 2441 or Schedule 2 (Form 1040A). You cannot use Form 1040EZ.

If you are self-employed and receive benefits from a qualified dependent care benefit plan, you are treated as both employer and employee. Therefore, you would not get an exclusion from wages. Instead, you would get a deduction on Form 1040, Schedule C, line 14; Schedule E, line 18 or 28; or Schedule F, line 17. To claim the deduction, you must use Form 2441.

The amount you can exclude or deduct is limited to the smallest of:

1. The total amount of dependent care benefits you received during the year,
2. The total amount of qualified expenses you incurred during the year,
3. Your earned income,
4. Your spouse's earned income, or
5. \$5,000 (\$2,500 if married filing separately).

The definition of earned income for this purpose is not exactly the same as the definition for the credit. See the instructions for Form 2441 or Schedule 2 (Form 1040A).

**Statement for employee.** Your employer must give you a Form W-2 (or similar statement) showing in box 10 the total amount of dependent care benefits provided to you during the year under a qualified plan. Your employer will also include any dependent care benefits over \$5,000 in your wages shown on your Form W-2 in box 10.

**Effect of exclusion.** If you exclude dependent care benefits from your income, the amount of the excluded benefits:

1. Is not included in your work-related expenses, and
2. Reduces the dollar limit, discussed later.

## Earned Income Limit

The amount of work-related expenses you use to figure your credit cannot be more than:

1. Your earned income for the year if you are single at the end of the year, or
2. The smaller of your or your spouse's earned income for the year if you are married at the end of the year.

Earned income is defined under *Earned Income Test*, earlier.



**TIP** *For purposes of item (2), use your spouse's earned income for the entire year, even if you were married for only part of the year.*

**Separated spouse.** If you are legally separated or married and living apart from your spouse (as described under *Joint Return Test*, earlier), you are not considered married for purposes of the earned income limit. Use only your income in figuring the earned income limit.

**Surviving spouse.** If your spouse died during the year and you file a joint return as a surviving spouse, you are not considered married for purposes of the earned income limit. Use only your income in figuring the earned income limit.

**Community property laws.** You should disregard community property laws when you figure earned income for this credit.

**Student-spouse or spouse not able to care for self.** Your spouse who is either a full-time student or not able to care for himself or herself is treated as having earned income. His or her earned income for each month is considered to be at least \$250 if there is one qualifying person in your home, or at least \$500 if there are two or more.

**Spouse works.** If your spouse works during that month, use the higher of \$250 (or \$500) or his or her actual earned income for that month.

**Spouse qualifies for part of month.** If your spouse is a full-time student or not able to care for himself or herself for only part of a month, the full \$250 (or \$500) still applies for that month.

**Both spouses qualify.** If, in the same month, both you and your spouse are either full-time students or not able to care for yourselves, only one spouse can be considered to have this earned income of \$250 (or \$500) for that month.

## Dollar Limit

There is a dollar limit on the amount of your work-related expenses you can use to figure the credit. This limit is \$3,000 for one qualifying person, or \$6,000 for two or more qualifying persons.



If you paid work-related expenses for the care of two or more qualifying persons, the \$6,000 limit does not need to be divided equally among them. For example, if your work-related expenses for the care of one qualifying person are \$3,200 and your work-related expenses for another qualifying person are \$2,800, you can use the total, \$6,000, when figuring the credit.

**Yearly limit.** The dollar limit is a yearly limit. The amount of the dollar limit remains the same no matter how long, during the year, you have a qualifying person in your household. Use the \$3,000 limit if you paid work-related expenses for the care of one qualifying person at any time during the year. Use \$6,000 if you paid work-related expenses for the care of more than one qualifying person at any time during the year.

### Reduced Dollar Limit

If you received dependent care benefits that you exclude or deduct from your income, you must subtract that amount from the dollar limit that applies to you. Your reduced dollar limit is figured on lines 29 through 33 of Form 2441 or lines 23 through 27 of Schedule 2 (Form 1040A). See *Dependent Care Benefits*, earlier, for information on excluding or deducting these benefits.

**Example.** George is a widower with one child and earns \$24,000 a year. He pays work-related expenses of \$2,900 for the care of his 4-year-old child and qualifies to claim the credit for child and dependent care expenses. His employer pays an additional \$1,000 under a dependent care benefit plan. This \$1,000 is excluded from George's income.

Although the dollar limit for his work-related expenses is \$3,000 (one qualifying person), George figures his credit on only \$2,000 of the \$2,900 work-related expenses he paid. This is because his dollar limit is reduced as shown next.

#### George's Reduced Dollar Limit

1) Maximum allowable expenses for one qualifying person . . . . .	\$3,000
2) Minus: Dependent care benefits George excludes from income . . . . .	-1,000
3) Reduced dollar limit on expenses George can use for the credit . . . . .	\$2,000

### Amount of Credit

To determine the amount of your credit, multiply your work-related expenses (after applying the earned income and dollar limits) by a percentage. This percentage depends on your adjusted gross income shown on Form 1040, line 38, or Form 1040A, line 22. The following table shows the percentage to use based on adjusted gross income.

<u>IF your adjusted gross income is:</u>		<u>THEN the percentage is:</u>
<u>Over</u>	<u>But not over</u>	
\$ 0	\$15,000	35%
15,000	17,000	34%
17,000	19,000	33%
19,000	21,000	32%
21,000	23,000	31%
23,000	25,000	30%
25,000	27,000	29%
27,000	29,000	28%
29,000	31,000	27%
31,000	33,000	26%
33,000	35,000	25%
35,000	37,000	24%
37,000	39,000	23%
39,000	41,000	22%
41,000	43,000	21%
43,000	No limit	20%

### How To Claim the Credit

To claim the credit, you can file Form 1040 or Form 1040A. You cannot claim the credit on Form 1040EZ.

**Form 1040.** You must complete Form 2441 and attach it to your Form 1040. Enter the credit on Form 1040, line 48. An example of a filled-in Form 2441 is at the end of this chapter.

**Form 1040A.** You must complete Schedule 2 (Form 1040A) and attach it to your Form 1040A. Enter the credit on your Form 1040A, line 29.

**Limit on credit.** The amount of credit you can claim is limited to the amount of your regular tax (after reduction by any allowable foreign tax credit) plus your alternative minimum tax, if any.

**Tax credit not refundable.** You cannot get a refund for any part of the credit that is more than this limit.



**Recordkeeping.** You should keep records of your work-related expenses. Also, if your dependent or spouse is not able to care for himself or herself, your records should show both the nature and the length of the disability. Other records you should keep to support your claim for the credit are described earlier under *Provider Identification Test*.

## Employment Taxes for Household Employers

If you pay someone to come to your home and care for your dependent or spouse, you may be a household employer. If you are a household employer, you will need an employer identification number (EIN) and you may have to pay employment taxes. If the individuals who work in your home are self-employed, you are not liable for any of the taxes discussed in this section. Self-employed persons who are in business for themselves are not household employees. Usually, you are not a household employer if the person who cares for your dependent or spouse does so at his or her home or place of business.

If you use a placement agency that exercises control over what work is done and how it will be done by a babysitter or companion who works in your home, that person is not your employee. This control could include providing rules of conduct and appearance and requiring regular reports. In this case, you do not have to pay employment taxes. But, if an agency merely gives you a list of sitters and you hire one from that list, the sitter may be your employee.

If you have a household employee you may be subject to:

1. Social security and Medicare taxes,
2. Federal unemployment tax, and
3. Federal income tax withholding.

Social security and Medicare taxes are generally withheld from the employee's pay and matched by the employer. Federal unemployment (FUTA) tax is paid by the employer only and provides for payments of unemployment compensation to workers who have lost their jobs. Federal income tax is withheld from the employee's total pay if the employee asks you to do so and you agree.

For more information on a household employer's tax responsibilities, see Publication 926 and Schedule H (Form 1040) and its instructions.

**State employment tax.** You may also have to pay state unemployment tax. Contact your state unemployment tax office for information. You should also find out whether you need to pay or collect other state employment taxes or carry workers' compensation insurance. A list of state employment tax agencies, including addresses and phone numbers, is in Publication 926.

## Example

The following example shows how to figure the credit for child and dependent care expenses for two children when employer-provided dependent care benefits are involved. The filled-in Form 2441 is shown at the end of this chapter.

**Illustrated example.** Joan Thomas is divorced and has two children, ages 3 and 9. She works at ACME Computers. Her adjusted gross income (AGI) is \$29,000, and the entire amount is earned income.

Joan's younger child (Susan) stays at her employer's on-site childcare center while she works. The benefits from this childcare center qualify to be excluded from her income. Her

employer reports the value of this service as \$3,000 for the year. This \$3,000 is shown on her Form W-2 in box 10, but is not included in taxable wages in box 1.

A neighbor cares for Joan's older child (Seth) after school, on holidays, and during the summer. Joan pays her neighbor \$2,400 for this care.

Joan figures her credit on Form 2441 as follows.

1)	Work-related expenses Joan paid . . . . .	<u>\$2,400</u>
2)	Dollar limit (2 or more qualified individuals) . . . . .	<u>\$6,000</u>
3)	Minus: Dependent care benefits excluded from Joan's income . . . . .	<u>-3,000</u>
4)	Reduced dollar limit . . . . .	<u>\$3,000</u>

5)	Lesser of expenses paid (\$2,400) or dollar limit (\$3,000) . . . . .	\$2,400
6)	Percentage for AGI of \$29,000 (28%) . . . . .	.28
7)	Multiply the amount on line 5 by the percentage on line 6 (\$2,400 x .28) . . . . .	<u>\$ 672</u>
8)	Enter the amount from Form 1040, line 46 . . . . .	\$1,199
9)	Enter the amount from Form 1040, line 47 . . . . .	-0-
10)	Subtract line 9 from line 8 . . . . .	<u>1,199</u>
11)	Credit (Enter the smaller of line 7 or line 10) . . . . .	<u>\$672</u>

# Child and Dependent Care Expenses

▶ Attach to Form 1040 or Form 1040NR.

▶ See separate instructions.

Name(s) shown on return

Joan Thomas

Your social security number

559 | 00 | 3436

**Before you begin:** You need to understand the following terms. See **Definitions** on page 1 of the instructions.

- **Dependent Care Benefits**
- **Qualifying Person(s)**
- **Qualified Expenses**

**Part I** **Persons or Organizations Who Provided the Care**—You must complete this part.  
 (If you need more space, use the bottom of page 2.)

1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)
	Pat Green	12 Ash Avenue Hometown, TX 75240	240-00-3811	2,400
	ACME Computers	(See W-2)		

Did you receive dependent care benefits?

**No** → Complete only Part II below.

**Yes** → Complete Part III on the back next.

**Caution.** If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 62, or Form 1040NR, line 57.

**Part II** **Credit for Child and Dependent Care Expenses**

**2** Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2006 for the person listed in column (a)
First	Last		
Seth	Thomas	559   00   1234	2,400
Susan	Thomas	559   00   5678	

**3** Add the amounts in column (c) of line 2. **Do not** enter more than \$3,000 for one qualifying person or \$6,000 for two or more persons. If you completed Part III, enter the amount from line 33

**4** Enter your **earned income**. See instructions

**5** If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); **all others**, enter the amount from line 4

**6** Enter the **smallest** of line 3, 4, or 5

**7** Enter the amount from Form 1040, line 38, or Form 1040NR, line 36

**8** Enter on line 8 the decimal amount shown below that applies to the amount on line 7

If line 7 is:

Over	But not over	Decimal amount is
\$0—15,000		.35
15,000—17,000		.34
17,000—19,000		.33
19,000—21,000		.32
21,000—23,000		.31
23,000—25,000		.30
25,000—27,000		.29
27,000—29,000		.28

If line 7 is:

Over	But not over	Decimal amount is
\$29,000—31,000		.27
31,000—33,000		.26
33,000—35,000		.25
35,000—37,000		.24
37,000—39,000		.23
39,000—41,000		.22
41,000—43,000		.21
43,000—No limit		.20

**9** Multiply line 6 by the decimal amount on line 8. If you paid 2005 expenses in 2006, see the instructions

**10** Enter the amount from Form 1040, line 46, minus any amount on Form 1040, line 47, or Form 1040NR, line 43, minus any amount on Form 1040NR, line 44

**11** **Credit for child and dependent care expenses.** Enter the **smaller** of line 9 or line 10 here and on Form 1040, line 48, or Form 1040NR, line 45

<b>3</b>	2,400
<b>4</b>	29,000
<b>5</b>	29,000
<b>6</b>	2,400
<b>7</b>	29,000
<b>8</b>	X .28
<b>9</b>	672
<b>10</b>	1,199
<b>11</b>	672

**For Paperwork Reduction Act Notice, see page 4 of the instructions.**

**Part III Dependent Care Benefits**

<b>12</b>	Enter the total amount of <b>dependent care benefits</b> you received in 2006. Amounts you received as an employee should be shown in box 10 of your Form(s) W-2. <b>Do not</b> include amounts reported as wages in box 1 of Form(s) W-2. If you were self-employed or a partner, include amounts you received under a dependent care assistance program from your sole proprietorship or partnership . . . . .	<b>12</b>	3,000	
<b>13</b>	Enter the amount, if any, you carried over from 2005 and used in 2006 during the grace period. See instructions . . . . .	<b>13</b>		
<b>14</b>	Enter the amount, if any, you forfeited or carried forward to 2007. See instructions . . . . .	<b>14</b>	( )	
<b>15</b>	Combine lines 12 through 14. See instructions . . . . .	<b>15</b>	3,000	
<b>16</b>	Enter the total amount of <b>qualified expenses</b> incurred in 2006 for the care of the <b>qualifying person(s)</b> . . . . .	<b>16</b>	5,400	
<b>17</b>	Enter the <b>smaller</b> of line 15 or 16 . . . . .	<b>17</b>	3,000	
<b>18</b>	Enter your <b>earned income</b> . See instructions . . . . .	<b>18</b>	29,000	
<b>19</b>	Enter the amount shown below that applies to you. <ul style="list-style-type: none"> <li>• If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5).</li> <li>• If married filing separately, see the instructions for the amount to enter.</li> <li>• All others, enter the amount from line 18.</li> </ul>	<b>19</b>	29,000	
<b>20</b>	Enter the <b>smallest</b> of line 17, 18, or 19 . . . . .	<b>20</b>	3,000	
<b>21</b>	Enter the amount from line 12 that you received from your sole proprietorship or partnership. If you did not receive any such amounts, enter -0- . . . . .	<b>21</b>	-0-	
<b>22</b>	Subtract line 21 from line 15 . . . . .	<b>22</b>	3,000	
<b>23</b>	Enter \$5,000 (\$2,500 if married filing separately <b>and</b> you were required to enter your spouse's earned income on line 19) . . . . .	<b>23</b>	5,000	
<b>24</b>	<b>Deductible benefits.</b> Enter the <b>smallest</b> of line 20, 21, or 23. Also, include this amount on the appropriate line(s) of your return. See instructions . . . . .	<b>24</b>	-0-	
<b>25</b>	Enter the <b>smaller</b> of line 20 or 23 . . . . .	<b>25</b>	3,000	
<b>26</b>	Enter the amount from line 24 . . . . .	<b>26</b>	-0-	
<b>27</b>	<b>Excluded benefits.</b> Subtract line 26 from line 25. If zero or less, enter -0- . . . . .	<b>27</b>	3,000	
<b>28</b>	<b>Taxable benefits.</b> Subtract line 27 from line 22. If zero or less, enter -0-. Also, include this amount on Form 1040, line 7, or Form 1040NR, line 8. On the dotted line next to Form 1040, line 7, or Form 1040NR, line 8, enter "DCB". . . . .	<b>28</b>	-0-	

To claim the child and dependent care credit, complete lines 29–33 below.

<b>29</b>	Enter \$3,000 (\$6,000 if two or more qualifying persons) . . . . .	<b>29</b>	6,000	
<b>30</b>	Add lines 24 and 27 . . . . .	<b>30</b>	3,000	
<b>31</b>	Subtract line 30 from line 29. If zero or less, <b>stop</b> . You cannot take the credit. <b>Exception.</b> If you paid 2005 expenses in 2006, see the instructions for line 9 . . . . .	<b>31</b>	3,000	
<b>32</b>	Complete line 2 on the front of this form. <b>Do not</b> include in column (c) any benefits shown on line 30 above. Then, add the amounts in column (c) and enter the total here . . . . .	<b>32</b>	2,400	
<b>33</b>	Enter the <b>smaller</b> of line 31 or 32. Also, enter this amount on line 3 on the front of this form and complete lines 4–11 . . . . .	<b>33</b>	2,400	

## 33.

# Credit for the Elderly or the Disabled

## Introduction

If you qualify, the law provides a number of credits that can reduce the tax you owe for a year. One of these credits is the credit for the elderly or the disabled.

This chapter explains the following.

- Who qualifies for the credit for the elderly or the disabled.
- How to figure this credit.

You may be able to take this credit if:

- You are age 65 or older, or
- You retired on permanent and total disability and have taxable disability income.

## Useful Items

You may want to see:

### Publication

- 524** Credit for the Elderly or the Disabled
- 554** Older Americans' Tax Guide
- 967** The IRS Will Figure Your Tax

### Forms (and Instructions)

- Schedule 3 (Form 1040A)** Credit for the Elderly or the Disabled for Form 1040A Filers
- Schedule R (Form 1040)** Credit for the Elderly or the Disabled

## Can You Take the Credit?

You can take the credit for the elderly or the disabled if you meet both of the following requirements.

- You are a qualified individual.
- Your income is not more than certain limits.

You can use Figure 33-A and Figure 33-B as guides to see if you qualify.

Use Figure 33-A first to see if you are a qualified individual. If you are, go to Figure 33-B to make sure your income is not too high to take the credit.



*You can take the credit only if you file Form 1040 or Form 1040A. You cannot take the credit if you file Form 1040EZ.*

## Qualified Individual

You are a qualified individual for this credit if you are a U.S. citizen or resident alien and either of the following applies.

1. You were age 65 or older at the end of 2006.
2. You were under age 65 at the end of 2006 and all three of the following statements are true.
  - a. You retired on permanent and total disability (explained later).
  - b. You received taxable disability income for 2006.
  - c. On January 1, 2006, you had not reached mandatory retirement age (defined later under *Disability income*).

**Age 65.** You are considered to be age 65 on the day before your 65th birthday. Therefore, if you were born on January 1, 1942, you are considered to be age 65 at the end of 2006.

## U.S. Citizen or Resident Alien

You must be a U.S. citizen or resident alien (or be treated as a resident alien) to take the credit. Generally, you cannot take the credit if you were a nonresident alien at any time during the tax year.

**Exceptions.** You may be able to take the credit if you are a nonresident alien who is married to a U.S. citizen or resident alien at the end of the tax year and you and your spouse choose to treat you as a U.S. resident alien. If you make that choice, both you and your spouse are taxed on your worldwide income.

If you were a nonresident alien at the beginning of the year and a resident alien at the end of the year, and you were married to a U.S. citizen or resident alien at the end of the year, you may be able to choose to be treated as a U.S. resident alien for the entire year. In that case, you may be allowed to take the credit.

For information on these choices, see chapter 1 of Publication 519, U.S. Tax Guide for Aliens.

## Married Persons

Generally, if you are married at the end of the tax year, you and your spouse must file a joint return to take the credit. However, if you and your spouse did not live in the same household at any time during the tax year, you can file either joint or separate returns and still take the credit.

**Head of household.** You can file as head of household and qualify to take the credit, even if your spouse lived with you during the first 6 months of the year, if you meet all the tests. See *Head of Household* in chapter 2 for the tests you must meet.

## Under Age 65

If you are under age 65 at the end of 2006, you can qualify for the credit only if you are retired on permanent and total disability (discussed next) and have taxable disability income (discussed later) under *Disability income*. You are retired on permanent and total disability if:

- You were permanently and totally disabled when you retired, and
- You retired on disability before the close of the tax year.

Even if you do not retire formally, you may be considered retired on disability when you have stopped working because of your disability.

If you retired on disability before 1977, and were not permanently and totally disabled at the time, you can qualify for the credit if you were permanently and totally disabled on January 1, 1976, or January 1, 1977.



*You are considered to be under age 65 at the end of 2006 if you were born after January 1, 1942.*

**Permanent and total disability.** You are permanently and totally disabled if you cannot engage in any substantial gainful activity because of your physical or mental condition. A physician must certify that the condition has lasted or can be expected to last continuously for 12 months or more, or that the condition can be expected to result in death. See *Physician's statement*, later.

**Substantial gainful activity.** Substantial gainful activity is the performance of significant duties over a reasonable period of time while working for pay or profit, or in work generally done for pay or profit. Full-time work (or part-time work done at your employer's convenience) in a competitive work situation for at least the minimum wage conclusively shows that you are able to engage in substantial gainful activity.

Substantial gainful activity is not work you do to take care of yourself or your home. It is not unpaid work on hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities. However, doing this kind of work may show that you are able to engage in substantial gainful activity.

The fact that you have not worked for some time is not, of itself, conclusive evidence that you cannot engage in substantial gainful activity.

**Sheltered employment.** Certain work offered at qualified locations to physically or mentally impaired persons is considered sheltered employment. These qualified locations are in sheltered workshops, hospitals and similar institutions, homebased programs, and Department of Veterans Affairs (VA) sponsored homes.

Compared to commercial employment, pay is lower for sheltered employment. Therefore, one usually does not look for sheltered employment if he or she can get other employment. The fact that one has accepted sheltered employment is not proof of that person's ability to engage in substantial gainful activity.

**Physician's statement.** If you are under age 65, you must have your physician complete a statement certifying that you were permanently and totally disabled on the date you retired. You can use the statement in the instructions for

**Table 33-1. Initial Amounts**

IF your filing status is ...	THEN enter on line 10 of Schedule R (Form 1040) or Schedule 3 (Form 1040A)...
<b>Single, head of household, or qualifying widow(er)</b> with dependent child and, by the end of 2006, you were <ul style="list-style-type: none"> <li>• 65 or older . . . . . \$5,000</li> <li>• under 65 and retired on permanent and total disability<sup>1</sup> . . . . . \$5,000</li> </ul>	
<b>Married filing a joint return</b> and by the end of 2006 <ul style="list-style-type: none"> <li>• both of you were 65 or older . . . . . \$7,500</li> <li>• both of you were under 65 and one of you retired on permanent and total disability<sup>1</sup> . . . . . \$5,000</li> <li>• both of you were under 65 and both of you retired on permanent and total disability<sup>2</sup> . . . . . \$7,500</li> <li>• one of you was 65 or older, and the other was under 65 and retired on permanent and total disability<sup>3</sup> . . . . . \$7,500</li> <li>• one of you was 65 or older, and the other was under 65 and not retired on permanent and total disability . . . . . \$5,000</li> </ul>	
<b>Married filing a separate return</b> and you did not live with your spouse at any time during the year and, by the end of 2006, you were <ul style="list-style-type: none"> <li>• 65 or older . . . . . \$3,750</li> <li>• under 65 and retired on permanent and total disability<sup>1</sup> . . . . . \$3,750</li> </ul>	

<sup>1</sup>Amount cannot be more than the taxable disability income.  
<sup>2</sup>Amount cannot be more than your combined taxable disability income.  
<sup>3</sup>Amount is \$5,000 plus the taxable disability income of the spouse under age 65, but not more than \$7,500.

Schedule R (Form 1040) or Schedule 3 (Form 1040A).  
 You do not have to file this statement with your Form 1040 or Form 1040A, but you must keep it for your records.

**Veterans.** If the Department of Veterans Affairs (VA) certifies that you are permanently and totally disabled, you can substitute VA Form 21-0172, Certification of Permanent and Total Disability, for the physician's statement you are required to keep. VA Form 21-0172 must be signed by a person authorized by the VA to do so. You can get this form from your local VA regional office.

**Physician's statement obtained in earlier year.** If you got a physician's statement in an earlier year and, due to your continued disabled condition, you were unable to engage in any substantial gainful activity during 2006, you may not need to get another physician's statement for 2006. For a detailed explanation of the conditions you must meet, see the instructions for Part II of Schedule R (Form 1040) or Schedule 3 (Form 1040A). If you meet the required conditions, check the box on line 2 of Part II of Schedule R (Form 1040) or Schedule 3 (Form 1040A).

If you checked box 4, 5, or 6 in Part I of either Schedule R or Schedule 3, enter, in the space above the box on line 2 in Part II, the first name(s) of the spouse(s) for whom the box is checked.

**Disability income.** If you are under age 65, you must also have taxable disability income to qualify for the credit. Disability income must meet both of the following requirements.

- It must be paid under your employer's accident or health plan or pension plan.
- It must be included in your income as wages (or payments instead of wages) for the time you are absent from work because of permanent and total disability.

**Payments that are not disability income.** Any payment you receive from a plan that does not provide for disability retirement is not disability income. Any lump-sum payment for accrued annual leave that you receive when you retire on disability is a salary payment and is not disability income.

For purposes of the credit for the elderly or the disabled, disability income does not include amounts you receive after you reach mandatory retirement age. Mandatory retirement age is the age set by your employer at which you would have had to retire, had you not become disabled.

**Income Limits**

To determine if you can claim the credit, you must consider two income limits. The first limit is the amount of your adjusted gross income (AGI). The second limit is the amount of nontaxable social security and other nontaxable pensions you received. The limits are shown in Figure 33-B, later.

If both your AGI and nontaxable pensions are less than the income limits, you may be able to claim the credit. See *Figuring the Credit*, next.



If either your AGI or your nontaxable pensions are equal to or more than the income limits, you cannot take the credit.

**Figuring the Credit**

You can figure the credit yourself (see the explanation that follows) or the IRS will figure it for you. See *Credit Figured for You*, later.

**Figuring the credit yourself.** If you figure the credit yourself, fill out the front of either Schedule R (if you are filing Form 1040) or Schedule 3 (if you are filing Form 1040A). Next, fill out Part III of either Schedule R or Schedule 3.



There are four steps in Part III to determine the amount of your credit:

1. Determine your initial amount (lines 10–12).
2. Determine the total of any nontaxable social security and certain other nontaxable pensions and disability benefits you received (lines 13a, 13b, and 13c).
3. Determine your excess adjusted gross income (lines 14–17).
4. Determine your credit (lines 18–24 of Schedule R or lines 18–22 of Schedule 3).

These steps are discussed in more detail next.

**Step 1. Determine Initial Amount**

To figure the credit, you must first determine your initial amount. See Table 33-1.

**Initial amounts for persons under age 65.** If you are a qualified individual under age 65, your initial amount cannot be more than your taxable disability income.

**Step 2. Total Certain Nontaxable Pensions and Benefits**

Step 2 is to figure the total amount of nontaxable social security and certain other nontaxable payments you received during the year. (See *Nontaxable payments*, later.)

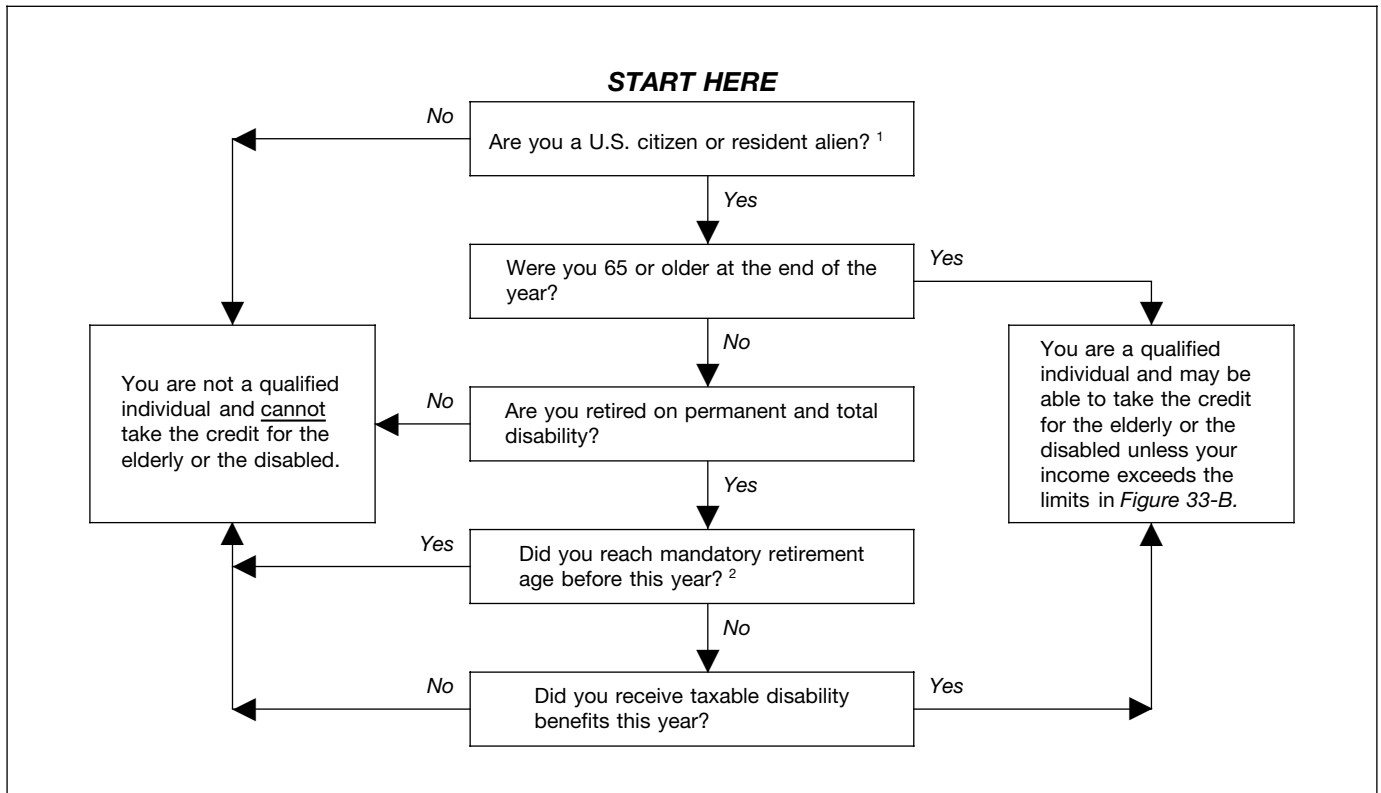
Enter these nontaxable payments on lines 13a or 13b, and total them on line 13c. If you are married filing a joint return, you must enter the combined amount of nontaxable payments both you and your spouse receive.



Worksheets are provided in the Form 1040 and Form 1040A instructions to help you determine if any of your social security benefits (or equivalent railroad retirement benefits) are taxable.

**Nontaxable payments.** Include the following nontaxable payments in the amounts you enter on lines 13a and 13b.

Figure 33-A. Are You a Qualified Individual?



<sup>1</sup> If you were a nonresident alien at any time during the tax year and were married to a U.S. citizen or resident alien at the end of the tax year, see *U.S. Citizen or Resident Alien under Qualified Individual*. If you and your spouse choose to treat you as a U.S. resident alien, answer “yes” to this question.

<sup>2</sup> Mandatory retirement age is the age set by your employer at which you would have been required to retire, had you not become disabled.

Figure 33-B. Income Limits

IF your filing status is ...	THEN even if you qualify (see Figure 33-A), you CANNOT take the credit if ...	
	Your adjusted gross income (AGI)* is equal to or more than ...	OR the total of your nontaxable social security and other nontaxable pension(s) is equal to or more than ...
single, head of household, or qualifying widow(er) with dependent child	\$17,500	\$5,000
married filing a joint return and both spouses qualify in Figure 33-A	\$25,000	\$7,500
married filing a joint return and only one spouse qualifies in Figure 33-A	\$20,000	\$5,000
married filing a separate return and you lived apart from your spouse the entire year	\$12,500	\$3,750

\*AGI is the amount on Form 1040A, line 22, or Form 1040, line 38.

- Nontaxable social security payments. This is the nontaxable part of the amount of benefits shown in box 5 of Form SSA-1099, which includes disability benefits, before deducting any amounts withheld to pay premiums on supplementary Medicare insurance, and before any reduction because of benefits received under workers' compensation. (Do not include a lump-sum death benefit payment you may receive as a surviving spouse, or a surviving child's insurance benefit payments you may receive as a guardian.)
- Nontaxable railroad retirement pension payments treated as social security. This is the nontaxable part of the amount of benefits shown in box 5 of Form RRB-1099.
- Nontaxable pension or annuity payments or disability benefits that are paid under a law administered by the Department of Veterans Affairs (VA). (Do not include amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the National Oceanic and Atmospheric Administration, or the Public Health Service, or as a disability annuity under section 808 of the Foreign Service Act of 1980.)
- Pension or annuity payments or disability benefits that are excluded from income under any provision of federal law other than the Internal Revenue Code. (Do not include amounts that are a return of your cost of a pension or annuity. These amounts do not reduce your initial amount.)



You should be sure to take into account all of the nontaxable amounts you receive. These amounts are verified by the IRS through information supplied by other government agencies.

### Step 3. Determine Excess Adjusted Gross Income

You also must reduce your initial amount by your excess adjusted gross income. Figure your excess adjusted gross income on lines 14–17.

You figure your excess adjusted gross income as follows:

1. Subtract from your adjusted gross income (Form 1040, line 38 or Form 1040A, line 22) the amount shown for your filing status in the following list:
  - a. \$7,500 if you are single, a head of household, or a qualifying widow(er) with a dependent child,
  - b. \$10,000 if you are married filing a joint return, or

- c. \$5,000 if you are married filing a separate return and you and your spouse did not live in the same household at any time during the tax year.

2. Divide the result of (1) by 2.

### Step 4. Determine Your Credit

To determine if you can take the credit, you must add the amounts you figured in Step 2 and Step 3.

IF the total of Steps 2 and 3 is ...	THEN ...
equal to or more than the amount in Step 1	you <b>cannot</b> take the credit.
less than the amount in Step 1	you <b>can</b> take the credit.

**Figuring the credit.** If you can take the credit, subtract the total of Step 2 and Step 3 from the amount in Step 1 and multiply the result by 15%.

In certain cases, the amount of your credit may be limited. See *Limit on credit*, later.

**Example.** You are 66 years old and your spouse is 64. Your spouse is not disabled. You file a joint return on Form 1040. Your adjusted gross income is \$14,630. Together you received \$3,200 from social security, which was nontaxable. You figure the credit as follows:

1) Initial amount . . . . .	\$5,000
2) Subtract from line 1 the total of:	
a) Nontaxable social security and other nontaxable pensions . . . . .	\$3,200
b) Excess adjusted gross income	
$[(\$14,630 - \$10,000) \div 2]$ . . . . .	2,315
3) Balance (Not less than -0-) . . . . .	-0-
4) Credit . . . . .	-0-

You cannot take the credit because your nontaxable social security (line 2a) plus your excess adjusted gross income (line 2b) is more than your initial amount (line 1).

**Limit on credit.** The amount of credit you can claim may be limited.

Figure any limit on your credit on lines 21–24 of Schedule R or lines 21–22 of Schedule 3.

### Credit Figured for You

If you choose to have the Internal Revenue Service (IRS) figure the credit for you, read the

following discussion for the form you will file (Form 1040 or 1040A). If you want the IRS to figure your tax, see chapter 30.

**Form 1040.** If you want the IRS to figure your credit, see *Form 1040 Line Entries* under *Tax Figured by IRS* in chapter 30.

**Form 1040A.** If you want the IRS to figure your credit, see *Form 1040A Line Entries* under *Tax Figured by IRS* in chapter 30.

### Example

The following example illustrates the credit for the elderly or the disabled. The initial amount is taken from Table 33-1, shown earlier.

James Davis is 58 years old, single, and files Form 1040A. In 1998 he retired on permanent and total disability, and he is still permanently and totally disabled. He got the required physician's statement in 1998, and kept it with his records. His physician signed on line B of the statement. This year James checks the box in Part II of Schedule 3. He does not need to get another statement for 2006.

He received the following income for the year:

Nontaxable social security . . . . .	\$1,500
Interest (taxable) . . . . .	100
Taxable disability pension . . . . .	11,400

James' adjusted gross income is \$11,500 (\$11,400 + \$100). He figures the credit on Schedule 3 as follows:

1) Initial amount . . . . .	\$5,000
2) Taxable disability pension . . . . .	11,400
3) Smaller of (1) or (2) . . . . .	5,000
4) Subtract from line 3 the total of:	
a) Nontaxable social security benefits . . . . .	\$1,500
b) Excess adjusted gross income	
$[(\$11,500 - \$7,500) \div 2]$ . . . . .	2,000
5) Balance (not less than -0-) . . . . .	1,500
6) Multiply line 5 by 15% (.15) . . . . .	225
7) Enter the amount from Form 1040A, line 28 . . . . .	308
8) Enter any amounts from Form 1040A, line 29 . . . . .	-0-
9) Subtract line 8 from line 7 . . . . .	308
10) Credit (Enter the smaller of line 6 or line 9) . . . . .	\$225

His credit is \$225. He enters \$225 on line 30 of Form 1040A. The Schedule 3 for James Davis is not shown.

# 34.

## Child Tax Credit

### Introduction

The child tax credit is a credit that may reduce your tax by as much as \$1,000 for each of your qualifying children.

The additional child tax credit is a credit you may be able to take if you are not able to claim the full amount of the child tax credit.

This chapter explains the following.

- Who is a qualifying child.
- How much is the credit.
- How to claim the credit.
- Why you should check your tax withholding.



*The child tax credit and the additional child tax credit should not be confused with the child and dependent care credit discussed in chapter 32.*

**If you have no tax.** Credits, such as the child tax credit, the adoption credit, or the credit for child and dependent care expenses, are used to reduce tax. If your tax on Form 1040, line 46, or Form 1040A, line 28, is zero, do not figure the child tax credit because there is no tax to reduce. However, you may qualify for the additional child tax credit on line 68 (Form 1040) or line 41 (Form 1040A).

### Useful Items

You may want to see:

#### Publication

- 972** Child Tax Credit

#### Form (and Instructions)

- 8812** Additional Child Tax Credit
- 8901** Information on Qualifying Children Who Are Not Dependents
- W-4** Employee's Withholding Allowance Certificate

### Qualifying Child

A qualifying child for purposes of the child tax credit is a child who:

1. Is your son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your grandchild),
2. Was under age 17 at the end of 2006,
3. Did not provide over half of his or her own support for 2006,

4. Lived with you for more than half of 2006 (see *Exception to time lived with you below*), and
5. Was a U.S. citizen, a U.S. national, or a resident of the United States. If the child was adopted, see *Adopted child* below.

For each qualifying child you must either check the box on Form 1040 or Form 1040A, line 6c, column (4), or complete Form 8901 (if the child is not your dependent).

**Example.** Your son turned 17 on December 30, 2006. He is a citizen of the United States and you claimed him as a dependent on your return. He is not a qualifying child for the child tax credit because he was not under age 17 at the end of 2006.

**Exceptions to time lived with you.** A child is considered to have lived with you for all of 2006 if the child was born or died in 2006 and your home was this child's home for the entire time he or she was alive. Temporary absences for special circumstances, such as for school, vacation, medical care, military service, or detention in a juvenile facility, count as time lived at home.

There are also exceptions for kidnapped children and children of divorced or separated parents. For details, see *Residency Test*, in chapter 3.

**Qualifying child of more than one person.** A special rule applies if your qualifying child is the qualifying child of more than one person. For details, see *Special Test for Qualifying Child of More Than One Person*, in chapter 3.

**Adopted child.** An adopted child is always treated as your own child. An adopted child includes a child lawfully placed with you for legal adoption.

If you are a U.S. citizen or U.S. national and your adopted child lived with you as a member of your household all year, that child meets condition (5) above to be a qualifying child for the child tax credit.

### Amount of Credit

The maximum amount you can claim for the credit is \$1,000 for each qualifying child.

### Limits on the Credit

You must reduce your child tax credit if either (1) or (2) applies.

1. The amount on Form 1040, line 46, or Form 1040A, line 28, is less than the credit. If this amount is zero, you cannot take this credit because there is no tax to reduce. But you may be able to take the additional child tax credit. See *Additional Child Tax Credit*, later.
2. Your modified adjusted gross income (AGI) is above the amount shown below for your filing status.
  - a. Married filing jointly - \$110,000.

- b. Single, head of household, or qualifying widow(er) - \$75,000.
- c. Married filing separately - \$55,000.

**Modified AGI.** For purposes of the child tax credit, your modified AGI is your AGI plus the following amounts that may apply to you.

- Any amount excluded from income because of the exclusion of income from Puerto Rico.
- Any amount on line 45 or line 50 of Form 2555, Foreign Earned Income.
- Any amount on line 18 of Form 2555-EZ, Foreign Earned Income Exclusion.
- Any amount on line 15 of Form 4563, Exclusion of Income for Bona Fide Residents of American Samoa.

If you do not have any of the above, your modified AGI is the same as your AGI.

**AGI.** Your AGI is the amount on Form 1040, line 38, or Form 1040A, line 22.

### Claiming the Credit

To claim the child tax credit, you must file Form 1040 or Form 1040A. You cannot claim the child tax credit on Form 1040EZ. You must provide the name and identification number (usually a social security number) on your tax return (or Form 8901) for each qualifying child.

Answer the *Questions* in your form instructions for Form 1040, line 53, or Form 1040A, line 33, to find out which child tax credit worksheet you can use to figure the credit.

If you answer "Yes" to question 1, 2, or 3 in your Form 1040 instructions or question 1 in your Form 1040A instructions, you must complete the child tax credit worksheet in Publication 972. Otherwise, you can use the Child Tax Credit Worksheet in your Form 1040 or Form 1040A instructions. (See the filled-in example, later.)

### Additional Child Tax Credit

This credit is for certain individuals who get less than the full amount of the child tax credit. The additional child tax credit may give you a refund even if you do not owe any tax.

**How to claim the additional child tax credit.** To claim the additional child tax credit, follow the steps below.

1. Make sure you figured the amount, if any, of your child tax credit. See *Claiming the Credit*, earlier.
2. If you answered "Yes" on line 4 or line 5 of the Child Tax Credit Worksheet in the Form 1040 or Form 1040A instructions, or line 13 of the Child Tax Credit Worksheet

in Publication 972, use Form 8812 to see if you can take the additional child tax credit.

3. If you have an additional child tax credit on line 13 of Form 8812, carry it to Form 1040, line 68 or Form 1040A, line 41.

## Checking Your Withholding

The child tax credit decreases your tax. You can check your tax withholding by using Publication 919, How Do I Adjust My Tax Withholding.

If you are having too much tax withheld, and you prefer to have the money during the year, you may be able to decrease your withholding. You do this by completing a new Form W-4 and giving it to your employer.

## Example

Amy Brown files as head of household and has two dependent children under age 17. The children are qualifying children for purposes of the child tax credit. Amy's only income is her salary of \$30,350. Amy chooses to itemize her deductions and files Form 1040. Her AGI, shown on line 38 of her Form 1040, is \$30,350. This is her taxable earned income.

Amy does not file Form 2555, 2555-EZ, or 4563. She does not exclude income from Puerto Rico. Her modified AGI is \$30,350.

Amy's tax, shown on line 46 of her Form 1040, is \$1,334. She claims a \$225 credit for child and dependent care expenses on line 48. She claims a \$1,029 earned income credit on line 66a. She has no other credits.

After answering the *Questions* in the Form 1040 instructions for line 53, she completes the child tax credit worksheet to figure her child tax credit of \$1,109. Amy's completed questions and child tax credit worksheet are shown later.

Amy reads the *TIP* in the worksheet and finds that she may be able to take the additional child tax credit. See *Additional Child Tax Credit* and Amy's completed Form 8812, later.

## Filled-in Questions for Amy Brown (Page references are to the Form 1040 instructions.)

### Questions

### Who Must Use Pub. 972



1. Is the amount on Form 1040, line 38, more than the amount shown below for your filing status?

- Married filing jointly – \$110,000
- Single, head of household, or qualifying widow(er) – \$75,000
- Married filing separately – \$55,000

**No.** *Continue* ↘

**Yes.** You must use Pub. 972 to figure your credit.

2. Are you claiming any of the following credits?

- Residential energy efficient property credit, Form 5695, Part II.
- Adoption credit, Form 8839 (see the instructions for Form 1040, line 53, on page 43).
- Mortgage interest credit, Form 8396 (see the instructions for Form 1040, line 54, on page 43).
- District of Columbia first-time homebuyer credit, Form 8859.

**No.** *Continue* ↘

**Yes.** You must use Pub. 972 to figure your child tax credit. You will also need the form(s) listed above for any credit(s) you are claiming.

3. Are you excluding income from Puerto Rico or are you filing any of the following forms?

- Form 2555 or 2555-EZ (relating to foreign earned income).
- Form 4563 (exclusion of income for residents of American Samoa).

**No.** Use the worksheet on page 43 to figure your credit.

**Yes.** You must use Pub. 972 to figure your credit.



- To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2006 and meet the other requirements listed on page 19.
- Do not** use this worksheet if you answered “Yes” to question 1, 2, or 3 on page 42. Instead, use Pub. 972.

1. Number of qualifying children: 2 × \$1,000. Enter the result. 1 | 2,000

2. Enter the amount from Form 1040, line 46. 2 | 1,334

3. Add the amounts from Form 1040:

Line 47 \_\_\_\_\_

Line 48 + 225

Line 49 + \_\_\_\_\_

Line 50 + \_\_\_\_\_

Line 51 + \_\_\_\_\_

Line 52\* + \_\_\_\_\_ Enter the total. 3 | 225

\*Include only the amount, if any, from Form 5695, line 12.

4. Are the amounts on lines 2 and 3 the same?

**Yes.** You cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit**. See the **TIP** below.

**No.** Subtract line 3 from line 2. 4 | 1,109

5. Is the amount on line 1 more than the amount on line 4?

**Yes.** Enter the amount from line 4. Also, you may be able to take the **additional child tax credit**. See the **TIP** below. 5 | 1,109

**No.** Enter the amount from line 1.

**This is your child tax credit.**

Enter this amount on Form 1040, line 53.

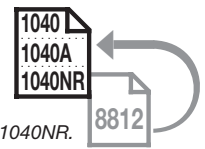


You may be able to take the **additional child tax credit** on Form 1040, line 68, if you answered “Yes” on line 4 or line 5 above.

- First, complete your Form 1040 through line 67.
- Then, use Form 8812 to figure any additional child tax credit.



# Additional Child Tax Credit



Complete and attach to Form 1040, Form 1040A, or Form 1040NR.

Name(s) shown on return: Amy Brown      Your social security number: 012 00 5678

**Part I All Filers**

<b>1</b>	Enter the amount from line 1 of your Child Tax Credit Worksheet on page 43 of the Form 1040 instructions, page 38 of the Form 1040A instructions, or page 20 of the Form 1040NR instructions. If you used Pub. 972, enter the amount from line 8 of the worksheet on page 4 of the publication . . . . .	<b>1</b>	2,000
<b>2</b>	Enter the amount from Form 1040, line 53, Form 1040A, line 33, or Form 1040NR, line 48 . . . . .	<b>2</b>	1,109
<b>3</b>	Subtract line 2 from line 1. If zero, <b>stop</b> ; you cannot take this credit . . . . .	<b>3</b>	891
<b>4a</b>	Enter your total earned income (see instructions on back) . . . . .	<b>4a</b>	30,350
<b>b</b>	Nontaxable combat pay (see instructions on back) . . . . .	<b>4b</b>	
<b>5</b>	Is the amount on line 4a more than \$11,300? <input type="checkbox"/> <b>No.</b> Leave line 5 blank and enter -0- on line 6. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract \$11,300 from the amount on line 4a. Enter the result . . . . .	<b>5</b>	19,050
<b>6</b>	Multiply the amount on line 5 by 15% (.15) and enter the result . . . . . <b>Next.</b> Do you have three or more qualifying children? <input checked="" type="checkbox"/> <b>No.</b> If line 6 is zero, stop; you cannot take this credit. Otherwise, skip Part II and enter the <b>smaller</b> of line 3 or line 6 on line 13. <input type="checkbox"/> <b>Yes.</b> If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7.	<b>6</b>	2,858

**Part II Certain Filers Who Have Three or More Qualifying Children**

<b>7</b>	Withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If you worked for a railroad, see instructions on back . . . . .	<b>7</b>	
<b>8</b>	<b>1040 filers:</b> Enter the total of the amounts from Form 1040, lines 27 and 59, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 63. <b>1040A filers:</b> Enter -0-. <b>1040NR filers:</b> Enter the total amounts from Form 1040NR, line 54, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 58.	<b>8</b>	
<b>9</b>	Add lines 7 and 8 . . . . .	<b>9</b>	
<b>10</b>	<b>1040 filers:</b> Enter the total of the amounts from Form 1040, lines 66a and 67. <b>1040A filers:</b> Enter the total of the amount from Form 1040A, line 40a, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 43 (see instructions on back). <b>1040NR filers:</b> Enter the amount from Form 1040NR, line 61.	<b>10</b>	
<b>11</b>	Subtract line 10 from line 9. If zero or less, enter -0- . . . . .	<b>11</b>	
<b>12</b>	Enter the <b>larger</b> of line 6 or line 11 . . . . . <b>Next,</b> enter the <b>smaller</b> of line 3 or line 12 on line 13.	<b>12</b>	

**Part III Additional Child Tax Credit**

<b>13</b>	<b>This is your additional child tax credit</b> . . . . .	<b>13</b>	891
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Enter this amount on . . .  
 Form 1040, line 68, . . .  
 Form 1040A, line 41, or . . .  
 Form 1040NR, line 62. . .

# 35.

## Education Credits

### What's New

**Income limits increased.** Beginning in 2006, the amount of your Hope or lifetime learning credit is gradually reduced (phased out) if your modified adjusted gross income (MAGI) is between \$45,000 and \$55,000 (\$90,000 and \$110,000 if you file a joint return). You cannot claim a credit if your MAGI is \$55,000 or more (\$110,000 or more if you file a joint return). This is an increase from the 2005 limits of \$43,000 and \$53,000 (\$87,000 and \$107,000 if filing a joint return). For more information, see *Effect of the Amount of Your Income on the Amount of Your Credit*, later.

### Reminders

**Katrina Emergency Tax Relief Act of 2005.** This Act provides tax relief for persons affected by Hurricane Katrina. Under the Act, you may be able to claim an education credit. See Publication 4492.

### Introduction

This chapter discusses two tax credits (referred to here as education credits) available to persons who pay expenses for higher education. They are:

- The Hope credit, and
- The lifetime learning credit.

The chapter will do the following.

- Give you general information that applies to both of the credits.
- Give you specific information about each of the credits.
- Help you choose which of the credits to claim.
- Show you how to figure the credit you choose.

**Can you claim both education credits this year.** For each student, you can elect for any year only one of the credits. For example, if you elect to take the Hope credit for a child on your 2006 tax return, you cannot, for that same child, also claim the lifetime learning credit for 2006.

If you are eligible to claim the Hope credit and you are also eligible to claim the lifetime learning credit for the same student in the same

Table 35-1. Comparison of Education Credits

Hope Credit	Lifetime Learning Credit
Up to \$1,650 credit per eligible student	Up to \$2,200 credit per return
Available only until the first 2 years of postsecondary education are completed	Available for all years of postsecondary education and for courses to acquire or improve job skills
Available only for 2 years per eligible student	Available for an unlimited number of years
Student must be pursuing an undergraduate degree or other recognized educational credential	Student does not need to be pursuing a degree or other recognized education credential
Student must be enrolled at least half time for at least one academic period beginning during the year	Available for one or more courses
No felony drug conviction on student's record	Felony drug conviction rule does not apply

year, you can choose to claim either credit, but not both. For 2006, if the total qualified education expenses for a student are less than \$7,500, it will generally be to your benefit to claim the Hope credit.

If you pay qualified education expenses for more than one student in the same year, you can choose to take credits on a per-student, per-year basis. This means that, for example, you can claim the Hope credit for one student and the lifetime learning credit for another student in the same year.

**Differences between the Hope and lifetime learning credits.** There are several differences between these two credits. For example, you can claim the Hope credit based on the same student's expenses for no more than 2 years. However, there is no limit on the number of years for which you can claim a lifetime learning credit based on the same student's expenses. The differences between the two credits are summarized in Table 35-1, above.



*At the time this publication went to print, Congress was considering legislation that would reinstate the tuition and fees deduction. If this deduction is reinstated, you may be able to take a deduction for your education expenses instead of a credit. Choose the one that will give you the lower tax. To find out if this legislation was enacted, and for more details, go to [www.irs.gov](http://www.irs.gov), click on More Forms and Publications, and then on What's Hot in forms and publications, or see Publication 553, Highlights of 2006 Tax Changes.*

### Useful Items

You may want to see:

#### Publication

- 970** Tax Benefits for Education

#### Form (and Instructions)

- 8863** Education Credits (Hope and Lifetime Learning Credits)

## Information for Both the Hope and Lifetime Learning Credits

Several rules are common to both education credits. These are discussed below.

### Can You Claim a Credit

The following rules will help you determine if you are eligible to claim an education credit on your tax return.

#### Who Can Claim a Credit

Generally, you can claim an education credit if all three of the following requirements are met.

- You pay qualified education expenses of higher education.
- You pay the education expenses for an eligible student.
- The eligible student is either yourself, your spouse, or a dependent for whom you claim an exemption on your tax return.

**Note.** Qualified education expenses paid by a dependent for whom you claim an exemption, or by a third party for that dependent, are considered paid by you.

"Qualified education expenses" are defined later under *What Expenses Qualify*. "Eligible students" are defined later under *Who Is an Eligible Student*. A "dependent for whom you claim an exemption" is defined later under *Who Can Claim a Dependent's Expenses*.

You may find Figure 35-A, on the next page, helpful in determining if you can claim an education credit on your tax return.

#### Who Cannot Claim a Credit

You cannot claim an education credit for 2006 if any of the following apply.

- Your filing status is married filing separately.

- You are listed as a dependent in the *Exemptions* section on another person's tax return (such as your parents'). See *Who Can Claim a Dependent's Expenses*, later.
- Your MAGI is \$55,000 or more (\$110,000 or more in the case of a joint return). MAGI is explained later under *Effect of the Amount of Your Income on the Amount of Your Credit*.
- You (or your spouse) were a nonresident alien for any part of 2006 and the nonresident alien did not elect to be treated as a resident alien for tax purposes. More information on nonresident aliens can be found in Publication 519, U.S. Tax Guide for Aliens.



At the time this publication went to print, Congress was considering legislation that would reinstate the tuition and fees deduction. If this deduction is reinstated, you cannot take both an education credit and a deduction for your education expenses for 2006. Choose the one that will give you the lower tax. To find out if this legislation was enacted, and for more details, go to [www.irs.gov](http://www.irs.gov), click on More Forms and Publications, and then on What's Hot in forms and publications, or see Publication 553, *Highlights of 2006 Tax Changes*.

## What Expenses Qualify

The education credits are based on qualified education expenses you pay for yourself, your spouse, or a dependent for whom you claim an exemption on your tax return. Generally, a credit is allowed for qualified education expenses paid in 2006 for an academic period beginning in 2006 or in the first 3 months of 2007.

For example, if you paid \$1,500 in December 2006 for qualified tuition for the Spring 2007 semester beginning in January 2007, you may be able to use that \$1,500 in figuring your 2006 credit.

**Academic period.** An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution. In the case of an educational institution that uses credit hours or clock hours and does not have academic terms, each payment period can be treated as an academic period.

**Paid with borrowed funds.** You can claim an education credit for qualified education expenses paid with the proceeds of a loan. You use the expenses to figure the education credit for the year in which the expenses are paid, not the year in which the loan is repaid. Treat loan payments sent directly to the educational institution as paid on the date the institution credits the student's account.

**Student withdraws from class(es).** You can claim an education credit for qualified education expenses not refunded when a student withdraws.

## Qualified Education Expenses

For purposes of an education credit, qualified education expenses are tuition and certain related expenses required for enrollment or attendance at an eligible educational institution.

**Eligible educational institution.** An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Certain educational institutions located outside the United States also participate in the U.S. Department of Education's Federal Student Aid (FSA) programs.

**Related expenses.** Student-activity fees and expenses for course-related books, supplies, and equipment are included in qualified education expenses only if the fees and expenses must be paid to the institution as a condition of enrollment or attendance.

In the following examples, assume that each student is an eligible student at an eligible educational institution.

**Example 1.** Jackson is a sophomore in University V's degree program in dentistry. This year, in addition to tuition, he is required to pay a fee to the university for the rental of the dental equipment he will use in this program. Because the equipment rental fee must be paid to University V for enrollment and attendance, Jackson's equipment rental fee is a qualified expense.

**Example 2.** Donna and Charles, both first-year students at College W, are required to have certain books and other reading materials to use in their mandatory first-year classes. The college has no policy about how students should obtain these materials, but any student who purchases them from College W's bookstore will receive a bill directly from the college. Charles bought his books from a friend, so what he paid for them is not a qualified education expense. Donna bought hers at College W's bookstore. Although Donna paid College W directly for her first-year books and materials, her payment is not a qualified expense because the books and materials are not required to be purchased from College W for enrollment or attendance at the institution.

**Example 3.** When Marci enrolled at College X for her freshman year, she had to pay a separate student activity fee in addition to her tuition. This activity fee is required of all students, and is used solely to fund on-campus organizations and activities run by students, such as the student newspaper and the student government. No portion of the fee covers personal expenses. Although labeled as a student activity fee, the fee is required for Marci's enrollment and attendance at College X. Therefore, it is a qualified expense.

## No Double Benefit Allowed

You cannot do any of the following.

- Deduct higher education expenses on your income tax return (as, for example, a business expense) and also claim an education credit based on those same expenses.
- Claim a Hope credit and a lifetime learning credit based on the same qualified education expenses.
- Claim an education credit based on the same expenses used to figure the tax-free portion of a distribution from a Coverdell education savings account (ESA) or qualified tuition program (QTP).
- Claim a credit based on qualified education expenses paid with tax-free scholarship, grant, or employer-provided educational assistance. See *Adjustments to Qualified Education Expenses*, later.



At the time this publication went to print, Congress was considering legislation that would reinstate the tuition and fees deduction. If this deduction is reinstated, you cannot take both an education credit and a deduction for your education expenses for 2006. Choose the one that will give you the lower tax. To find out if this legislation was enacted, and for more details, go to [www.irs.gov](http://www.irs.gov), click on More Forms and Publications, and then on What's Hot in forms and publications, or see Publication 553, *Highlights of 2006 Tax Changes*.

## Adjustments to Qualified Education Expenses

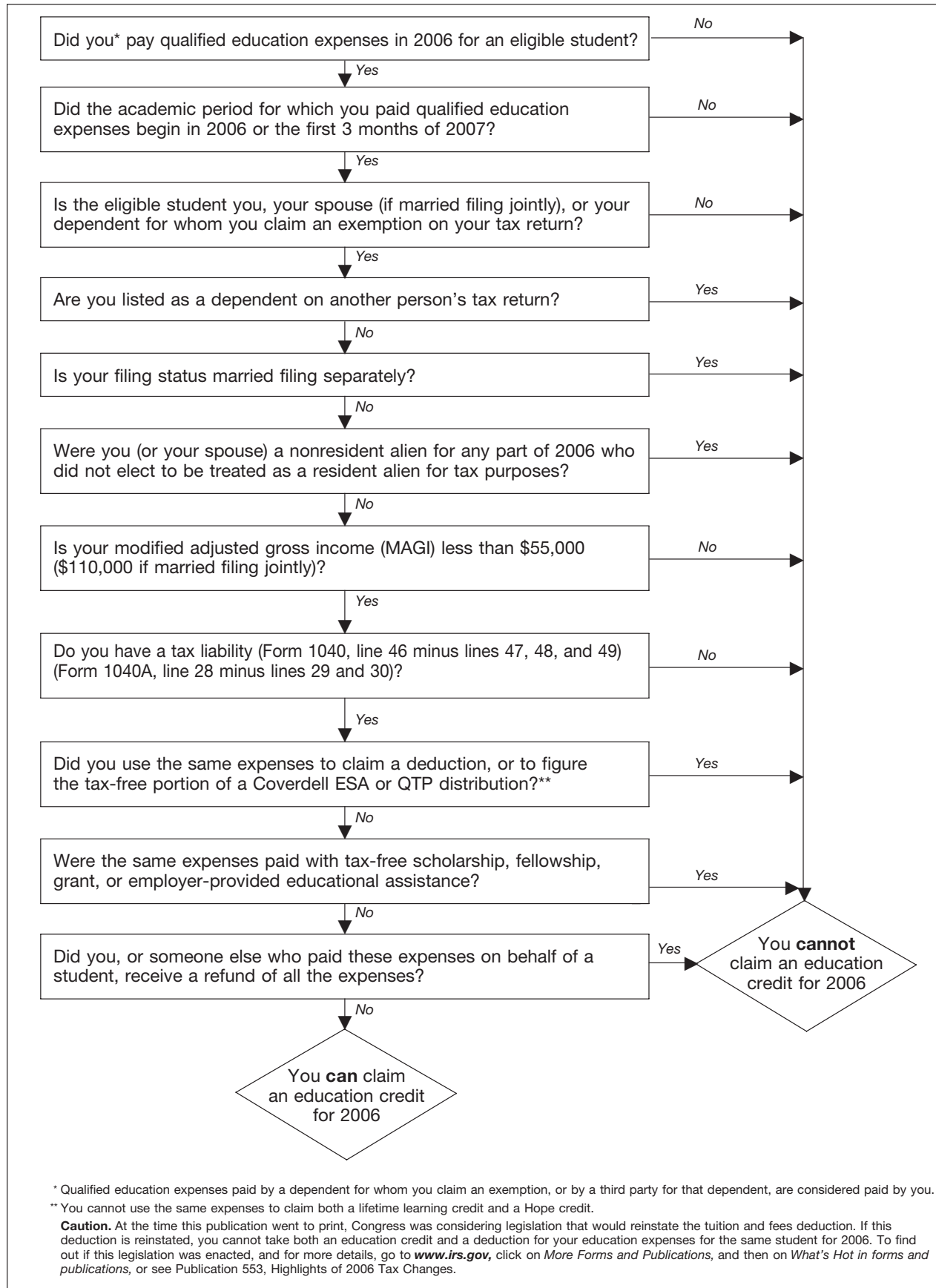
If you pay qualified education expenses with certain tax-free funds, you cannot claim a credit for those amounts. You must reduce the qualified education expenses by the amount of any tax-free educational assistance and refund(s) you received.

**Tax-free educational assistance.** This includes:

- Tax-free parts of scholarships and fellowships (see chapter 12 of this publication and chapter 1 of Publication 970),
- Pell grants (see chapter 1 of Publication 970),
- Employer-provided educational assistance (see chapter 10 of Publication 970),
- Veterans' educational assistance (see chapter 1 of Publication 970), and
- Any other nontaxable (tax-free) payments (other than gifts or inheritances) received as educational assistance.

**Refunds.** Qualified education expenses do not include expenses for which you, or someone else who paid qualified education expenses on behalf of a student, receive a refund. For more

Figure 35-A. **Can You Claim an Education Credit for 2006?**



information, see *Refunds* in chapters 2 and 3 of Publication 970.

**Amounts that do not reduce qualified education expenses.** Do not reduce qualified education expenses by amounts paid with funds the student receives as:

- Payment for services, such as wages,
- A loan,
- A gift,
- An inheritance, or
- A withdrawal from the student's personal savings.

Do not reduce the qualified education expenses by any scholarship or fellowship reported as income on the student's tax return in the following situations.

- The use of the money is restricted to costs of attendance (such as room and board) other than qualified education expenses.
- The use of the money is not restricted and is used to pay education expenses that are not qualified (such as room and board).

**Example 1.** Jackie paid \$3,000 for tuition and \$5,000 for room and board at University X. The university did not require her to pay any fees in addition to her tuition in order to enroll in or attend classes. To help pay these costs, she was awarded a \$2,000 scholarship and a \$4,000 student loan.

The terms of the scholarship state that it may be used to pay any of Jackie's college expenses. Because she applied it toward her tuition, the scholarship is tax free. Therefore, for purposes of figuring an education credit (either Hope or lifetime learning), she must first use the \$2,000 scholarship to reduce her tuition (her only qualified education expense). The student loan is not tax-free educational assistance, so she does not use it to reduce her qualified expenses. Jackie is treated as having paid \$1,000 in qualified education expenses (\$3,000 tuition – \$2,000 scholarship).

**Example 2.** The facts are the same as in *Example 1*, except that Jackie uses the \$2,000 scholarship to pay room and board, and, therefore, reports her entire scholarship as income on her tax return. In this case, the scholarship is allocated to expenses other than qualified education expenses. Jackie is treated as paying the entire \$3,000 tuition with other funds and can figure her education credit on the entire \$3,000.

### Expenses That Do Not Qualify

Qualified education expenses do not include amounts paid for:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation, or

- Similar personal, living, or family expenses.

This is true even if the amount must be paid to the institution as a condition of enrollment or attendance.

**Sports, games, hobbies, and noncredit courses.** Qualified education expenses generally do not include expenses that relate to any course of instruction or other education that involves sports, games or hobbies, or any non-credit course. However, if the course of instruction or other education is part of the student's degree program, these expenses can qualify.

**Comprehensive or bundled fees.** Some eligible educational institutions combine all of their fees for an academic period into one amount. If you do not receive or do not have access to an allocation showing how much you paid for qualified education expenses and how much you paid for personal expenses, such as those listed above, contact the institution. The institution is required to make this allocation and provide you with the amount you paid (or were billed) for qualified education expenses on Form 1098-T, Tuition Statement. See *Figuring the Credit*, later, for more information about Form 1098-T.

## Who Can Claim a Dependent's Expenses

If there are qualified education expenses for your dependent for a year, either you or your dependent, but not both of you, can claim an education credit for your dependent's expenses for that year.

For you to claim an education credit for your dependent's expenses, you must also claim an exemption for your dependent. You do this by listing your dependent's name and other required information on Form 1040 (or Form 1040A), line 6c.

IF you...	THEN only...
claim an exemption on your tax return for a dependent who is an eligible student	you can claim an education credit based on that dependent's expenses. The dependent cannot claim a credit.
do <b>not</b> claim an exemption on your tax return for a dependent who is an eligible student (even if entitled to the exemption)	the dependent can claim an education credit. You cannot claim a credit based on this dependent's expenses.

**Expenses paid by dependent.** If you claim an exemption on your tax return for an eligible student who is your dependent, treat any expenses paid (or deemed paid) by your dependent as if you had paid them. Include these expenses when figuring the amount of your education credit.



*Qualified education expenses paid directly to an eligible educational institution for your dependent under a court-approved divorce decree are treated as paid by your dependent.*

**Expenses paid by you.** If you claim an exemption for a dependent who is an eligible student, only you can include any expenses you paid when figuring the amount of an education credit. If neither you nor anyone else claims an exemption for the dependent, only the dependent can include any expenses you paid when figuring an education credit.

**Expenses paid by others.** Someone other than you, your spouse, or your dependent (such as a relative or former spouse) may make a payment directly to an eligible educational institution to pay for an eligible student's qualified education expenses. In this case, the student is treated as receiving the payment from the other person and, in turn, paying the institution. If you claim an exemption on your tax return for the student, you are considered to have paid the expenses.

**Example.** In 2006, Ms. Allen makes a payment directly to an eligible educational institution for her grandson Todd's qualified education expenses. For purposes of claiming an education credit, Todd is treated as receiving the money as a gift from his grandmother and, in turn, paying his qualified education expenses himself.

Unless an exemption for Todd is claimed on someone else's 2006 tax return, only Todd can use the payment to claim an education credit.

If anyone, such as Todd's parents, claims an exemption for Todd on his or her 2006 tax return, whoever claims the exemption may be able to use the expenses to claim an education credit. If anyone else claims an exemption for Todd, Todd cannot claim an education credit.

**Tuition reduction.** When an eligible educational institution provides a reduction in tuition to an employee of the institution (or spouse or dependent child of an employee), the amount of the reduction may or may not be taxable. If it is taxable, the employee is treated as receiving a payment of that amount and, in turn, paying it to the educational institution on behalf of the student. For more information on tuition reductions, see *Qualified Tuition Reduction* in chapter 1 of Publication 970.

## Effect of the Amount of Your Income on the Amount of Your Credit

The amount of your education credit is phased out (gradually reduced) if your MAGI is between \$45,000 and \$55,000 (\$90,000 and \$110,000 if you file a joint return). You cannot claim an education credit if your MAGI is \$55,000 or more (\$110,000 or more if you file a joint return).

**Modified adjusted gross income (MAGI).** For most taxpayers, MAGI is adjusted gross income (AGI) as figured on their federal income tax return.

**MAGI when using Form 1040A.** If you file Form 1040A, your MAGI is the AGI on line 22 of that form.

**MAGI when using Form 1040.** If you file Form 1040, your MAGI is the AGI on line 38 of that form, modified by adding back any:

1. Foreign earned income exclusion,
2. Foreign housing exclusion,
3. Exclusion of income for *bona fide* residents of American Samoa, and
4. Exclusion of income from Puerto Rico.

**Phaseout.** If your MAGI is within the range of incomes where the credit must be reduced, you will figure your reduced credit using lines 7–13 of Form 8863.

## When Must the Credit Be Repaid (Recaptured)

If, after you file your 2006 tax return, you or someone else receives tax-free educational assistance for, or a refund of, an expense you used to figure an education credit on that return, you may have to repay all or part of the credit. You must refigure your education credit(s) for 2006 as if the assistance or refund was received in 2006. Subtract the amount of the refigured credit from the amount of the credit you claimed. The result is the amount you must repay. You add the repayment (recapture) to your tax liability for the year in which you receive the assistance or refund (see the instructions for your tax return for that year). Your original 2006 tax return does not change.

## Information for Only the Hope Credit

You may be able to claim a Hope credit of up to \$1,650 for qualified education expenses paid for each eligible student.

## Who Is an Eligible Student

To claim the Hope credit, the student for whom you pay qualified education expenses must be an eligible student. This is a student who meets all of the following requirements.

- The student did not have expenses that were used to figure a Hope credit in any 2 earlier tax years.
- The student had not completed the first 2 years of postsecondary education (generally, the freshman and sophomore years of college) before 2006.
- For at least one academic period beginning in 2006, the student was enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential.
- The student was free of any federal or state felony conviction for possessing or

distributing a controlled substance as of the end of 2006.

**Completion of first 2 years.** A student who was awarded 2 years of academic credit for postsecondary work completed before 2006 has completed the first 2 years of postsecondary education. This student generally would not be an eligible student for purposes of the Hope credit.

**Exception.** Any academic credit awarded solely on the basis of the student's performance on proficiency examinations is disregarded in determining whether the student has completed 2 years of postsecondary education.

**Enrolled at least half-time.** A student was enrolled at least half-time if the student was taking at least half the normal full-time work load for his or her course of study.

The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard may not be lower than any of those established by the Department of Education under the Higher Education Act of 1965.

**Example 1.** Marty graduated from high school in June 2005. In September, he enrolled in an undergraduate degree program at College U, and attended full time for both the 2005 Fall and 2006 Spring semesters. For the 2006 Fall semester, Marty was enrolled less than half-time. Because Marty was enrolled in an undergraduate degree program on at least a half-time basis for at least one academic period that began during 2005 and at least one academic period that began during 2006, he is an eligible student for tax years 2005 and 2006 (including the 2006 Fall semester when he enrolled at College U on less than a half-time basis).

**Example 2.** After taking classes at College V on a half-time basis for the 2005 Spring and Fall semesters, Sharon became a full-time student for the 2006 Spring semester. College V classified Sharon as a second-semester sophomore for the 2006 Spring semester and as a first-semester junior for the 2006 Fall semester. Because College V did not classify Sharon as having completed the first two years of postsecondary education as of the beginning of 2006, Sharon is an eligible student for tax year 2006. Therefore, the qualified education expenses paid for the 2006 Spring semester and the 2006 Fall semester are taken into account in calculating any Hope credit for 2006.

**Example 3.** During the 2005 Fall semester, Luis was a high school student who took classes on a half-time basis at College X. Luis was not enrolled as part of a degree program at College X because College X only admits students to a degree program if they have a high school diploma or equivalent. Because Luis was not enrolled in a degree program at College X during 2005, Luis was not an eligible student for tax year 2005.

**Example 4.** The facts are the same as in Example 3. During the 2006 Spring semester,

Luis again attended College X but not as part of a degree program. Luis graduated from high school in June 2006. For the 2006 Fall semester, Luis enrolled as a full-time student in College X as part of a degree program, and College X awarded Luis credit for his prior coursework at College X. Because Luis was enrolled in a degree program at College X for the 2006 Fall term on at least a half-time basis, Luis is an eligible student for all of tax year 2006. Therefore, the qualified education expenses paid for classes taken at College X during both the 2006 Spring semester (during which Luis was not enrolled in a degree program) and the 2006 Fall semester are taken into account in computing any Hope credit.

**Example 5.** Diana graduated from high school in June 2004. In January 2005, Diana enrolled in a one-year postsecondary certificate program on a full-time basis to obtain a certificate as a travel agent. Diana completed the program in December 2005, and was awarded a certificate. In January 2006, she enrolled in a one-year postsecondary certificate program on a full-time basis to obtain a certificate as a computer programmer. Diana is an eligible student for both tax years 2005 and 2006 because she meets the degree requirement, the work load requirement, and the year of study requirement for those years.

## Figuring the Credit

The amount of the Hope credit (per eligible student) is the sum of:

1. 100% of the first \$1,100 of qualified education expenses you paid for the eligible student, and
2. 50% of the next \$1,100 of qualified education expenses you paid for that student.

The maximum amount of Hope credit you can claim in 2006 is \$1,650 times the number of eligible students. You can claim the full \$1,650 for each eligible student for whom you paid at least \$2,200 of qualified education expenses. However, the credit may be reduced based on your MAGI. See *Effect of the Amount of Your Income on the Amount of Your Credit*, earlier.

**Example.** Jon and Karen Frost are married and file a joint tax return. For 2006, they claim an exemption for their dependent daughter on their tax return. Their MAGI is \$70,000. Their daughter is in her sophomore (second) year of studies at the local university. Jon and Karen paid qualified education expenses of \$4,300 in 2006.

Jon and Karen, their daughter, and the local university meet all of the requirements for the Hope credit. Jon and Karen can claim a \$1,650 Hope credit in 2006. This is 100% of the first \$1,100 of qualified education expenses, plus 50% of the next \$1,100.

**Form 1098-T.** To help you figure your Hope credit, you should receive Form 1098-T. Generally, an eligible educational institution (such as a college or university) must send Form 1098-T (or acceptable substitute) to each enrolled student by January 31, 2007.

## Claiming the Credit

You claim the Hope credit by completing Parts I and III of Form 8863 and submitting it with your Form 1040 or 1040A. Enter the credit on Form 1040, line 50, or on Form 1040A, line 31. An illustrated example using Form 8863 appears at the end of this chapter.

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## Information for Only the Lifetime Learning Credit

You may be able to claim a lifetime learning credit of up to \$2,000 for qualified education expenses paid for all students enrolled in eligible educational institutions.

### Who Is an Eligible Student

For purposes of the lifetime learning credit, an eligible student is a student who is enrolled in one or more courses at an eligible educational institution.

### Figuring the Credit

The amount of the lifetime learning credit is 20% of the first \$10,000 of qualified education expenses you paid for all eligible students. The maximum amount of lifetime learning credit you can claim for 2006 is \$2,000 (20% × \$10,000). However, that amount may be reduced based

on your MAGI. See *Effect of the Amount of Your Income on the Amount of Your Credit*, earlier.

**Example.** Bruce and Toni are married and file a joint tax return. For 2006, their MAGI is \$75,000. Toni is attending a local college (an eligible educational institution) to earn credits toward a degree in nursing. She already has a bachelor's degree in history and wants to become a nurse. In August 2006, Toni paid \$6,000 of qualified education expenses for her Fall 2006 semester. Bruce and Toni can claim a \$1,200 (20% × \$6,000) lifetime learning credit on their 2006 joint tax return.

**Form 1098-T.** To help you figure your lifetime learning credit, you should receive Form 1098-T. Generally, an eligible educational institution (such as a college or university) must send Form 1098-T (or acceptable substitute) to each enrolled student by January 31, 2007.

## Claiming the Credit

You claim the lifetime learning credit by completing Parts II and III of Form 8863 and submitting it with your Form 1040 or 1040A. Enter the credit on Form 1040, line 50, or Form 1040A, line 31. An illustrated example using Form 8863 is shown at the end of this chapter.

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## Illustrated Example

Dave and Valerie Jones are married and file a joint tax return. For 2006, they claim exemptions

for their two dependent children on their tax return. Their modified adjusted gross income is \$93,000. Their tax, before credits, is \$9,956. Their son, Sean, will receive his bachelor's degree in psychology from the state college in May 2007. Their daughter, Corey, enrolled full-time at that same college in August 2005, to begin working on her bachelor's degree in physical education. In July 2006, Dave and Valerie paid \$2,200 in tuition costs for each child for the Fall 2006 semester. In December 2006, they also paid \$2,600 of tuition for each child for the Spring 2007 semester that begins in January.

Dave and Valerie, their children, and the college meet all of the requirements for the higher education credits. Because Sean is beyond the second (sophomore) year of his postsecondary education, his expenses do not qualify for the Hope credit. But, amounts paid for Sean's expenses in 2006 for academic periods beginning in 2006 and the first 3 months of 2007 qualify for the lifetime learning credit. Corey is in her first 2 (freshman and sophomore) years of postsecondary education, and expenses paid for her in 2006, for academic periods beginning in 2006 and January 2007, qualify for the Hope credit.

Dave and Valerie figure their tentative education credits for 2006, \$2,610, as shown in the completed Form 8863. They cannot claim the full amount because their modified adjusted gross income is more than \$90,000. They carry the amount from line 17 of Form 8863, \$2,219, to line 50 of Form 1040, and they attach the Form 8863 to their return.

**Education Credits**  
**(Hope and Lifetime Learning Credits)**

**2006**

▶ See instructions.

▶ Attach to Form 1040 or Form 1040A.

Name(s) shown on return

Dave and Valerie Jones

Your social security number

987 : 00 : 6543

**Caution:** You **cannot** take the Hope credit and the lifetime learning credit for the **same student** in the same year.

**Part I Hope Credit. Caution:** You **cannot** take the Hope credit for more than **2 tax years** for the **same student**.

1	(a) Student's name (as shown on page 1 of your tax return) First name ..... Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (see instructions). <b>Do not</b> enter more than \$2,200* for each student.	(d) Enter the <b>smaller</b> of the amount in column (c) or \$1,100**	(e) Add column (c) and column (d)	(f) Enter one-half of the amount in column (e)	
	Corey ..... Jones	137 : 00 : 9642	2,200	1,100	3,300	1,650	
	.....						
	.....						
	.....						
	* For each student who attended an eligible educational institution in the Gulf Opportunity Zone, <b>do not</b> enter more than \$4,400. ** For each student who attended an eligible educational institution in the Gulf Opportunity Zone, enter the <b>smaller</b> of the amount in column (c) or \$2,200.						
<b>2</b>	<b>Tentative Hope credit.</b> Add the amounts on line 1, column (f). If you are taking the lifetime learning credit for another student, go to Part II; otherwise, go to Part III					<b>2</b>	1,650

**Part II Lifetime Learning Credit**

3	(a) Student's name (as shown on page 1 of your tax return) First name ..... Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (see instructions)	
	Sean ..... Jones	246 : 00 : 9731	4,800	
	.....			
	.....			
<b>4</b>	Add the amounts on line 3, column (c), and enter the total		<b>4</b>	4,800
<b>5a</b>	Enter the <b>smaller</b> of line 4 or \$10,000		<b>5a</b>	4,800
<b>b</b>	For students who attended an eligible educational institution in the Gulf Opportunity Zone, enter the smaller of \$10,000 or their qualified expenses included on line 4 (see special rules on page 3)		<b>5b</b>	
<b>c</b>	Subtract line 5b from line 5a		<b>5c</b>	4,800
<b>6a</b>	Multiply line 5b by 40% (.40)		<b>6a</b>	
<b>b</b>	Multiply line 5c by 20% (.20)		<b>6b</b>	960
<b>c</b>	<b>Tentative lifetime learning credit.</b> Add lines 6a and 6b and go to Part III		<b>6c</b>	960

**Part III Allowable Education Credits**

<b>7</b>	Tentative education credits. Add lines 2 and 6c		<b>7</b>	2,610
<b>8</b>	Enter: \$110,000 if married filing jointly; \$55,000 if single, head of household, or qualifying widow(er)		<b>8</b>	110,000
<b>9</b>	Enter the amount from Form 1040, line 38*, or Form 1040A, line 22		<b>9</b>	93,000
<b>10</b>	Subtract line 9 from line 8. If zero or less, <b>stop</b> ; you cannot take any education credits		<b>10</b>	17,000
<b>11</b>	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)		<b>11</b>	20,000
<b>12</b>	If line 10 is equal to or more than line 11, enter the amount from line 7 on line 13 and go to line 14. If line 10 is less than line 11, divide line 10 by line 11. Enter the result as a decimal (rounded to at least three places)		<b>12</b>	X .850
<b>13</b>	Multiply line 7 by line 12		<b>13</b>	2,219
<b>14</b>	Enter the amount from Form 1040, line 46, or Form 1040A, line 28		<b>14</b>	9,956
<b>15</b>	Enter the total, if any, of your credits from Form 1040, lines 47 through 49, or Form 1040A, lines 29 and 30		<b>15</b>	-0-
<b>16</b>	Subtract line 15 from line 14. If zero or less, <b>stop</b> ; you cannot take any education credits		<b>16</b>	9,956
<b>17</b>	<b>Education credits.</b> Enter the <b>smaller</b> of line 13 or line 16 here and on Form 1040, line 50, or Form 1040A, line 31		<b>17</b>	2,219

\* If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter.

## 36.

# Earned Income Credit

## What's New

**Earned income amount is more.** The maximum amount of income you can earn and still get the credit has increased. You may be able to take the credit if:

- You have more than one qualifying child and you earned less than \$36,348 (\$38,348 if married filing jointly),
- You have one qualifying child and you earned less than \$32,001 (\$34,001 if married filing jointly), or
- You do not have a qualifying child and you earned less than \$12,120 (\$14,120 if married filing jointly).

Your adjusted gross income also must be less than the amount in the above list that applies to you. For details, see *Rules 1 and 15*.

**Investment income amount is more.** The maximum amount of investment income you can have and still get the credit has increased to \$2,800. See *Rule 6*.

## Reminders

**Increased EIC on certain joint returns.** A married person filing a joint return may get more EIC than someone with the same income but a different filing status. As a result, the EIC table has different columns for married persons filing jointly than for everyone else. When you look up your EIC in the EIC Table, be sure to use the correct column for your filing status and the number of children you have.

**Advance payment of the earned income credit in your paycheck.** If you expect to qualify for the earned income credit in 2007, you can receive part of it in each paycheck throughout the year. See *Advance Earned Income Credit*, later, for more information.

**Online help.** You can use the EITC Assistant at [www.irs.gov/eitc](http://www.irs.gov/eitc) to find out if you are eligible for the credit. The EITC Assistant is available in English and Spanish.

**EIC questioned by IRS.** The IRS may ask you to provide documents to prove you are entitled to claim the EIC. We will tell you what documents to send us. These may include: birth certificates, school records, medical records, etc. We will also send you a letter with the name, address, and telephone number of the IRS employee assigned to your case. The process of establishing your eligibility will delay your refund.

## Introduction

The earned income credit (EIC) is a tax credit for certain people who work and have less than \$38,348 of earned income. A tax credit usually means more money in your pocket. It reduces the amount of tax you owe. The EIC may also give you a refund.

**How do you get the earned income credit?**  
To claim the EIC, you must:

1. Qualify by meeting certain rules, and
2. File a tax return, even if you:
  - a. Do not owe any tax,
  - b. Did not earn enough money to file a return, or
  - c. Did not have income taxes withheld from your pay.

When you complete your return, you can figure your EIC by using a worksheet in the instructions for Form 1040, Form 1040A, or Form 1040EZ. Or, if you prefer, you can let the IRS figure the credit for you.

**How will this chapter help you?**

This chapter will explain the following.

- The rules you must meet to qualify for the EIC.
- How to figure the EIC.
- How to get advance payment of the EIC in your paycheck.

## Useful Items

You may want to see:

### Publication

- **596** Earned Income Credit (EIC)

### Form (and Instructions)

- **Schedule EIC** Earned Income Credit (Qualifying Child Information)
- **W-5** Earned Income Credit Advance Payment Certificate
- **8862** Information To Claim Earned Income Credit After Disallowance

## Do You Qualify for the Credit?

To qualify to claim the EIC, you must first meet all of the rules explained in Part A, *Rules for Everyone*. Then you must meet the rules in Part B, *Rules If You Have a Qualifying Child*, or Part C, *Rules If You Do Not Have a Qualifying Child*. There is one final rule you must meet in Part D, *Figuring and Claiming the EIC*. You qualify for the credit if you meet all the rules in each part that applies to you.

- If you have a qualifying child, the rules in *Parts A, B, and D* apply to you.
- If you do not have a qualifying child, the rules in *Parts A, C, and D* apply to you.

**Table 36-1, Earned Income Credit in a Nutshell.** Use Table 36-1 as a guide to *Parts A, B, C, and D*. The table is a summary of all the rules in each part.

**Do you have a qualifying child?** You have a qualifying child only if you have a child who meets the three tests described in *Rule 8* and illustrated in Figure 36-1.

## If Improper Claim Made in Prior Year

If your EIC for any year after 1996 was denied or reduced for any reason other than a math or clerical error, you must attach a completed Form 8862 to your next tax return to claim the EIC. You must also qualify to claim the EIC by meeting all the rules described in this chapter.

However, if your EIC was denied or reduced as a result of a math or clerical error, do not attach Form 8862 to your next tax return. For example, if your arithmetic is incorrect, the IRS can correct it. If you do not provide a correct social security number, the IRS can deny the EIC. These kinds of errors are called math or clerical errors.

If your EIC for any year after 1996 was denied and it was determined that your error was due to reckless or intentional disregard of the EIC rules, then you cannot claim the EIC for the next 2 years. If your error was due to fraud, then you cannot claim the EIC for the next 10 years.

**More information.** See chapter 5 in Publication 596 for more detailed information about the disallowance period and Form 8862.

## Part A. Rules for Everyone

This part of the chapter discusses *Rules 1* through *7*. You must meet all seven rules to qualify for the earned income credit. If you do not meet all seven rules, you cannot get the credit and you do not need to read the rest of the chapter.

If you meet all seven rules in this part, then read either *Part B* or *Part C* (whichever applies) for more rules you must meet.

### Rule 1. Your AGI Must Be Less Than:

- \$36,348 (\$38,348 for married filing jointly) if you have more than one qualifying child,
- \$32,001 (\$34,001 for married filing jointly) if you have one qualifying child, or
- \$12,120 (\$14,120 for married filing jointly) if you do not have a qualifying child.

**Adjusted gross income (AGI).** AGI is the amount on line 38 (Form 1040), line 22 (Form 1040A), or line 4 (Form 1040EZ). If your AGI is equal to or more than the applicable limit listed above, you cannot claim the EIC.

**Example.** Your AGI is \$32,500, you are single, and you have one qualifying child. You cannot claim the EIC because your AGI is not less than \$32,001. However, if your filing status was

Table 36-1. **Earned Income Credit in a Nutshell**

First, you must meet all the rules in this column.		Second, you must meet all the rules in <i>one</i> of these columns, whichever applies.		Third, you must meet the rule in this column.
Part A. Rules for Everyone		Part B. Rules If You Have a Qualifying Child	Part C. Rules If You Do Not Have a Qualifying Child	Part D. Figuring and Claiming the EIC
<p><b>1.</b> Your adjusted gross income (AGI) must be less than:</p> <ul style="list-style-type: none"> <li>•\$36,348 (\$38,348 for married filing jointly) if you have more than one qualifying child,</li> <li>•\$32,001 (\$34,001 for married filing jointly) if you have one qualifying child, or</li> <li>•\$12,120 (\$14,120 for married filing jointly) if you do not have a qualifying child.</li> </ul>	<p><b>2.</b> You must have a valid social security number.</p> <p><b>3.</b> Your filing status cannot be “Married filing separately.”</p> <p><b>4.</b> You must be a U.S. citizen or resident alien all year.</p> <p><b>5.</b> You cannot file Form 2555 or Form 2555-EZ (relating to foreign earned income).</p> <p><b>6.</b> Your investment income must be \$2,800 or less.</p> <p><b>7.</b> You must have earned income.</p>	<p><b>8.</b> Your child must meet the relationship, age, and residency tests.</p> <p><b>9.</b> Your qualifying child cannot be used by more than one person to claim the EIC.</p> <p><b>10.</b> You cannot be a qualifying child of another person.</p>	<p><b>11.</b> You must be at least age 25 but under age 65.</p> <p><b>12.</b> You cannot be the dependent of another person.</p> <p><b>13.</b> You cannot be a qualifying child of another person.</p> <p><b>14.</b> You must have lived in the United States more than half of the year.</p>	<p><b>15.</b> Your earned income must be less than:</p> <ul style="list-style-type: none"> <li>•\$36,348 (\$38,348 for married filing jointly) if you have more than one qualifying child,</li> <li>•\$32,001 (\$34,001 for married filing jointly) if you have one qualifying child, or</li> <li>•\$12,120 (\$14,120 for married filing jointly) if you do not have a qualifying child.</li> </ul>

married filing jointly, you might be able to claim the EIC because your AGI is less than \$34,001.

**Community property.** If you are married, but qualify to file as head of household under special rules for married taxpayers living apart (see *Rule 3*), and live in a state that has community property laws, your AGI includes that portion of both your and your spouse’s wages that you are required to include in gross income. This is different from the community property rules that apply under *Rule 7*.

## Rule 2. You Must Have a Valid Social Security Number (SSN)

To claim the EIC, you (and your spouse if filing a joint return) must have a valid SSN issued by the Social Security Administration (SSA). Any qualifying child listed on Schedule EIC also must have a valid SSN. (See *Rule 8* if you have a qualifying child.)

If your social security card (or your spouse’s if filing a joint return) says “Not valid for employment” and your SSN was issued so that you (or your spouse) could get a federally funded benefit, you cannot get the EIC. An example of a federally funded benefit is Medicaid.

If you have a card with the legend “Not valid for employment” and your immigration status has changed so that you are now a U.S. citizen or permanent resident, ask the SSA for a new social security card without the legend.

**U. S. citizen.** If you were a U. S. citizen when you received your SSN, you have a valid SSN.

**Valid for work only with INS or DHS authorization.** If your social security card reads “Valid for work only with INS authorization,” or “Valid for work only with DHS authorization,” you have a valid SSN.

**SSN missing or incorrect.** If an SSN for you or your spouse is missing from your tax return or is incorrect, you may not get the EIC.

**Other taxpayer identification number.** You cannot get the EIC if, instead of an SSN, you (or your spouse if filing a joint return) have an individual taxpayer identification number (ITIN). ITINs are issued by the Internal Revenue Service to noncitizens who cannot get an SSN.

**No SSN.** If you do not have a valid SSN, put “No” next to line 66a (Form 1040), line 40a (Form 1040A), or line 8a (Form 1040EZ). You cannot claim the EIC.

**Getting an SSN.** If you (or your spouse if filing a joint return) do not have an SSN, you can apply for one by filing Form SS-5, Application for a Social Security Card, with the Social Security Administration.

**Filing deadline approaching and still no SSN.** If the filing deadline is approaching and you still do not have an SSN, you have two choices.

1. Request an automatic 6-month extension of time to file your return. You can get this extension by filing Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return. For more information, see chapter 1.
2. File the return on time without claiming the EIC. After receiving the SSN, file an amended return (Form 1040X, Amended U.S. Individual Income Tax Return) claiming the EIC. Attach a filled-in Schedule EIC if you have a qualifying child.

## Rule 3. Your Filing Status Cannot Be Married Filing Separately

If you are married, you usually must file a joint return to claim the EIC. Your filing status cannot be “Married filing separately.”

**Spouse did not live with you.** If you are married and your spouse did not live in your home at any time during the last 6 months of the year, you may be able to file as head of household,

instead of married filing separately. In that case, you may be able to claim the EIC. For detailed information about filing as head of household, see chapter 2.

## Rule 4. You Must Be a U.S. Citizen or Resident Alien All Year

If you (or your spouse, if married) were a nonresident alien for any part of the year, you cannot claim the earned income credit unless your filing status is married filing jointly. You can use that filing status only if one spouse is a U.S. citizen or resident alien and you choose to treat the nonresident spouse as a U.S. resident. If you make this choice, you and your spouse are taxed on your worldwide income. If you need more information on making this choice, get Publication 519, U.S. Tax Guide for Aliens.

## Rule 5. You Cannot File Form 2555 or Form 2555-EZ

You cannot claim the earned income credit if you file Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion. You file these forms to exclude income earned in foreign countries from your gross income, or to deduct or exclude a foreign housing amount. U.S. possessions are not foreign countries. See Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad, for more detailed information.

## Rule 6. Your Investment Income Must Be \$2,800 or Less

You cannot claim the earned income credit unless your investment income is \$2,800 or less. If your investment income is more than \$2,800, you cannot claim the credit. For most people,

investment income is the total of the following amounts.

- Taxable interest (line 8a of Form 1040 or 1040A).
- Tax-exempt interest (line 8b of Form 1040 or 1040A).
- Dividend income (line 9a of Form 1040 or 1040A).
- Capital gain net income (line 13 of Form 1040, if more than zero, or line 10 of Form 1040A).

If you file Form 1040EZ, your investment income is the total of the amount of line 2 and the amount of any tax-exempt interest you wrote to the right of the words "Form 1040EZ" on line 2.

However, if you are reporting income or loss from the rental of personal property on Form 1040, line 21, or are filing Schedule E (Form 1040), Form 8814, or Form 4797, see *Rule 6* in chapter 1 of Publication 596 for more information.

## Rule 7. You Must Have Earned Income

This credit is called the "earned income" credit because, to qualify, you must work and have earned income. If you are married and file a joint return, you meet this rule if at least one spouse works and has earned income. If you are an employee, earned income includes all the taxable income you get from your employer. If you are self-employed or a statutory employee, you will figure your earned income on EIC Worksheet B in the instructions for Form 1040.

### Earned Income

Earned income includes all of the following types of income.

1. Wages, salaries, tips, and other taxable employee pay. Employee pay is earned income only if it is taxable. Nontaxable employee pay, such as certain dependent care benefits and adoption benefits, is not earned income. But there is an exception for nontaxable combat pay, which you can choose to include in earned income, as explained below.
2. Net earnings from self-employment.
3. Gross income received as a statutory employee.

**Wages, salaries, and tips.** Wages, salaries, and tips you receive for working are reported to you on Form W-2, box 1. You should report these on line 1 (Form 1040EZ) or line 7 (Forms 1040A and 1040).

**Nontaxable combat pay election.** You can elect to include your nontaxable combat pay in earned income for the earned income credit. Electing to include nontaxable combat pay in earned income may increase or decrease your EIC. Figure the credit with and without your nontaxable combat pay before making the election. If you make the election, you must include in earned income all nontaxable combat pay you received. If you are filing a joint return and both you and your spouse received nontaxable combat pay, you can each make your own election.

The amount of your nontaxable combat pay should be shown on your Form W-2, in box 12, with code Q.

**Self-employed persons and statutory employees.** If you are self-employed or received income as a statutory employee, you must use the Form 1040 instructions to see if you qualify to get the EIC.

### Approved Form 4361 or Form 4029

This section is for persons who have an approved:

- Form 4361, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, or
- Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits.

Each approved form exempts certain income from social security taxes. Each form is discussed in this section in terms of what is or is not earned income for purposes of the EIC.

**Form 4361.** Even if you have an approved Form 4361, amounts you received for performing ministerial duties as an employee count as earned income. This includes wages, salaries, tips, and other taxable employee compensation. Amounts you received for performing ministerial duties, but not as an employee, do not count as earned income. Examples include fees for performing marriages and honoraria for delivering speeches.

**Form 4029.** Even if you have an approved Form 4029, all wages, salaries, tips, and other taxable employee compensation count as earned income. However, amounts you received as a self-employed individual do not count as earned income. Also, in figuring earned income, do not subtract losses on Schedule C, C-EZ, or F from wages on line 7 of Form 1040.

### Disability Benefits

If you retired on disability, benefits you receive under your employer's disability retirement plan are considered earned income until you reach minimum retirement age. Minimum retirement age generally is the earliest age at which you could have received a pension or annuity if you were not disabled. You must report your taxable disability payments on line 7 of either Form 1040 or Form 1040A until you reach minimum retirement age.

Beginning on the day after you reach minimum retirement age, payments you receive are taxable as a pension and are not considered earned income. Report taxable pension payments on Form 1040, lines 16a and 16b (or Form 1040A, lines 12a and 12b).

**Disability insurance payments.** Payments you received from a disability insurance policy that you paid the premiums for are not earned income. It does not matter whether you have reached minimum retirement age. If this policy is through your employer, the amount may be shown in box 12 of your Form W-2 with code "J."

## Income That Is Not Earned Income

Examples of items that are **not** earned income include interest and dividends, pensions and annuities, social security and railroad retirement benefits (including disability benefits), alimony and child support, welfare benefits, workers' compensation benefits, unemployment compensation (insurance), nontaxable foster care payments, and veterans' benefits, including VA rehabilitation payments. Do **not** include any of these items in your earned income.

**Earnings while an inmate.** Amounts received for work performed while an inmate in a penal institution are not earned income when figuring the earned income credit. This includes amounts for work performed while in a work release program or while in a halfway house.

**Workfare payments.** Nontaxable workfare payments are not earned income for the EIC. These are cash payments certain people receive from a state or local agency that administers public assistance programs funded under the federal Temporary Assistance for Needy Families (TANF) program in return for certain work activities such as (1) work experience activities (including remodeling or repairing public housing) if sufficient private sector employment is not available, or (2) community service program activities.

**Community property.** If you are married, but qualify to file as head of household under special rules for married taxpayers living apart (see *Rule 3*), and live in a state that has community property laws, your earned income for the EIC does not include any amount earned by your spouse that is treated as belonging to you under those laws. That amount is not earned income for the EIC, even though you must include it in your gross income on your income tax return. Your earned income includes the entire amount you earned, even if part of it is treated as belonging to your spouse under your state's community property laws.

**Nontaxable military pay.** Nontaxable pay for members of the Armed Forces is not considered earned income for the EIC. Examples of nontaxable military pay are combat pay, the Basic Allowance for Housing (BAH), and the Basic Allowance for Subsistence (BAS). See Publication 3, Armed Forces' Tax Guide, for more information.

**TIP** *Combat pay.* You can elect to have your nontaxable combat pay considered earned income for the EIC. See Nontaxable combat pay election, *earlier*.

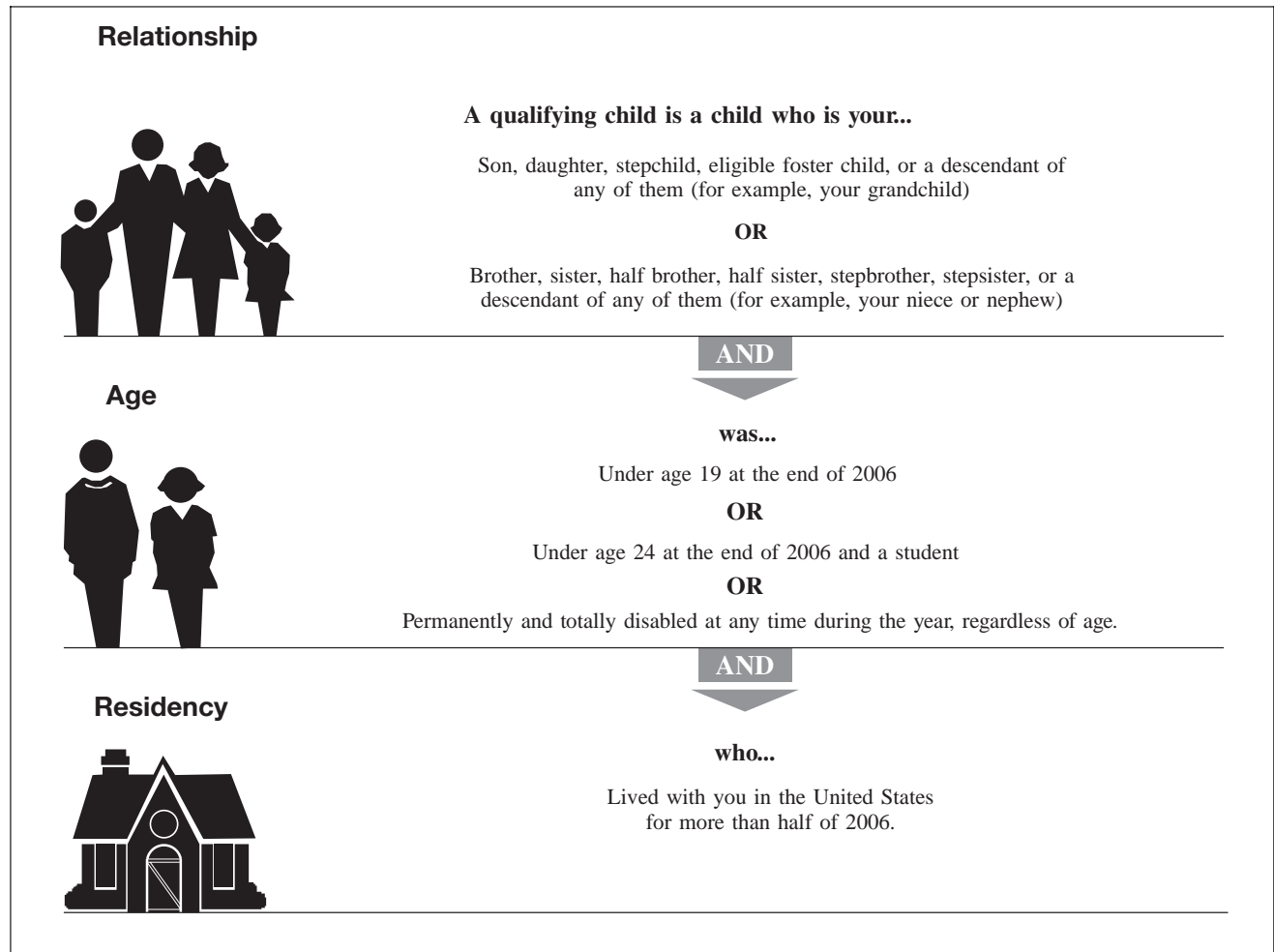
## Part B. Rules If You Have a Qualifying Child

If you have met all of the rules in *Part A*, read *Part B* to see if you have a qualifying child.

*Part B* discusses *Rules 8* through *10*. You must meet all three of these rules, in addition to the rules in *Parts A* and *D*, to qualify for the earned income credit with a qualifying child.

You must file Form 1040 or Form 1040A to claim the EIC with a qualifying child. (You cannot

Figure 36-1. Tests for Qualifying Child



file Form 1040EZ.) You also must complete Schedule EIC and attach it to your return. If you meet all the rules in Part A and this part, read Part D to find out what to do next.



*If you do not meet Rule 8, you do not have a qualifying child. Read Part C to find out if you can get the earned income credit without a qualifying child.*

## Rule 8. Your Child Must Meet the Relationship, Age, and Residency Tests

Your child is a qualifying child if your child meets three tests. The three tests are:

1. Relationship,
2. Age, and
3. Residency.

The three tests are illustrated in Figure 36-1. The paragraphs that follow contain more information about each test.

### Relationship Test

To be your qualifying child, a child must be your:

- Son, daughter, stepchild, eligible foster child, or a descendant of any of them (for example, your grandchild), or
- Brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew).

The following definitions clarify the relationship test.

**Adopted child.** An adopted child is always treated as your own child. The term "adopted child" includes a child who was lawfully placed with you for legal adoption.

**Eligible foster child.** For the EIC, a person is your eligible foster child if the child is placed with you by an authorized placement agency or by judgement, decree, or other order of any court of competent jurisdiction. An authorized placement agency includes a state or local government agency. It also includes a tax-exempt organization licensed by a state. In addition, it includes an Indian tribal government or an organization authorized by an Indian tribal government to place Indian children.

**Example.** Debbie, who is 12 years old, was placed in your care 2 years ago by an authorized agency responsible for placing children in foster homes. Debbie is your eligible foster child.

**Married child.** If your child was married at the end of the year, he or she does not meet the relationship test unless either of these two situations applies to you:

1. You can claim the child's exemption, or
2. The reason you cannot claim the child's exemption is that you gave that right to your child's other parent under the *Special rule for divorced or separated parents*, described later.

### Age Test

Your child must be:

1. Under age 19 at the end of 2006,
2. Under age 24 at the end of 2006 and a full-time student, or
3. Permanently and totally disabled at any time during 2006, regardless of age.

The following example and definitions clarify the age test.

**Example.** Your son turned 19 on December 10. Unless he was disabled or a full-time student, he is not a qualifying child because, at the end of the year, he was not **under** age 19.

**Full-time student.** A full-time student is a student who is enrolled for the number of hours or courses the school considers to be full-time attendance.

**Student defined.** To qualify as a student, your child must be, during some part of each of any 5 calendar months during the calendar year:

1. A full-time student at a school that has a regular teaching staff, course of study, and regular student body at the school, or
2. A student taking a full-time, on-farm training course given by a school described in (1), or a state, county, or local government.

The 5 calendar months need not be consecutive.

**Hurricane Katrina, Rita, or Wilma.** You may be able to treat your child as a student for each month of the enrollment period, in 2005 or 2006, he or she was unable to attend class because of Hurricane Katrina, Rita or Wilma. For details, see Publication 596.

**School defined.** A school can be an elementary school, junior or senior high school, college, university, or technical, trade, or mechanical school. However, on-the-job training courses, correspondence schools, and schools offering courses only through the Internet do not count as schools for the EIC.

**Vocational high school students.** Students who work in co-op jobs in private industry as a part of a school's regular course of classroom and practical training are considered full-time students.

**Permanently and totally disabled.** Your child is permanently and totally disabled if both of the following apply.

1. He or she cannot engage in any substantial gainful activity because of a physical or mental condition.
2. A doctor determines the condition has lasted or can be expected to last continuously for at least a year or can lead to death.

## Residency Test

Your child must have lived with you in the United States for more than half of 2006. The following definitions clarify the residency test.

**United States.** This means the 50 states and the District of Columbia. It does not include Puerto Rico or U.S. possessions such as Guam.

**Homeless shelter.** Your home can be any location where you regularly live. You do not need a traditional home. For example, if your child lived with you for more than half the year in one or more homeless shelters, your child meets the residency test.

**Military personnel stationed outside the United States.** U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States during that duty period for purposes of the EIC.

**Extended active duty.** Extended active duty means you are called or ordered to duty for an indefinite period or for a period of more than 90 days. Once you begin serving your extended

active duty, you are still considered to have been on extended active duty even if you do not serve more than 90 days.

**Birth or death of a child.** A child who was born or died in 2006 is treated as having lived with you for all of 2006 if your home was the child's home the entire time he or she was alive in 2006.

**Temporary absences.** Count time that you or your child is away from home on a temporary absence due to a special circumstance as time lived with you. Examples of a special circumstance include:

- Illness,
- School attendance,
- Detention in a juvenile facility,
- Business,
- Vacation, and
- Military service.

**Kidnapped child.** A kidnapped child is treated as living with you for more than half of the year if the child lived with you for more than half the part of the year before the date of the kidnapping. The child must be presumed by law enforcement authorities to have been kidnapped by someone who is not a member of your family or your child's family. This treatment applies for all years until the child is returned. However, the last year this treatment can apply is the earlier of:

1. The year there is a determination that the child is dead, or
2. The year the child would have reached age 18.

If your qualifying child has been kidnapped and meets these requirements, enter "KC," instead of a number, on line 6 of Schedule EIC.

**Social security number.** Your qualifying child must have a valid social security number (SSN) unless the child was born and died in 2006. You cannot claim the EIC on the basis of a qualifying child if:

1. Your qualifying child's SSN is missing from your tax return or is incorrect,
2. Your qualifying child's social security card says "Not valid for employment" and was issued for use in getting a federally funded benefit, or
3. Instead of an SSN, your qualifying child has:
  - a. An individual taxpayer identification number (ITIN), which is issued to a noncitizen who cannot get an SSN, or
  - b. An adoption taxpayer identification number (ATIN), which is issued to adopting parents who cannot get an SSN for the child being adopted until the adoption is final.

If you have two qualifying children and only one has a valid SSN, you can claim the EIC only on the basis of that child. For more information about SSNs, see *Rule 2*.

## Rule 9. Your Qualifying Child Cannot Be Used By More Than One Person To Claim the EIC

Sometimes a child meets the rules to be a qualifying child of more than one person. However, only one person can treat that child as a qualifying child and claim the EIC using that child. The paragraphs that follow will help you decide who, if anyone, can claim the EIC when more than one person has the same qualifying child.

**You can choose which person will claim the EIC.** If you and someone else have the same qualifying child, you and the other person(s) can decide which of you, if otherwise eligible, will take all of the following tax benefits based on the qualifying child.

- The child's exemption.
- The child tax credit.
- Head of household filing status.
- The credit for child and dependent care expenses.
- The exclusion for dependent care benefits.
- The EIC.

The other person cannot take any of these six tax benefits unless he or she has a different qualifying child.

If you and the other person(s) cannot agree and more than one person claims the EIC or the other tax benefits just listed using the same child, the tie-breaker rule (explained in Table 36-2) applies. However, the tie-breaker rule does not apply if the other person is your spouse and you file a joint return.

**If another person claims the EIC using this child.** If your EIC is denied because your qualifying child is treated under this rule as the qualifying child of another person for 2006, you may be able to take the EIC using a different qualifying child, but you cannot take the EIC using the rules in *Part C* for people who do not have a qualifying child.

**If the other person cannot claim the EIC.** If you and someone else have the same qualifying child but the other person cannot claim the EIC because he or she is not eligible or his or her earned income or AGI is too high, you may be able to treat the child as a qualifying child. See *Example 5*. But also see *You can choose which person will claim the EIC*, earlier.

**Example 1 – child lived with parent and grandparent.** You and your 2-year-old son lived with your mother all year. You are 25 years old. Your only income was \$9,000 from a part-time job. Your mother's only income was \$20,000 from her job. Your son is a qualifying child of both you and your mother because he meets the relationship, age, and residency tests for both you and your mother. However, only one of you can treat him as a qualifying child to claim the EIC (and, if that person qualifies, the other tax benefits listed in *You can choose which person will claim the EIC*, earlier). You agree to let your mother claim him.

This means, if you do not claim your son as a qualifying child for the EIC or any of the other tax benefits listed in *You can choose which person will claim the EIC*, your mother can treat your

son as a qualifying child to claim the EIC and any other tax benefit listed for which she qualifies.

**Example 2 – child lived with parent and grandparent.** The facts are the same as in *Example 1* except that you and your mother both claim your son as a qualifying child. In this case, you as the child’s parent will be the only one allowed to claim your son as a qualifying child for the EIC and the other tax benefits listed in *You can choose which person will claim the EIC*. The IRS will disallow your mother’s claim to the EIC and any other tax benefit listed, unless she has another qualifying child.

**Example 3 – three children lived with parent and grandparent.** The facts are the same as in *Example 1* except that you also have two other young children who are qualifying children of both you and your mother. Only one of you can claim each child as a qualifying child. However, you and your mother can split the three qualifying children between you. For example, you can use one child and your mother can use the other two.

**Example 4 – parent is qualifying child of grandparent.** The facts are the same as in *Example 1* except that you are only 18 years old. This means you are a qualifying child of your mother. Because of *Rule 10*, discussed next, you cannot claim the EIC. Only your mother may be able to treat your son as a qualifying child to claim the EIC. If your mother meets all the other requirements for claiming the EIC, she can treat both you and your son as qualifying children for the EIC.

**Example 5 – parent can claim EIC because grandparent cannot.** The facts are the same as in *Example 1* except that your mother earned \$50,000 from her job. Because your mother’s earned income is too high for her to claim the EIC, only you can claim the EIC using your son.

**Example 6 – separated parents.** You, your husband, and your 10-year-old son lived together until August 1, 2006, when your husband moved out of the household. In August and September, your son lived with you. For the rest of the year, your son lived with your husband. Your son is a qualifying child of both you and your husband because your son lived with each of you for more than half the year and because he met the relationship and age tests for both of you. At the end of the year, you and your husband still were not divorced, legally separated, or separated under a written separation agreement, so the special rule for divorced or separated parents does not apply.

You and your husband will file separate returns. Your husband agrees to let you treat your son as a qualifying child. This means, if your husband does not claim your son as a qualifying child for the EIC or any of the other tax benefits listed in *You can choose which person will claim the EIC*, earlier, you can claim him as a qualifying child for the EIC and any other tax benefit listed for which you qualify. However, you cannot claim head of household filing status because you and your husband did not live apart the last 6 months of the year. As a result, your filing status is married filing separately, so you cannot claim the EIC or the credit for child and dependent care expenses. See *Rule 3*.

**Table 36-2. When More Than One Person Files a Return Claiming the Same Qualifying Child (Tie-Breaker Rule)**

**Caution.** If a child is treated as the qualifying child of the noncustodial parent under the special rule for divorced or separated parents, described later, see *Applying Rule 9 to divorced or separated parents*.

<b>IF more than one person files a return claiming the same qualifying child and . . .</b>	<b>THEN the child will be treated as the qualifying child of the . . .</b>
only one of the persons is the child’s parent,	parent.
two of the persons are parents of the child, and they do not file a joint return together,	parent with whom the child lived the longest during the year.
two of the persons are parents of the child, the child lived with each parent the same amount of time during the year, and the parents do not file a joint return together,	parent with the higher adjusted gross income (AGI).
none of the persons are the child’s parent,	person with the highest AGI.

**Example 7 – separated parents.** The facts are the same as in *Example 6* except that you and your husband both claim your son as a qualifying child. In this case, only your husband will be allowed to treat your son as a qualifying child. This is because, during 2006, the boy lived with him longer than with you. You cannot claim the EIC for persons either with or without a qualifying child. However, because you and your husband did not live apart the last 6 months of the year your husband cannot claim head of household filing status. As a result, his filing status is married filing separately, so he cannot claim the EIC or the credit for child and dependent care expenses. See *Rule 3*.

**Example 8 – unmarried parents.** You, your 5-year-old son, and your son’s father lived together all year. You and your son’s father are not married. Your son is a qualifying child of both you and his father because he meets the relationship, age, and residency tests for both you and his father. You earned \$8,000 and your son’s father earned \$18,000. Neither of you had any other income. Your son’s father agrees to let you treat the child as a qualifying child. This means, if your son’s father does not claim your son as a qualifying child for the EIC or any of the other tax benefits listed in *You can choose which person will claim the EIC*, earlier, you can claim him as a qualifying child for the EIC and any other tax benefit listed for which you qualify.

**Example 9 – unmarried parents.** The facts are the same as in *Example 8* except that you and your son’s father both claim your son as a qualifying child. In this case, only your son’s father will be allowed to treat your son as a qualifying child. This is because his AGI, \$18,000, is more than your AGI, \$8,000. You cannot claim the EIC for persons either with or without a qualifying child.

**Example 10 – child did not live with a parent.** You and your 7-year-old niece, your sister’s child, lived with your mother all year. You are 25 years old, and your only income was \$9,300 from a part-time job. Your mother’s only income was \$15,000 from her job. Your niece is a qualifying child of both you and your mother because she meets the relationship, age, and residency tests for both you and your mother. However, only one of you can treat her as a qualifying child. Your mother agrees to let you treat the child as a qualifying child. This means,

if your mother does not claim her as a qualifying child for the EIC or any of the other tax benefits listed in *You can choose which person will claim the EIC*, you can claim your niece as a qualifying child for the EIC and any other tax benefit listed for which you qualify.

**Example 11 – child did not live with a parent.** The facts are the same as in *Example 10* except that you and your mother both claim your niece as a qualifying child. In this case, only your mother will be allowed to treat your niece as a qualifying child. This is because your mother’s AGI, \$15,000, is more than your AGI, \$9,300.

**Special rule for divorced or separated parents.** A child will be treated as the qualifying child of his or her noncustodial parent (for purposes of claiming an exemption, but not for the EIC) if all of the following apply.

1. The parents:
  - a. Are divorced or legally separated under a decree of divorce or separate maintenance,
  - b. Are separated under a written separation agreement, or
  - c. Lived apart at all times during the last 6 months of the year.
2. The child received over half of his or her support for the year from the parents.
3. The child is in the custody of one or both parents for more than half of the year.
4. Either of the following statements is true.
  - a. The custodial parent signs Form 8332 or a substantially similar statement that he or she will not claim the child as a dependent for the year, and the non-custodial parent attaches the form or statement to his or her return. (If the divorce decree or separation agreement went into effect after 1984, the non-custodial parent can attach certain pages from the decree or agreement instead of Form 8332.)
  - b. A pre-1985 decree of divorce or separate maintenance or written separation agreement that applies to 2006 provides that the noncustodial parent can claim the child as a dependent and the noncustodial parent provides at least

\$600 for the support of the child during the year.

For details, see chapter 3. Also see *Applying Rule 9 to divorced or separated parents*, next.

**Applying Rule 9 to divorced or separated parents.** If a child is treated as the qualifying child of the noncustodial parent under the special rule for children of divorced or separated parents just described, only the noncustodial parent can claim an exemption and the child tax credit for the child. However, the noncustodial parent cannot claim the child as a qualifying child for the other tax benefits listed in *You can choose which person will claim the EIC*, earlier. Only the custodial parent or other eligible taxpayer can claim the child as a qualifying child for those tax benefits. However, if the custodial parent and another eligible taxpayer both file a return claiming the child as a qualifying child for any of these four tax benefits, the IRS will disallow all but one of the claims using the tie-breaker rule in Table 36-2.

## Rule 10. You Cannot Be a Qualifying Child of Another Person

You are a qualifying child of another person (your parent, guardian, foster parent, etc.) if all of the following statements are true.

1. You are that person's son, daughter, stepchild, grandchild, or eligible foster child. Or, you are that person's brother, sister, half brother, half sister, stepbrother, or stepsister (or the child or grandchild of that person's brother, sister, half brother, half sister, stepbrother, or stepsister).
2. At the end of the year you were under age 19, or under age 24 and a full-time student, or any age if you were permanently and totally disabled at any time during the year.
3. You lived with that person in the United States for more than half of the year.

For more details about the tests to be a qualifying child, see *Rule 8*.

If you (or your spouse if filing a joint return) are a qualifying child of another person, you cannot claim the EIC. This is true even if the person for whom you are a qualifying child does not claim the EIC or meet all of the rules to claim the EIC. Put "No" beside line 66a (Form 1040) or line 40a (Form 1040A).

**Example.** You and your daughter lived with your mother all year. You are 22 years old and attended a trade school full time. You had a part-time job and earned \$5,700. You had no other income. Because you meet the relationship, age, and residency tests, you are a qualifying child of your mother. She can claim the EIC if she meets all the other requirements. Because you are your mother's qualifying child, you cannot claim the EIC. This is so even if your mother cannot or does not claim the EIC.

## Part C. Rules If You Do Not Have a Qualifying Child

Read this part if you:

1. Do not have a qualifying child, and
2. Have met all the rules in *Part A*.

*Part C* discusses *Rules 11* through *14*. You must meet all four of these rules, in addition to the rules in *Parts A* and *D*, to qualify for the earned income credit without a qualifying child.



*If you have a qualifying child, the rules in this part do not apply to you. You can claim the credit only if you meet all the rules in Parts A, B, and D. See Rule 8 to find out if you have a qualifying child.*

## Rule 11. You Must Be at Least Age 25 but Under Age 65

You must be at least age 25 but under age 65 at the end of 2006. If you are married filing a joint return, either you or your spouse must be at least age 25 but under age 65 at the end of 2006. It does not matter which spouse meets the age test, as long as one of the spouses does.

If neither you nor your spouse meets the age test, you cannot claim the EIC. Put "No" next to line 66a (Form 1040), line 40a (Form 1040A), or line 8a (Form 1040EZ).

**Example 1.** You are age 28 and unmarried. You meet the age test.

**Example 2.** You are married and filing a joint return. You are age 23 and your spouse is age 27. You meet the age test because your spouse is at least age 25 but under age 65.

## Rule 12. You Cannot Be the Dependent of Another Person

If you are **not** filing a joint return, you meet this rule if:

- You checked box 6a on Form 1040 or 1040A, or
- You did not check the "You" box on line 5 of Form 1040EZ, and you entered \$8,450 on that line.

If you are filing a joint return, you meet this rule if:

- You checked both box 6a and box 6b on Form 1040 or 1040A, or
- You and your spouse did not check either the "You" box or the "Spouse" box on line 5 of Form 1040EZ, and you entered \$16,900 on that line.

If you are not sure whether someone else can claim you (or your spouse if filing a joint return) as a dependent, read the rules for claiming a dependent in chapter 3.

If someone else can claim you (or your spouse if filing a joint return) as a dependent on his or her return, but does not, you still cannot claim the credit.

**Example 1.** In 2006, you were age 25, single, and living at home with your parents. You worked and were not a student. You earned \$7,500. Your parents cannot claim you as a dependent. When you file your return, you claim an exemption for yourself by not checking the "You" box on line 5 of your Form 1040EZ and by entering \$8,450 on that line. You meet this rule.

**Example 2.** The facts are the same as in *Example 1*, except that you earned \$2,000. Your parents can claim you as a dependent but decide not to. You do not meet this rule. You cannot claim the credit because your parents could have claimed you as a dependent.

## Rule 13. You Cannot Be a Qualifying Child of Another Person

You are a qualifying child of another person (your parent, guardian, foster parent, etc.) if all of the following statements are true.

1. You are that person's son, daughter, stepchild, grandchild, or eligible foster child. Or, you are that person's brother, sister, half brother, half sister, stepbrother, or stepsister (or the child or grandchild of that person's brother, sister, half brother, half sister, stepbrother, or stepsister).
2. At the end of the year you were under age 19, or under age 24 and a full-time student, or any age if you were permanently and totally disabled at any time during the year.
3. You lived with that person in the United States for more than half of the year.

If you (or your spouse if filing a joint return) are a qualifying child of another person, you cannot claim the EIC. This is true even if the person for whom you are a qualifying child does not claim the EIC or meet all of the rules to claim the EIC. Put "No" next to line 66a (Form 1040), line 40a (Form 1040A), or line 8a (Form 1040EZ).

**Example.** You lived with your mother all year. You are age 26 and permanently and totally disabled. Your only income was from a community center where you went three days a week to answer telephones. You earned \$3,400 for the year and provided more than half of your own support. Because you meet the relationship, age, and residency tests, you are a qualifying child of your mother for the EIC. She can claim the EIC if she meets all the other requirements. Because you are a qualifying child of your mother, you cannot claim the EIC. This is so even if your mother cannot or does not claim the EIC.

## Rule 14. You Must Have Lived in the United States More Than Half of the Year

Your home (and your spouse's, if filing a joint return) must have been in the United States for more than half the year.

If it was not, put "No" next to line 66a (Form 1040), line 40a (Form 1040A), or line 8a (Form 1040EZ).

**United States.** This means the 50 states and the District of Columbia. It does not include Puerto Rico or U.S. possessions such as Guam.

**Homeless shelter.** Your home can be any location where you regularly live. You do not need a traditional home. If you lived in one or more homeless shelters in the United States for more than half the year, you meet this rule.

**Military personnel stationed outside the United States.** U.S. military personnel stationed outside the United States on extended active duty (defined in *Rule 8*) are considered to live in the United States during that duty period for purposes of the EIC.

## Part D. Figuring and Claiming the EIC

Read this part if you have met all the rules in *Parts A and B*, or all the rules in *Parts A and C*.

*Part D* discusses *Rule 15*. You must meet this rule, in addition to the rules in *Parts A and B*, or *Parts A and C*, to qualify for the earned income credit.

This part of the chapter also explains how to figure the amount of your credit. You have two choices.

1. Have the IRS figure the EIC for you. If you want to do this, see *IRS Will Figure the EIC for You*.
2. Figure the EIC yourself. If you want to do this, see *How To Figure the EIC Yourself*.

## Rule 15. Your Earned Income Must Be Less Than:

- \$36,348 (\$38,348 for married filing jointly) if you have more than one qualifying child,
- \$32,001 (\$34,001 for married filing jointly) if you have one qualifying child, or
- \$12,120 (\$14,120 for married filing jointly) if you do not have a qualifying child.

Earned income generally means wages, salaries, tips, other taxable employee pay, and net earnings from self-employment. Employee pay is earned income only if it is taxable. Nontaxable employee pay, such as certain dependent care benefits and adoption benefits, is not earned income. But there is an exception for nontaxable combat pay, which you can choose to include in earned income. Earned income is explained in detail in *Rule 7*.

**Figuring earned income.** If you are self-employed, a statutory employee, or a member of the clergy or a church employee who files Schedule SE (Form 1040), you will figure your earned income when you fill out Part 4 of EIC Worksheet B in the Form 1040 instructions.

Otherwise, figure your earned income by using the worksheet in *Step 5* of the Form 1040 instructions for lines 66a and 66b or the Form 1040A instructions for lines 40a and 40b, or the worksheet in *Step 2* of the Form 1040EZ instructions for lines 8a and 8b.

When using one of those worksheets to figure your earned income, you will start with the amount on line 7 (Form 1040 or Form 1040A) or line 1 (Form 1040EZ). You will then reduce that amount by any amount included on that line and described in the following list.

- **Scholarship or fellowship grants not reported on a Form W-2.** A scholarship or fellowship grant that was not reported to you on a Form W-2 is not considered earned income for the earned income credit.
- **Inmates.** Amounts received for work performed while an inmate in a penal institution are not earned income for the earned income credit. This includes amounts received for work performed while in a work release program or while in a halfway house. If you received any amount for work done while an inmate in a penal institution and that amount is included in the total on line 7 (Form 1040 or Form 1040A) or line 1 (Form 1040EZ), put "PRI" and the amount on the dotted line next to line 7 (Form 1040), in the space to the left of the entry space for line 7 (Form 1040A), or in the space to the left of line 1 (Form 1040EZ).
- **Deferred compensation plans.** A pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan is not considered earned income for the earned income credit. If you received such an amount and it was included in the total on line 7 (Form 1040 or Form 1040A) or line 1 (Form 1040EZ), put "DFC" and the amount on the dotted line next to line 7 (Form 1040), in the space to the left of the entry space for line 7 (Form 1040A), or in the space to the left of line 1 (Form 1040EZ). This amount may be reported in box 11 of your Form W-2. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

**Clergy.** If you are a member of the clergy who files Schedule SE and the amount on line 2 of that schedule includes an amount that was also reported on line 7 (Form 1040), subtract that amount from the amount on line 7 (Form 1040) and enter the result in the first space of the worksheet in *Step 5* of the Form 1040 instructions for lines 66a and 66b. Put "Clergy" on the dotted line next to line 66a (Form 1040).

**Church employees.** A church employee means an employee (other than a minister or member of a religious order) of a church or qualified church-controlled organization that is exempt from employer social security and Medicare taxes. If you received wages as a church employee and included any amount on both line

5a of Schedule SE and line 7 (Form 1040), subtract that amount from the amount on line 7 (Form 1040) and enter the result in the first space of the worksheet in *Step 5* of the Form 1040 instructions for lines 66a and 66b.

## IRS Will Figure the EIC for You

The IRS will figure your EIC for you if you follow the steps explained in this section.



*Do not ask the IRS to figure your EIC unless you are eligible for it. Read the rules in Parts A, B, C, and D to see if you qualify.*



*If you want the IRS to also figure the amount of your income tax, see chapter 30.*

## Form 1040

If you file Form 1040 and want the IRS to figure your credit for you, follow these steps.

1. Put "EIC" on the dotted line next to line 66a. Then, if you have any of the types of income described earlier under *Inmates*, *Deferred compensation plans*, or *Clergy*, follow the instructions given there.
2. If you received nontaxable combat pay and are electing to include it in your earned income for the EIC, enter the amount on line 66b. For details, see *Nontaxable combat pay election* in *Rule 7*.
3. Complete all other parts of your return that apply to you (including line 61), but do not fill in lines 72, 73, 74a, and 76. If you do not have a qualifying child, stop here.
4. If you have a qualifying child, complete Schedule EIC according to its instructions. Be sure to enter the child's social security number on line 2 of that schedule. If you do not, your credit may be reduced or disallowed. Attach Schedule EIC to your return.

## Form 1040A

If you file Form 1040A and want the IRS to figure your credit for you, follow these steps.

1. Put "EIC" to the left of the entry space for line 40a. Then, if you have any of the types of income described earlier under *Inmates* or *Deferred compensation plans*, follow the instructions given there.
2. If you received nontaxable combat pay and are electing to include it in your earned income for the EIC, enter the amount on line 40b. For details, see *Nontaxable combat pay election* in *Rule 7*.
3. Complete all other parts of your return that apply to you (including line 36), but do not fill in lines 43, 44, 45a, and 47. If you do not have a qualifying child, stop here.
4. If you have a qualifying child, complete Schedule EIC according to its instructions. Be sure to enter the child's social security number on line 2 of that schedule. If you

do not, your credit may be reduced or disallowed. Attach Schedule EIC to your return.

## Form 1040EZ

If you file Form 1040EZ and want the IRS to figure your credit for you, follow these steps.

1. Put "EIC" in the space to the left of line 8a. Then if you have any of the types of income described earlier under *Inmates* or *Deferred compensation plans*, follow the instructions given there.
2. If you received nontaxable combat pay and are electing to include it in your earned income for the EIC, enter the amount on line 8b. For details, see *Nontaxable combat pay election* in Rule 7.
3. Complete all other parts of your return that apply to you, but do not fill in lines 10, 12a, or 13.

## How To Figure the EIC Yourself

To figure the EIC yourself use the EIC Worksheet in the instructions for the form you are using (Form 1040, Form 1040A, or Form 1040EZ).

**Form 1040 and EIC Worksheet.** If you file Form 1040 and want to figure the credit yourself, follow these steps.

1. Go to your form instruction booklet and turn to the instructions for lines 66a and 66b, and look for Worksheet A or Worksheet B.
2. Complete the EIC Worksheet that applies to your situation according to its instructions. Complete Worksheet B if you were self-employed, a member of the clergy or a church employee who files Schedule SE, or a statutory employee filing Schedule C or C-EZ. Find the amount of your credit in the EIC Table in your instruction booklet.
3. Enter the amount of your earned income credit from Worksheet A or B on Form 1040, line 66a.
4. Keep the EIC Worksheet for your records. Do not attach it to your income tax return. If you do not have a qualifying child, stop here.
5. If you have a qualifying child, complete Schedule EIC according to its instructions. Be sure to enter the child's social security number on line 2 of that schedule. If you do not, your credit may be reduced or disallowed. Attach Schedule EIC to your return.

**Form 1040A and EIC Worksheet.** If you file Form 1040A and want to figure the credit yourself, follow these steps.

1. Go to your form instruction booklet and turn to the instructions for lines 40a and 40b, and look for the EIC Worksheet.
2. Complete the EIC Worksheet according to its instructions. Find the amount of your

credit in the EIC Table in your form instruction booklet.

3. Enter the amount of your earned income credit from line 6 of the EIC Worksheet on Form 1040A, line 40a.
4. Keep the EIC Worksheet for your records. Do not attach it to your income tax return. If you do not have a qualifying child, stop here.
5. If you have a qualifying child, complete Schedule EIC according to its instructions. Be sure to enter the child's social security number on line 2 of that schedule. If you do not, your credit may be reduced or disallowed. Attach Schedule EIC to your return.

**Form 1040EZ and EIC Worksheet.** If you file Form 1040EZ and want to figure the credit yourself, follow these steps.

1. Go to your form instruction booklet and turn to the instructions for lines 8a and 8b and look for the EIC Worksheet.
2. Complete the EIC Worksheet according to its instructions. Find the amount of your credit in the EIC Table in your form instruction booklet.
3. Enter the amount of your earned income credit from line 6 of the EIC Worksheet on Form 1040EZ, line 8a.
4. Keep the EIC Worksheet for your records. Do not attach it to your income tax return.

## Examples

The following two comprehensive examples (complete with filled-in forms) may be helpful.

1. John and Janet Smith, a married couple with one qualifying child and using Form 1040A.
2. Kelly Green, age 30, a student, with no qualifying child and using Form 1040EZ.

### Example 1. John and Janet Smith (Form 1040A)

John and Janet Smith are married and will file a joint return. They have one child, Amy, who is 3 years old. Amy lived with John and Janet for all of 2006. John worked and earned \$9,500. Janet worked part of the year and earned \$1,500. Their earned income and AGI are \$11,000. John and Janet qualify for the earned income credit and fill out the EIC Worksheet and Schedule EIC. The Smiths will attach Schedule EIC to Form 1040A when they send their completed return to the IRS.

They took the following steps to complete Schedule EIC and the EIC Worksheet.

#### Completing Schedule EIC

The Smiths complete Schedule EIC because they have a qualifying child. They enter "John and Janet Smith" and John's SSN (the SSN that appears first on their Form 1040A) on the line at

the top of Schedule EIC. The Smiths then fill out *Qualifying Child Information* (lines 1–6).

**Line 1.** The Smiths enter Amy's first name and last name in the column "Child 1."

**Line 2.** They enter Amy's SSN.

**Line 3.** They enter Amy's year of birth (2003).

**Lines 4a and 4b.** The Smiths skip lines 4a and 4b because Amy was born after 1987.

**Line 5.** The Smiths enter "Daughter." This line shows Amy's relationship to John and Janet.

**Line 6.** The Smiths enter "12." This is how many months Amy lived with them in 2006.

#### Completing the EIC Worksheet

Next, the Smiths will complete the EIC Worksheet to figure their earned income credit.

**Line 1.** The Smiths enter \$11,000 (their earned income).

**Line 2.** The Smiths go to the Earned Income Credit Table in the Form 1040A instructions. The Smiths find their income of \$11,000 within the range of \$11,000 to \$11,050. They follow this line across to the column that describes their filing status and number of children and find \$2,747. They enter \$2,747 on line 2.

**Line 3.** The Smiths enter their AGI of \$11,000.

**Line 4.** The Smiths check the "Yes" box because lines 1 and 3 are the same (\$11,000). They skip line 5 and enter the amount from line 2 (\$2,747) on line 6.

**Line 6.** The Smiths' EIC is \$2,747.

### Example 2. Kelly Green (Form 1040EZ)

Kelly Green is age 30 and a full-time student. She lived with her parents in the United States for all of 2006. She had a part-time job and earned \$6,240. She earned \$20 interest on a savings account. She is not eligible to be claimed as a dependent on her parents' return. Although she lived with her parents, she is not their qualifying child because she does not meet the age test. She does not have any children.

Kelly qualifies for the earned income credit. Kelly will file Form 1040EZ and complete the EIC Worksheet.

#### Completing the EIC Worksheet

Kelly figures the amount of her earned income credit on the EIC Worksheet as follows.

**Line 1.** She enters \$6,240 (her earned income).

**Line 2.** Kelly goes to the Earned Income Credit Table in the forms instruction booklet. She finds her earned income of \$6,240 in the range of \$6,200 to \$6,250. Kelly follows this line across to the column that describes her filing status and finds \$412. She enters \$412 on line 2.

**Line 3.** Kelly enters \$6,260 (her AGI).

**Line 4.** Kelly checks the “No” box because lines 1 and 3 are not the same.

**Line 5.** Kelly checks the “Yes” box because the amount on line 3 (\$6,260) is less than \$6,750. She leaves line 5 blank and enters the amount from line 2, \$412, on line 6.

**Line 6.** She enters \$412 here and on Form 1040EZ, line 8a. Kelly’s earned income credit is \$412.

---

## Advance Earned Income Credit

Do you expect to be eligible for the EIC this year (2007) and to have a qualifying child? If so, you can choose to get payments of the EIC in your paycheck now instead of waiting to get your EIC all at once in 2008 when you file your tax return for the year 2007. These payments are called advance EIC payments. This chapter explains how you may be able to get them this year and how to report them on your tax return.

**Who can get the advance payment of the earned income credit?** To get part of the earned income credit paid to you throughout the year in your paycheck, you must meet all the following rules.

1. You must expect that your earned income and AGI will each be less than \$33,241 (\$35,241 if you expect to file married filing jointly).
2. You must expect to have a qualifying child.
3. You must expect to meet all the rules in *Parts A, B, and D* of this chapter or in the instructions for Form W-5.

**Persons who are not entitled to receive advance payments.** Under certain circumstances, even if you meet these rules, you may

not be entitled to get EIC. If your wages are not subject to federal income tax, social security tax, or Medicare tax withholding, you cannot get the advance payment of the earned income credit. If you are a farm worker paid on a daily basis, your employer is not required to pay you the advance amount of the credit.

## How To Get Advance Payments for 2007

If you meet the rules stated above under *Who can get the advance payment of the earned income credit*, give your employer a Form W-5, Earned Income Credit Advance Payment Certificate, for 2007.

After you have read the instructions and completed Form W-5, give the lower part of the form to your employer. Keep the top part for your records.

**More than one employer.** If you have more than one employer, give a certificate to only one of them. If you are married and both you and your spouse are employed and expect to qualify for the credit, you may give a Form W-5 to your employer and your spouse may give one to his or her employer.

If you receive advance payments of EIC in 2007, you must file a 2007 tax return (even if you would not otherwise have to file) to report the payments and claim any additional EIC. Box 9 of your Form W-2 will show the amount you received. See the instructions for Form 1040 or Form 1040A for the line number on which you report advance payments of EIC.

**Receipt of advance payments you do not qualify for.** If you receive advance payments of EIC in 2007, and later find out that you are not

eligible for some or all of them, you still must report them on your tax return.



*You cannot use Form 1040EZ to report your advance payments. You must file Form 1040 or Form 1040A.*

### When to give your employer a new Form W-5.

The 2007 Form W-5 you give to your employer is valid until December 31, 2007. If you expect to be eligible for EIC in 2008 and you want to receive advance payments, you must give your employer a new Form W-5 in 2008. Do this each year you expect to be eligible for the EIC.

If you no longer want to get advance payments or if your situation changes and you no longer qualify for the earned income credit, you must give your employer a new Form W-5. Check the “No” box on line 1 of the new form.

If your spouse files a Form W-5 with his or her employer, you must file a new Form W-5 with your employer. Check the “Yes” box on line 3.

## Advance Payments Received in 2006

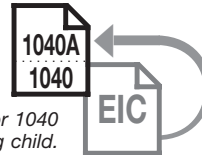
If you received advance payments of EIC in 2006, you must file Form 1040 or Form 1040A to report the payments. Your Form W-2, box 9, will show the amount you received. Report the amount on line 61 (Form 1040) or line 36 (Form 1040A).



*You cannot use Form 1040EZ to report your advance payments.*

**SCHEDULE EIC**  
**(Form 1040A or 1040)**

**Earned Income Credit**  
**Qualifying Child Information**



OMB No. 1545-0074

**2006**

Attachment  
Sequence No. **43**

Department of the Treasury  
Internal Revenue Service (99)

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.

Name(s) shown on return

John and Janet Smith

Your social security number

222 : 00 : 2222

**Before you begin:** See the instructions for Form 1040A, lines 40a and 40b, or Form 1040, lines 66a and 66b, to make sure that **(a)** you can take the EIC, and **(b)** you have a qualifying child.



- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

**Qualifying Child Information**

**Child 1**

**Child 2**

	First name	Last name	First name	Last name
<b>1 Child's name</b> If you have more than two qualifying children, you only have to list two to get the maximum credit.	Amy Smith			
<b>2 Child's SSN</b> The child must have an SSN as defined on page 43 of the Form 1040A instructions or page 49 of the Form 1040 instructions unless the child was born and died in 2006. If your child was born and died in 2006 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.	0 0 0 : 0 0 : 2 2 2 3			
<b>3 Child's year of birth</b>	Year <u>2</u> <u>0</u> <u>0</u> <u>3</u> <i>If born after 1987, skip lines 4a and 4b; go to line 5.</i>		Year _____ <i>If born after 1987, skip lines 4a and 4b; go to line 5.</i>	
<b>4 If the child was born before 1988—</b>				
<b>a</b> Was the child under age 24 at the end of 2006 and a student?	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 5.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue.</i>	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 5.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue.</i>
<b>b</b> Was the child permanently and totally disabled during any part of 2006?	<input type="checkbox"/> <b>Yes.</b> <i>Continue.</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.	<input type="checkbox"/> <b>Yes.</b> <i>Continue.</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.
<b>5 Child's relationship to you</b> (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)	Daughter			
<b>6 Number of months child lived with you in the United States during 2006</b> • If the child lived with you for more than half of 2006 but less than 7 months, enter "7." • If the child was born or died in 2006 and your home was the child's home for the entire time he or she was alive during 2006, enter "12."	<u>12</u> months <i>Do not enter more than 12 months.</i>		_____ months <i>Do not enter more than 12 months.</i>	



You may also be able to take the additional child tax credit if your child **(a)** was under age 17 at the end of 2006, **and** **(b)** is a U.S. citizen or resident alien. For more details, see the instructions for line 41 of Form 1040A or line 68 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2006

**Part 1**


**All Filers**

1. Enter your earned income from Step 5 on page 42. 

<b>1</b>	11,000
----------	--------

2. Look up the amount on line 1 in the EIC Table on pages 45–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. 

<b>2</b>	2,747
----------	-------

If line 2 is zero,  You cannot take the credit. Enter “No” to the left of the entry space for line 40a.

3. Enter the amount from Form 1040A, line 22. 

<b>3</b>	11,000
----------	--------

4. Are the amounts on lines 3 and 1 the same?  
 **Yes.** Skip line 5; enter the amount from line 2 on line 6.  
 **No.** Go to line 5.

**Part 2**

**Filers Who Answered “No” on Line 4**

5. If you have:  
 • No qualifying children, is the amount on line 3 less than \$6,750 (\$8,750 if married filing jointly)?  
 • 1 or more qualifying children, is the amount on line 3 less than \$14,850 (\$16,850 if married filing jointly)?  
 **Yes.** Leave line 5 blank; enter the amount from line 2 on line 6.  
 **No.** Look up the amount on line 3 in the EIC Table on pages 45–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.  
 Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

<b>5</b>	
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**Part 3**

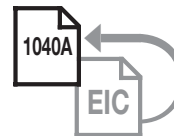
**Your Earned Income Credit**

6. **This is your earned income credit.**

<b>6</b>	2,747
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Enter this amount on Form 1040A, line 40a.

**Reminder—**  
 If you have a qualifying child, complete and attach Schedule EIC.



*If your EIC for a year after 1996 was reduced or disallowed, see page 43 to find out if you must file Form 8862 to take the credit for 2006.*



**Part 1**

**All Filers**

1. Enter your earned income from Step 2 on page 14. 

<b>1</b>	6,240
----------	-------

2. Look up the amount on line 1 above in the EIC Table on page 17 to find the credit. Be sure you use the correct column for your filing status. Enter the credit here. 

<b>2</b>	412
----------	-----

If line 2 is zero, You cannot take the credit. Enter “No” in the space to the left of line 8a.

3. Enter the amount from Form 1040EZ, line 4. 

<b>3</b>	6,260
----------	-------

4. Are the amounts on lines 3 and 1 the same?  
 **Yes.** Skip line 5; enter the amount from line 2 on line 6.  
 **No.** Go to line 5.

**Part 2**

**Filers Who Answered “No” on Line 4**

5. Is the amount on line 3 less than \$6,750 (\$8,750 if married filing jointly)?  
 **Yes.** Leave line 5 blank; enter the amount from line 2 on line 6.  
 **No.** Look up the amount on line 3 in the EIC Table on page 17 to find the credit. Be sure you use the correct column for your filing status. Enter the credit here. 

<b>5</b>	
----------	--

  
 Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

**Part 3**

**Your Earned Income Credit**

6. **This is your earned income credit.**

<b>6</b>	412
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Enter this amount on Form 1040EZ, line 8a.



*If your EIC for a year after 1996 was reduced or disallowed, see page 15 to find out if you must file Form 8862 to take the credit for 2006.*



# EIC Eligibility Checklist

Keep for Your Records



**You may claim the EIC if you answer “Yes” to all the following questions.\***

	Yes	No
1. Is your AGI less than: <ul style="list-style-type: none"> <li>• \$12,120 (\$14,120 if married filing jointly) if you do not have a qualifying child,</li> <li>• \$32,001 (\$34,001 if married filing jointly) if you have one qualifying child, or</li> <li>• \$36,348 (\$38,348 if married filing jointly) if you have more than one qualifying child? (See <i>Rule 1</i>.)</li> </ul>	<input type="checkbox"/>	<input type="checkbox"/>
2. Do you, your spouse, and your qualifying child each have a valid SSN? (See <i>Rule 2</i> .)	<input type="checkbox"/>	<input type="checkbox"/>
3. Is your filing status married filing jointly, head of household, qualifying widow(er), or single? (See <i>Rule 3</i> .) <b>Caution:</b> If you are a nonresident alien, answer “Yes” only if your filing status is married filing jointly and you are married to a U.S. citizen or resident alien. (See <i>Rule 4</i> .)	<input type="checkbox"/>	<input type="checkbox"/>
4. Answer “Yes” if you are not filing Form 2555 or Form 2555-EZ. Otherwise, answer “No.” (See <i>Rule 5</i> .)	<input type="checkbox"/>	<input type="checkbox"/>
5. Is your investment income \$2,800 or less? (See <i>Rule 6</i> .)	<input type="checkbox"/>	<input type="checkbox"/>
6. Is your total earned income at least \$1 but less than: <ul style="list-style-type: none"> <li>• \$12,120 (\$14,120 if married filing jointly) if you do not have a qualifying child,</li> <li>• \$32,001 (\$34,001 if married filing jointly) if you have one qualifying child, or</li> <li>• \$36,348 (\$38,348 if married filing jointly) if you have more than one qualifying child? (See <i>Rules 7 and 15</i>.)</li> </ul>	<input type="checkbox"/>	<input type="checkbox"/>
7. Answer “Yes” if you (and your spouse if filing a joint return) are not a qualifying child of another person. Otherwise, answer “No.” (See <i>Rules 10 and 13</i> .) <b>STOP: If you have a qualifying child, answer questions 8 and 9 and skip 10–12. If you do not have a qualifying child, skip questions 8 and 9 and answer 10–12.*</b>	<input type="checkbox"/>	<input type="checkbox"/>
8. Does your child meet the age, residency, and relationship tests for a qualifying child? (See <i>Rule 8</i> .)	<input type="checkbox"/>	<input type="checkbox"/>
9. Is your child a qualifying child only for you? Answer “Yes” if your qualifying child also meets the tests to be a qualifying child of another person, but the other person is not claiming any child-related tax benefits using that child. Answer “No” if you do not know whether the other person is claiming any child-related tax benefits using that child.	<input type="checkbox"/>	<input type="checkbox"/>
10. Were you (or your spouse if filing a joint return) at least age 25 but under 65 at the end of 2006? (See <i>Rule 11</i> .)	<input type="checkbox"/>	<input type="checkbox"/>
11. Answer “Yes” if you (and your spouse if filing a joint return) cannot be claimed as a dependent on anyone else’s return. Answer “No” if you (or your spouse if filing a joint return) can be claimed as a dependent on someone else’s return. (See <i>Rule 12</i> .)	<input type="checkbox"/>	<input type="checkbox"/>
12. Was your main home (and your spouse’s if filing a joint return) in the United States for more than half the year? (See <i>Rule 14</i> .)	<input type="checkbox"/>	<input type="checkbox"/>

\* **PERSONS WITH A QUALIFYING CHILD:** If you answered “Yes” to questions 1 through 9, you can claim the EIC. Remember to fill out Schedule EIC and attach it to your Form 1040 or Form 1040A. You cannot use Form 1040EZ. If you answered “Yes” to questions 1 through 8 and “No” to question 9, see *Rule 9* to help you determine whether you can claim the EIC. If you answered “Yes” to questions 1 through 7 and “No” to question 8, answer questions 10 through 12 to see if you can claim the EIC without a qualifying child.

**PERSONS WITHOUT A QUALIFYING CHILD:** If you answered “Yes” to questions 1 through 7, and 10 through 12, you can claim the EIC.

**If you answered “No” to any question that applies to you:** You cannot claim the EIC.

# 37.

## Other Credits

### What's New

**Residential energy credits.** You may be able to take the two new residential energy credits if you made energy saving improvements to your home in 2006. See *Residential Energy Credits* for more information.

**Alternative motor vehicle and alternative fuel vehicle refueling property credits.** You may be able to take a credit if you placed an alternative motor vehicle or alternative fuel vehicle refueling property in service in 2006. See *Alternative Motor Vehicle Credit* and *Alternative Fuel Vehicle Refueling Property Credit* for more information.

**Qualified electric vehicle credit.** The maximum qualified electric vehicle credit is reduced from \$4,000 to \$1,000 for any qualified vehicle placed in service in 2006. See *Qualified Electric Vehicle Credit* for more information.

**Credit for clean renewable energy bonds or Gulf tax credit bonds.** You may be able to take a credit if you are a holder of a clean renewable energy bond or Gulf tax credit bond during 2006. The amount of any credit figured before applying tax liability limits must be included as interest income on your tax return. See *Credits for Clean Renewable Energy Bonds or Gulf Tax Credit Bonds* for more information.

**Adoption credit.** The maximum adoption credit increases to \$10,960. The adoption credit can no longer be claimed on Form 1040A. See *Adoption Credit* for more information.

**Excess withholding of social security tax and railroad retirement tax.** Social security tax and tier 1 railroad retirement tax (RRTA) are both withheld at a rate of 6.2% of wages. The maximum wages subject to these taxes increased to \$94,200 in 2006. The withholding rate of tier 2 RRTA is 4.4% of wages in 2006. The maximum wages subject to this tax increased to \$69,900 in 2006. If you had too much social security or RRTA tax withheld during 2006, you may be entitled to a credit of the excess withholding. For more information about the credit, see *Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld* under *Refundable Credits*, later.

**Credit for federal telephone excise tax paid.** If you paid the federal telephone excise tax on certain long distance or bundled telephone service, you may be able to request a credit. See *Credit for Federal Telephone Excise Tax Paid* for more information.

### Introduction

This chapter discusses the following credits.

- Adoption credit.
- Foreign tax credit.
- Mortgage interest credit.
- Retirement savings contributions credit.
- Credit for prior year minimum tax.
- Alternative motor vehicle credit.
- Alternative fuel vehicle refueling property credit.
- Qualified electric vehicle credit.
- Residential energy credits.
- Credit for clean renewable energy bonds or Gulf tax credit bonds.
- Credit for excess social security tax or railroad retirement tax withheld.
- Credit for tax on undistributed capital gain.
- Health coverage tax credit.
- Credit for federal telephone excise tax paid.

Several other credits are discussed in other chapters in this publication.

- Child and dependent care credit (chapter 32).
- Credit for the elderly or the disabled (chapter 33).
- Child tax credit (chapter 34).
- Education credits (chapter 35).
- Earned income credit (chapter 36).

**Nonrefundable credits.** The first part of this chapter, *Nonrefundable Credits*, covers ten credits that you subtract from your tax. These credits may reduce your tax to zero. If these credits are more than your tax, the excess is not refunded to you.

**Refundable credits.** The second part of this chapter, *Refundable Credits*, covers four credits that are treated as payments and are refundable to you. These credits are added to the federal income tax withheld and any estimated tax payments you made. If this total is more than your total tax, the excess will be refunded to you.

### Useful Items

You may want to see:

#### Publication

- ❑ **502** Medical and Dental Expenses
- ❑ **514** Foreign Tax Credit for Individuals
- ❑ **530** Tax Information for First-Time Homeowners
- ❑ **535** Business Expenses
- ❑ **590** Individual Retirement Arrangements (IRAs)

#### Form (and Instructions)

- ❑ **1116** Foreign Tax Credit (Individual, Estate, or Trust)
- ❑ **2439** Notice to Shareholder of Undistributed Long-Term Capital Gains
- ❑ **5695** Residential Energy Credits
- ❑ **8396** Mortgage Interest Credit
- ❑ **8801** Credit For Prior Year Minimum Tax — Individuals, Estates, and Trusts

- ❑ **8828** Recapture of Federal Mortgage Subsidy
- ❑ **8834** Qualified Electric Vehicle Credit
- ❑ **8839** Qualified Adoption Expenses
- ❑ **8880** Credit for Qualified Retirement Savings Contributions
- ❑ **8885** Health Coverage Tax Credit
- ❑ **8910** Alternative Motor Vehicle Credit
- ❑ **8911** Alternative Fuel Vehicle Refueling Property Credit
- ❑ **8912** Credit for Clean Renewable Energy and Gulf Tax Credit Bonds
- ❑ **8913** Credit for Federal Telephone Excise Tax Paid

## Nonrefundable Credits

The credits discussed in this part of the chapter can reduce your tax. However, if the total of these credits is more than your tax, the excess is not refunded to you.

### Adoption Credit

You may be able to take a tax credit of up to \$10,960 for qualified expenses paid to adopt an eligible child. The credit may be allowed for the adoption of a child with special needs even if you do not have any qualified expenses.

If your modified adjusted gross income (AGI) is more than \$164,410, your credit is reduced. If your modified AGI is \$204,410 or more, you cannot take the credit.

**Qualified adoption expenses.** Qualified adoption expenses are reasonable and necessary expenses directly related to, and whose principal purpose is for, the legal adoption of an eligible child. These expenses include:

- Adoption fees,
- Court costs,
- Attorney fees,
- Travel expenses (including amounts spent for meals and lodging) while away from home, and
- Re-adoption expenses to adopt a foreign child.

**Nonqualified expenses.** Qualified adoption expenses do not include expenses:

- That violate state or federal law,
- For carrying out any surrogate parenting arrangement,
- For the adoption of your spouse's child,
- For which you received funds under any federal, state, or local program,
- Allowed as a credit or deduction under any other federal income tax rule,
- Paid or reimbursed by your employer or any other person or organization, or
- Paid before 1997.

**Eligible child.** The term "eligible child" means any individual:

- Under 18 years old, or

- Physically or mentally incapable of caring for himself or herself.

**Child with special needs.** An eligible child is a child with special needs if all three of the following apply.

1. He or she was a citizen or resident of the United States (including U.S. possessions) at the time the adoption process began.
2. A state (including the District of Columbia) has determined that the child cannot or should not be returned to his or her parents' home.
3. The state has determined that the child will not be adopted unless assistance is provided to the adoptive parents. Factors used by states to make this determination include:
  - a. The child's ethnic background,
  - b. The child's age,
  - c. Whether the child is a member of a minority or sibling group, and
  - d. Whether the child has a medical condition or a physical, mental, or emotional handicap.

**When to take the credit.** Generally, until the adoption becomes final, you take the credit in the year after your qualified expenses were paid or incurred. If the adoption credit becomes final, you take the credit in the year your expenses were paid or incurred. See the instructions for Form 8839 for more specific information on when to take the credit.

**Foreign child.** If the child is not a U.S. citizen or resident at the time the adoption process began, you cannot take the credit unless the adoption becomes final. You treat all adoption expenses paid or incurred in years before the adoption becomes final as paid or incurred in the year it becomes final.

**How to take the credit.** To take the credit, you must complete Form 8839 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 54, and check box b on that line.

## Foreign Tax Credit

You generally can choose to take income taxes you paid or accrued during the year to a foreign country or U.S. possession as a credit against your U.S. income tax. Or, you can deduct them as an itemized deduction (see chapter 22).

You cannot take a credit (or deduction) for foreign income taxes paid on income that you exclude from U.S. tax under any of the following.

1. Foreign earned income exclusion.
2. Foreign housing exclusion.
3. Income from Puerto Rico exempt from U.S. tax.
4. Possession exclusion.
5. Extraterritorial income exclusion.

**Limit on the credit.** Unless you can elect not to file Form 1116 (see *Exception*, later), your foreign tax credit cannot be more than your U.S. tax liability (Form 1040, line 44), multiplied by a fraction. The numerator of the fraction is your taxable income from sources outside the United States. The denominator is your total taxable

income from U.S. and foreign sources. See Publication 514 for more information.

**How to take the credit.** Complete Form 1116 and attach it to your Form 1040. Enter the credit on Form 1040, line 47.

**Exception.** You do not have to complete Form 1116 to take the credit if all of the following apply.

- All of your foreign source gross income was from passive income, which generally includes interest and dividends.
- All of your foreign source gross income and the foreign tax paid on it were reported to you on a qualified payee statement, which includes Form 1099-INT and Form 1099-DIV.
- The total of your creditable foreign taxes was not more than \$300 (not more than \$600 if married filing jointly).
- You elect this procedure for the tax year.

For more details on these requirements, see the instructions for Form 1116.

## Mortgage Interest Credit

The mortgage interest credit is intended to help lower-income individuals own a home. If you qualify, you can take the credit each year for part of the home mortgage interest you pay.

**Who qualifies.** You may be eligible for the credit if you were issued a mortgage credit certificate (MCC) from your state or local government. Generally, an MCC is issued only in connection with a new mortgage for the purchase of your main home.

**Amount of credit.** Figure your credit on Form 8396. If your mortgage loan amount is equal to (or smaller than) the certified indebtedness amount (loan) shown on your MCC, enter on Form 8396, line 1, all the interest you paid on your mortgage during the year.

If your mortgage loan amount is larger than the certified indebtedness amount shown on your MCC, you can figure the credit on only part of the interest you paid. To find the amount to enter on line 1, multiply the total interest you paid during the year on your mortgage by the following fraction.

$$\frac{\text{Certified indebtedness amount on your MCC}}{\text{Original amount of your mortgage}}$$

If two or more persons (other than a married couple filing a joint return) hold an interest in the home to which the MCC relates, the credit must be divided based on the interest held by each person. See Publication 530 for more information.



*If the certificate credit rate is more than 20%, the credit you are allowed cannot be more than \$2,000.*

**Carryforward.** If your allowable credit is reduced because of the limit based on your tax, you can carry forward the unused portion of the credit to the next 3 years or until used, whichever comes first.

If you are subject to the \$2,000 limit because your certificate credit rate is more than 20%, you cannot carry forward any amount more than \$2,000 (or your share of the \$2,000 if you must divide the credit).

**How to take the credit.** Figure your 2006 credit and any carryforward to 2007 on Form 8396, and attach it to your Form 1040. Be sure to include any credit carryforward from 2003, 2004, and 2005.

Include the credit in your total for Form 1040, line 54, and check box a.

**Reduced home mortgage interest deduction.** If you itemize your deductions on Schedule A (Form 1040), you must reduce your home mortgage interest deduction by the amount of the mortgage interest credit shown on Form 8396, line 3. You must do this even if part of that amount is to be carried forward to 2007. For more information about the home mortgage interest deduction, see chapter 23.

**Recapture of federal mortgage subsidy.** If you received an MCC with your mortgage loan, you may have to recapture (pay back) all or part of the benefit you received from that program. The recapture may be required if you sell or dispose of your home at a gain during the first 9 years after the date you closed your mortgage loan. See Publication 523, *Selling Your Home*, for more information.

## Retirement Savings Contributions Credit

You may be able to take this credit if you, or your spouse if filing jointly, made:

- Contributions (other than rollover contributions) to a traditional or Roth IRA,
- Elective deferrals to a 401(k) or 403(b) plan (including designated Roth contributions) or to a governmental 457, SEP, or SIMPLE plan,
- Voluntary employee contributions to a qualified retirement plan (including the federal Thrift Savings Plan), or
- Contributions to a 501(c)(18)(D) plan.

However, you cannot take the credit if either of the following applies.

1. The amount on Form 1040, line 38, or Form 1040A, line 22, is more than \$25,000 (\$37,500 if head of household; \$50,000 if married filing jointly).
2. The person(s) who made the qualified contribution or elective deferral (a) was born after January 1, 1989, (b) is claimed as a dependent on someone else's 2006 tax return or (c) was a student (defined next).

**Student.** You were a student if during any part of 5 calendar months of 2006 you:

- Were enrolled as a full-time student at a school, or
- Took a full-time, on-farm training course given by a school or a state, county, or local government agency.

**School.** A school includes a technical, trade, or mechanical school. It does not include an on-the-job training course, correspondence

school, or school offering courses only through the Internet.

**How to take the credit.** Figure the credit on Form 8880. Enter the credit on your Form 1040, line 51, or your Form 1040A, line 32, and attach Form 8880 to your return.

## Credit for Prior Year Minimum Tax

The tax laws give special treatment to some kinds of income and allow special deductions and credits for some kinds of expenses. If you benefit from these laws, you may have to pay at least a minimum amount of tax in addition to any other tax on these items. This is called the alternative minimum tax.

The special treatment of some items of income and expenses only allows you to postpone paying tax until a later year. If in prior years you paid alternative minimum tax because of these tax postponement items, you may be able to take a credit for prior year minimum tax against your current year's regular tax. The amount of the credit cannot reduce your current year's tax below your current year's tentative alternative minimum tax.

You may be able to take a credit against your regular tax if for 2005 you had:

- An alternative minimum tax liability and adjustments or preferences other than exclusion items,
- A minimum tax credit that you are carrying forward to 2006, or
- An unallowed nonconventional source fuel credit or qualified electric vehicle credit.

**How to take the credit.** Figure your 2006 credit and any carryforward to 2007 on Form 8801, and attach it to your Form 1040. Include the credit in your total for Form 1040, line 55, and check box b. You can carry forward any unused credit for prior year minimum tax to later years until it is completely used.

**More information.** For more information about the credit, see the instructions for Form 8801.

## Alternative Motor Vehicle Credit

You may be able to take a credit if you place an alternative motor vehicle in service in 2006. You can no longer take a deduction for clean-fuel vehicles.

**Alternative motor vehicle.** An alternative motor vehicle is a new vehicle that qualifies as one of the following four types of vehicles.

- Qualified hybrid vehicle.
- Advanced lean burn technology vehicle.
- Qualified alternative fuel vehicle.
- Qualified fuel cell vehicle.

**Amount of credit.** Generally, for a passenger car or light duty truck that is either a qualified hybrid vehicle or an advanced lean burn technology vehicle, you can rely on the manufacturer's (or, in the case of a foreign manufacturer,

its domestic distributor's) certification that a specific make, model, and model year vehicle qualifies for the credit and the maximum amount of the credit for which it qualifies. For an updated list of certified vehicles and the specific credit amounts for each model, go to [www.irs.gov/newsroom/article/0,,id=157632,00.html](http://www.irs.gov/newsroom/article/0,,id=157632,00.html) on the Internet.

**Additional requirements.** In addition to the manufacturer's (or domestic distributor's) certification, the following requirements must be met to qualify for the credit:

- You placed the vehicle in service after 2005;
- The original use of the vehicle began with you;
- You acquired the vehicle for your use or to lease to others, and not for resale; and
- You use the vehicle primarily in the United States.

**Phaseout of credit.** Ordinarily the amount of the credit is 100% of the manufacturer's (or domestic distributor's) certification of the maximum credit allowable as explained above. However, if you purchased a qualified vehicle from a manufacturer who previously sold at least 60,000 qualified vehicles, the amount of your credit may be reduced. Your manufacturer should give you the information you need to figure your phaseout percentage. See the Form 8910 instructions



*The phaseout period has begun for certain qualifying vehicles purchased for use or lease from Toyota Motor Corporation after September 30, 2006. See IRS news release IR 2006-145 on the Internet at [www.irs.gov/newsroom/article/0,,id=162562,00.html](http://www.irs.gov/newsroom/article/0,,id=162562,00.html).*

**Recapture of credit.** If the vehicle no longer qualifies for the credit, you must recapture part or all of the credit.

**How to take the credit.** To take the credit, you must complete Form 8910 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 55. Check box c and enter "8910" on the line next to box c.

**More information.** For more information on the credit, see the instructions for Form 8910.

## Alternative Fuel Vehicle Refueling Property Credit

You may be able to take a credit if you place a qualified alternative fuel vehicle refueling property in service in 2006. You can no longer take a deduction for clean fuel vehicle refueling property.

**Qualified alternative fuel refueling property.** Qualified alternative fuel vehicle property is any property (other than a building or its structural components) used to do either of the following.

- Store or dispense a clean-burning fuel into the fuel tank of a motor vehicle propelled by the fuel, but only if the storage or dispensing is at the point where the fuel is delivered into the tank.

- Recharge motor vehicles propelled by electricity, but only if the property is located at the point where the vehicles are recharged.

**Amount of the credit.** For personal use property, the credit is generally the smaller of 30% of the property's cost or \$1,000. For business use property, the credit is generally the smaller of 30% of the property's cost or \$30,000. Each property's cost must first be reduced by any section 179 deduction before figuring the credit.

**How to take the credit.** To take the credit, you must complete Form 8911 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 55. Check box c and enter "8911" on the line next to box c.

**More information.** For more information on the credit, see the instructions for Form 8911.

## Qualified Electric Vehicle Credit

You may be allowed a tax credit if you placed a qualified electric vehicle in service during the year.

**Qualified electric vehicle.** Generally, this is a vehicle that:

- Has at least four wheels and is manufactured primarily for use on public streets, roads, and highways,
- Is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current,
- Is originally used by you,
- Is acquired for your own use and not for resale,
- Has never been used as a nonelectric vehicle, and
- Is used predominately in the United States.

**Amount of credit.** If you placed a qualified electric vehicle in service during 2006, the credit is generally 2.5% of the cost of the vehicle. However, if the vehicle is a depreciable business asset, you must reduce the cost of the vehicle by any section 179 deduction before figuring the credit. See Publication 463, Travel, Entertainment, Gift, and Car Expenses, for information on the section 179 deduction.

The credit is limited to \$1,000 for each vehicle placed in service in 2006.

**Recapture.** If the vehicle no longer qualifies for the credit within 3 years of the date you placed it in service, you must recapture part or all of the credit. You recapture the credit by adding part or all of it to your income tax for the year in which the recapture event occurs.

The vehicle will no longer qualify if it is changed in either of the following ways.

- The vehicle is modified so that it is no longer primarily powered by electricity.
- It becomes nonqualifying property.

**Sale or other disposition.** Generally, no recapture occurs on the sale or other disposition of the vehicle. However, if the vehicle will be modified after you dispose of it so that it no

longer qualifies for the credit, the credit may be subject to recapture.

See Publication 535, chapter 12, for more information.

**How to take the credit.** To take the credit, complete Form 8834 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 55. Check box c and enter "8834" on the line next to box c.



*Do not confuse this credit with the alternative motor vehicle credit which is discussed above.*

## Residential Energy Credits

You may be eligible for 2 credits, the nonbusiness energy property credit and the residential energy efficient property credit, if you made energy saving improvements to your home.

**Nonbusiness energy property credit** You may be able to take this credit for any of the following improvements to your main home located in the United States in 2006 if they are new and meet certain requirements for energy efficiency.

- Any insulation material or system primarily designed to reduce heat gain or loss in your home.
- Exterior windows (including skylights).
- Exterior doors.
- A metal roof with pigmented coatings primarily designed to reduce heat gain in your home.

You may also be able to claim this credit for the cost of any of the following items if the items meet certain performance and quality standards.

- Certain electric heat pump water heaters, electric heat pumps, geothermal heat pumps, central air conditioners, and natural gas, propane, or oil water heaters.
- A qualified natural gas, propane, or oil furnace or hot water boiler.
- An advanced main air circulating fan used in a natural gas, propane, or oil furnace.

For more information about the nonbusiness energy property credit, see the Instructions for Form 5695.

**Residential energy efficient property credit.** You may be able to take this credit if you paid for any of the following during 2006.

- Qualified photovoltaic property for use in your home located in the United States.
- Qualified solar water heating property for use in your home located in the United States.
- Qualified fuel cell property installed on or in connection with your main home located in the United States.

For more information about the residential energy efficient property credit, see the instructions for Form 5695.

**Condominiums and cooperative apartments.** If you are a member of a condominium management association for a condominium you own or a tenant-stockholder in a cooperative housing corporation, you are treated as having paid your

proportionate share of any costs of such association or corporation for purposes of these credits.

**Basis reduction.** You must reduce the basis of your home by the amount of any credits allowed.

**How to take the credits.** To take either of the credits, you must complete Form 5695 and attach it to your Form 1040. Enter the credit on Form 1040, line 52.

**More information.** For more information on these credits, see the instructions for Form 5695.

## Credit for Clean Renewable Energy Bonds or Gulf Tax Credit Bonds

You may be able to take a credit if you are a holder of a clean renewable energy bond (CREB) or Gulf tax credit bond (GTCB). CREBs are tax credit bonds issued after 2005 by certain tax-exempt electricity providers to finance renewable energy projects. GTCBs are tax credit bonds issued after 2005 by the state of Alabama, Louisiana, or Mississippi that are designated by the governor of those states as GTCBs and that meet certain other requirements. The issuers do not pay interest on both types of bonds. Instead of receiving interest, the bondholders qualify to claim a tax credit.

**Who can claim the credits.** If you hold a CREB and/or a GTCB on 1 or more credit allowance dates, you can claim either the CREB credit or the GTCB credit by filing Form 8912. The credit allowance dates are:

- March 15,
- June 15,
- September 15, and
- December 15.

The credit allowance date also includes the last day on which the CREB or GTCB is outstanding.

**Amount of credit.** The amount of the credit with respect to each credit allowance date is generally equal to 25 percent of the annual credit for the bond. However, the 25% will be prorated for the quarters in which the bond is issued, redeemed or matures.

**Interest income.** The amount of any tax credit allowed (figured before applying tax liability limits) must be included as interest income on your tax return.

**How to take the credit.** To take either credit, you must complete Form 8912 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 55. Check box c, and enter "8912" on the line next to box c.

**More information.** For more information on these credits, see the instructions for Form 8912.

## Refundable Credits

The credits discussed in this part of the chapter are treated as payments of tax. If the total of

these credits, withheld federal income tax, and estimated tax payments is more than your total tax, the excess can be refunded to you.

## Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld

Most employers must withhold social security tax from your wages. If you work for a railroad employer, that employer must withhold tier 1 railroad retirement (RRTA) tax and tier 2 RRTA tax.

If you worked for two or more employers in 2006, you may have had too much social security or RRTA tax withheld from your pay. You can claim the excess social security or RRTA tier 1 tax as a credit against your income tax. The following table shows the maximum amount of wages subject to tax and the maximum amount of tax that should have been withheld in 2006.

Type of tax	Maximum wages subject to tax	Maximum tax that should have been withheld
Social security or RRTA tier 1	\$94,200	\$5,840.40
RRTA tier 2	\$69,900	\$3,075.60



*All wages are subject to Medicare tax withholding.*



*Use Form 843, Claim for Refund and Request for Abatement, to claim a refund of excess RRTA tier 2 tax. See Publication 505, Tax Withholding and Estimated Tax, for details.*

**Employer's error.** If any one employer withheld too much social security or RRTA tax, you cannot take the excess as a credit against your income tax. The employer should adjust the tax for you. If the employer does not adjust the overcollection, you can file a claim for refund using Form 843.

**Joint return.** If you are filing a joint return, you cannot add the social security or RRTA tax withheld from your spouse's wages to the amount withheld from your wages. Figure the withholding separately for you and your spouse to determine if either of you has excess withholding.

**How to figure the credit if you did not work for a railroad.** If you did not work for a railroad during 2006, figure the credit as follows:

1. Add all social security tax withheld (but not more than \$5,840.40 for each employer). Enter the total here . . . . . \_\_\_\_\_
2. Enter any uncollected social security tax on tips or group-term life insurance included in the total on Form 1040, line 63 . . . . . \_\_\_\_\_
3. Add lines 1 and 2. If \$5,840.40 or less, stop here. You cannot take the credit . . . . . \_\_\_\_\_

4. Social security tax limit . . . . .	5,840.40
5. Credit. Subtract line 4 from line 3. Enter the result here and on Form 1040, line 67 (or Form 1040A, line 43) . . . . .	_____

**Example.** You are married and file a joint return with your spouse who had no gross income in 2006. During 2006, you worked for the Brown Shoe Company and earned \$58,000 in wages. Social security tax of \$3,596 was withheld. You also worked for another employer in 2006 and earned \$47,000 in wages. \$2,914 of social security tax was withheld from these wages. Because you worked for more than one employer and your total wages were more than \$94,200, you can take a credit of \$669.60 for the excess social security tax withheld.

1. Add all social security tax withheld (but not more than \$5,840.40 for each employer). Enter the total here . . . . .	\$6,510.00
2. Enter any uncollected social security tax on tips or group-term life insurance included in the total on Form 1040, line 63 . . . . .	-0-
3. Add lines 1 and 2. If \$5,840.40 or less, stop here. You cannot take the credit . . . . .	6,510.00
4. Social security tax limit . . . . .	5,840.40
5. Credit. Subtract line 4 from line 3. Enter the result here and on Form 1040, line 67 (or Form 1040A, line 43) . . . . .	\$669.60

**How to figure the credit if you worked for a railroad.** If you were a railroad employee at any time during 2006, figure the credit as follows:

1. Add all social security and tier 1 RRTA tax withheld (but not more than \$5,840.40 for each employer). Enter the total here . . . . .	_____
2. Enter any uncollected social security and tier 1 RRTA tax on tips or group-term life insurance included in the total on Form 1040, line 63 . . . . .	_____
3. Add lines 1 and 2. If \$5,840.40 or less, stop here. You cannot take the credit . . . . .	_____
4. Social security and tier 1 RRTA tax limit . . . . .	5,840.40
5. Credit. Subtract line 4 from line 3. Enter the result here and on Form 1040, line 67 (or Form 1040A, line 43) . . . . .	_____

**How to take the credit.** Enter the credit on Form 1040, line 67, or include it in the total for Form 1040A, line 43.

## Credit for Tax on Undistributed Capital Gain

You must include in your income any amounts that regulated investment companies (commonly called mutual funds) or real estate investment trusts (REITs) allocated to you as capital gain distributions, even if you did not actually receive them. If the mutual fund or REIT paid a

tax on the capital gain, you are allowed a credit for the tax since it is considered paid by you. The mutual fund or REIT will send you Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains, showing the undistributed capital gains and the tax paid, if any. Take the credit for the tax paid by entering the amount on Form 1040, line 70, and checking box a. Attach Copy B of Form 2439 to your return. See *Capital Gain Distributions* in chapter 8 for more information on undistributed capital gains.

## Health Coverage Tax Credit

You may be able to take this credit for any month in which all the following statements were true on the first day of the month.

- You were an eligible trade adjustment assistance (TAA) recipient, alternative TAA recipient, or Pension Benefit Guaranty Corporation (PBGC) pension recipient (defined later).
- You were covered by a qualified health insurance plan for which you paid the premiums.
- You were not entitled to Medicare Part A or enrolled in Medicare Part B.
- You were not enrolled in Medicaid or State Children's Health Insurance Program (SCHIP).
- You were not enrolled in the Federal Employees Health Benefits Program or eligible to receive benefits under the U.S. military health system (TRICARE).
- You were not covered by, or eligible for coverage under, any employer-sponsored health insurance plan (including any employer-sponsored health insurance plan of your spouse).
- You were not imprisoned under federal, state, or local authority.

But, you cannot take the credit if you can be claimed as a dependent on someone else's 2006 tax return. If you meet all of these conditions, you may be able to take a credit of up to 65% of the amount you paid for qualified health insurance coverage. The amount you paid for qualified health insurance coverage must be reduced by any (a) Archer MSA and health savings account distributions used to pay for the coverage, and (b) National Emergency Grants you received for health insurance in 2006.

You can take this credit on your tax return or have it paid on your behalf in advance to your insurance company. If the credit is paid on your behalf in advance, that amount will reduce the amount of the credit you can take on your tax return.

For definitions and special rules including those relating to qualified health insurance plans and employer-sponsored health insurance plans, see Publication 502 and the instructions for Form 8885.

### TAA Recipient

You were an eligible TAA recipient on the first day of the month if, for any day in that month or the prior month, you:

- Received a trade readjustment allowance, or
- Would have been entitled to receive such an allowance except that you had not exhausted all rights to any unemployment insurance (except additional compensation that is funded by a state and is not reimbursed from any federal funds) to which you were entitled (or would be entitled if you applied).

**Example.** You received a trade adjustment allowance for January 2006. You were an eligible TAA recipient on the first day of January and February.

### Alternative TAA Recipient

You were an eligible alternative TAA recipient on the first day of the month if, for that month or the prior month, you received benefits under an alternative trade adjustment assistance program for older workers established by the Department of Labor.

**Example.** You received benefits under an alternative trade adjustment assistance program for older workers for October 2006. The program was established by the Department of Labor. You were an eligible alternative TAA recipient on the first day of October and November.

### PBGC Pension Recipient

You were an eligible PBGC pension recipient on the first day of the month, if both of the following apply.

1. You were age 55 or older on the first day of the month.
2. You received a benefit for that month that was paid by the PBGC under title IV of the Employee Retirement Income Security Act of 1974 (ERISA).

If you received a lump-sum payment from the PBGC after August 5, 2002, you meet item (2) above for any month that you would have received a PBGC benefit if you had not received the lump-sum payment.

### How To Take the Credit

To take the credit, complete Form 8885 and attach it to your Form 1040. Include your credit in the total for Form 1040, line 70, and check box c.

You must attach invoices and proof of payment for any amounts you include on Form 8885, line 2, for which you did not receive an advance payment. For details, see Publication 502 or Form 8885.

## Credit for Federal Telephone Excise Tax Paid

If you were billed after February 28, 2003, and before August 1, 2006, for the federal telephone excise tax on long distance or bundled service, you may be able to request a credit for the tax paid. You had bundled service if your local and long distance service was provided under a plan

that does not separately state the charge for local service.

You cannot request the credit if you are claimed as a dependent on someone else's return or have already received a refund from your service provider. If you request the credit, you cannot ask your service provider for a credit or refund and must withdraw any request previously submitted to your provider.

You can request a credit for either the actual amount of tax paid or a standard amount.



*It usually will be to your benefit to request the actual amount if it is larger than the standard amount.*

**Actual amount.** If you request the actual amount paid, you must attach Form 8913 showing the amount paid and keep records to substantiate the amount. See the Form 8913 instructions for details.

**Standard amount.** The standard amount depends on the number of exemptions claimed on

your return. If you are not required to file a tax return, the standard amount depends on the number of exemptions you would be allowed to claim if you were required to file. See chapter 3 for information on exemptions. The standard amounts, which include both the tax paid and interest owed on that tax, are shown in the following table.

IF the number of exemptions claimed is ...	THEN the standard amount is ...
0	\$ 0*
1	30
2	40
3	50
4 or more	60

\* Even though your standard amount is zero, you can request the actual amount paid on Form 8913.

If you request the standard amount and you later want to change it to the actual amount, file an amended return. See *Amended Returns and Claims for Refund* in chapter 1 for information on amended returns.

If you request the standard amount, you do not have to include the credit in income for any tax year.

**How to request the credit.** To request this credit, enter the amount on Form 1040, line 71; Form 1040A, line 42; or Form 1040-EZ, line 9. Attach Form 8913 if requesting the actual amount. If you are not otherwise required to file a federal income tax return, you must nevertheless file Form 1040EZ-T, Request for Refund of Federal Telephone Excise Tax, to request the credit.