

Chapter 2: Individual Taxpayer Issues

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Please note. Corrections were made to this workbook through January of 2022. No subsequent modifications were made.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

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AMENDED RETURNS

An amended return enables a taxpayer to correct income, deductions, or credits on a previously filed return. Additionally, taxpayers may file an amended return to change filing status, to change elections, maximize recovery rebate payments, change reported education expenses, or respond to certain IRS notices.

Typically, the IRS does not require an amended return for mathematical changes or errors. The IRS generally catches many mathematical errors during the processing stage and therefore, the individual taxpayer may not be required to file an amended return. Additionally, it is not always necessary to file an amended return because schedules or forms were not attached to the original return. The IRS normally sends a request asking for the forms or schedules.¹

Practitioner Planning Tip

Some tax practitioners believe that they are obligated to prepare amended returns when they discover errors on returns that were previously filed. Although Circular 230 does require practitioners to **advise** the client promptly of noncompliance, errors, or omissions² they are not required to **prepare** returns on the client's behalf. If a preparer is engaged to prepare the amended returns, they must correct **all** errors of which they have knowledge, not just those that would benefit their clients.³

REASONS TO AMEND

Changing Elections of a Previously Filed Return

The IRS allows an individual taxpayer to file an amended return to adjust certain elections, including the following.⁴

- Casualty loss from a federally declared disaster
- Presidential election campaign fund
- Parent's election to report child's interest and dividends
- Net operating losses (NOL)

Note. The Tax Cuts and Jobs Act (TCJA) eliminated the option for most taxpayers to carry back an NOL prior to a tax year ending after 2017.⁵ An exception applied to certain farming losses.⁶ The TCJA changes were modified by the Coronavirus Aid, Relief, and Economic Security (CARES) Act for tax years 2018, 2019, and 2020 only.⁷ The provisions created under TCJA are again in effect for tax years 2021 through 2025.

- Depreciation expense elections

¹ *Tips for Taxpayers Who Have to Amend a Tax Return*. Nov. 24, 2020. IRS. [www.irs.gov/newsroom/tips-for-taxpayers-who-have-to-amend-a-tax-return] Accessed on Jun. 8, 2021.

² Circular 230, §10.21.

³ Circular 230, §10.22.

⁴ Instructions for Form 1040-X.

⁵ *Tax Cuts and Jobs Act*, PL 115-97, §13302, amending IRC §172.

⁶ *Tax Cuts and Jobs Act*, PL 115-97, §13302(c)(1)(B).

⁷ *CARES Act*, PL 116-136, §2303, temporarily amending IRC §172.

Change in Filing Status

Taxpayers can amend their returns to change the filing status on a previously filed return. While changing from single to married filing jointly (MFJ) is relatively straight forward, changing between the two married categories can be more complex.

In general, changing a taxpayer's filing status from MFJ to married filing separately (MFS) is typically more restrictive because the amended return must be filed before the due date of the originally filed return, not including extensions.⁸

Example 1. Cody and Jessica were married on December 31, 2020, and timely filed their return as MFJ on March 15, 2021. If they wish to change their filing status to MFS, they must file an amended return by the original date of the return, excluding extension. This was May 17, 2021, for the 2020 filing season.

Practitioner Planning Tip

If, after filing an original return but before the original due date (including extensions) a taxpayer wishes to file a change in that tax return, they may file a superseding return. A superseding return effectively deletes the original return and replaces it with the superseding return. The IRS has not provided instructions on **how** to file a superseding return. Best practices recommend that a practitioner paper file the superseding return and write "Superseding Return" at the top of each page.

Note. There is an exception to changing from MFJ to MFS. A decedent's personal representative can change from a joint return elected by the surviving spouse to a separate return for the decedent. The personal representative has one year from the due date (including extensions) to make the change.⁹

⁸. IRC §6013(b)(2).

⁹. IRC §6013(a)(3).

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On the other hand, a taxpayer who wishes to change their filing status from MFS to MFJ can do so any time up to three years from the original due date, not including extensions.¹⁰ A married couple who amends their return to change from MFS to MFJ status must use the following steps in completing Form 1040-X, *Amended U.S. Individual Income Tax Return*.¹¹

Note. As of January 2020, Form 1040X was renamed Form 1040-X.¹²

1. Enter the amounts from the return as originally filed or as previously adjusted (either by taxpayer or the IRS) in column A.
2. Enter the amounts of the spouse's income and deductions as originally filed or previously adjusted plus any other increases or decreases for the tax year in column B.
3. Add any increase in column B to the amount in column A or subtract any decrease in column B from the amount in column A, and enter the amount in column C.
4. Enter an explanation for the change.
5. Both spouses must sign and date the form.

Note. The tax calculation for the additional spouse is the difference between the primary taxpayer's tax as originally filed and the tax calculated under the MFJ tables.

Example 2. Use the same facts as **Example 1**, except due to differences of opinion, Cody and Jessica decided to amend their 2020 returns and file as MFS before May 17, 2021.

The following table shows relevant data from their originally filed 2020 Form 1040, *U.S. Individual Income Tax Return*. Cody and Jessica's Forms 1040-X follow the table.

	Cody (MFS)	Jessica (MFS)	MFJ
Adjusted gross income (AGI)	\$100,500	\$120,000	\$220,500
Itemized or standard deduction	(15,400)	(15,000)	(30,400)
Taxable income	\$ 85,100	\$105,000	\$190,100
Tax	\$ 14,518	\$ 19,280	\$ 33,783
Federal tax withholding	(15,000)	(20,000)	(35,000)
Overpayment	(\$ 482)	(\$ 720)	(\$ 1,217)

Note. Cody's overpayment when filing separately of \$482 plus Jessica's overpayment of \$720 when MFS equals \$1,202. This is a \$15 difference when compared to their MFJ overpayment of \$1,217. This \$15 is reflected on Jessica's Form 1040-X as the higher income earner.

¹⁰ IRS Pub. 17, *Your Federal Income Tax for Individuals*.

¹¹ Instructions for Form 1040-X.

¹² *Ibid.*

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For Example 2

Form **1040-X** Department of the Treasury—Internal Revenue Service
Amended U.S. Individual Income Tax Return OMB No. 1545-0074
 (Rev. January 2020) ▶ Go to www.irs.gov/Form1040X for instructions and the latest information.

This return is for calendar year 2019 2018 2017 2016
Other year. Enter one: calendar year **2020** or fiscal year (month and year ended):

Your first name and middle initial: **Cody** Last name: **Jones** Your social security number: **1 1 1 | 1 1 | 1 1 1 1**
 If joint return, spouse's first name and middle initial: Last name: Spouse's social security number: **2 2 2 | 2 2 | 2 2 2 2**

Current home address (number and street). If you have a P.O. box, see instructions. **12345 Smith Street** Apt. no. Your phone number
 City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below. See instructions. **Urbana, IL 61801**

Foreign country name Foreign province/state/county Foreign postal code

Amended return filing status. You must check one box even if you are not changing your filing status. **Caution:** In general, you can't change your filing status from a joint return to separate returns after the due date.
 Full-year health care coverage (or, for amended 2018 returns only, exempt). If amending a 2019 return, leave blank. See instructions.

Single Married filing jointly Married filing separately (MFS) Qualifying widow(er) (QW) Head of household (HOH)
 If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶ **Jessica Jones**

Use Part III on the back to explain any changes

	A. Original amount reported or as previously adjusted (see instructions)	B. Net change—amount of increase or (decrease)—explain in Part III	C. Correct amount
Income and Deductions			
1 Adjusted gross income. If a net operating loss (NOL) carryback is included, check here <input type="checkbox"/>	1	220,500	100,500
2 Itemized deductions or standard deduction	2	30,400	15,400
3 Subtract line 2 from line 1	3	190,100	85,100
4a Exemptions (amended 2017 or earlier returns only). If changing, complete Part I on page 2 and enter the amount from line 29	4a		
b Qualified business income deduction (amended 2018 or later returns only)	4b		
5 Taxable income. Subtract line 4a or 4b from line 3. If the result is zero or less, enter -0-	5	190,100	85,100
Tax Liability			
6 Tax. Enter method(s) used to figure tax (see instructions): TCW	6	33,783	14,518
7 Credits. If a general business credit carryback is included, check here <input type="checkbox"/>	7		
8 Subtract line 7 from line 6. If the result is zero or less, enter -0-	8	33,783	14,518
9 Health care: individual responsibility (amended 2018 or earlier returns only). See instructions	9		
10 Other taxes	10		
11 Total tax. Add lines 8, 9, and 10	11	33,783	14,518
Payments			
12 Federal income tax withheld and excess social security and tier 1 RRTA tax withheld. (If changing, see instructions.)	12	35,000	15,000
13 Estimated tax payments, including amount applied from prior year's return	13		
14 Earned income credit (EIC)	14		
15 Refundable credits from: <input type="checkbox"/> Schedule 8812 Form(s) <input type="checkbox"/> 2439 <input type="checkbox"/> 4136 <input type="checkbox"/> 8863 <input type="checkbox"/> 8885 <input type="checkbox"/> 8962 or <input type="checkbox"/> other (specify):	15		
16 Total amount paid with request for extension of time to file, tax paid with original return, and additional tax paid after return was filed	16		
17 Total payments. Add lines 12 through 15, column C, and line 16	17		15,000
Refund or Amount You Owe			
18 Overpayment, if any, as shown on original return or as previously adjusted by the IRS	18		482
19 Subtract line 18 from line 17. (If less than zero, see instructions.)	19		14,518
20 Amount you owe. If line 11, column C, is more than line 19, enter the difference	20		
21 If line 11, column C, is less than line 19, enter the difference. This is the amount overpaid on this return	21		
22 Amount of line 21 you want refunded to you	22		
23 Amount of line 21 you want applied to your (enter year): estimated tax	23		

Complete and sign this form on page 2.
 For Paperwork Reduction Act Notice, see instructions. Cat. No. 11360L Form 1040-X (Rev. 1-2020)

Check here if the original return and spouse did not previously want to go to the fund, but now does.

Part III Explanation of Changes. In the space provided below, tell us why you are filing Form 1040-X.
 ▶ Attach any supporting documents and new or changed forms and schedules.

Taxpayer is amending the return to file as married filing separately (original return was married filing jointly). On the married filing jointly return a refund of \$1,202 was calculated. \$482 is the taxpayer's allocable share of the refund.

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For Example 2

Form 1040-X (Rev. January 2020)	Department of the Treasury—Internal Revenue Service Amended U.S. Individual Income Tax Return ▶ Go to www.irs.gov/Form1040X for instructions and the latest information.	OMB No. 1545-0074	
This return is for calendar year <input type="checkbox"/> 2019 <input type="checkbox"/> 2018 <input type="checkbox"/> 2017 <input type="checkbox"/> 2016 Other year. Enter one: calendar year 2020 or fiscal year (month and year ended):			
Your first name and middle initial Jessica	Last name Jones	Your social security number 2 2 2 2 2 2 2 2 2	
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number 1 1 1 1 1 1 1 1 1	
Current home address (number and street). If you have a P.O. box, see instructions. 12345 Smith Street		Apt. no. Your phone number	
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below. See instructions. Urbana, IL 61801			
Foreign country name	Foreign province/state/county	Foreign postal code	
Amended return filing status. You must check one box even if you are not changing your filing status. Caution: In general, you can't change your filing status from a joint return to separate returns after the due date.			
<input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input checked="" type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Qualifying widow(er) (QW) <input type="checkbox"/> Head of household (HOH)		<input type="checkbox"/> Full-year health care coverage (or, for amended 2018 returns only, exempt). If amending a 2019 return, leave blank. See instructions.	
If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶ Cody Jones			
Use Part III on the back to explain any changes			
Income and Deductions	A. Original amount reported or as previously adjusted (see instructions)	B. Net change—amount of increase or (decrease)—explain in Part III	C. Correct amount
1 Adjusted gross income. If a net operating loss (NOL) carryback is included, check here ▶ <input type="checkbox"/>	1 220,500	(100,500)	120,000
2 Itemized deductions or standard deduction	2 30,400	(15,400)	15,000
3 Subtract line 2 from line 1	3 190,100	(85,100)	105,000
4a Exemptions (amended 2017 or earlier returns only). If changing, complete Part I on page 2 and enter the amount from line 29	4a		
b Qualified business income deduction (amended 2018 or later returns only)	4b		
5 Taxable income. Subtract line 4a or 4b from line 3. If the result is zero or less, enter -0-	5 190,100	(85,100)	105,000
Tax Liability			
6 Tax. Enter method(s) used to figure tax (see instructions): TCW	6 33,783	(14,503)	19,280
7 Credits. If a general business credit carryback is included, check here ▶ <input type="checkbox"/>	7		
8 Subtract line 7 from line 6. If the result is zero or less, enter -0-	8 33,783	(14,503)	19,280
9 Health care: individual responsibility (amended 2018 or earlier returns only). See instructions	9		
10 Other taxes	10		
11 Total tax. Add lines 8, 9, and 10	11 33,783	(14,503)	19,280
Payments			
12 Federal income tax withheld and excess social security and tier 1 RRTA tax withheld. (If changing, see instructions.)	12 35,000	(15,000)	20,000
13 Estimated tax payments, including amount applied from prior year's return	13		
14 Earned income credit (EIC)	14		
15 Refundable credits from: <input type="checkbox"/> Schedule 8812 Form(s) <input type="checkbox"/> 2439 <input type="checkbox"/> 4136 <input type="checkbox"/> 8863 <input type="checkbox"/> 8885 <input type="checkbox"/> 8962 or <input type="checkbox"/> other (specify):	15		
16 Total amount paid with request for extension of time to file, tax paid with original return, and additional tax paid after return was filed	16		
17 Total payments. Add lines 12 through 15, column C, and line 16	17		20,000
Refund or Amount You Owe			
18 Overpayment, if any, as shown on original return or as previously adjusted by the IRS	18		735
19 Subtract line 18 from line 17. (If less than zero, see instructions.)	19		19,265
20 Amount you owe. If line 11, column C, is more than line 19, enter the difference	20		15
21 If line 11, column C, is less than line 19, enter the difference. This is the amount overpaid on this return	21		
22 Amount of line 21 you want refunded to you	22		
23 Amount of line 21 you want applied to your (enter year): estimated tax 23			

For Paperwork Reduction Act Notice, see instructions. Cat. No. 11360L Form 1040-X (Rev. 1-2020)

Check here if this return and any amendments were filed electronically.

Part III Explanation of Changes. In the space provided below, tell us why you are filing Form 1040-X.

▶ Attach any supporting documents and new or changed forms and schedules.

Taxpayer is amending the return to file as married filing separately (original return was married filing jointly). On the married filing jointly return a refund of \$1,202 was calculated. \$720 was the taxpayer's allocable share of the refund. This filing results in the taxpayer owing \$15.

If any of the following conditions apply, a taxpayer **may not file** an amended return to elect MFJ status.¹³

- It is three years after the due date for filing the return (not including extensions).
- Either spouse filed a petition with the Tax Court within the time prescribed in IRC §6213 and received a notice of deficiency for the tax year.
- Either spouse brought suit in any court for the recovery of any part of the tax for such taxable year.
- Either spouse entered into a closing agreement for the tax year or has compromised any civil or criminal case that arose against either spouse for the tax year.

Note. The IRS considers spouses of MFJ returns to have joint and several liability.¹⁴ This means each spouse is legally responsible for the entire tax liability, any interest and penalties due on the return, and any understatement of tax that may be assessed later.¹⁵

Practitioner Planning Tip

Even if the divorce decree states one spouse is obligated to pay the tax liability, both are equally responsible when filing jointly. Possible relief available to the impacted spouse is to seek remedy in court or file for innocent spouse relief (discussed later). See the *2021 University of Illinois Federal Tax Workbook*, Volume B, Chapter 4: Rulings and Cases, for information on the *Sleeth*¹⁶ case which discusses a situation where a spouse was found to be responsible for the tax liability even though the divorce decree stated otherwise.

Annulment.¹⁷ The IRS considers taxpayers who obtain a decree of annulment to never have been married. Annulled taxpayers **must** file amended returns for all affected tax years that are not closed by the statute of limitations (discussed later). The amended returns should show each taxpayer's filing status as single or head of household (HoH), if applicable.

¹³ IRC §6013(b)(2).

¹⁴ IRC §6013(d)(3).

¹⁵ Instructions for Form 1040-X; *Topic No. 205 Innocent Spouse Relief (Including Separation of Liability and Equitable Relief)*. Mar. 5, 2021. IRS [www.irs.gov/taxtopics/tc205] Accessed May 29, 2021.

¹⁶ *Lori D. Sleeth v. Comm'r*, 991 F.3d 1201 (11th Cir. 2021).

¹⁷ IRS Pub. 504, *Divorced or Separated Individuals*.

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Recovery Rebate Payments, Benefits and Credits

The CARES Act, the Consolidated Appropriations Act of 2021 (CAA), and the American Rescue Plan Act of 2021 (ARPA), provided taxpayers with economic impact/stimulus payments, also known as the recovery rebate payments, beginning in 2020 and 2021. When the ARPA was signed into law in March 2021, many taxpayers had already filed their tax returns. At this time, the IRS advises taxpayers not to file amended returns related to the new legislation.¹⁸

Note. The CARES Act, the CAA, and the ARPA are covered in more detail in the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: New Developments.

When to File an Amended Return. If an eligible taxpayer **did not** claim any 2020 recovery rebate credits on an originally filed return, they must file an amended return to receive the credit. The IRS notes the return should include “Recovery Rebate Credit” in the Explanation of Changes section.¹⁹

Note. A taxpayer should not file an amended tax return if the credit included on the originally filed return is incorrect. As with most mathematical errors, the IRS automatically recalculates the amount and continues processing the return. The IRS does not reject a return due to an incorrect rebate calculation.²⁰

Note. For more detail regarding recovery rebate payments, see the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: New Developments.

Education Credits and Deductions

A taxpayer with qualifying education expenses may be eligible for the American opportunity credit (AOC), the lifetime learning credit, and/or the tuition and fees deduction. A taxpayer can amend a previously filed individual income tax return to change which type of credit or deduction they claim or to claim a credit or deduction that was not included on the original return.²¹

Note. The tuition and fees deduction expired on December 31, 2020.²²

Limitations. A taxpayer cannot claim both the AOC and lifetime learning credit simultaneously for the same student. However, either credit is allowed in the same year that a beneficiary takes a tax-free distribution from a qualified tuition plan if the same expenses are not used for both benefits.²³

Amending a return may cause a taxpayer to lose an education credit or deduction if their amended modified AGI (MAGI) exceeds the phaseout limits for the credit or deduction. For 2020, the lifetime learning credit is phased out for MAGI between \$59,000 and \$69,000 (\$118,000 and \$138,000 for MFJ). The credit is eliminated for MAGI of \$69,000 or more (\$138,000 or more if MFJ).²⁴

¹⁸ *IRS Statement — American Rescue Plan Act of 2021*. Mar. 12, 2021. IRS [www.irs.gov/newsroom/irs-statement-american-rescue-plan-act-of-2021] Accessed on May 21, 2021.

¹⁹ *2020 Recovery Rebate Credit – Topic G: Correcting issues after the 2020 tax return is filed*. May 18, 2021. IRS [www.irs.gov/newsroom/2020-recovery-rebate-credit-topic-g-correcting-issues-after-the-2020-tax-return-is-filed] Accessed on May 21, 2021.

²⁰ *Ibid.*

²¹ *Tax Benefits for Education: Information Center*. Mar. 11, 2021. IRS. [www.irs.gov/newsroom/tax-benefits-for-education-information-center#deductions] Accessed on Jun. 14, 2021.

²² IRC §222(e).

²³ IRS Pub. 970, *Tax Benefits for Education*.

²⁴ *Lifetime Learning Credit*. Jan. 26, 2021. IRS. [www.irs.gov/credits-deductions/individuals/llc] Accessed on Jun. 24, 2021.

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For 2020, the AOC is phased out for MAGI between \$80,000 and \$90,000 (\$160,000 and \$180,000 for MFJ). The credit is eliminated for MAGI of \$90,000 or more (\$180,000 or more if MFJ).²⁵

For 2021, the AOC and the lifetime learning credit are phased out between \$160,000 and \$180,000 (MFJ) and between \$80,000 and \$90,000 (other filers).²⁶ **Individuals filing separately are not eligible for either the lifetime learning credit or the AOC.** More information on the changes to the lifetime learning credit are covered later in this chapter.

For 2020, the tuition and fees deduction is phased out for MAGI between \$65,000 and \$80,000 (\$130,000 and \$160,000 for MFJ). The deduction is eliminated for MAGI of \$80,000 or more (\$160,000 or more if MFJ).²⁷

Example 3. Sally Sue is a student working toward her Associate’s degree in accounting at a local college. During 2020, Sally paid \$20,000 in tuition. She and her husband claimed the lifetime learning credit of \$200 on their joint 2020 tax return that she self-prepared. The next day, they receive an additional Form W-2, *Wage and Tax Statement*, reporting \$10,500 for work Sally’s husband did early in the previous year that was not included in their filed return.

Sally prepares Form 1040-X (shown on the next page) for 2020 to report the additional income. Because the additional income increases their AGI to \$145,706, which exceeds the \$138,000 threshold for the lifetime learning credit, Sally must also remove the credit on their Form 1040-X. As she is preparing the amended return, she realizes that the tuition and fees deduction is available for them. She includes the \$2,000 deduction on the amended return. The AGI shown on line 1, column C of Form 1040-X includes the following items.

Wages		\$136,000
Unreported wage income from Form W-2	\$10,500	
Tuition and fees deduction	(2,000)	
Total adjustments	\$ 8,500	8,500
AGI		\$144,500

²⁵ *American Opportunity Tax Credit*. Jan. 26, 2021. [www.irs.gov/credits-deductions/individuals/aotc] Accessed on Jun. 24, 2021.

²⁶ *Consolidated Appropriations Act of 2021*, PL 116-260, §104(a)(1)(1), Div. EE.

²⁷ IRS Pub. 970, *Tax Benefits for Education*.

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For Example 3

Form **1040-X**
(Rev. January 2020)

Department of the Treasury—Internal Revenue Service

Amended U.S. Individual Income Tax Return

OMB No. 1545-0074

▶ Go to www.irs.gov/Form1040X for instructions and the latest information.

This return is for calendar year 2019 2018 2017 2016

Other year. Enter one: calendar year **2020** or fiscal year (month and year ended):

Your first name and middle initial Sam	Last name Sue	Your social security number 1 2 3 4 5 6 7 8 9
If joint return, spouse's first name and middle initial Sally	Last name Sue	Spouse's social security number 9 8 7 6 5 4 3 2 1
Current home address (number and street). If you have a P.O. box, see instructions. 1122345 Glenrove Dr		Apt. no. Your phone number
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below. See instructions. Urbana, IL 61801		
Foreign country name	Foreign province/state/county	Foreign postal code

Amended return filing status. You must check one box even if you are not changing your filing status. **Caution:** In general, you can't change your filing status from a joint return to separate returns after the due date.

Full-year health care coverage (or, for amended 2018 returns only, exempt). If amending a 2019 return, leave blank. See instructions.

Single Married filing jointly Married filing separately (MFS) Qualifying widow(er) (QW) Head of household (HOH)

If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶

		A. Original amount reported or as previously adjusted (see instructions)	B. Net change—amount of increase or (decrease)—explain in Part III	C. Correct amount
Use Part III on the back to explain any changes				
Income and Deductions				
1 Adjusted gross income. If a net operating loss (NOL) carryback is included, check here ▶ <input type="checkbox"/>	1	136,000	(8,500)	144,500
2 Itemized deductions or standard deduction	2	24,800		24,800
3 Subtract line 2 from line 1	3	111,200	8,500	119,700
4a Exemptions (amended 2017 or earlier returns only). If changing, complete Part I on page 2 and enter the amount from line 29	4a			
b Qualified business income deduction (amended 2018 or later returns only)	4b			
5 Taxable income. Subtract line 4a or 4b from line 3. If the result is zero or less, enter -0-	5	111,200	8,500	119,700
Tax Liability				
6 Tax. Enter method(s) used to figure tax (see instructions): TCW	6	16,044	1,870	17,914
7 Credits. If a general business credit carryback is included, check here ▶ <input type="checkbox"/>	7	200	(200)	
8 Subtract line 7 from line 6. If the result is zero or less, enter -0-	8	15,844	2,070	17,914
9 Health care: individual responsibility (amended 2018 or earlier returns only). See instructions	9			
10 Other taxes	10			
11 Total tax. Add lines 8, 9, and 10	11	15,844	2,070	17,914
Payments				
12 Federal income tax withheld and excess social security and tier 1 RRTA tax withheld. (If changing, see instructions.)	12	16,000		16,000
13 Estimated tax payments, including amount applied from prior year's return	13			
14 Earned income credit (EIC)	14			
15 Refundable credits from: <input type="checkbox"/> Schedule 8812 Form(s) <input type="checkbox"/> 2439 <input type="checkbox"/> 4136 <input type="checkbox"/> 8863 <input type="checkbox"/> 8885 <input type="checkbox"/> 8962 or <input type="checkbox"/> other (specify):	15			
16 Total amount paid with request for extension of time to file, tax paid with original return, and additional tax paid after return was filed	16			
17 Total payments. Add lines 12 through 15, column C, and line 16	17			16,000
Refund or Amount You Owe				
18 Overpayment, if any, as shown on original return or as previously adjusted by the IRS	18			156
19 Subtract line 18 from line 17. (If less than zero, see instructions.)	19			15,844
20 Amount you owe. If line 11, column C, is more than line 19, enter the difference	20			2,070
21 If line 11, column C, is less than line 19, enter the difference. This is the amount overpaid on this return	21			
22 Amount of line 21 you want refunded to you	22			
23 Amount of line 21 you want applied to your (enter year): estimated tax 23				

Complete and sign this form on page 2.

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11360L

Form **1040-X** (Rev. 1-2020)

Not Claimed on Original Return. A taxpayer who did not claim an education credit on their originally filed Form 1040 may make the election on an amended return before the expiration of the statute of limitations by attaching Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*, to the amended return.²⁸

Practitioner Planning Tip

Because of the potential for missed credits on prior year returns, it is a good idea to ask the taxpayer for the prior three years of tax returns when they (or their dependents) are in college, to provide the practitioner an opportunity to review the previous filings.

Example 4. Jay and Jody filed their joint 2019 return on July 13, 2020, but failed to take the AOC for their daughter, Danielle, who is studying to be a chemist. They have up to three years to file an amended return to claim the AOC.

Eliminating Credit.²⁹ If a taxpayer determines after filing their tax return that they were ineligible for either the lifetime learning credit or the AOC, they must amend their return using Form 1040-X to remove the credit. The IRS may assess a penalty or ban the taxpayer from claiming the AOTC for two to 10 years.

The AOC is not allowed on either the original or amended return for a student who has not been issued a taxpayer identification number (TIN) by the due date of the return, including extensions. While there are other examples, for the purposes of this credit, a TIN is typically either a social security number (SSN) or individual taxpayer identification number (ITIN).³⁰

Note. The IRS instructions for Form 1040-X indicate that only lines 11–23 should be completed when the only changes being made are to payments and refundable credits.

Refunds.³¹ Occasionally, a taxpayer receives tax-free educational assistance or a refund of tuition and fees after filing a return on which they claimed an education credit. When this occurs, the taxpayer may have to repay some or all the credit. **However, they do not have to file an amended return.** A taxpayer who claimed one of the education credits must recapture any excess credit. To do so, the taxpayer should follow these steps.

1. Reduce the amount of adjusted qualified education expenses for the prior year by the amount of the refund or tax-free educational assistance.
2. Recalculate the education credit.
3. Calculate the amount by which the prior year's tax liability would have increased if the taxpayer had claimed the reduced credit.
4. Complete Schedule 2, *Additional Taxes*, line 8 (taxes from), check box C and write "ECR" in the space next to that box.³²
5. Include the amount of any increased tax liability on Form 1040, line 24 (tax).

²⁸ Instructions for Form 1040-X.

²⁹ *American Opportunity Tax Credit*. Jan. 26, 2021. IRS. [www.irs.gov/credits-deductions/individuals/aotc] Accessed on Jun. 2, 2021.

³⁰ *Taxpayer Identification Numbers (TIN)*. Jan. 7, 2021. IRS. [www.irs.gov/individuals/international-taxpayers/taxpayer-identification-numbers-tin] Accessed on Jun. 14, 2021.

³¹ IRS Pub. 970, *Tax Benefits for Education*.

³² Instructions for Form 1040.

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Example 5. In November 2020, Davis received \$14,000 from his grandparents. As a good accounting student, Davis used part of the gift to pay \$5,000 tuition and fees to his college for the spring 2021 semester. Davis was registered to continue as a full-time student, but early in the spring semester, he decided to take some time off and visit friends in Urbana. Davis had to drop classes to make the trip. Davis usually files his taxes early, and he submitted his return in late February. The return included an AOC of \$2,500.

In mid-March, the university reimbursed Davis \$2,500 for classes dropped.

When Davis files his 2021 return, he enters \$375 on the “Total Tax” line with the notation “ECR.”

AOC as reported on Davis’ 2020 tax return	\$2,500
Less: AOC as recomputed after refund	<u>(2,125)</u>
Additional tax reported on 2021 Form 1040	\$ 375

Response to CP2000 Notice³³

The IRS automatically issues CP2000 notices to taxpayers whose tax return information does not match information on file at the IRS. The result may be an overpayment, underpayment, or no change to tax liability. It is important to read the notice carefully because it explains the information the IRS received and how it affects the taxpayer’s return.³⁴

The CP2000 notice provides a summary of proposed changes to the return and the steps the taxpayer should take to respond. The notice also shows the following information.³⁵

- The amounts reported on the original or processed amended return
- The amounts reported to the IRS by the payer
- The payer’s name, identification number, the type of document issued (e.g., Forms W-2, 1098, *Mortgage Interest Statement*, or 1099), and the TIN of the person to whom the document was issued
- The proposed changes to income, tax, credits, and/or payments
- A response form, payment voucher, and an envelope (if applicable)

The taxpayer must indicate whether they agree or disagree with all, some, or none of the proposed changes on the response form. If the taxpayer agrees with the proposed adjustments on the CP2000 notice, they complete and sign the response form and return it in the enclosed envelope.

If the taxpayer disagrees with one or more of the proposed adjustments, they should not sign the response form. The taxpayer should mark the appropriate box and explain in a **separate signed statement** why they disagree with one or more of the changes. Then, the taxpayer submits the statement and supporting documentation with the response form to the IRS.

³³ IRS Pub. 970, *Tax Benefits for Education*.

³⁴ *Understanding Your CP2000 Notice*. Feb. 24, 2021. IRS [www.irs.gov/individuals/understanding-your-cp2000-notice] Accessed on Jun. 2, 2021.

³⁵ *Topic No. 652 Notice of Underreported Income – CP2000*. Mar. 12, 2021. IRS. [www.irs.gov/taxtopics/tc652] Accessed on Jun. 2, 2021.



Practitioner Planning Tip

If a taxpayer receives a notice and determines the additional amount owed is incorrect, the tax practitioner should consider recomputing the amount due and submit the computation with the statement and supporting documentation. The practitioner can advise the taxpayers to submit a check to pay the balance due or make a direct payment online at www.irs.gov/payments. If the practitioner can compute the amount of interest, the taxpayer can also make payment for that amount.

The taxpayer does not need to file an amended return unless they have additional income, credits, or expenses to report. However, the taxpayer should consider filing amended returns for other years not listed on the CP2000 notice if they made similar errors or omissions.

Unemployment Benefits

The ARPA potentially excludes up to \$10,200 (\$20,400 for MFJ and both spouses received unemployment benefits)³⁶ of unemployment benefits from income. If a taxpayer already filed their 2020 Form 1040 or 1040-SR, *U.S. Tax Return for Seniors*, they **should not file an amended return**. The IRS will automatically refund money to taxpayers who already filed their tax return reporting unemployment compensation as income.³⁷

FORMS USED

Form 1040

An individual who makes corrections to their originally filed income tax return prior to the original return due date, including timely filed extensions, may use Form 1040 as a superseding return (as discussed earlier).³⁸

Form 1040-X³⁹

An individual who needs to make corrections to their originally filed income tax return may file an amended return. In addition to the reasons mentioned earlier, Form 1040-X can be used for the following purposes.

- To make certain elections after the filing deadline (See Treas. Regs. §§301.9100-1 through -3)
- To change amounts previously adjusted by the IRS
- To claim a carryback due to a loss or unused credit

³⁶ 2020 Unemployment Compensation Exclusion FAQs – Topic A: Eligibility. Jul. 7, 2021. IRS. [www.irs.gov/newsroom/2020-unemployment-compensation-exclusion-faqs-topic-a-eligibility] Accessed on Aug. 9, 2021.

³⁷ New Exclusion of up to \$10,200 of Unemployment Compensation. Apr. 1, 2021. IRS. [www.irs.gov/forms-pubs/new-exclusion-of-up-to-10200-of-unemployment-compensation] Accessed on Jun. 16, 2021.

³⁸ IRM 3.11.6.3.3.2 (2021).

³⁹ Instructions for Form 1040-X.

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To complete Form 1040-X, a taxpayer uses the following steps.

1. Enter the amounts from the return as originally filed or as previously adjusted (either by taxpayer or the IRS) in column A.
2. Enter the amounts of the increase or decrease for each line item changed or adjusted by the IRS in column B.
3. Add any increase in column B to the amount in column A or subtract any decrease in column B from the amount in column A, and enter the amount in column C.
4. Enter an explanation for the change.
5. Both spouses must sign and date the form.

A taxpayer who amends more than one tax return should prepare a Form 1040-X for each return and electronically file or mail the returns in separate envelopes to the appropriate IRS address. A taxpayer should not file an amended return for an additional refund until they have received their original refund. The taxpayer can cash the initial refund check while they wait for any additional refund.⁴⁰

Note. While there are no limits to the number of amended returns filed per taxpayer per year, the IRS accepts up to three electronically filed amended returns. Additional returns must be paper filed. Electronic filing of amended returns is now available for 2019 and 2020 tax years for returns that were originally electronically filed. Software providers may have specific directions and limitations.⁴¹

Generally, the IRS takes eight to 12 weeks to process a Form 1040-X. However, in some cases, processing may take up to 16 weeks. A taxpayer can check the status of their amended return using the “Where’s My Amended Return?” tool on the IRS.gov website. The taxpayer must provide the following information.⁴²

- TIN
- Date of birth
- Zip code

Note. It can take up to three weeks from the time the return is mailed before it appears in the IRS system.⁴³

Form 1045⁴⁴

An individual applying for a quick tax refund may file Form 1045, *Application for Tentative Refund*, instead of an amended return. A taxpayer can file Form 1045 in the following situations.

- Carryback of an NOL
- Carryback of an unused general business credit
- Carryback of a net IRC §1256 contracts loss
- Overpayment of tax due to a claim of right adjustment under IRC §1341(b)(1)

⁴⁰ *What Taxpayers Should Know about Amending a Tax Return*. May 25, 2021. IRS. [www.irs.gov/newsroom/what-taxpayers-should-know-about-amending-a-tax-return] Accessed on Jun. 14, 2021.

⁴¹ *Form 1040-X, Amended U.S. Individual Income Tax Return, Frequently Asked Questions*. May 3, 2021. IRS. [www.irs.gov/filing/amended-return-frequently-asked-questions] Accessed on Jun. 14, 2021.

⁴² Instructions for Form 1040-X.

⁴³ Ibid.

⁴⁴ Instructions for Form 1045.

Generally, Form 1045 must be filed within one year after the end of the year in which the NOL, unused credit, net section §1256 contracts loss, or claim of right adjustment arose.

The IRS must process Form 1045 within 90 days from the later of the following.

1. The date the taxpayer files Form 1045, or
2. The last day of the month that includes the due date (including extensions) for filing the current year income tax return (or for a claim of right adjustment, the date of the overpayment under §1341(b)(1)).

Form 1040-X differs from Form 1045 in that the IRS is not required to process Form 1040-X within 90 days. Additionally, processing Form 1045 does not mean that the IRS accepts the application as correct. The IRS can issue penalties if it determines that the information on Form 1045 overstates the value of property, is negligent, disregards rules, or there is a substantial understatement of income tax.

The IRS may disallow a Form 1045 if it contains material omissions or math errors that are not corrected within the 90-day processing period. A taxpayer cannot bring suit against the IRS in any court if the IRS disallows the application for refund in whole or in part.

Note. By filing Form 1045, a taxpayer cannot bring suit against the IRS in any court. However, when Form 1040-X is filed, a taxpayer can bring suit against the IRS if the IRS does not process the Form 1040-X within six months from the day the taxpayer files the return or if the taxpayer disagrees with the IRS's determination. The taxpayer must file the suit within two years after the date the IRS disallows the determination.

Note. When a taxpayer amends their federal income tax return, they may also need to file an amended state income tax return. Some states require proof of IRS acceptance of the amended federal return before filing an amended return for a refund. In addition, some states may have differing deadlines for when the amended state return must be filed.

WHEN TO AMEND

Statute of Limitations

The statute of limitations is the period established by law to review, analyze, and resolve taxpayer and/or IRS tax-related issues. The Code requires the IRS to assess, refund, credit, and collect taxes within these specific time limits. After the statute of limitations expires, the IRS can no longer assess additional tax, allow a taxpayer's claim for refund, or take collection action.⁴⁵

An individual filing an amended return on Form 1040-X for a credit or refund generally must do so by the later of three years (including extensions) after the date the original Form 1040 was filed, or two years after the date the tax was paid. A return filed before the unextended due date (generally April 15) is considered to have been filed on the due date. A taxpayer with an extension who files before the extended due date is deemed to have filed on the day the IRS receives the return.⁴⁶

Example 6. Jonathan filed his 2019 original Form 1040 and paid all tax due on July 15, 2020. The statute of limitation on Jonathan's 2019 return begins on April 15, 2020, (the unextended and original due date) and runs for three years. He has until April 15, 2023, to file an amended return for 2019.

Example 7. Beth filed an extension on July 14, 2020, for her 2019 Form 1040. She completed the return and paid the taxes on September 12, 2020. Beth's limitations period extends until September 12, 2023.

⁴⁵ IRM 25.6.1.2 (2001).

⁴⁶ Instructions for Form 1040-X.

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Exceptions.⁴⁷ The general statute of limitations remains in place unless the following situations occur.

Individual is Unable to Manage Their Financial Affairs.⁴⁸ The statute of limitations period can be suspended during periods when an individual cannot manage their financial affairs because of a physical or mental impairment. The impairment must be medically determinable and either:

- Lasted or can be expected to last continuously for at least one year, or
- Can be expected to result in death.

The statute of limitations cannot be suspended during any time that **another individual**, such as a spouse or guardian, is **authorized to act on behalf of the taxpayer** for financial matters. To claim financial disability, a taxpayer must submit the following statements with the claim for a credit or refund.

1. A written statement must be signed by a physician qualified to make the determination that includes all the following information.
 - a. The name and descriptions of the physical or mental impairment
 - b. The physician's medical opinion that the physical or mental impairment prevented the taxpayer from managing their financial affairs
 - c. The physician's medical opinion that the physical or mental impairment was or can be expected to result in death or has lasted (or can be expected to last) for a continuous period of not less than one year
 - d. To the best of the physician's knowledge, the specific time period during which the taxpayer was prevented by such physical or mental impairment from managing their financial affairs
2. A written statement is made by the person signing the claim for credit or refund that no person, including the taxpayer's spouse, was authorized to act on the taxpayer's behalf in financial matters during the period specified in the physician's statement. Alternatively, if a person was authorized to act on the taxpayer's behalf in financial matters during any part of the period, the statement should indicate the beginning and ending dates of any period that a person was so authorized.

Note. The IRS will not accept a written statement from anyone other than a physician. For example, a letter from a nursing home director verifying the diagnosis and condition of the taxpayer is not sufficient.

Debt or Worthless Security. If the return is amended because a debt or security became worthless, the statute of limitations is extended to seven years.⁴⁹ Nonbusiness bad debts and securities must be totally worthless to be deductible.⁵⁰ Worthlessness is determined based on the facts and circumstances that indicate there is no reasonable expectation of payment.

Foreign Tax Credit or Deduction. If the return is amended because of a correction to a foreign tax credit or deduction, the statute of limitations is extended to 10 years from the due date for filing the return (without regard to any extension of time to file) for the year in which the foreign taxes were actually paid or accrued.⁵¹

⁴⁷ Ibid.

⁴⁸ IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*.

⁴⁹ IRC §6511(d)(1).

⁵⁰ *Topic 453 — Bad Debt Deduction*. Mar. 12, 2021. IRS. [www.irs.gov/taxtopics/tc453] Accessed on Jun. 15, 2021.

⁵¹ Instructions for Form 1040-X.

Example 8. Sanjay paid foreign taxes for the last 13 years and deducted them on his federal income tax returns. He timely filed his returns and paid his tax liability. In February 2019, Sanjay filed an amended return for tax year 2008 to take the credit for foreign taxes because he realized that the credit is more advantageous than the deduction for that year. Because the due date of his 2008 return was April 15, 2009, Sanjay is within the 10-year statute of limitations period for filing the return.⁵²

Carrybacks. Form 1045 or Form 1040-X may be used to carry back an NOL, corporate capital loss, or tax credit. The taxpayer has three years after the due date of the return (including extensions) that generated the loss and/or credit to amend the carryback year's return. A copy of the first two pages of the return that produced the loss/credit should be attached to the claim. In addition, the forms, schedules, and tax documents from the original return that support the loss/credit should be attached. For example, if the NOL is caused by a loss passed through from a partnership, the Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.*, the taxpayer received from the partnership should be attached to the carryback claim. All copies of the forms and schedules from the original return should be marked at the top: "Attachment to Form 1040-X — Copy Only — Do Not Process."⁵³

Note. If Form 1040-X is used instead of Form 1045 to carry back an NOL, the taxpayer must still attach the Form 1045, Schedule A, *NOL*, to show the computation of the NOL. If there is any NOL left over from the carryback year, Form 1045, Schedule B, *NOL Carryover*, must also be attached.⁵⁴

Other Exceptions.

- Federally declared disaster is in place.
- The taxpayer serves in a combat zone and in contingency operations.

Protective Claim.⁵⁵ A protective claim preserves the right to claim a refund when a taxpayer's right to a refund is contingent on future events and may not be determinable until after the statute of limitations for filing a refund claim expires. Protective claims are often based on current litigation or anticipated changes in tax law, legislation, or regulations. The claim does not need to state a particular dollar amount or demand an immediate refund.

A protective claim can be a formal claim, an informal claim, or an amended return for either a credit or refund. A formal claim is a request by or for the taxpayer to reduce liabilities previously assessed and meet the statutory requirements of Treas. Reg. §301.6402-2. An informal claim can include a letter or other document requesting changes to obtain the correct and accurate reflection of a tax liability. It can also either be in writing or oral. Generally, the claim is filed on Form 1040-X.

Both formal and informal claims must meet all the following requirements.

- Be in writing and signed
- Include the taxpayer's name, address, SSN or ITIN, and other contact information
- Identify and describe the contingencies affecting the claim
- Clearly alert the IRS to the essential nature of the claim
- Identify the specific year(s) for which a refund is sought

⁵² Example adapted from IRS Pub. 514, *Foreign Tax Credit for Individuals*.

⁵³ Instructions for Form 1040-X.

⁵⁴ Ibid.

⁵⁵ IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*.

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The IRS generally waits to act on the protective claim until the underlying contingency is resolved. Once the contingency is resolved, the IRS may request additional information to make a proper decision on whether to accept or deny the claim. However, no statutory or regulatory provision requires the IRS to respond within a specific period.⁵⁶

Example 9. Sam and Sarah are siblings. They are in a legal dispute over an inheritance which arose in 2018 and it impacted Sarah's return. It is unlikely to be resolved before the statute of limitations for filing an amended return for 2018 expires. She may wish to file a protective claim on Form 1040-X to extend the 2018 statutory period. If she prevails in court, the statute extension provides her with an opportunity to amend the return and reduce her taxable income for 2018.

ELECTRONIC FILING

Starting in 2020, taxpayers were able to file their 2019 Form 1040-X returns electronically using available tax software products. The electronic Form 1040-X is being implemented in phases; as such, during the first phase only tax year 2019 Forms 1040 and 1040-SR returns can be amended electronically. Taxpayers still have the option to submit a paper version of Form 1040-X and should follow the instructions for preparing and submitting the paper form.⁵⁷

As previously mentioned, for years beginning on or after 2019, electronic filing of Form 1040-X is available for up to three amended returns. Additional amended returns filed for that tax year must be paper filed. For years ending on or before December 31, 2018, a paper return is required.

While the process of electronically filing amended returns is ongoing, the returns **must be paper filed** in the following scenarios.⁵⁸

1. Only tax year 2019 and 2020 Forms 1040 and 1040-SR can be amended electronically at this time. Amended returns for any other tax years or tax types must be filed by paper.
2. There must be a record of an original electronically filed return for tax year 2019 or 2020. If the original tax year 2019 or 2020 return was filed by paper, it must be amended by paper.
3. If the primary SSN is different from the one provided on the original return, then the amended return must be filed by paper.
4. If the spouse's SSN (if applicable) is different from the one provided on the original return, then the amended return must be filed by paper.
5. If the filing status differs from the filing status on the original return, then the amended return must be filed by paper.

Caution. Practitioners should check whether states for which they are filing amended returns accept those amended returns electronically.

⁵⁶ GCM 38786 (Aug. 1981).

⁵⁷ IRS Pub. 17, *Your Federal Income Tax for Individuals*.

⁵⁸ *Form 1040-X, Amended U.S. Individual Income Tax Return, Frequently Asked Questions*. May 3, 2021. IRS. [www.irs.gov/filing/amended-return-frequently-asked-questions] Accessed on Jun. 16, 2021.

FILING STATUS

For most taxpayers, the identification of filing status does not require much thought: they are either married or they are not. But often taxpayers have choices of which filing status to claim that have tax and nontax consequences. This section describes the various filing statuses from which a taxpayer must choose and then describes some of the issues that arise from the filing status they select.

Generally, a taxpayer is required to use a filing status that corresponds to their marital status under state law on the last day of the tax year.⁵⁹ Consequently, the exchange of vows on December 31 has significant tax consequences for the couple involved. Even though each of the newlyweds may have been single for most of the year, the fact that they are legally married on the last day of the year requires them to file as either MFJ or MFS.⁶⁰

AVAILABLE FILING STATUSES⁶¹

Single

Taxpayers select single status as a default if they are not married on the last day of the year and cannot select another filing status.⁶²

Note. For the definition and filing status options for a taxpayer who is **considered unmarried** as of the end of the year, see Head of Household (discussed later).

A taxpayer selects this status by checking the box marked ‘Single’ at the top of Form 1040.

Practitioner Planning Tip

A newly married taxpayer may not realize that they need to select a filing status other than single, particularly if they have grown accustomed to filing that way. For example, if a current client arrives in the tax office without their spouse and informs the tax professional that they were married during the past year, the tax practitioner may need to ask additional questions to determine when the marriage occurred. If the taxpayers married before the end of the year, it is appropriate to request a copy of the marriage certificate and, assuming the absent spouse is not using the same tax professional, to request a copy of the new spouse’s return to verify the filing status they used.

⁵⁹ *Taxpayers Should Know and Understand Their Correct Filing Status*. Nov. 13, 2020. IRS. [www.irs.gov/newsroom/taxpayers-should-know-and-understand-their-correct-filing-status] Accessed on Jul. 6, 2021.

⁶⁰ Ibid.

⁶¹ IRS Pub. 17, *Your Federal Income Tax for Individuals*.

⁶² IRS Pub. 504, *Divorced or Separated Individuals*.

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Divorced Persons. Filing status complications arise when a marriage is terminated. State law governs when a divorce decree is final and a marriage is dissolved. A taxpayer is still married if a final decree of divorce or a joint maintenance agreement is not in effect by December 31.⁶³

Practitioner Planning Tip

Tax practitioners should ask clients for a copy of their divorce decree to verify that the divorce is final, and that the taxpayer filed all appropriate documents with the court.

Legal Separation. The Code states that an individual is **not** considered married if they are “legally separated from [their] spouse under a decree of divorce or of separate maintenance.”⁶⁴ Although it may be relatively easy to determine if a decree of divorce is final, the issue of legal separation is more ambiguous. Consequently, a tax preparer with a legally separated client may find it necessary to secure additional information from the client’s attorney.

The key principle is whether individuals who are parties to a decree of separate maintenance are legally separated under **state** law. Caselaw established that the IRS properly looks to state law to determine whether a marriage exists or not.⁶⁵ Therefore, tax preparers need to examine the marital laws of the states in which their clients are domiciled to determine if legally separated persons are still married or if under state laws the marriage no longer exists.

Annulled Marriages. Although uncommon, taxpayers may have their marriages annulled. For legal purposes, an annulment holds that a valid marriage never existed. A taxpayer who annulled their marriage is responsible for amending returns that are still in an open statutory position (typically three years after the original filing deadline),⁶⁶ to select one of the unmarried filing statuses. The amended filing status is either single or HoH (discussed later), provided that the taxpayer meets the criteria for the HoH filing status.⁶⁷

Surviving Spouses. When a person loses their spouse to death, they can file an MFJ return for the year of death. In the following year, the surviving spouse files a return as either single, qualifying widow(er) (QW) (discussed later), or HoH, unless they remarry before the end of the year. For example, a taxpayer’s 2021 filing status may be single if they were widowed before January 1, 2021, and do not remarry before January 1, 2022. They may find that they qualify for another filing status, such as HoH or QW, which often results in a lower tax.

Example 10. Jeff and Maggie celebrated their 50th wedding anniversary in November 2020 with their grown children. Maggie died on December 31, 2020. Jeff prepared and filed their 2020 return using MFJ filing status. When filing his 2021 return, Jeff selects the single filing status. He does not meet the rules to use QW filing status (discussed later). Furthermore, he did not remarry during 2021 and therefore the single filing status is the appropriate choice for tax year 2021.

⁶³ Ibid.

⁶⁴ IRC §2(b)(2)(A).

⁶⁵ *Boyer v. Comm’r*, 668 F.2d 1382, 1384 (4th Cir.1981).

⁶⁶ IRC §6511(a).

⁶⁷ IRS Pub. 504, *Divorced or Separated Individuals*.

Married Filing Jointly

If two taxpayers are legally married as of the last day of the year, they may choose MFJ status. They report their combined incomes and their collective deductions and credits on their joint Form 1040. Each spouse is jointly and severally⁶⁸ responsible for the entire tax liability on the return, as well as any interest and penalties that arise from filing the return. A subsequent divorce does not nullify the liability that each of them accepts by signing the MFJ return under penalties of perjury. Joint and several liability is discussed in more detail later in this section.

Practitioner Planning Tip

Joint and several liability is a serious matter and one which should be discussed with a newly married couple at the very beginning of an engagement with a tax professional. The tax practitioner has a duty to explain the responsibilities and pitfalls of filing a joint return and ask probing questions of each party regarding potential liabilities as well as the joint and several responsibility for any taxes owed on the MFJ return.

Taxpayers who do not believe they should be responsible for the tax liability of their spouse may seek relief under innocent or injured spouse rules. For more information on innocent or injured spouse relief, see the 2018 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 5: Divorce. This can be found at uofi.tax/arc [taxschool.illinois.edu/taxbookarchive].

The taxpayers signing the MFJ return must be legally married on the last day of the tax year. This filing status is also used when one of the spouses died during the year, provided that the surviving spouse has not remarried and the decedent's executor or administrator agrees to the MFJ filing.⁶⁹ **If the surviving spouse has remarried, an MFS return must be filed on behalf of the deceased spouse by their executor or administrator.**

Note. As discussed earlier, amending an MFJ return to MFS is **not** permitted **unless** one of the spouses has died and their personal representative files an amended return within one year of the return's due date.⁷⁰

Married Filing Separately

By filing MFS, instead of pooling their incomes and deductions, each spouse files a separate Form 1040 with their own income and deductions. Taxpayers select this status by checking the box on Form 1040 marked "Married filing separately (MFS)." Each spouse accepts responsibility for only their own tax liability, interest, and penalties, and not those of their spouse.

Although this separation of responsibility may be appropriate when a couple is contemplating divorce, MFS filing status is also useful in other situations. Some of these are described later in the section on Filing Status Issues. But the lower number of MFS returns is likely a response to the unavailability of many tax credits and deductions.⁷¹

⁶⁸ IRC §6013(d)(3).

⁶⁹ IRC §6013(a)(3).

⁷⁰ Ibid.

⁷¹ IRS Pub. 1304, *Statistics of Income: Individual Income Tax Returns Complete Report*.

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Taxpayers using MFS filing status are generally permitted to amend their separate returns to MFJ filing status within three years of the filing deadline.⁷² However, if either spouse has filed a petition with the U.S. Tax Court in response to a notice of deficiency, they may not amend the MFS filing status.⁷³

Head of Household

Taxpayers who are either unmarried or **considered unmarried** may benefit from HoH filing status. To qualify for HoH filing status, taxpayers must satisfy **all** the following three conditions.⁷⁴

1. They are either unmarried or **considered unmarried** on the last day of the year.
2. They paid more than 50% of the cost of upkeep of their home during the tax year.
3. The home was the principal residence for either the taxpayer's qualifying child or a qualifying relative of the taxpayer. However, if the qualifying relative is the taxpayer's parent, they do not need to live with the taxpayer if the taxpayer maintains the home for their parent (i.e., at least 50% of the cost of the upkeep of the home or the nursing home expenses). A parent **who is a qualifying relative** qualifies as a dependent that enables the taxpayer to use HoH filing status. The parent must occupy the home that the taxpayer maintains for the entire year other than for temporary absences.⁷⁵

To be considered unmarried, the taxpayer must meet **all** the following requirements.⁷⁶

- The taxpayer files a separate tax return using a filing status of HoH, single, or MFS.
- The taxpayer paid more than half the cost of maintaining their principal residence for the tax year.
- The taxpayer's spouse did not live in the taxpayer's home during the final six months of the tax year. If the spouse is absent for a special circumstance, such as illness, military service, business, vacation, education, etc., the spouse is **not** considered absent, even though they are not physically present in the house.
- The taxpayer's home was also the principal residence of their child, stepchild, or foster child for more than half the year. There are exceptions for temporary absences during the year.
- The taxpayer must be able to claim the child as a dependent unless the dependency exemption was released to a noncustodial parent.

Note. If a married taxpayer qualifies to be considered as unmarried and files as HoH, the other spouse files as MFS unless that spouse is also eligible to claim a different dependent.⁷⁷

⁷² IRC §6013(b)(1).

⁷³ IRC §6013(b)(2)(B).

⁷⁴ Ibid.

⁷⁵ Treas. Regs. §§1.2-2(b)4 and 1.2-2(c)(2).

⁷⁶ IRC §7703(b).

⁷⁷ IRS Pub. 501, *Dependents, Standard Deduction, and Filing Information*.

A married child may still count for the parents' HoH filing status if they are a dependent of the taxpayer. The taxpayer's father or mother can also qualify the taxpayer for HoH status if they are the dependent of the taxpayer, and they do not need to live half the year with the taxpayer. Other relatives may also qualify the taxpayer for the HoH dependency test but only if they:

- Live more than half the year with the taxpayer,
- Are claimed as the taxpayer's dependent, and
- Are related to the taxpayer as a:⁷⁸
 - ♦ Child or a descendant of a child,
 - ♦ Stepchild,
 - ♦ Foster child,
 - ♦ Sibling,
 - ♦ Half-brother or half-sister,
 - ♦ Grandparent or direct ancestor,
 - ♦ Niece or nephew,
 - ♦ Uncle or aunt,
 - ♦ Son-in-law,
 - ♦ Daughter-in-law,
 - ♦ Father-in-law,
 - ♦ Mother-in-law, or
 - ♦ Brother- or sister-in-law.

For 2020 and 2021, a qualifying relative cannot have gross income of \$4,300 or more, otherwise the taxpayer loses the ability to claim the qualifying relative as a dependent.⁷⁹ The upper limit for a qualifying relative's gross income is indexed for inflation for years 2019 to 2025.⁸⁰

Example 11. Mamma is Francine's mother. Mamma moved into a long-term care facility from her home on December 1, 2019 and lived there during all of 2020. Prior to moving to this facility, Mamma paid for the cost of maintaining her own home. Francine is unmarried and pays 60% of the expenses for Mamma's long-term care facility. Mamma pays the remaining balance from her late husband's savings. Mamma's gross income in 2019 and 2020 consisted of qualified dividends totaling \$3,500 and social security benefits of \$11,200 annually. Francine does not qualify for HoH filing status **in 2019** because she did not pay 50% or more of maintaining Mamma's home as is required for HoH filing status.

Francine does qualify for HoH filing status **in 2020** because Mamma lived at the long-term care facility for the entire year and earned less than \$4,300, thereby qualifying as Francine's dependent. Mamma's gross income does not include nontaxable social security income received for the support test.

⁷⁸ IRC §152(d)(2).

⁷⁹ Rev. Proc. 2019-44, 2019-47 IRB 1093; Rev. Proc. 2020-45, 2020-46 IRB 1016.

⁸⁰ Treas. Reg. §1.152-2(e).

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Example 12. Larry is retired, 66 years old, and divorced. He has a teenage granddaughter, Mary, who is estranged from both of her parents. Mary and her infant son, Gary (Larry's great-grandson), lived at the residence of a foster mother through May 20, 2020, as arranged through the state department of family services.

In May, the department of family services arranged for both Mary and Gary to live with Larry. They live with Larry from May 21, 2020, through February 2021. Larry claims both Mary and Gary as dependents and claims HoH on his 2020 Form 1040.

Unfortunately, the IRS rejects the electronically filed return because someone else filed a return using Mary's and Gary's SSNs as dependents. Larry paper files his tax return, attaching a letter from the case worker attesting to the time Mary and Gary lived with Larry. He is entitled to file as HoH for the following reasons.

- Larry is unmarried.
- He paid the entire cost of maintaining his home.
- Mary and Gary are qualifying relatives because they are descendants of one of Larry's children.

This filing status provides benefits to single parents that they might miss if they use the single filing status. Taxpayers choosing HoH filing status benefit from lower tax rates compared with taxpayers using single filing status who have the same income, deductions, and credits. Married taxpayers who would otherwise use MFS filing status benefit from using HoH filing status because they are eligible for various credits denied under MFS. However, the taxpayers must be considered unmarried (as discussed previously).

Tax professionals must complete a due diligence checklist on Form 8867, *Paid Preparer's Due Diligence Checklist*, to affirm that they have verified the taxpayer's eligibility for the HoH filing status.⁸¹ The IRS may assess a penalty of \$540 for 2020 returns if the tax preparer does not fulfill the following due diligence responsibilities.⁸²

- Complete and submit Form 8867
- Gain knowledge that enables the tax preparer to conclude that the taxpayer is eligible to file as HoH and that there is no implied information that the taxpayer is not eligible for HoH filing status
- Retain records, including Form 8867, a copy of any worksheets prepared in the course of due diligence, and documents provided by the taxpayer, for three years from the unextended due date of the return, the date the return was electronically filed, or the date the taxpayer received a copy of the return for signature, whichever is later

Qualifying Widow(er)⁸³

Filing as a QW is only available to surviving spouses **with a child or stepchild for two tax years following the year their spouse died.** In most cases, the surviving spouse and the decedent filed an MFJ return, but this is not a requirement; they must only have met the requirements to file a joint return, not necessarily have done so. Also, the surviving spouse must not have remarried during the 2-year period following the year of death and must pay more than 50% of the cost of maintaining a home during the tax year.

⁸¹ IRC §§6695(g)(2) and (h). See also Treas. Reg. §1.6695-2 and Instructions for Form 8867.

⁸² Treas. Reg. §1.6695-2(b).

⁸³ IRC §2(a)(1).

The taxpayer must have a child or stepchild that the taxpayer can claim as a dependent or could be dependents except for one of the following three reasons.

- The child or stepchild had \$4,300 or more in 2021 gross income.⁸⁴
- The child or stepchild is married and filed a joint return.
- The taxpayer could be a dependent on someone else's tax return.

These requirements carry several implications for dependents who support a taxpayer's use of QW status. First, eligible dependents for QW filing status do not include foster children. Second, children must be younger than 19 years old unless they are full-time students, in which case they must be younger than 24. No age limit applies when a dependent child is completely and totally disabled.⁸⁵

Example 13. John's wife, Marge, died on December 15, 2018. John is left with two children, Joseph, born to John and Marge on January 1, 2002, and Trent, John's stepchild born in 1997 to Marge from a previous marriage. Neither Joseph nor Trent are students in 2020. Marge and John also have a foster child who is five years old at the time of Marge's death who continues to live in John's home.

On his 2018 return, John files MFJ with Marge. The dependent foster child does not confer eligibility for QW filing status.⁸⁶ For 2019, John can select the QW filing status because Joseph is still a dependent under the age of 19. However, for 2020 John cannot use the QW filing status. He may qualify for HoH filing status because Joseph is now 19 years of age.

FILING STATUS ISSUES

The selection of a filing status is more than just checking a box on a tax return. In addition to tax return specific implications such as whether a taxpayer is required to file a return based on their filing status, eligibility for credits and rebates, exclusion of unemployment compensation, comparing itemized and standard deductions, and medical expense deductions, there are also legal consequences to selecting a filing status. Furthermore, before selecting a filing status, taxpayers should also consider the impact on state issues, the availability of contributions to either a traditional individual retirement arrangement (IRA) or a Roth IRA, as well as any effect on Medicare premiums.

The most fundamental consequence of filing status is that different filing statuses use different tax tables. For example, a single taxpayer has a 10% tax rate on 2021 taxable income up to \$9,950.⁸⁷ Conversely, MFJ couples use a 10% tax rate on taxable income up to \$19,900,⁸⁸ or twice that of a single taxpayer.

Filing statuses phase out of certain credits at different income levels. For example, a single taxpayer loses the American opportunity credit if their MAGI exceeds \$90,000.⁸⁹ An MFJ taxpayer can take this credit until their MAGI exceeds \$180,000.⁹⁰ The credit is not permitted for MFS.⁹¹ Other limitations apply to MFS filing such as the special allowance for passive activity losses of \$25,000, which is reduced by half for MFS, as are the income phase outs for the special allowance.⁹²

⁸⁴ Rev. Proc. 2020-45, 2020-46 IRB 1016.

⁸⁵ IRC §§2(a) and 152(c)(3)(B).

⁸⁶ Ibid.

⁸⁷ Rev. Proc. 2020-45, 2020-46 IRB 1016.

⁸⁸ Ibid.

⁸⁹ IRC §§25A(d)(1)(A) and (B).

⁹⁰ Ibid.

⁹¹ IRC §25A(g)(6).

⁹² IRC §469(i)(5).

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Filing Requirements

Not all taxpayers are required to file income tax returns, and filing requirements depend on gross income, age, and filing status. The choice of filing status may indicate whether a filing requirement exists for a taxpayer or not. IRS Pub. 17, *Your Federal Income Tax for Individuals*, contains the following table showing the amount of gross income that triggers a filing requirement for each filing status and whether a taxpayer is over age 65.⁹³ For example, while a taxpayer under 65 years old using the single filing status must have AGI of at least \$12,400 in 2020 (\$12,550 in 2021⁹⁴) before a filing requirement is triggered, an MFS taxpayer of any age with **gross** income of only \$5 must file a tax return.

Table 1-1. 2020 Filing Requirements for Most Taxpayers

IF your filing status is...	AND at the end of 2020 you were...*	THEN file a return if your gross income was at least...**
Single	under 65	\$12,400
	65 or older	\$14,050
Married filing jointly***	under 65 (both spouses)	\$24,800
	65 or older (one spouse)	\$26,100
	65 or older (both spouses)	\$27,400
Married filing separately	any age	\$5
Head of household	under 65	\$18,650
	65 or older	\$20,300
Qualifying widow(er)	under 65	\$24,800
	65 or older	\$26,100

* If you were born on January 1, 1956, you are considered to be age 65 at the end of 2020. (If your spouse died in 2020 or if you are preparing a return for someone who died in 2020, see Pub. 501.)

** Gross income means all income you received in the form of money, goods, property, and services that isn't exempt from tax, including any income from sources outside the United States or from the sale of your main home (even if you can exclude part or all of it). Don't include any social security benefits unless (a) you are married filing a separate return and you lived with your spouse at any time during 2020, or (b) one-half of your social security benefits plus your other gross income and any tax-exempt interest is more than \$25,000 (\$32,000 if married filing jointly). If (a) or (b) applies, see the Instructions for Forms 1040 and 1040-SR or Pub. 915 to figure the taxable part of social security benefits you must include in gross income. Gross income includes gains, but not losses, reported on Form 8949 or Schedule D. Gross income from a business means, for example, the amount on Schedule C, line 7, or Schedule F, line 9. But, in figuring gross income, don't reduce your income by any losses, including any loss on Schedule C, line 7, or Schedule F, line 9.

*** If you didn't live with your spouse at the end of 2020 (or on the date your spouse died) and your gross income was at least \$5, you must file a return regardless of your age.

⁹³ IRS Pub. 17, *Your Federal Income Tax for Individuals*.

⁹⁴ Rev. Proc. 2020-45, 2020-46 IRB 1016.

Example 14. Shirley is age 64 and has been widowed for five years. Her 16-year-old granddaughter, Nancy lived with her from January 1, 2020, until January 14, 2021. Shirley earned \$14,562 in Form W-2 wages from her job at the corner store and paid all the costs of maintaining her home.

Shirley qualifies for HoH in 2020 because:

- She was unmarried at the end of the year,
- Provided more than half the cost of maintaining her home, and
- The home was the principal residence for a qualifying relative.

Therefore, Shirley has no filing requirement for 2020 because her income of \$14,562 is less than the filing threshold of \$18,650 for HoH taxpayers under 65 years old. However, if Shirley were considered single in 2020, her income of \$14,562 exceeds the threshold of \$12,400 for single taxpayers, and she would be required to file a return.

Example 15. Bob and Laurie have been married for 10 years. Bob moves out of their home on November 1, 2020, and establishes a separate residence. He does not return home during 2020. Bob is self-employed, doing odd jobs for friends. He earns \$200 with \$225 in associated expenses that are not considered cost of goods sold. Although Bob's net income is negative and there is no self-employment tax, he has a 2020 filing requirement because his gross income exceeds the \$5 threshold for a taxpayer who lives apart from their spouse on the last day of the year and chooses to file separately.

Recovery Rebates

The first recovery rebate established by the CARES Act tied the amount of a taxpayer's payment to their filing status.⁹⁵

- MFJ: \$2,400 recovery rebate, plus \$500 per qualifying child, if their AGI did not exceed \$150,000 (reduced by 5% of the amount AGI exceeded \$150,000 until it reached zero)
- HoH: \$1,200 recovery rebate, plus \$500 per qualifying child, if their AGI did not exceed \$112,500 (reduced by 5% of the amount AGI exceeded \$112,500 until it reached zero)
- Other filing statuses: \$1,200 recovery rebate if their AGI did not exceed \$75,000 threshold (reduced by 5% of the amount AGI exceeded \$75,000 until it reached zero)

The CAA provided for the second recovery rebate which is also based on an individual's filing status.⁹⁶ Individuals using the MFJ filing status received a \$1,200 recovery rebate, while everyone else received \$600.

The ARPA similarly awarded recovery rebates based on filing status.⁹⁷ Taxpayers who used MFJ filing status received \$2,800, while those using any other filing status received \$1,400, subject to a limitation based on their AGI. The ARPA authorized an additional \$1,400 for each dependent, depending on the taxpayer's AGI.

Note. For more information on the recovery rebates, see the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: New Developments.

Couples whose income straddles the AGI thresholds can maximize their recovery rebate by planning which filing status to select. For example, an MFJ couple with AGI exceeding \$150,000 receives either a limited recovery rebate or no recovery rebate. However, if one spouse has income under the \$75,000 threshold, that individual may be entitled to receive a recovery rebate. On their two MFS returns, the two spouses should evenly report any recovery rebate they received.⁹⁸

⁹⁵ CARES Act, PL 116-136, §2201; IRC §6428.

⁹⁶ Consolidated Appropriations Act of 2021, PL 116-260, §272; IRC §6428A

⁹⁷ American Rescue Plan Act of 2021, PL 117-2, §9601; IRC §6428B.

⁹⁸ 2020 Recovery Rebate Credit — Topic D: Calculating the Credit. Jun. 28, 2021. IRS. [www.irs.gov/newsroom/2020-recovery-rebate-credit-topic-d-calculating-the-credit] Accessed on Jul. 7, 2021.

Practitioner Planning Tip

Using MFS to maximize recovery rebates may, at first glance, appear to be illegal or at the very least improper. However, taxpayers have the right to utilize any proper filing status for their situation which may minimize the tax owed to the government. Further, married taxpayers may make an annual decision as to whether to file jointly or separately; they are not required to use the same filing status every year. It is worth noting, as mentioned earlier, that when filing jointly, taxpayers typically cannot amend to file separately after the extended filing deadline. However, taxpayers who file separately have until the statutory deadline as described previously to amend separate filings and file MFJ.

Example 16. Gordon and Julia are married with two children under 6 years of age and reside within the same household. In 2019, Gordon earned a salary of \$100,000 and Julia earned \$53,000. They filed early in 2020 and the government used their 2019 jointly filed income to determine their first recovery rebate as provided by the CARES Act.

Their maximum potential recovery rebate amount without phaseout was \$3,400 (\$1,200 for Gordon and Julia each + \$500 for each of their two children). Because their income was \$3,000 above the beginning of the phaseout threshold, (discussed earlier) (\$153,000 – \$150,000 phaseout threshold) the rebate they received was reduced by 5% for each \$1,000 their income was over \$150,000 resulting in an actual rebate of **\$3,250** ($\$3,400 - (5\% \times \$3,000)$).

The maximum second recovery rebate as provided by the CAA was \$2,400 (\$600 for each spouse + \$600 for each child) before consideration of phaseout. However, their 2019 MFJ income was \$3,000 into the phaseout range. They only received **\$2,250** because the second recovery rebate was reduced 5% for each \$1,000 above \$150,000.⁹⁹ Their \$153,000 income resulted in a 5% reduction, and their reduced rebate was \$2,250 ($\$2,400 - (\$3,000 \times 5\%)$).

Although the recovery rebate was based on either 2018 or 2019 filed returns, they were an advance on a 2020 refundable tax credit. When meeting with their tax professional, Nick O'Time to file their 2020 returns, he suggested they consider MFS to maximize the rebates. Nick explained that if Julia filed MFS and claimed both children, she would be entitled to an additional \$1,250 because her income did not reach any level of phaseout. However, Julia must report half of the recovery rebate received under MFJ (\$2,750, which is half of \$5,500 (\$3,250 first rebate + \$2,250 second rebate)). Her potential 2020 recovery rebates under MFS were \$4,000 (\$1,200 for her + \$500 for each child in round one = \$2,200 + \$1,800 (\$600 for her + \$600 for each child in the second round)), but she was entitled to an additional \$1,250 after subtracting the \$2,750 allocated to her from the rebates calculated using their joint 2019 income ($\$2,200 + \$1,800 - \$2,750 = \$1,250$).

Gordon is not entitled under MFS to additional recovery rebate because his income of \$100,000 resulted in a complete phaseout of both rounds of recovery rebates. **However, Gordon is not required to repay any of the advance rebates he received.**¹⁰⁰

⁹⁹ IRC §6428A(c).

¹⁰⁰ *Recovery Rebate Credit — Topic E: Receiving the Credit*. Jun. 28, 2021. IRS. [www.irs.gov/newsroom/recovery-rebate-credit-topic-e-receiving-the-credit] Accessed on Jul. 20, 2021.

Additionally, Nick suggests they file their separate returns as quickly as possible to maximize the third recovery rebate under the ARPA. He explains that the third recovery rebate is an advance on a 2021 tax credit, but the early payout is determined by 2019 income on file with IRS unless the 2020 filing was already processed. If the IRS uses their 2019 income, they are faced with a 30% reduction¹⁰¹ in payments ($(\$153,000 \text{ joint income} - \$150,000 \text{ threshold amount}) \div \$10,000$). With Julia utilizing MFS, the 2021 recovery rebate is \$4,200 ($\$1,400 \text{ per person} \times 3$ for her and the two children).

Gordan does not qualify for a 2021 recovery rebate based on his 2020 income of \$100,000. If their 2019 joint income was used to calculate the rebates, the rebates are \$3,920 ($\$1,400 \times 4 \text{ persons} \times 70\%$). The decision to use MFS for Gordan and Julia results in \$1,530 additional recovery rebate ($\$1,250$ from the first and second rounds + $\$280$ ($\$4,200 - \$3,920$) from the third round).

Although receiving an additional \$1,530 in recovery rebate appears to be an easy decision, Nick compares the total tax under MFS and MFJ. Assuming the couple uses the standard deduction, their 2020 total tax under MFJ is \$15,784 (after deducting the \$2,000 child tax credit for each child). Under MFS, Gordan's tax is \$14,672 and Julia's tax under MFS is \$459 after deducting the two \$2,000 child tax credits. Total tax for their family is \$15,131.

These results appear to be the best of all worlds.

- Family tax is reduced by \$653 ($\$15,784$ MFJ vs. $\$15,131$ MFS)
- Recovery rebates are increased by \$1,530
- Gordan did not have to return his allocated \$2,750 of recovery rebates received

Education Credits and the Student Loan Interest Deduction

Filing status plays a critical role in the availability of both the AOC and the lifetime learning credit because MFS taxpayers cannot claim these credits.¹⁰² Taxpayers with dependent college students who opt to file as MFS may wish to consider not claiming their son, daughter, or other dependent if that person may qualify to file on their own.

Caution. Merely deciding not to claim a dependent does not automatically mean that the nonclaimed dependent is now an independent filer. Reviewing the factors¹⁰³ used in determining dependency status is paramount in making the proper conclusion in this regard.

Similarly, neither the student loan interest deduction nor the tuition and fees deduction are available to MFS taxpayers.¹⁰⁴

Practitioner Planning Tip

In this situation, if a tax preparer is aware that a couple is considering MFS filing status and has **lived apart** for the second half of the previous year, they may wish to examine the possibility of HoH filing status. If it turns out that one spouse meets the requirements to be “considered unmarried,” as discussed previously, educational tax benefits are potentially available.¹⁰⁵

¹⁰¹ IRC §6428B(d).

¹⁰² IRS Pub. 970, *Tax Benefits for Education*.

¹⁰³ IRS Pub. 501, *Dependents, Standard Deduction, and Filing Information*.

¹⁰⁴ IRS Pub. 970, *Tax Benefits for Education*.

¹⁰⁵ IRS Pub. 17, *Your Federal Income Tax for Individuals*.

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Example 17. Josephine prepares a 2020 tax return for Mary, who is legally married to Peter. Peter is in graduate school in another state working on a Ph.D. and has not lived with Mary since April of the previous year. Mary explains to Josephine that Peter reportedly filed his own tax return as MFS.

Mary wants to claim the AOC for her son who is in his first year of college. Josephine verifies that Mary pays more than half the costs of maintaining her home for herself and her son and prepares Mary's income tax return using HoH filing status because she believes that Mary meets the criteria to be considered unmarried. Accordingly, Mary can claim the AOC, which makes a big difference in her refund.

Unfortunately, Josephine overlooked the possibility that Peter's absence from the home is considered a temporary special circumstance, and she may be subject to a \$540 fine for the mistake on Form 8867.

Practitioner Planning Tip

The previous example illustrates why tax practitioners need to ask probing questions of their clients and to document the responses.

Earned Income Credit (EIC)

The EIC provides a refundable tax credit to subsidize taxpayers with low to moderate earned income.¹⁰⁶ The calculation for the EIC is based on AGI, number of qualifying children, and filing status. Taxpayers who file separately are not eligible for the EIC.¹⁰⁷

Practitioner Planning Tip

A common occurrence in the EIC area happens when an HoH filer received EIC for several years and does not discuss with their tax professional the implication marriage has on the EIC. When meeting with the tax practitioner, it may be uncomfortable to explain how the client's marital situation may cause them to be ineligible for the EIC (i.e., income is too high or the spouse has an ITIN) and when the client requests to file separately, the tax professional is forced to explain that EIC is not allowed for MFS status. Practitioners are advised to conduct client outreach to encourage them to discuss the tax implications of life changing events with their tax advisor prior to executing these decisions.

^{106.} IRC §32.

^{107.} *Who Qualifies for the Earned Income Tax Credit (EITC)*. Mar. 22, 2021. IRS. [www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/who-qualifies-for-the-earned-income-tax-credit-eitc] Accessed on Jul. 7, 2021.

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IRS Pub. 596, *Earned Income Credit (EIC)* contains EIC tables that calculate the credit.¹⁰⁸ At lower income levels, the credit available to either set of columns is the same, implying that filing status does not make a difference for the EIC. However, at higher levels of income and with multiple dependents, the difference between MFJ and the other filing statuses can exceed \$1,000.

Example 18. Michael and Flora have three children, Aaron, Bertram, and Charles, all under the age of 16. Michael earned \$25,600 from his job in 2020. Flora has no earned income, and neither of them has any unearned income. On their MFJ tax return for 2020, they are entitled to an EIC of \$6,575, as shown in the following table from IRS Pub. 596.

If the amount you are looking up from the worksheet is—		And your filing status is—							
		Single, head of household, or qualifying widow(er) and you have—				Married filing jointly and you have—			
		0	1	2	3	0	1	2	3
At least	But less than	Your credit is—				Your credit is—			
25,600	25,650	0	2,578	4,594	5,334	0	3,519	5,835	6,575
25,650	25,700	0	2,570	4,584	5,324	0	3,511	5,824	6,564
25,700	25,750	0	2,562	4,573	5,313	0	3,503	5,814	6,554
25,750	25,800	0	2,554	4,563	5,303	0	3,495	5,803	6,543
25,800	25,850	0	2,546	4,552	5,292	0	3,487	5,793	6,533
25,850	25,900	0	2,538	4,542	5,282	0	3,479	5,782	6,522
25,900	25,950	0	2,530	4,531	5,271	0	3,471	5,772	6,512
25,950	26,000	0	2,522	4,521	5,261	0	3,463	5,761	6,501

Example 19. Use the same facts as **Example 18**, except Flora died on December 31, 2019. Michael is eligible to use QW filing status, but this reduces his 2020 EIC to \$5,334.

If the amount you are looking up from the worksheet is—		And your filing status is—							
		Single, head of household, or qualifying widow(er) and you have—				Married filing jointly and you have—			
		0	1	2	3	0	1	2	3
At least	But less than	Your credit is—				Your credit is—			
25,600	25,650	0	2,578	4,594	5,334	0	3,519	5,835	6,575
25,650	25,700	0	2,570	4,584	5,324	0	3,511	5,824	6,564
25,700	25,750	0	2,562	4,573	5,313	0	3,503	5,814	6,554
25,750	25,800	0	2,554	4,563	5,303	0	3,495	5,803	6,543
25,800	25,850	0	2,546	4,552	5,292	0	3,487	5,793	6,533
25,850	25,900	0	2,538	4,542	5,282	0	3,479	5,782	6,522
25,900	25,950	0	2,530	4,531	5,271	0	3,471	5,772	6,512
25,950	26,000	0	2,522	4,521	5,261	0	3,463	5,761	6,501

Caution. Because of the prevalence of the EIC and issues with fraud, tax preparers should be careful to properly document filing status and dependency in fulfillment of their responsibilities under Form 8867.

¹⁰⁸ IRS Pub. 596, *Earned Income Credit (EIC)*.

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Example 20. Use the same facts as **Example 18**. Because Michael and Flora claim the EIC, their preparer completes the following Form 8867.

Form 8867 Department of the Treasury Internal Revenue Service	Paid Preparer's Due Diligence Checklist <i>Earned Income Credit (EIC), American Opportunity Tax Credit (AOTC), Child Tax Credit (CTC) (including the Additional Child Tax Credit (ACTC) and Credit for Other Dependents (ODC)), and Head of Household (HOH) Filing Status</i> ► To be completed by preparer and filed with Form 1040, 1040-SR, 1040-NR, 1040-PR, or 1040-SS. ► Go to www.irs.gov/Form8867 for instructions and the latest information.	OMB No. 1545-0074 <div style="text-align: center; font-size: 2em; font-weight: bold;">2020</div> Attachment Sequence No. 70	
Taxpayer name(s) shown on return Michael and Flora Smith		Taxpayer identification number 555-99-7777	
Enter preparer's name and PTIN Joe Preparer			
Part I Due Diligence Requirements			
Please check the appropriate box for the credit(s) and/or HOH filing status claimed on the return and complete the related Parts I–V for the benefit(s) claimed (check all that apply). <input checked="" type="checkbox"/> EIC <input checked="" type="checkbox"/> CTC/ACTC/ODC <input type="checkbox"/> AOTC <input type="checkbox"/> HOH 			
1 Did you complete the return based on information for tax year 2020 provided by the taxpayer or reasonably obtained by you?	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>	N/A <input type="checkbox"/>
2 If credits are claimed on the return, did you complete the applicable EIC and/or CTC/ACTC/ODC worksheets found in the Form 1040, 1040-SR, 1040-NR, 1040-PR, or 1040-SS instructions, and/or the AOTC worksheet found in the Form 8863 instructions, or your own worksheet(s) that provides the same information, and all related forms and schedules for each credit claimed?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3 Did you satisfy the knowledge requirement? To meet the knowledge requirement, you must do both of the following. <ul style="list-style-type: none"> • Interview the taxpayer, ask questions, and contemporaneously document the taxpayer's responses to determine that the taxpayer is eligible to claim the credit(s) and/or HOH filing status. • Review information to determine that the taxpayer is eligible to claim the credit(s) and/or HOH filing status and to figure the amount(s) of any credit(s) 	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4 Did any information provided by the taxpayer or a third party for use in preparing the return, or information reasonably known to you, appear to be incorrect, incomplete, or inconsistent? (If "Yes," answer questions 4a and 4b. If "No," go to question 5.)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
a Did you make reasonable inquiries to determine the correct, complete, and consistent information?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b Did you contemporaneously document your inquiries? (Documentation should include the questions you asked, whom you asked, when you asked, the information that was provided, and the impact the information had on your preparation of the return.)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5 Did you satisfy the record retention requirement? To meet the record retention requirement, you must keep a copy of your documentation referenced in 4b, a copy of this Form 8867, a copy of any applicable worksheet(s), a record of how, when, and from whom the information used to prepare Form 8867 and any applicable worksheet(s) was obtained, and a copy of any document(s) provided by the taxpayer that you relied on to determine eligibility for the credit(s) and/or HOH filing status or to figure the amount(s) of the credit(s)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
List those documents provided by the taxpayer, if any, that you relied on: CHILDREN'S BIRTH CERTIFICATES, MEDICAL RECORDS SHOWING ADDRESS, SCHOOL RECORDS SHOWING ADDRESS			
6 Did you ask the taxpayer whether he/she could provide documentation to substantiate eligibility for the credit(s) and/or HOH filing status and the amount(s) of any credit(s) claimed on the return if his/her return is selected for audit?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7 Did you ask the taxpayer if any of these credits were disallowed or reduced in a previous year? (If credits were disallowed or reduced, go to question 7a; if not, go to question 8.)	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
a Did you complete the required recertification Form 8862?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8 If the taxpayer is reporting self-employment income, did you ask questions to prepare a complete and correct Schedule C (Form 1040)?	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 26142H

Form **8867** (2020)

Unemployment Benefits Exclusion¹⁰⁹

The ARPA contains a provision that suspends the tax on a portion of unemployment benefits received in 2020. The exclusion of up to \$10,200 is available to taxpayers with AGI less than \$150,000. If both spouses on an MFJ return received unemployment benefits, they can both claim up to the \$10,200 exclusion, provided their AGI does not equal or exceed \$150,000 without inclusion of the unemployment benefits received.¹¹⁰ This allows married taxpayers the possibility of changing filing status from MFJ to MFS to exclude at least a portion of one spouse's unemployment benefits.

Example 21. Martin and Bev have been married for 30 years and filed MFJ for each year until 2020. Their combined AGI for 2020 is \$163,000, including \$20,000 of Bev's wages before she lost her job on March 20, 2020, due to her employer shutting down operations.

She filed for unemployment benefits and received \$11,000 during the year until her next job started. Their tax preparer finds that if they split their returns into two MFS returns, Martin's AGI is \$82,000 and Bev's is \$81,000 before the exclusion is taken into consideration.

When Bev's return incorporates the unemployment exclusion of ARPA §9042, her AGI decreases by \$10,200 to \$70,800. If they file an MFJ return, she is ineligible to exclude any of her unemployment benefits from their AGI because their AGI exceeds \$150,000.

Itemized and Standard Deductions

A taxpayer filing a return using MFS filing status is ineligible to use a standard deduction if their spouse also files an MFS return with itemized deductions. If one MFS spouse itemizes, the other must also.¹¹¹ Consequently, there are advantages to using HoH filing status if the spouse providing a home for their child(ren) would benefit from itemizing, but the other spouse would not. The requirements for a taxpayer to be considered unmarried were mentioned previously. The passage of the TCJA with its provisions for increased standard deductions and for the near elimination of miscellaneous itemized deductions makes it less likely for taxpayers to itemize deductions.¹¹²

Medical Expenses

When not reimbursed by insurance or otherwise, taxpayers are allowed a deduction for medical expenses paid during the tax year for medical care of the taxpayer, spouse, or a dependent¹¹³ if they itemize deductions on Schedule A, *Itemized Deductions*. The CAA made all medical deductions limited to the amount exceeding a threshold of 7.5% of AGI permanent.¹¹⁴ The population benefiting from this itemized deduction tends to have high medical expenses relative to their income.

A married couple may benefit from MFS status if a spouse with relatively little income has relatively high medical expenses. This is because only medical expenses exceeding a threshold of 7.5% of AGI are deductible. If one spouse has a proportionately lower AGI, more of their medical expenses exceed the medical deduction threshold and can be deductible if they itemize. But it is more likely that any benefit offered by the difference in incomes and medical expenses between the two spouses would be offset by the requirement that both spouses either itemize or use the standard deduction.

¹⁰⁹ *American Rescue Plan Act of 2021*, PL 117-7, §9042.

¹¹⁰ IRC §85(c)(1); *New Exclusion of up to \$10,200 of Unemployment Compensation*. Apr. 1, 2021. IRS. [www.irs.gov/forms-pubs/new-exclusion-of-up-to-10200-of-unemployment-compensation] Accessed on Jul. 30, 2021.

¹¹¹ IRC §63(c)(6)(A).

¹¹² *Tax Cuts and Jobs Act*, PL 115-97, §1002.

¹¹³ IRC §213(a).

¹¹⁴ IRC §213(f); *Consolidated Appropriations Act of 2021*, PL 116-260, §§101(a) and (b) amending IRC §213(f).

2021 Workbook

Example 22. Jose and Berniece are considering whether they should use MFS or MFJ filing status. Jose's Form W-2 reports Box 1 earnings of \$20,000, and he was relatively healthy during the year and incurred virtually no medical expenses. Berniece earned \$60,000 and incurred medical expenses of \$30,000 for a long-term condition. They have a deduction on Schedule A for state and local taxes of \$10,000, and they paid \$14,800 in deductible mortgage interest during 2020. This appears on a Form 1098 reported under Berniece's SSN. They do not live in a community property state. The couple owes federal tax of \$3,352 by filing MFJ as shown on their following Schedule A and relevant portions of Form 1040.

Form 1040	<small>Department of the Treasury—Internal Revenue Service (99)</small> U.S. Individual Income Tax Return	2020	<small>OMB No. 1545-0074</small>	<small>IRS Use Only—Do not write or staple in this space.</small>
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Filing Status Single Married filing jointly Married filing separately (MFS) Head of household (HOH) Qualifying widow(er) (QW)
 Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial Jose	Last name Zylander	Your social security number 9 9 9 9 9 9 9 9 9
If joint return, spouse's first name and middle initial Berniece	Last name Zylander	Spouse's social security number 8 8 8 8 8 8 8 8 8

Home address (number and street). If you have a P.O. box, see instructions.
123 Maple St Apt. no. _____

City, town, or post office. If you have a foreign address, also complete spaces below. State **IL** ZIP code **62960**

Foreign country name _____ Foreign province/state/country _____ Foreign postal code _____

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? Yes No

Standard Deduction Someone can claim: You as a dependent Your spouse as a dependent Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness You: Were born before January 2, 1956 Are blind Spouse: Was born before January 2, 1956 Is blind

Dependents <small>(see instructions):</small>	(1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) <input checked="" type="checkbox"/> if qualifies for (see instructions):	
					Child tax credit	Credit for other dependents
If more than four dependents, see instructions and check here ▶ <input type="checkbox"/>					<input type="checkbox"/>	<input type="checkbox"/>
					<input type="checkbox"/>	<input type="checkbox"/>
					<input type="checkbox"/>	<input type="checkbox"/>
					<input type="checkbox"/>	<input type="checkbox"/>
					<input type="checkbox"/>	<input type="checkbox"/>

Attach Sch. B if required. Standard Deduction for— • Single or Married filing separately, \$12,400 • Married filing jointly or Qualifying widow(er), \$24,800 • Head of household, \$18,650 • If you checked any box under Standard Deduction, see instructions.	1 Wages, salaries, tips, etc. Attach Form(s) W-2	1	80,000
	2a Tax-exempt interest	2a	2b
	3a Qualified dividends	3a	3b
	4a IRA distributions	4a	4b
	5a Pensions and annuities	5a	5b
	6a Social security benefits	6a	6b
	7 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ <input type="checkbox"/>	7	7
	8 Other income from Schedule 1, line 9	8	8
	9 Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your total income ▶	9	80,000
	10 Adjustments to income:		
	a From Schedule 1, line 22	10a	
	b Charitable contributions if you take the standard deduction. See instructions	10b	
	c Add lines 10a and 10b. These are your total adjustments to income ▶	10c	
	11 Subtract line 10c from line 9. This is your adjusted gross income ▶	11	80,000
	12 Standard deduction or itemized deductions (from Schedule A)	12	48,800
13 Qualified business income deduction. Attach Form 8995 or Form 8995-A	13		
14 Add lines 12 and 13	14	48,800	
15 Taxable income. Subtract line 14 from line 11. If zero or less, enter -0-	15	31,200	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form 1040 (2020)

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For Example 22

Form 1040 (2020)

Page **2**

2

16	Tax (see instructions). Check if any from Form(s): 1 <input type="checkbox"/> 8814 2 <input type="checkbox"/> 4972 3 <input type="checkbox"/>	16	3,352
17	Amount from Schedule 2, line 3	17	
18	Add lines 16 and 17	18	3,352
19	Child tax credit or credit for other dependents	19	
20	Amount from Schedule 3, line 7	20	
21	Add lines 19 and 20	21	0
22	Subtract line 21 from line 18. If zero or less, enter -0-	22	3,352
23	Other taxes, including self-employment tax, from Schedule 2, line 10	23	
24	Add lines 22 and 23. This is your total tax	24	3,352
25	Federal income tax withheld from:		
a	Form(s) W-2	25a	
b	Form(s) 1099	25b	
c	Other forms (see instructions)	25c	
d	Add lines 25a through 25c	25d	0
26	2020 estimated tax payments and amount applied from 2019 return	26	
27	Earned income credit (EIC)	27	
28	Additional child tax credit. Attach Schedule 8812	28	
29	American opportunity credit from Form 8863, line 8	29	
30	Recovery rebate credit. See instructions	30	
31	Amount from Schedule 3, line 13	31	
32	Add lines 27 through 31. These are your total other payments and refundable credits	32	
33	Add lines 25d, 26, and 32. These are your total payments	33	0
Refund			
34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you overpaid	34	
35a	Amount of line 34 you want refunded to you . If Form 8888 is attached, check here <input type="checkbox"/>	35a	
Direct deposit? See instructions.	b Routing number	c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
	d Account number		
36	Amount of line 34 you want applied to your 2021 estimated tax	36	
Amount You Owe			
For details on how to pay, see instructions.	37 Subtract line 33 from line 24. This is the amount you owe now	37	3,352
	Note: Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.		
38	Estimated tax penalty (see instructions)	38	

- If you have a qualifying child, attach Sch. EIC.
- If you have nontaxable combat pay, see instructions.

Do you want to allow another person to discuss this return with the IRS? See

2021 Workbook

For Example 22

SCHEDULE A (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Itemized Deductions

▶ Go to www.irs.gov/ScheduleA for instructions and the latest information.
▶ Attach to Form 1040 or 1040-SR.

Caution: If you are claiming a net qualified disaster loss on Form 4684, see the instructions for line 16.

OMB No. 1545-0074

2020

Attachment
Sequence No. **07**

Name(s) shown on Form 1040 or 1040-SR

Jose and Berniece Zylander

Your social security number

999-99-9999

Medical and Dental Expenses	Caution: Do not include expenses reimbursed or paid by others.			
	1 Medical and dental expenses (see instructions)	1	30,000	
	2 Enter amount from Form 1040 or 1040-SR, line 11 2 80,000	2		
	3 Multiply line 2 by 7.5% (0.075)	3	6,000	
	4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4		24,000
Taxes You Paid	5 State and local taxes.			
	a State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box <input checked="" type="checkbox"/>	5a	0	
	b State and local real estate taxes (see instructions)	5b	10,000	
	c State and local personal property taxes	5c		
	d Add lines 5a through 5c	5d	10,000	
	e Enter the smaller of line 5d or \$10,000 (\$5,000 if married filing separately)	5e	10,000	
	6 Other taxes. List type and amount ▶	6		
	7 Add lines 5e and 6	7		10,000
Interest You Paid <small>Caution: Your mortgage interest deduction may be limited (see instructions).</small>	8 Home mortgage interest and points. If you didn't use all of your home mortgage loan(s) to buy, build, or improve your home, see instructions and check this box <input type="checkbox"/>			
	a Home mortgage interest and points reported to you on Form 1098. See instructions if limited	8a	14,800	
	b Home mortgage interest not reported to you on Form 1098. See instructions if limited. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address	8b		
	c Points not reported to you on Form 1098. See instructions for special rules	8c		
	d Mortgage insurance premiums (see instructions)	8d		
	e Add lines 8a through 8d	8e	14,800	
	9 Investment interest. Attach Form 4952 if required. See instructions	9		
	10 Add lines 8e and 9	10		14,800
Gifts to Charity <small>Caution: If you made a gift and got a benefit for it, see instructions.</small>	11 Gifts by cash or check. If you made any gift of \$250 or more, see instructions	11		
	12 Other than by cash or check. If you made any gift of \$250 or more, see instructions. You must attach Form 8283 if over \$500.	12		
	13 Carryover from prior year	13		
	14 Add lines 11 through 13	14		0
Casualty and Theft Losses	15 Casualty and theft loss(es) from a federally declared disaster (other than net qualified disaster losses). Attach Form 4684 and enter the amount from line 18 of that form. See instructions	15		0
Other Itemized Deductions	16 Other—from list in instructions. List type and amount ▶	16		0
Total Itemized Deductions	17 Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on Form 1040 or 1040-SR, line 12	17		48,800
	18 If you elect to itemize deductions even though they are less than your standard deduction, check this box <input type="checkbox"/>			

For Paperwork Reduction Act Notice, see the Instructions for Forms 1040 and 1040-SR.

Cat. No. 17145C

Schedule A (Form 1040) 2020

2021 Workbook

Example 23. Use the same facts as **Example 22**, except Jose and Berniece file separately. Jose's Schedule A and relevant portions of Form 1040 using MFS status follow.

Form 1040	Department of the Treasury—Internal Revenue Service (99) U.S. Individual Income Tax Return	2020	OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.																																																																																																																														
Filing Status <input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input checked="" type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Head of household (HOH) <input type="checkbox"/> Qualifying widow(er) (QW) Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶ Berniece Zylander																																																																																																																																		
Your first name and middle initial Jose		Last name Zylander		Your social security number 9 9 9 9 9 9 9 9 9																																																																																																																														
If joint return, spouse's first name and middle initial		Last name		Spouse's social security number 8 8 8 8 8 8 8 8 8																																																																																																																														
Home address (number and street). If you have a P.O. box, see instructions. 123 Maple St				Apt. no.																																																																																																																														
City, town, or post office. If you have a foreign address, also complete spaces below. Metropolis			State IL	ZIP code 62960																																																																																																																														
Foreign country name		Foreign province/state/county		Foreign postal code																																																																																																																														
Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse																																																																																																																																		
At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No																																																																																																																																		
Standard Deduction Someone can claim: <input type="checkbox"/> You as a dependent <input type="checkbox"/> Your spouse as a dependent <input checked="" type="checkbox"/> Spouse itemizes on a separate return or you were a dual-status alien																																																																																																																																		
Age/Blindness You: <input type="checkbox"/> Were born before January 2, 1956 <input type="checkbox"/> Are blind Spouse: <input type="checkbox"/> Was born before January 2, 1956 <input type="checkbox"/> Is blind																																																																																																																																		
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1 Wages, salaries, tips, etc. Attach Form(s) W-2					1	20,000																																																																																																																												
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5a Pensions and annuities	5a		b Taxable amount		5b																																																																																																																													
6a Social security benefits	6a		b Taxable amount		6b																																																																																																																													
7 Capital gain or (loss). Attach Schedule D if required. If not required, check here				<input type="checkbox"/>	7																																																																																																																													
8 Other income from Schedule 1, line 9					8																																																																																																																													
9 Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your total income					9	20,000																																																																																																																												
10 Adjustments to income:																																																																																																																																		
a From Schedule 1, line 22			10a																																																																																																																															
b Charitable contributions if you take the standard deduction. See instructions			10b																																																																																																																															
c Add lines 10a and 10b. These are your total adjustments to income					10c																																																																																																																													
11 Subtract line 10c from line 9. This is your adjusted gross income					11	20,000																																																																																																																												
12 Standard deduction or itemized deductions (from Schedule A)					12	5,000																																																																																																																												
13 Qualified business income deduction. Attach Form 8995 or Form 8995-A					13																																																																																																																													
14 Add lines 12 and 13					14	5,000																																																																																																																												
15 Taxable income. Subtract line 14 from line 11. If zero or less, enter -0-					15	15,000																																																																																																																												
Standard Deduction for— <ul style="list-style-type: none"> • Single or Married filing separately, \$12,400 • Married filing jointly or Qualifying widow(er), \$24,800 • Head of household, \$18,650 • If you checked any box under Standard Deduction, see instructions. 																																																																																																																																		
Attach Sch. B if required.																																																																																																																																		
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			Cat. No. 11320B	Form 1040 (2020)																																																																																																																														

2021 Workbook

For Example 23

Form 1040 (2020)

Page **2**

	16	Tax (see instructions). Check if any from Form(s): 1 <input type="checkbox"/> 8814 2 <input type="checkbox"/> 4972 3 <input type="checkbox"/> . . .	16	1,606
	17	Amount from Schedule 2, line 3	17	
	18	Add lines 16 and 17	18	1,606
	19	Child tax credit or credit for other dependents	19	
	20	Amount from Schedule 3, line 7	20	
	21	Add lines 19 and 20	21	0.
	22	Subtract line 21 from line 18. If zero or less, enter -0-	22	1,606
	23	Other taxes, including self-employment tax, from Schedule 2, line 10	23	
	24	Add lines 22 and 23. This is your total tax ▶	24	1,606
	25	Federal income tax withheld from:		
	a	Form(s) W-2	25a	
	b	Form(s) 1099	25b	
	c	Other forms (see instructions)	25c	
	d	Add lines 25a through 25c	25d	0
	26	2020 estimated tax payments and amount applied from 2019 return	26	
	27	Earned income credit (EIC)	27	
	28	Additional child tax credit. Attach Schedule 8812	28	
	29	American opportunity credit from Form 8863, line 8	29	
	30	Recovery rebate credit. See instructions	30	
	31	Amount from Schedule 3, line 13	31	
	32	Add lines 27 through 31. These are your total other payments and refundable credits ▶	32	
	33	Add lines 25d, 26, and 32. These are your total payments ▶	33	0
	Refund	34 If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you overpaid	34	
	35a	Amount of line 34 you want refunded to you . If Form 8888 is attached, check here ▶ <input type="checkbox"/>	35a	
Direct deposit? See instructions.	▶ b	Routing number X X X X X X X X X X ▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
	▶ d	Account number X X X X X X X X X X X X X X X X X X		
	36	Amount of line 34 you want applied to your 2021 estimated tax ▶	36	
	Amount You Owe	37 Subtract line 33 from line 24. This is the amount you owe now ▶	37	1,606
For details on how to pay, see instructions.		Note: Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.		
	38	Estimated tax penalty (see instructions) ▶	38	

• If you have a qualifying child, attach Sch. EIC.
• If you have nontaxable combat pay, see instructions.

Do you want to allow another person to disclose this return with the IRS? See

2021 Workbook

For Example 23

SCHEDULE A (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Itemized Deductions

► Go to www.irs.gov/ScheduleA for instructions and the latest information.
► Attach to Form 1040 or 1040-SR.

OMB No. 1545-0074

2020

Attachment
Sequence No. **07**

2

Name(s) shown on Form 1040 or 1040-SR

Jose Zylander

Your social security number

999-99-9999

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18		
Medical and Dental Expenses	Caution: Do not include expenses reimbursed or paid by others.																				
	1 Medical and dental expenses (see instructions)																				
	2 Enter amount from Form 1040 or 1040-SR, line 11		2																		
	3 Multiply line 2 by 7.5% (0.075)																				
	4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-																			0	
Taxes You Paid	5 State and local taxes.																				
	a State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box <input checked="" type="checkbox"/>	5a																			
	b State and local real estate taxes (see instructions)	5b				5,000															
	c State and local personal property taxes	5c																			
	d Add lines 5a through 5c	5d				5,000															
	e Enter the smaller of line 5d or \$10,000 (\$5,000 if married filing separately)	5e				5,000															
	6 Other taxes. List type and amount	6																			
	7 Add lines 5e and 6																			5,000	
Interest You Paid	Caution: Your mortgage interest deduction may be limited (see instructions).																				
	8 Home mortgage interest and points. If you didn't use all of your home mortgage loan(s) to buy, build, or improve your home, see instructions and check this box <input type="checkbox"/>																				
	a Home mortgage interest and points reported to you on Form 1098. See instructions if limited	8a																			
	b Home mortgage interest not reported to you on Form 1098. See instructions if limited. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address	8b																			
	c Points not reported to you on Form 1098. See instructions for special rules	8c																			
	d Mortgage insurance premiums (see instructions)	8d																			
	e Add lines 8a through 8d	8e																			
9 Investment interest. Attach Form 4952 if required. See instructions	9																				
	10 Add lines 8e and 9																			0	
Gifts to Charity	Caution: If you made a gift and got a benefit for it, see instructions.																				
	11 Gifts by cash or check. If you made any gift of \$250 or more, see instructions	11																			
	12 Other than by cash or check. If you made any gift of \$250 or more, see instructions. You must attach Form 8283 if over \$500.	12																			
	13 Carryover from prior year	13																			
	14 Add lines 11 through 13																			0	
Casualty and Theft Losses	15 Casualty and theft loss(es) from a federally declared disaster (other than net qualified disaster losses). Attach Form 4684 and enter the amount from line 18 of that form. See instructions																			0	
Other Itemized Deductions	16 Other—from list in instructions. List type and amount																			0	
Total Itemized Deductions	17 Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on Form 1040 or 1040-SR, line 12																			5,000	
	18 If you elect to itemize deductions even though they are less than your standard deduction, check this box <input type="checkbox"/>																				

For Paperwork Reduction Act Notice, see the Instructions for Forms 1040 and 1040-SR.

Cat. No. 17145C

Schedule A (Form 1040) 2020

2021 Workbook

Berniece's Schedule A and relevant portions of Form 1040 using MFS status follow.

Form **1040** Department of the Treasury—Internal Revenue Service (99) **2020** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Single Married filing jointly Married filing separately (MFS) Head of household (HOH) Qualifying widow(er) (QW)
 Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶ **Jose Zylander**

Your first name and middle initial Berniece	Last name Zylander	Your social security number 8 8 8 8 8 8 8 8 8
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number 9 9 9 9 9 9 9 9 9

Home address (number and street). If you have a P.O. box, see instructions.
123 Maple St Apt. no.

City, town, or post office. If you have a foreign address, also complete spaces below. State **IL** ZIP code **62960**

Foreign country name Foreign province/state/county Foreign postal code

Metropolis

Presidential Election Campaign
 Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund.
 You Spouse

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? Yes No

Standard Deduction **Someone can claim:** You as a dependent Your spouse as a dependent
 Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** Were born before January 2, 1956 Are blind **Spouse:** Was born before January 2, 1956 Is blind

Dependents (see instructions):

(1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) <input checked="" type="checkbox"/> if qualifies for (see instructions): Child tax credit	Credit for other dependents
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>

	1 Wages, salaries, tips, etc. Attach Form(s) W-2			1	60,000
Attach Sch. B if required.	2a Tax-exempt interest	2a	b Taxable interest	2b	
	3a Qualified dividends	3a	b Ordinary dividends	3b	
Standard Deduction for— • Single or Married filing separately, \$12,400 • Married filing jointly or Qualifying widow(er), \$24,800 • Head of household, \$18,650 • If you checked any box under Standard Deduction, see instructions.	4a IRA distributions	4a	b Taxable amount	4b	
	5a Pensions and annuities	5a	b Taxable amount	5b	
	6a Social security benefits	6a	b Taxable amount	6b	
	7 Capital gain or (loss). Attach Schedule D if required. If not required, check here			7	
	8 Other income from Schedule 1, line 9			8	
	9 Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your total income			9	60,000
	10 Adjustments to income:				
	a From Schedule 1, line 22	10a			
	b Charitable contributions if you take the standard deduction. See instructions	10b			
	c Add lines 10a and 10b. These are your total adjustments to income			10c	
	11 Subtract line 10c from line 9. This is your adjusted gross income			11	60,000
	12 Standard deduction or itemized deductions (from Schedule A)			12	45,300
	13 Qualified business income deduction. Attach Form 8995 or Form 8995-A			13	
	14 Add lines 12 and 13			14	45,300
	15 Taxable income. Subtract line 14 from line 11. If zero or less, enter -0-			15	14,700

2021 Workbook

For Example 23

Form 1040 (2020)

Page 2

16	Tax (see instructions). Check if any from Form(s): 1 <input type="checkbox"/> 8814 2 <input type="checkbox"/> 4972 3 <input type="checkbox"/>	16	1,570
17	Amount from Schedule 2, line 3	17	
18	Add lines 16 and 17	18	1,570
19	Child tax credit or credit for other dependents	19	
20	Amount from Schedule 3, line 7	20	
21	Add lines 19 and 20	21	0
22	Subtract line 21 from line 18. If zero or less, enter -0-	22	1,570
23	Other taxes, including self-employment tax, from Schedule 2, line 10	23	
24	Add lines 22 and 23. This is your total tax	24	1,570
25	Federal income tax withheld from:		
a	Form(s) W-2	25a	
b	Form(s) 1099	25b	
c	Other forms (see instructions)	25c	
d	Add lines 25a through 25c	25d	0
26	2020 estimated tax payments and amount applied from 2019 return	26	
27	Earned income credit (EIC)	27	
28	Additional child tax credit. Attach Schedule 8812	28	
29	American opportunity credit from Form 8863, line 8	29	
30	Recovery rebate credit. See instructions	30	
31	Amount from Schedule 3, line 13	31	
32	Add lines 27 through 31. These are your total other payments and refundable credits	32	
33	Add lines 25d, 26, and 32. These are your total payments	33	0
Refund			
34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you overpaid	34	
35a	Amount of line 34 you want refunded to you . If Form 8888 is attached, check here <input type="checkbox"/>	35a	
▶ b	Routing number	▶ c Type:	<input type="checkbox"/> Checking <input type="checkbox"/> Savings
▶ d	Account number		
36	Amount of line 34 you want applied to your 2021 estimated tax	36	
Amount You Owe			
37	Subtract line 33 from line 24. This is the amount you owe now Note: Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.	37	1,570
38	Estimated tax penalty (see instructions)	38	
Third Party Designee	Do you want to allow another person to discuss this return with the IRS? See instructions <input type="checkbox"/> Yes. Complete below. <input checked="" type="checkbox"/> No		
	Designee's name	Phone no.	Personal identification number (PIN)
Sign Here	Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.		
	Your signature	Date	Your occupation Executive
	Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation
	Phone no.	Email address	
Paid Preparer Use Only	Preparer's name	Preparer's signature	Date
	Firm's name	PTIN	Check if: <input type="checkbox"/> Self-employed
	Firm's address	Phone no.	Firm's EIN

Go to www.irs.gov/Form1040 for instructions and the latest information.

Form 1040 (2020)

2021 Workbook

For Example 23

SCHEDULE A (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Itemized Deductions

▶ Go to www.irs.gov/ScheduleA for instructions and the latest information.
▶ Attach to Form 1040 or 1040-SR.

Caution: If you are claiming a net qualified disaster loss on Form 4684, see the instructions for line 16.

OMB No. 1545-0074

2020

Attachment
Sequence No. **07**

Name(s) shown on Form 1040 or 1040-SR

Your social security number

Berniece Zylander

888-88-8888

Medical and Dental Expenses	Caution: Do not include expenses reimbursed or paid by others.			
	1 Medical and dental expenses (see instructions)	1	30,000	
	2 Enter amount from Form 1040 or 1040-SR, line 11 2 60,000	2		
	3 Multiply line 2 by 7.5% (0.075)	3	4,500	
	4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4		25,500
Taxes You Paid	5 State and local taxes.			
	a State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box <input checked="" type="checkbox"/>	5a		
	b State and local real estate taxes (see instructions)	5b	5,000	
	c State and local personal property taxes	5c		
	d Add lines 5a through 5c	5d		
	e Enter the smaller of line 5d or \$10,000 (\$5,000 if married filing separately)	5e	5,000	
	6 Other taxes. List type and amount ▶	6		
	7 Add lines 5e and 6	7		5,000
Interest You Paid <small>Caution: Your mortgage interest deduction may be limited (see instructions).</small>	8 Home mortgage interest and points. If you didn't use all of your home mortgage loan(s) to buy, build, or improve your home, see instructions and check this box <input type="checkbox"/>			
	a Home mortgage interest and points reported to you on Form 1098. See instructions if limited	8a	14,800	
	b Home mortgage interest not reported to you on Form 1098. See instructions if limited. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address	8b		
	c Points not reported to you on Form 1098. See instructions for special rules	8c		
	d Mortgage insurance premiums (see instructions)	8d		
	e Add lines 8a through 8d	8e	14,800	
	9 Investment interest. Attach Form 4952 if required. See instructions	9		
	10 Add lines 8e and 9	10		14,800
Gifts to Charity <small>Caution: If you made a gift and got a benefit for it, see instructions.</small>	11 Gifts by cash or check. If you made any gift of \$250 or more, see instructions	11		
	12 Other than by cash or check. If you made any gift of \$250 or more, see instructions. You must attach Form 8283 if over \$500.	12		
	13 Carryover from prior year	13		
	14 Add lines 11 through 13	14		0
Casualty and Theft Losses	15 Casualty and theft loss(es) from a federally declared disaster (other than net qualified disaster losses). Attach Form 4684 and enter the amount from line 18 of that form. See instructions	15		0
Other Itemized Deductions	16 Other—from list in instructions. List type and amount ▶	16		0
Total Itemized Deductions	17 Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on Form 1040 or 1040-SR, line 12	17		45,300
	18 If you elect to itemize deductions even though they are less than your standard deduction, check this box <input type="checkbox"/>			

For Paperwork Reduction Act Notice, see the Instructions for Forms 1040 and 1040-SR.

Cat. No. 17145C

Schedule A (Form 1040) 2020

Their combined tax liability is \$3,176 (\$1,606 Jose + \$1,570 Berniece). By filing separately, the couple saves \$176 (\$3,352 MFJ – \$3,176 MFS).

Note. While the previous example resulted in a small tax difference between MFS and MFJ, there may be other nontax reasons why clients file separately. Examples include the following.

- Requesting an income-based student loan repayment program (income-based student loan repayment programs are covered in the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 2: Financial Distress).
- The two parties want to keep their financial affairs separate
- One of the parties has outside financial obligations for which the other party does not want to assume responsibility
- Their own personal preference

Practitioner Planning Tip

Although on the surface, this change in filing status may seem like a good idea, there are other factors to consider such as ability to make retirement contributions, cost of Medicare premiums, and tax preparation fees.

Joint and Several Liability

MFJ filing status confers significant tax benefits when filing a tax return. The married couple has a broad range of deductions, adjustments, and credits available that are not available if they file separately. However, the parties to an MFJ return consent to **joint and several liability** for the taxes, interest and penalties associated with a tax return.¹¹⁵ The liability can be an unexpected burden if one of the spouses is unaware that the other spouse had unreported income or made false statements that inappropriately reduced taxable income.

There are three types of relief from joint and several liability.¹¹⁶

- **Innocent spouse relief** if the spouse or former spouse improperly reported income, deductions, or credits on the tax return
- **Separation of liability relief** if the two spouses are no longer married to, are legally separated from their spouse or have lived apart from the spouse with whom they jointly filed in the year of question for 12 months¹¹⁷
- **Equitable relief**¹¹⁸ if the imposition of tax would be inequitable and neither innocent spouse relief nor separation of liability relief is available

¹¹⁵ *Topic No. 205 Innocent Spouse Relief (Including Separation of Liability and Equitable Relief)*. Mar. 5, 2021. IRS. [www.irs.gov/taxtopics/tc205] Accessed on Jun. 8, 2021.

¹¹⁶ IRC §6015.

¹¹⁷ IRC §6015(c)(3)(A)(i)(II).

¹¹⁸ *Equitable Relief*. Apr. 2, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/equitable-relief] Accessed on Jul. 7, 2021.

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Example 24. Harold and Joan have been married for 10 years. In December 2019, Joan suffered a severe brain injury in a traffic accident that leaves her unable to properly review the tax return that Harold prepares for them in April 2020. Nevertheless, she signs the return because she is physically able.

Joan is unaware that Harold made a significant amount of money trading virtual currency and he did not report those transactions on their 2019 tax return. In March 2021, they receive a notice from the IRS advising them of a substantial understatement of their tax liability for which they are both liable.

Joan has no knowledge of the unreported income. She has not lived apart from Harold for 12 months. Therefore, separation of liability relief is not an option for Joan. Innocent spouse relief may be available if Joan can demonstrate that because of her medical condition, it is unfair to make her pay the assessed taxes. Equitable relief may also be possible in this case, given Joan's impairment when she signed the return.

Practitioner Planning Tip

Because taxpayers cannot change their MFJ filing status on an amended return, tax practitioners should carefully consider the permanency of this filing status decision. The practitioner has a responsibility to advise both parties regarding the consequences each party is assuming by selecting the MFJ status and that they cannot change their filing status after the filing deadline.

State Issues

State and Federal Conformity. States vary with how closely they follow federal rules on filing status for state tax returns. Generally, states require that taxpayers use the same filing status on their state returns as they do with their federal returns. Other states, like Arizona,¹¹⁹ permit a choice of filing status independent of taxpayers' federal returns. Many states, including Illinois, permit exceptions to the general rule that taxpayers use the same filing status as their federal returns.

Illinois permits spouses to file an MFS return even though they filed a federal MFJ return.¹²⁰ For example, if one spouse lives in Illinois for a full year and the other spouse lives in Illinois only part of the year, the state requires that they file MFS returns, although they may make an election to file joint returns.¹²¹

Example 25. Peter and Priscilla have been Illinois residents for many years, but in June 2020 they decided to move to Alabama. Alabama is not a community property state and does not require use of the same filing status on state returns as federal. Priscilla gets a job in Mobile and relocates in September 2020. Peter does not get a job in the Mobile area until early January 2021, so he is a resident of Illinois for the full year. Even though they use MFJ filing status on their federal tax return, they file MFS returns in Illinois. Priscilla must allocate her income between the two states on her MFS state returns.

¹¹⁹ *Individual Income Tax Information*. Arizona Department of Revenue. [azdor.gov/individual-income-tax-information] Accessed on Jul. 2, 2021.

¹²⁰ 35 ILCS 5/502 (c)(4).

¹²¹ 35 ILCS 5/502 (c)(3).

Community Property States.¹²² The consequences of community property status are intertwined with the consequences of filing status. Community property laws formalize the assumption that both spouses jointly share and report income, regardless of who earned it. Similarly, two members of a couple in a community property state share the deductions that may be associated with just one of their SSNs. State legislatures originally enacted community property laws to ensure that the needs of a spouse with lower income were met.

Rules for property align with those for earned income, provided that one spouse acquired the property during the marriage. Real estate is treated as community property if it is located in a community property state, even if the owner is not a resident of that state. Most income received during marriage while domiciled in a community property state is considered jointly owned, although gifts received by one partner during the marriage are considered separate property, not community property.

The following nine states are community property states.

- Arizona
- California
- Idaho
- Louisiana
- Nevada
- New Mexico
- Texas
- Washington
- Wisconsin

An additional four states, Alaska, Kentucky, South Dakota, and Tennessee have elective community property laws. Couples can make a formal election to apply community property concepts to their property.

Community property states produce interesting results for filing status. If an MFS couple in a community property state earns very different incomes, they each report half of the total income on their separate tax returns. However, IRA distributions are not community property, as they arise from an account that is in one spouse's name only.

Practitioner Planning Tip

When a married couple in a community property state decides to choose MFS to file their returns, the IRS requires each party to submit Form 8958, *Allocation of Tax Amounts Between Certain Individuals in Community Property States*, to each of their returns to explain to IRS how the community income has been allocated.¹²³ It is important that the practitioner understands which income and property is eligible for allocation and which property and income must be considered as separate property or income. Unlike the outcome for selecting MFS in noncommunity property states, the decision to utilize MFS in community property states can have an entirely different outcome given the flexibility of income allocation allowed for community income and property in community property states.

¹²² IRS Pub. 555, *Community Property*; IRM 25.18.1 (2017).

¹²³ *Ibid.*

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Form **8958**
(Rev. November 2019)
Department of the Treasury
Internal Revenue Service (99)

Allocation of Tax Amounts Between Certain Individuals in Community Property States

▶ Attach to Form 1040, 1040-SR, or 1040-NR.
▶ Go to www.irs.gov/Form8958 for the latest information.

OMB No. 1545-0074

Attachment
Sequence No. **63**

Your first name and initial	Your last name		Your social security number
Spouse's or partner's first name and initial	Spouse's or partner's last name		Spouse's or partner's social security number
	A Total Amount	B Allocated to Spouse or RDP SSN ____ - ____ - ____	C Allocated to Spouse or RDP SSN ____ - ____ - ____
1 Wages (each employer)			
2 Interest Income (each payer)			
3 Dividends (each payer)			
4 State Income Tax Refund			
5 Self-Employment Income (See instructions)			
6 Capital Gains and Losses			
7 Pension Income			
8 Rents, Royalties, Partnerships, Estates, Trusts			

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 37779G

Form **8958** (Rev. 11-2019)

2021 Workbook

Form 8958 (Rev. 11-2019)

Page **2**

2

	A Total Amount	B Allocated to Spouse or RDP <small>SSN ___ - __ - ___</small>	C Allocated to Spouse or RDP <small>SSN ___ - __ - ___</small>
9 Deductible part of Self-Employment Tax (See instructions)			
10 Self-Employment Tax (See instructions)			
11 Taxes Withheld			
12 Other items such as: Social Security Benefits, Unemployment Compensation, Deductions, Credits, etc.			

Form **8958** (Rev. 11-2019)

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2021 Workbook

Example 26. Edward and Joan have been married for many years and live in Texas. Edward earns \$80,000 annually from his job, and Joan earns \$20,000 from working part-time at the local school. If they file their federal return using MFS filing status, each report \$50,000 of wages $((\$80,000 + \$20,000) \div 2)$ because the community properties laws of their state require them to split their incomes. In the same year, Joan receives a \$3,000 distribution from the traditional IRA to which she contributed after they were married. She reports this income on her MFS return, and Edward reports none of it on his MFS return.

Example 27. Fred and Ethel live in Illinois near the Wisconsin border. Shortly after they were married in 1987, Fred purchased a rental house in Wisconsin.¹²⁴ The title to the house is in his name only.

In 2021, the house generated \$10,000 of rental income. Because the house is in Wisconsin, and federal law respects the laws of the state in which property is located, Fred and Ethel must split the income from this house equally if they use MFS filing status. Even though they are residents of Illinois, they must apply the laws of the state in which the property is located. Because Wisconsin is a community property state, they must equally share the income.

Traditional IRA Contribution Deduction¹²⁵

Although the amount a taxpayer can contribute to a traditional IRA does not depend on their filing status, the availability of a deduction for that contribution depends on their filing status, as well as their MAGI. Unless a taxpayer receives social security benefits, MAGI for IRA deductibility purposes is the AGI from a 2020 Form 1040, line 11 plus the following.

- Student loan interest deduction
- Tuition and fees deduction
- Foreign earned income exclusion
- Foreign housing exclusion or deduction
- Any savings bond interest that has been excluded
- Any excluded adoption benefits provided by an employer

Note. The MAGI for determining deductibility of contributions to a traditional IRA is different from the MAGI used for other purposes, including the modified AGI used for determining eligibility to make Roth IRA contributions.¹²⁶

^{124.} Wisconsin became a community property state in the previous year.

^{125.} IRS Pub. 17, *Your Federal Income Tax for Individuals*.

^{126.} See *2021 IRA Deduction Limits — Effect of Modified AGI on Deduction if You Are Covered by a Retirement Plan at Work*. Nov. 16, 2020. IRS. [www.irs.gov/retirement-plans/2021-ira-deduction-limits-effect-of-modified-agi-on-deduction-if-you-are-covered-by-a-retirement-plan-at-work] Accessed on Jul. 8, 2021; *2021 IRA Deduction Limits — Effect of Modified AGI on Deduction if You Are NOT Covered by a Retirement Plan at Work*. Jun. 26, 2021. IRS. [www.irs.gov/retirement-plans/2021-ira-deduction-limits-effect-of-modified-agi-on-deduction-if-you-are-not-covered-by-a-retirement-plan-at-work] Accessed on Jul. 8, 2021.

Filing status affects the amount of a contribution to a traditional IRA that is deductible, and coverage of an employer's retirement plan also affects deductibility. A taxpayer filing as single can deduct on their Form 1040, Schedule 1, *Additional Income and Adjustments to Income*, all their 2020 IRA contribution if their MAGI is \$65,000 or less, assuming they are covered by an employer's retirement plan. The deduction phases out for MAGI greater than \$65,000 so there is no deduction if MAGI equals or exceeds \$75,000.¹²⁷ In contrast, an MFS taxpayer covered by an employer's retirement plan cannot take a deduction for their IRA contribution if their MAGI is at least \$10,000. The following table excerpted from IRS shows the various 2021 threshold amounts for taxpayers covered by a retirement plan at work.¹²⁸

Taxpayer's Filing Status ^a	2021 MAGI	Deduction
Single or HoH	\$66,000 or less	Full deduction up to the amount of the contribution limit
	More than \$66,000 but less than \$76,000	Partial deduction
	\$76,000 or more	No deduction
MFJ or QW	\$105,000 or less	Full deduction up to the amount of the contribution limit
	More than \$105,000 but less than \$125,000	Partial deduction
	\$125,000 or more	No deduction
MFS	Less than \$10,000	Partial deduction
	\$10,000 or more	No deduction

^a If filing separately and the spouses did not live together at any time during the year, the IRA deduction is determined under the single filing status.

Example 28. Harvey and Beth file MFS for 2020. They are both 80 years old and still work. Harvey earns \$18,000 and Beth earns \$50,000. Both have retirement plans with their jobs. They each contribute \$7,000 to their IRAs. They receive no deduction because of their filing status and the fact that each of their incomes exceeds the \$10,000 limit. Coverage by an employer's retirement plan does not affect the MAGI limit in this case because the limit is the same whether an MFS taxpayer has a retirement plan or not.

Example 29. Use the same facts as **Example 28**, except that Harvey and Beth choose to file as MFJ. They can now deduct the full \$14,000 deduction because their AGI of \$68,000 is under the MFJ limit of \$104,000 for MAGI when deducting traditional IRA contributions.

¹²⁷ These amounts increase by \$1,000 for 2021 in the case of taxpayers using single filing status. The limits for all filing statuses increase by the same amount for 2021 except MFS, which does not increase. See IRS Notice 2020-79, 2020-46 IRB 1014.

¹²⁸ *2021 IRA Deduction Limits — Effect of Modified AGI on Deduction if You Are Covered by a Retirement Plan at Work*. Nov. 16, 2020. IRS. [www.irs.gov/retirement-plans/2021-ira-deduction-limits-effect-of-modified-agi-on-deduction-if-you-are-covered-by-a-retirement-plan-at-work] Accessed on Jul. 30, 2021.

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When a taxpayer is **not covered** by an employer's retirement plan for any portion of a tax year, the deduction is permitted up to the full contribution permitted for a taxpayer, unless they are either MFS or MFJ with a spouse who is covered by an employer's retirement plan. Taxpayers filing MFS with a spouse who is covered by an employer's retirement plan and has MAGI exceeding \$10,000 cannot deduct any of their IRA contribution; if they have MAGI less than \$10,000, they are eligible for a partial deduction. The following table from the IRS shows the various 2021 threshold amounts for taxpayers not covered by a retirement plan at work.¹²⁹

Taxpayer's Filing Status^a	2021 MAGI	Deduction
Single, HoH, or QW	Any amount	Full deduction up to the amount of the contribution limit
MFJ or MFS with a spouse who is not covered by a plan at work	Any amount	Full deduction up to the amount of the contribution limit
MFJ with a spouse who is covered by a plan at work	\$198,000 or less	Full deduction up to the amount of the contribution limit
	More than \$198,000 but less than \$208,000	Partial deduction
	\$208,000 or more	No deduction
MFS with a spouse who is covered by a plan at work	Less than \$10,000	Partial deduction
	\$10,000 or more	No deduction

^a If filing separately and the spouses did not live together at any time during the year, the IRA deduction is determined under the single filing status.

Roth IRA Contribution Eligibility¹³⁰

Filing status also influences whether an individual can contribute to a Roth IRA because the MAGI limits are different for each filing status. Each MFJ spouse can make a full contribution to their Roth IRA if they meet the earned income requirement and their 2021 MAGI does not exceed \$198,000. If their income exceeds \$208,000 no Roth IRA contribution is permitted. The following table from IRS Pub. 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*, (modified with amounts applicable in 2021) illustrates the effect of MAGI on Roth IRA contributions.¹³¹

¹²⁹ 2021 IRA Deduction Limits — Effect of Modified AGI on Deduction if You Are NOT Covered by a Retirement Plan at Work. Jun. 26, 2021. IRS. [www.irs.gov/retirement-plans/2021-ira-deduction-limits-effect-of-modified-agi-on-deduction-if-you-are-not-covered-by-a-retirement-plan-at-work] Accessed on Jul. 30, 2021.

¹³⁰ IRS Pub. 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*.

¹³¹ Table adopted from IRS Pub. 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*, with changes for 2021 ranges from IRS Notice 2020-79, 2020-46 IRB 1014.

Taxpayer's Filing Status	2021 MAGI	Contribution Limit
MFJ or QW	Less than \$198,000	Up to \$6,000 (\$7,000 if 50 or older in 2021)
	At least \$198,000 but less than \$208,000	Partial contribution
	\$208,000 or more	No contribution
MFS and lived with spouse at any time during 2021	\$0	Up to \$6,000 (\$7,000 if 50 or older in 2021)
	More than \$0 but less than \$10,000	Partial contribution
	\$10,000 or more	No contribution
MFS (did not live with spouse at any time during year), HoH, or single	Less than \$125,000	Up to \$6,000 (\$7,000 if 50 or older in 2021)
	At least \$125,000 but less than \$140,000	Partial contribution
	\$140,000 or more	No contribution



Practitioner Planning Tip

It is important to question clients about Roth IRA contributions even though they are not tax deductible. Making the decision to choose MFS may disallow Roth IRA contributions, requiring removal or recharacterization of those contributions.

In contrast, an individual using an MFS filing status can make **no** Roth IRA contribution if their MAGI is \$10,000 or more, and if they lived with their spouse at any time during the year.

Example 30. Frank, age 60, is married to Meg, and they choose MFS on their 2020 Forms 1040. Frank earns a salary of \$5,000 during the year. Meg has no earned income during 2020. Frank can make a partial contribution of \$2,500 to his Roth IRA.¹³²

Example 31. Use the same facts as **Example 30**, except that Frank and Meg choose MFJ for 2020. Frank can now contribute up to \$5,000 to his Roth IRA, limited by his earned income.

Note. For more discussion regarding Roth IRAs and other retirement plans, see the 2020 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 1: Retirement Plan Distributions.

¹³². In this example Meg is also able to make a Roth IRA contribution of \$2,500 because of the spousal IRA rules. See IRS Pub. 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*.

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Medicare Premiums

Americans aged 65 and older are required to participate in Medicare, a federal health insurance program, if they are not covered by an employer's health plan and the employer has at least 20 employees.¹³³ The Social Security Administration (SSA) uses filing status to determine Medicare premiums and bases the premiums on AGI modified by adding tax-exempt income.¹³⁴ For Medicare purposes, MAGI is AGI from a taxpayer's Form 1040, line 11, plus tax-exempt income, which appears on line 2a. Because tax returns are not available immediately, differences in income that result from different filing statuses can also affect Medicare premium amounts two years later. The following table shows the difference that filing status makes at different MAGI levels.¹³⁵

2019 MAGI (Single)		2019 MAGI (MFJ)		2019 MAGI (MFS)		2021 Monthly Medicare Part B Premium
Over	But Not Over	Over	But Not Over	Over	But Not Over	
\$ 0	\$ 88,000	\$ 0	\$176,000	\$ 0	\$ 88,000	\$148.50
88,000	111,000	176,000	222,000	Not applicable		\$207.90
111,000	138,000	222,000	276,000	Not applicable		\$297.00
138,000	165,000	276,000	330,000	Not applicable		\$386.10
165,000	499,999	330,000	749,999	88,000	411,999	\$475.20
499,999		749,999		411,999		\$504.90

Of the six rows of data in this table, the second, third and fourth contain no data for MFS taxpayers. Consequently, a \$1 increase in MAGI above \$88,000 (first row), promotes an MFS taxpayer from the first row to the fourth row with a Medicare premium more than three times higher. In this extreme case, a taxpayer's monthly premium increase from \$148.50 to \$475.20 in 2021. There are no intermediate brackets in this range for MFS taxpayers, as there are for all other filing statuses.

Example 32. Herb and Jennifer both turned 65 in 2020 and signed up for Medicare. In 2019, Herb earned wages of \$50,000 and Jennifer earned wages of \$87,000. She also earned \$5,000 in tax-exempt income. For 2019, their MAGI for the Medicare premium calculation is \$142,000 (\$50,000 Herb's wages + \$87,000 Jennifer's wages + \$5,000 tax-exempt income) if they filed as MFJ.

However, they filed MFS returns. Herb has MAGI of \$50,000 for Medicare Part B purposes and Jennifer now has MAGI for Medicare premium purposes of \$92,000 (\$87,000 wages + \$5,000 tax-exempt income). For 2021, Herb's monthly Medicare Part B premium is \$148.50, whereas Jennifer has a 2021 Medicare Part B premium of \$475.20 **per month**. Filing a 2020 tax return using MFJ filing status would result in substantially smaller Medicare Part B premiums that they will pay in 2022. In conclusion, although they would not have paid an extra amount if they had filed MFJ, Jennifer pays a substantial additional amount for Medicare Part B because they chose to file MFS.

¹³³ *Getting Started with Medicare*. U.S. Centers for Medicare & Medicaid Services. [www.medicare.gov/sign-up-change-plans/get-started-with-medicare] Accessed on Jun. 24, 2021.

¹³⁴ *Premiums: Rules for Higher-Income Beneficiaries*. Social Security Administration. [www.ssa.gov/benefits/medicare/medicare-premiums.html] Accessed on Jun. 17, 2021.

¹³⁵ *Part B Costs*. Centers for Medicare & Medicaid Services, [www.medicare.gov/your-medicare-costs/part-b-costs] Accessed on Aug. 10, 2021.

Appealing a Medicare Premium Increase.¹³⁶ The SSA uses historical data from previously filed tax returns (e.g., for the SSA uses 2019 information on file to calculate 2021 premiums). Taxpayers may appeal the SSA decision on Form SSA-44 *Medicare Income-Related Monthly Adjustment Amount — Life-Changing Event*, if any of the following situations arise which result in income decreasing.

- Marriage, divorce, or death of a spouse
- Taxpayer or spouse stopped working or reduced the number of hours worked
- Taxpayer or spouse lost income-producing property because of a disaster or other event beyond their control
- Taxpayer or spouse's pension plan payments were altered or terminated
- Taxpayer or spouse received a settlement from an employer or former employer because of the employer's closure, bankruptcy, or reorganization

IDENTITY THEFT

Over the years, many tax professionals have prepared returns for unwitting identity theft victims. Oftentimes, the tax professional is alerted about potential identity theft only after problems arise when filing an individual's return. It is useful to understand the various prevention and detection measures available to reduce or eliminate the threat. As a client's trusted advisor, a tax practitioner can suggest strategies to help clients avoid being victimized.

Fortunately, through efforts of the IRS Security Summit and attentive tax practitioners and taxpayers, the instances of fraudulent returns have significantly decreased. The Security Summit includes the IRS, state agencies (42 states), and the private-sector tax industry (25 businesses and associations). Between 2015 and 2019, the number of taxpayers reporting they were victims of identity theft decreased by 80% and returns stopped by the IRS for identity theft dropped by 68%. The IRS safeguarded \$26 billion in fraudulent refunds.¹³⁷

Note. To minimize identity theft, the IRS sometimes flags legitimate returns for potential identity theft issues which slows the processing of legitimate refunds. A useful tool showing the complexity of return processing that can be shared with clients is found at [uofi.tax/21b2x1](https://www.irs.gov/efile/21b2x1) [www.taxpayeradvocate.irs.gov/get-help/roadmap].

Unfortunately, with various provisions of newly enacted laws, there are more opportunities and incentives for thieves to steal an individual's identity. Under the CARES Act, unemployment compensation benefits have been targeted for fraud. The Federal Trade Commission (FTC) produced a report¹³⁸ in April 2021 related to fraudulent activity associated with the COVID-19 pandemic. Of the identity theft reported to the FTC in 2020, over 394,000 were associated with an attempt to apply for a government benefit. This number represents a nearly **3,000% increase** since 2019.

¹³⁶ *Premiums: Rules For Higher-Income Beneficiaries*. Social Security Administration. [www.ssa.gov/benefits/medicare/medicare-premiums.html] Accessed on Jul. 30, 2021.

¹³⁷ *How the IRS Protects Taxpayers from Tax-Related Identity Theft*. Feb. 25, 2021. IRS. [www.irs.gov/about-irs/how-the-irs-protects-taxpayers-from-tax-related-identity-theft] Accessed on Jun. 29, 2021.

¹³⁸ *Protecting Consumers During the COVID-19 Pandemic: A Year in Review*. Apr. 2021. FTC. [www.ftc.gov/system/files/documents/reports/protecting-consumers-during-covid-19-pandemic-year-review/covid_staff_report_final_419_0.pdf] Accessed on Jun. 29, 2021.

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PREVENTION AND DETECTION

The IRS and its Security Summit partners use various measures to prevent and detect invalid refunds. For example, tax software providers strengthened password protocols, state agencies request taxpayers' driver's license numbers to prove identities, the IRS limits the number of refunds that can be deposited in financial accounts or sent to addresses, and the IRS redacts personal information on tax transcripts. Additional prevention and detection strategies for 2021 include multi-factor authentication, expansion of identity protection personal identification numbers (IP PIN) to all taxpayers, and a shared information center for Security Summit partners that quickly identifies emerging scams.¹³⁹

Taxpayer IP PIN

In the past, the IRS only provided IP PINs to taxpayers who were confirmed victims of identity theft. Beginning in 2021, any taxpayer who can properly verify their identity can apply for an IP PIN.¹⁴⁰ The IP PIN is a 6-digit number used when filing an income tax return. It prevents criminals from filing a fraudulent return by misusing a taxpayer's SSN.

Taxpayers **individually** apply for an IP PIN online at **IRS.gov/ippin** or by filing Form 15227, *Application for Identity Protection Personal Identification Number (IP PIN)*. This form is **not used** to retrieve a lost IP PIN. Form 15227 is used only when a taxpayer meets the following criteria.¹⁴¹

- The taxpayer does not already have an IP PIN.
- The taxpayer has an SSN or ITIN.
- The taxpayer's annual adjusted gross income is less than \$72,000.
- The taxpayer has access to a telephone.

After the IRS assigns an IP PIN, it sends the taxpayer a CP01A Notice identifying the IP PIN the taxpayer uses on their federal tax return. This notice is sent to taxpayers annually in December or January. Taxpayers should secure this number and not share it with anyone other than their tax return preparer.¹⁴²

The first step to obtaining an IP PIN **online** is to register for an online services account on the IRS website. The taxpayer must provide the following information to verify their identity and establish an online services account.¹⁴³

1. Email address
2. SSN or ITIN
3. Filing status and mailing address
4. One financial account linked to the taxpayer (credit card, student loan, mortgage loan, auto loan, etc.)
5. Mobile phone number linked to the taxpayer's name

¹³⁹ *How the IRS Protects Taxpayers from Tax-Related Identity Theft*. Feb. 25, 2021. IRS. [www.irs.gov/about-irs/how-the-irs-protects-taxpayers-from-tax-related-identity-theft] Accessed on Jun. 29, 2021.

¹⁴⁰ IRS News Rel. 2020-267 (Dec. 2, 2020).

¹⁴¹ IRS Form 15227, *Application for an Identity Protection Personal Identification Number (IP PIN)*.


¹⁴² *Understanding Your CP01A Notice*. Jan. 28, 2021. IRS. [www.irs.gov/individuals/understanding-your-cp01a-notice] Accessed on Jul. 20, 2021.

¹⁴³ *Secure Access: How to Register for Certain Online Self-Help Tools*. Apr. 14, 2021. IRS. [www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools#activation] Accessed on Jun. 29, 2021.

Occasional problems arise when a taxpayer attempts to establish an online services account. Below are common issues that can prevent establishment of an account.

- **The mailing address does not exactly match the address used on the last tax return filed.** The taxpayer recently moved, recently filed their first tax return, or the address format did not match (e.g., P.O. Box instead of PO Box).
- **The financial account number must be accurately entered.** For credit cards, only the last eight digits are used, and no corporate, debit, or American Express cards are accepted. Student loans by Nelnet cannot be verified.
- **The mobile phone must be associated with the taxpayer's name.** A mobile phone in another person's name cannot be verified. If there is no mobile phone associated with the taxpayer, they can request an authentication code by mail. It usually takes 10 business days for an authentication code to arrive by mail.

Once an online services account is established, the taxpayer can use the tool: Get an IP PIN on the IRS website.¹⁴⁴ This tool is generally unavailable beginning mid-November until mid-January in preparation for the coming filing season. An IP PIN is valid for one calendar year and a taxpayer must obtain a new IP PIN each year. Below is a sample online notification of an IP PIN with personally identifying information redacted.

 Signed in as: [REDACTED] | [Profile](#) | [Sign Out](#)

Identity Protection PIN (IP PIN)

Congratulations, your 2021 Identity Protection PIN is: [REDACTED]

What You Need To Do

Print this page and secure it along with your tax records.

Enter your IP PIN on your Federal tax return as indicated below:

- If you file electronically, your tax software or practitioner will tell you where to enter your IP PIN for you, your spouse, and/or dependents if applicable.
- If filing a paper return, enter your IP PIN(s) as applicable in the boxes marked "Identity Protection PIN" in signature area of the return.

What To Remember About Your IP PIN

- You must use the IP PIN on all federal income tax returns 1040 and 1040 PR/SS and any delinquent returns filed during the current calendar year.
- Don't reveal your IP PIN to anyone other than your tax preparer.
- You can't use your IRS IP PIN on a state income tax return.
- New IP PINs are generated each year and can be retrieved from the IP PIN application in early January each year. You will not receive an IP PIN notice..

Additional Information About Your IP PIN

For common questions about the IP PIN, please visit the [IP PIN FAQ](#) page on IRS.gov.

[PRINT](#) [SIGN OUT](#)

[IRS Privacy Policy](#) | [Privacy Notice](#)

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¹⁴⁴ *Get an Identity Protection PIN (IP PIN)*. Apr. 13, 2021. IRS. [www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin] Accessed on Jun. 29, 2021.

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If the taxpayer cannot file Form 15227 and cannot establish an online services account, they must schedule an in-person appointment with a Taxpayer Assistance Center (TAC) to verify their identity. The TAC nearest to the taxpayer can be located on the IRS website. Taxpayers can schedule an appointment by calling the TAC office appointment line at 844-545-5640, because taxpayers are typically only seen by appointment.

Occasionally, taxpayers lose their CP01A notices. In other circumstances, taxpayers never receive the notice, possibly because they moved. If the IP PIN is lost or the taxpayer fails to receive a CP01A Notice, the IP PIN tool can be used to retrieve the lost number.¹⁴⁵

The IRS can generate a replacement IP PIN online if the taxpayer has access to the Internet and can establish an IRS account. The taxpayer starts the process by visiting **uofi.tax/21b2x2** [www.irs.gov/identity-theft-fraud-scams/retrieve-your-ip-pin]. They are directed to the same website for requesting an IP PIN to retrieve the one that appeared in the CP01A notice previously sent to the taxpayer.¹⁴⁶

If they are unable to use the website, taxpayers may call a toll-free number, 800-908-4490, to have the IRS reissue an IP PIN. This phone call triggers the use of high-risk authentication by the IRS assister so the taxpayer should expect challenging questions. The Internal Revenue Manual (IRM) does not publish the list of possible questions that are used to verify a taxpayer's identity in this circumstance.¹⁴⁷ After verifying their identity, the IRS assister generates a new IP PIN and sends a Letter 4869C. It is mailed to the address of the taxpayer on record within three weeks.¹⁴⁸ If the taxpayer is unable to verify their identity, they should file their return by mail without the IP PIN. This will delay any refund the taxpayer may be due.¹⁴⁹

Example 33. Jerry received a Notice CP01A on January 8, 2021 but does not store it with his 2020 tax materials. When preparing for his April 5 appointment with his tax preparer, Jerry cannot locate this notice with the IP PIN. His tax preparer guides him through the process of retrieving the IP PIN using the IRS's IP PIN retrieval web site. Because Jerry can authenticate his identity with the online tool, he does not need to call the IRS to request assistance with retrieving his IP PIN. The tax preparer asks Jerry to sign a Form 8821, *Tax Information Authorization*, so the IRS will send a copy of the next year's Notice CP01A to both of them.

Practitioner Planning Tip

The IRS sends a copy of Notice CP01A to tax preparers if a Form 2848, *Power of Attorney and Declaration of Representative*, or Form 8821 is in the Centralized Authorization File (CAF) system covering the tax year. Receiving this form directly from the IRS can streamline tax preparation by removing a single point of failure, namely the receipt of the IP PIN, without which the practitioner cannot electronically file the return.

¹⁴⁵. Ibid.

¹⁴⁶. *Retrieve Your Identity Protection PIN (IP PIN)*. Mar. 3, 2021. IRS. [www.irs.gov/identity-theft-fraud-scams/retrieve-your-ip-pin] Accessed on Jul. 2, 2021.

¹⁴⁷. IRM 25.25.6.4 (2020).

¹⁴⁸. IRM 25.23.2.9.1 (2020).

¹⁴⁹. *Retrieve Your Identity Protection PIN (IP PIN)*. Mar. 3, 2021. IRS. [www.irs.gov/identity-theft-fraud-scams/retrieve-your-ip-pin] Accessed on Jul. 2, 2021.

Taxpayer Protection Program

The Taxpayer Protection Program was implemented with the purpose of identifying fraudulent returns and preventing fraudulent refunds. There are various filters and measures the IRS uses to evaluate the validity of a tax return.¹⁵⁰ When a return is flagged as suspicious, the IRS issues Letter 4883C to the taxpayer requesting verification of the taxpayer's information. The taxpayer is instructed to call the phone number included in the letter. If the taxpayer wants their tax professional involved, both individuals must participate in the call to the IRS.¹⁵¹

Personal Strategies to Protect Identity and Monitor Identity Theft

There are several precautions a taxpayer can take to reduce the chances of becoming an identity theft victim. Some of these include the following.

- **Protect SSNs.** They should not carry social security cards in a wallet or purse.
- **Check credit reports.** Credit reports should be reviewed periodically and at least annually.
- **Protect online information.** Personal computers, laptops, tablets, and mobile phones should be protected using firewalls, virtual private networks (VPN), anti-malware/virus/spam software, and strong passwords or biometrics (fingerprints, facial recognition) to access the devices.
- **Be alert for phishing and potential malware.** Taxpayers should not click on links in email or text messages from unknown sources. Examining the sender's email address to determine if the address is legitimate before clicking on links embedded in the email or text message can prevent installation of malware. Taxpayers can look for misspellings and odd sentence structures to determine legitimacy of email or text message.
- **Protect information on the phone.** Many scammers and thieves try to collect personal information during phone calls. This information is used to steal individual identities. Examples of information that scammers try to get individuals to reveal include SSNs, Medicare numbers, driver's license numbers, mailing addresses, mobile phone numbers, etc.
- **Protect information on wireless hotspots.** If taxpayers must use a publicly available wireless hotspot, protecting their information by using a VPN is essential.
- **Protect information in websites.** Most websites that contain sensitive information now allow 2-factor authentication. This requires receipt of a text message or entry of a code in some manner, usually involving a smart phone.
- **Protect passwords.** Instead of simplifying passwords to make them easier to remember, taxpayers can store them in an encrypted password database. These products are not expensive and are very secure.

A quick response is important when a taxpayer suspects they are a victim of identity theft. IRS Pub. 5027, *Identity Theft Information for Taxpayers*, contains identity theft warning signs, steps to take for victims of identity theft, and strategies to reduce risk of identity theft.

¹⁵⁰ IRM 25.25.6.1.7 (2020).

¹⁵¹ *Understanding Your Letter 4883C or 6330C*. May 5, 2021. IRS. [www.irs.gov/individuals/understanding-your-letter-4883c-or-6330c] Accessed on Jun. 29, 2021.

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Warning signs that a taxpayer's identity was stolen include the following.¹⁵²

- An electronically filed return is rejected because of a duplicate SSN.
- The taxpayer receives an IRS letter inquiring about a suspicious tax return that the taxpayer did not file.
- An unrequested tax transcript is received in the mail.
- A notice regarding initiating an online account is received when no action was taken by the taxpayer.
- A notice about accessing an existing online account is received when no action was taken by the taxpayer.
- The taxpayer receives an IRS notice that they owe additional tax or refund offset, or that they have had collection actions taken against them for a year they did not file a tax return.
- IRS records indicate the taxpayer received wages or other income from an unknown employer.
- An employer identification number was assigned when no request was made.

IRS Informs Taxpayer of Suspected Identity Theft¹⁵³

As mentioned previously, the Taxpayer Protection Program scans and analyzes tax returns for suspected identity theft. When the IRS flags a return for analysis, the taxpayer receives Letter 4883C. Within 30 days of receiving the letter, the taxpayer calls the IRS at the number included in the letter and verifies their identity. If it is determined the tax return was filed fraudulently, the return is removed from the taxpayer's record. If the taxpayer has not yet filed their annual tax return, it is recommended they file using a paper return.

Alternatively, if the flagged tax return was filed accurately by the taxpayer, it is processed and a refund is eventually released, as appropriate.

Taxpayer Informs IRS of Suspected Identity Theft¹⁵⁴

Filing Form 14039, *Identity Theft Affidavit*, alerts the IRS about a taxpayer's identity theft when an electronically filed return was rejected, or when any of the other warning signs occur. It is completed after the taxpayer receives Letter 4883C from the IRS. After the electronically filed return is rejected, the taxpayer files a paper tax return and attaches Form 14039 to the return. The IRS acknowledges receipt of the form, and the case is referred to an IRS Identity Theft Victim Assistance organization. This organization's intervention includes the following actions.

- Identifies the scope of the identity theft
- Authenticates whether all names, addresses, and SSNs on the return are accurate or fraudulent
- Analyzes whether other issues are outstanding
- Processes the tax return and releases the refund, if due
- Removes the fraudulent return from the taxpayer's record
- Marks the account with an identity theft indicator

Cases are generally resolved within 120 days. Complex cases can take as long as 180 days to resolve.

¹⁵² *Taxpayer Guide to Identity Theft*. Jun. 8, 2021. IRS. [www.irs.gov/newsroom/taxpayer-guide-to-identity-theft] Accessed on Jun. 29, 2021.

¹⁵³ *IRS Identity Theft Victim Assistance: How It Works*. Jun. 26, 2021. IRS. [www.irs.gov/individuals/how-irs-id-theft-victim-assistance-works] Accessed on Jun. 29, 2021.

¹⁵⁴ *Ibid.*

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Form 14039 (December 2020)	Department of the Treasury - Internal Revenue Service Identity Theft Affidavit	OMB Number 1545-2139
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Complete this form if you need the IRS to mark an account to identify questionable activity.

Section A - Check the following boxes in this section that apply to the specific situation you are reporting (Required for all filers)

- 1. I am submitting this Form 14039 for myself
- 2. This Form 14039 is submitted in response to a 'Notice' or 'Letter' received from the IRS
 - Please provide 'Notice' or 'Letter' number(s) on the **line to the right**
 - Please check box 1 in **Section B** and see special mailing and faxing instructions on reverse side of this form.
- 3. I am submitting this Form 14039 on behalf of my 'dependent child or dependent relative'
 - Please complete **Section E** on reverse side of this form.
- 4. I am submitting this Form 14039 on behalf of another person (other than my dependent child or dependent relative)
 - Please complete **Section E** on reverse side of this form.

Section B - Reason For Filing This Form (Required)

Check only **ONE** of the following boxes that apply to the person listed in **Section C** below. If the taxpayer in 'Section C' has previously submitted a Form 14039 to the IRS on the same affected tax year(s), there's no need to submit another Form 14039.

- 1. **Someone used my information to file taxes, including being incorrectly claimed as a dependent**
- 2. **I don't know if someone used my information to file taxes, but I'm a victim of identity theft**

Please provide an explanation of the identity theft issue, how you became aware of it and provide relevant dates. If needed, please attach additional information and/or pages to this form.

Section C - Name and Contact Information of Identity Theft Victim (Required)

Victim's last name	First name	Middle initial	Taxpayer Identification Number (Please provide 9-digit Social Security Number)
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Current mailing address (apartment or suite number and street, or P.O. Box) If deceased, please provide last known address

Current city	State	ZIP code
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Tax Year(s) you experienced identity theft (If not known, enter 'Unknown' in one box below)	What is the last year you filed a return
--	---

Address used on last filed tax return (If different than 'Current')	Names used on last filed tax return (If different than 'Current')
--	--

City (on last tax return filed)	State	ZIP code
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Telephone number with area code (Optional) If deceased, please indicate 'Deceased'	Best time(s) to call
Home telephone number	Cell phone number

Language in which you would like to be contacted English Spanish

Section D - Penalty of Perjury Statement and Signature (Required)

Under penalty of perjury, I declare that, to the best of my knowledge and belief, the information entered on this Form 14039 is true, correct, complete, and made in good faith.

Signature of taxpayer, or representative, conservator, parent or guardian	Date signed
--	-------------

Submit this completed form to either the mailing address or the FAX number provided on the reverse side of this form.

Section E – Representative, Conservator, Parent or Guardian Information (Required if completing Form 14039 on someone else's behalf)

Check only **ONE** of the following five boxes next to the reason you are submitting this form

- 1. The taxpayer is deceased and I am the surviving spouse**
 - No attachments are required, including death certificate.
- 2. The taxpayer is deceased and I am the court-appointed or certified personal representative**
 - Attach a copy of the court certificate showing your appointment.
- 3. The taxpayer is deceased and a court-appointed or certified personal representative has not been appointed**
 - Attach copy of death certificate or formal notification from a government office informing next of kin of the decedent's death.
 - Indicate your relationship to decedent: Child Parent/Legal Guardian Other _____
- 4. The taxpayer is unable to complete this form and I am the appointed conservator or have Power of Attorney/Declaration of Representative authorization per IRS Form 2848**
 - Attach a **copy** of documentation showing your appointment as conservator or POA authorization.
 - If you have an IRS issued **Centralized Authorization File (CAF) number, enter the nine-digit number:**

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- 5. The person is my dependent child or my dependent relative**

By checking this box and signing below you are indicating that you are an authorized representative, as parent, guardian or legal guardian, to file a legal document on the dependent's behalf.

 - Indicate your relationship to person: Parent/Legal Guardian Fiduciary Relationship per IRS Form 56
 Power of Attorney Other

Representative's name

Last name	First name	Middle initial
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Representative's current mailing address (City, town or post office, state, and ZIP code)

Representative's telephone number

Options for Submitting this Form

Other Agencies to Notify

Victims of identity theft should take additional steps to alert other government agencies of their compromised identity.

Law Enforcement. Identity theft should be reported to the local police department. If the local department is not equipped to investigate the issue, a local office of the Federal Bureau of Investigation or U.S. Secret Service should be contacted.

Credit Bureaus. There are three major credit bureaus. A taxpayer should place a freeze on their credit record at all three bureaus. The bureaus' contact information is listed below.

- **Equifax**
uofi.tax/16a6x12 [www.Equifax.com/CreditReportAssistance]
800-685-1111
P.O. Box 740241
Atlanta, GA 30374-0241
- **Experian**
uofi.tax/16a6x13 [www.Experian.com/fraudalert]
888-397-3742
P.O. Box 2104
Allen, TX 75013-0949
- **TransUnion**
uofi.tax/16a6x14 [www.TransUnion.com/fraud]
800-916-8800
P.O. Box 1000
Chester, PA 19022

FTC. The FTC established a website to help identity theft victims create an identity theft report and create a personal recovery plan. The website is **IdentityTheft.gov**.

INDIVIDUAL TAX CREDITS

The passage of the ARPA modified several characteristics of the child tax credit (CTC) for 2021. Also, there are changes to and eliminations of various education tax credits applicable in 2021. The CAA extended the energy credits for individuals through 2021.

CHILD TAX CREDIT¹⁵⁵

For the 2021 tax year, a taxpayer can claim a CTC of up to \$3,600 per qualifying child who is five years old or younger. The maximum CTC is \$3,000 per qualifying child who is 6–17 years old. The credit phases out at a 5% rate when the taxpayer's income exceeds \$75,000 for single or MFS taxpayers, \$112,500 for HoH taxpayers, and \$150,000 for MFJ taxpayers. The credit phases out completely for taxpayers with income that exceeds \$200,000 (\$400,000 for MFJ).

The CTC is fully refundable in 2021. In addition, the full amount of the credit is available to eligible taxpayers with **no earned income**.

Note. A detailed comparison of the old rules and the new rules that apply for the CTC in 2021 can be found in the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: New Developments.

Practitioner Planning Tip

Unmarried taxpayers with a qualifying child or children may wish to discuss which taxpayer should claim dependents to maximize the CTC. A custodial parent may decide to release the exemption to a noncustodial parent to maximize CTC. Additionally, nonmarried parents residing within the same household can allow the parent who will benefit more from the CTC and other credits to claim the dependents. For answers to additional questions in this area, the IRS provides an interactive tax assistant tool at [uofi.tax/21b2x3](https://www.irs.gov/help/ita/whom-may-i-claim-as-a-dependent) [www.irs.gov/help/ita/whom-may-i-claim-as-a-dependent].

Advance Payment of Child Tax Credit (ACTC)¹⁵⁶

Beginning July 15, 2021, the IRS started paying half of the expected CTC in equal periodic payments. No advance payments will be made after December 31, 2021. Taxpayers who receive ACTC claim the other half of the total 2021 CTC when they file their 2021 income tax return.

Note. The IRS announced it will send notices (Letter 6419) in January 2022 regarding the amount, if any, of ACTC the taxpayer(s) received.¹⁵⁷ Eligibility for the ACTC is covered in the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: New Developments.

¹⁵⁵ IRC §24; *American Rescue Plan Act of 2021*, PL 117-2, §9611; *The Child Tax Credit: Temporary Expansion for 2021 Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2)*. Crandall-Hollick, Margot L. Mar. 15, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IN/IN11613] Accessed on Apr. 20, 2021.

¹⁵⁶ *2021 Child Tax Credit and Advance Child Tax Credit Payments — Topic A: General Information*. Jul. 15, 2021. IRS. [www.irs.gov/credits-deductions/2021-child-tax-credit-and-advance-child-tax-credit-payments-topic-a-general-information] Accessed on Jul. 20, 2021.

¹⁵⁷ *2021 Child Tax Credit and Advance Child Tax Credit Payments — Topic H: Reconciling Your Advance Child Tax Credit Payments on Your 2021 Tax Return*. Jul. 6, 2021. IRS. [www.irs.gov/credits-deductions/2021-child-tax-credit-and-advance-child-tax-credit-payments-topic-h-reconciling-your-advance-child-tax-credit-payments-on-your-2021-tax-return] Accessed on Jul. 12, 2021.



Practitioner Planning Tip

Taxpayers eligible for the ACTC could adjust their information (and therefore impact their ACTC payments) at the beginning of each month through November of 2021. Although the IRS, as noted previously, will send a Letter 6419 to taxpayers in January 2022 with information regarding the amount of ACTC paid, taxpayers may lose or not include this information with their tax documents. With access to client information continuing to move away from traditional contact methods such as phone calls and toward digital access to information, practitioners should encourage taxpayers to establish online access to their information and make certain they create meaningful passwords to protect against identity theft. In July 2021, the IRS established Tax Pro Accounts, an online portal environment for access to client data or to initiate actions such as powers of attorney. However, it requires **online** action by the taxpayer to grant the tax professional permission to access their records. Taxpayers may be directed to the IRS website entitled *View Your Account Information* at [uofi.tax/21b2x4](https://www.irs.gov/payments/view-your-tax-account) [www.irs.gov/payments/view-your-tax-account] and click on ‘*Create or view your account*’ for more information or to establish their online IRS account portal.

The IRS established a separate portal for nonfilers¹⁵⁸ to provide information to the IRS regarding their situation and eligibility to receive ACTC. For those persons who do not provide information to the IRS via the portal, it is unknown how they will receive either ACTC or CTC. They may need to file a 2021 return.

Taxpayers who successfully unenroll from the ACTC are not excluding themselves from the CTC on their 2021 returns. Unenrolling is only a decision not to receive ACTC payments. The facts and circumstances of the taxpayer’s 2021 return will determine the amount of CTC to which the taxpayer is entitled.¹⁵⁹

Note. See the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: New Developments, for more details on reconciling the ACTC with the CTC.

¹⁵⁸. Nonfilers may be a poor choice of terminology. The IRS is actually referring to taxpayers who may not have a filing requirement and yet are still eligible for ACTC. These “nonfilers” must use the portal to receive ACTC without filing a return. The IRS is not attempting to suggest nonfilers refers to persons guilty of failing to file when they have a filing requirement.

¹⁵⁹. 2021 *Child Tax Credit and Advance Child Tax Credit Payments — Topic A: General Information*. Jul. 15, 2021. IRS. [www.irs.gov/credits-deductions/2021-child-tax-credit-and-advance-child-tax-credit-payments-topic-a-general-information] Accessed on Jul. 20, 2021.

Practitioner Planning Tip

Taxpayers who wished to unenroll from the ACTC had very little time to do so. In addition, the portal created by the IRS appeared intrusive and difficult to navigate. With these factors in mind, many taxpayers decided to receive the payments even though they might need to be repaid. For those taxpayers, it is advisable for practitioners to project their client's 2021 net tax. If a balance due to the IRS is predicted, clients may be advised to send the ACTC payments back to the IRS in the form of a fourth quarter estimated tax payment to avoid potential underpayment penalties when filing their 2021 returns.

EDUCATION TAX CREDITS

Tuition and Fees Deduction¹⁶⁰

For tax years prior to 2021, an individual was allowed a deduction for qualified tuition and related expenses the taxpayer paid during the year. For tax years beginning after December 31, 2020, **the tuition and fees deduction is eliminated.**¹⁶¹ The intent is to transition away from the tuition and fees in support of an increased income limitation on the lifetime learning credit.

Lifetime Learning Credit¹⁶²

The lifetime learning credit is a nonrefundable tax credit of up to \$2,000 (20% of \$10,000 of qualified higher education expenses) subject to phase-out limits shown in the table below. The credit is available for an unlimited number of years for both degree and nondegree programs.¹⁶³

The CAA made a significant change to the lifetime learning credit.¹⁶⁴ The lifetime learning credit now uses the same MAGI phase-out limits as the American opportunity credit (AOC).

	2020 MAGI Phaseout Range (Lifetime Learning Credit)	2021 MAGI Phaseout Range (Lifetime Learning Credit and AOC)
MFJ	\$118,000–\$138,000	\$160,000–\$180,000
Single, HoH	59,000– 69,000	80,000– 90,000
Qualifying Widow(er)	59,000– 69,000	80,000– 90,000
MFS	Not eligible	Not eligible

Note. The phase-out amounts for AOC and lifetime learning credit are not adjusted for inflation, although this is not specifically stated in the statute. However, the income phaseouts for the AOC have never been adjusted since the AOC was enacted in 2009 under the American Recovery and Reinvestment Act of 2009.¹⁶⁵

^{160.} IRC §222.

^{161.} *Consolidated Appropriations Act of 2021*, PL 116-260, Div. EE, §§104(b) and (c).

^{162.} IRC §25A(c).

^{163.} *Lifetime Learning Credit*. Jan. 26, 2021. IRS. [www.irs.gov/credits-deductions/individuals/lfc] Accessed on Jul. 20, 2021.

^{164.} *Consolidated Appropriations Act of 2021*, PL 116-260, Div. EE, §104(a)(1)(1).

^{165.} *American Recovery and Reinvestment Act of 2009*, PL 111-5, §1004(i)(4)(A)(ii).

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Coordination of AOC and Lifetime Learning Credit

Eligible students may **not** receive both credits on the same return.¹⁶⁶

The basic rules for AOC and lifetime learning credit have not changed. AOC can only be claimed four times for the same student during the first four years of postsecondary education, and that student must be enrolled at least half time for at least one academic period during the year.¹⁶⁷

Practitioner Planning Tip

Practitioners and clients should consider the benefits of AOC versus the lifetime learning credit when and if a client returns to school to complete their first 4-year degree. The compliance issues are fewer when utilizing the lifetime learning credit versus having to conduct due diligence from potentially many years earlier to determine how many times the taxpayer may have previously claimed the AOC.

The lifetime learning credit does not have these limitations and may prove to be a practical alternative for students attending post-secondary education part-time and for students who may take longer than four years to complete an undergraduate program. The lifetime learning credit is also available for persons who are not in pursuit of a degree or are seeking to enhance their job skills by taking a course at their leisure.¹⁶⁸

Example 34. Sheldon is a bright and gifted young man. Even though he is only 16 years old and a high school student, he is taking several college classes at the local university that will give him credit toward a college degree. He has taken enough classes to be considered at least a half-time student and the fees his parents paid to the university reflect his half-time status. Given the 4-year limitation to the AOC, it may be more beneficial for Sheldon's family to use the lifetime learning credit for the qualified education expenses incurred during 2021 so as not to waste one year of AOC eligibility.

Note. The IRS has an interactive tax assistant tool to assist in the decision-making process for claiming education credits.¹⁶⁹

^{166.} IRC §25A(c)(2)(A).

^{167.} *American Recovery and Reinvestment Act of 2009*, PL 111-5, §1004(a)(i)(4)(A)(ii).

^{168.} IRC §25A(f)(1).

^{169.} *Am I Eligible to Claim an Education Credit?* Jun. 25, 2021. IRS. [www.irs.gov/help/ita/am-i-eligible-to-claim-an-education-credit] Accessed on Jul. 12, 2021. The website refers to a student's enrollment in postsecondary education program leading to a degree but indicates no requirement that the student be a high school graduate.

ENERGY CREDITS

Residential Energy Efficient Property Credit¹⁷⁰

The CAA extended the **residential energy efficient property credit** through December 31, 2021. Taxpayers who install qualified alternate energy equipment or make energy-saving improvements to their residence may be entitled to the credit. The nonrefundable credit is equal to the applicable percent of the cost of qualified property (26% for property placed in service after December 31, 2019, and before January 1, 2023.) The following are qualifying equipment.

- Solar electric property
- Solar water heaters
- Geothermal heat pumps
- Small wind turbines
- Fuel cell property (subject to a \$500 limitation with respect to each half kilowatt of capacity of the qualified fuel cell property,¹⁷¹ which must be installed at a taxpayer's principal residence¹⁷²)
- Qualified biomass fuel property

Nonbusiness Energy Property Credit¹⁷³

For 2021, an individual may claim a credit for 10% of the cost of qualified energy efficiency improvements. Qualified energy efficiency improvements include the following.

- Energy-efficient exterior windows, doors, and skylights
- Roofs (metal and asphalt) and roof products
- Insulation

The residential energy property credit is limited to an **overall lifetime credit limit of \$500** (\$200 lifetime limit for windows). The following individual limitations also apply.

- \$50 for any advanced main air circulating fan
- \$150 for any qualified natural gas, propane, or oil furnace or hot water boiler
- \$300 for any item of energy-efficient building property

Residential energy property expenditures include the following qualifying products which are subject to the overall credit limit of \$500.

- Energy-efficient heating and air conditioning systems
- Water heaters (natural gas, propane, or oil)
- Biomass stoves

¹⁷⁰. IRC §25D, *Energy Incentives for Individuals: Residential Property Updated Questions and Answers*. May 4, 2021. IRS. [www.irs.gov/newsroom/energy-incentives-for-individuals-residential-property-updated-questions-and-answers] Accessed on Jul. 20, 2021.

¹⁷¹. IRC §25D(b)(1).

¹⁷². IRC §25D(d)(3).

¹⁷³. IRC §25C.

VIRTUAL CURRENCY

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like “real” currency, but it does not have legal tender status in the United States. The following are various types of virtual currency.¹⁷⁴

Note. For purposes of this chapter, “real” currency would be actual hard currencies such as the U.S. dollar (USD).

- **Cryptocurrency** is a type of virtual currency that utilizes cryptography (practice of anonymously encoding and decoding data to prevent unauthorized access by unintended recipients)¹⁷⁵ to validate and secure transactions that are digitally recorded on a distributed ledger. A **distributed ledger** is a database shared across multiple sites and accessible by several individuals,¹⁷⁶ such as blockchain.
- **Convertible virtual currency** is virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency (e.g., Bitcoin (BTC), Ethereum).

Digital currency is the overarching category of funds representing monetary assets in electronic form that includes virtual currency, cryptocurrency, and convertible virtual currency.¹⁷⁷ Digital currency can be either regulated or unregulated. An example of **regulated digital currency** is an electronic form of monetary assets issued by a central authority (i.e., currency that is backed and supported by a regulated institution like a country’s central bank). For example, China has been distributing virtual yuan, a digital currency backed by the People’s Bank of China.¹⁷⁸ Conversely, **unregulated digital currency** is all the other types of electronic funds that are not controlled by a centralized authority, such as BTC.

IRS Notice 2014-21¹⁷⁹ **establishes that virtual currency is treated as property.** As property, the tax treatment depends on what the cybercurrency represents to the individual in possession of it. The individual may be a miner, investor, merchant, or someone who uses cybercurrency as a medium of exchange in a similar manner as any other traditional currency.

Note. The various users of virtual currency and their associated tax treatments are explained in detail in the 2018 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Individual Taxpayer Issues. This can be found at uofi.tax/arc [taxschool.illinois.edu/taxbookarchive/].

¹⁷⁴. *Virtual Currencies*. Apr. 30, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies]. Accessed on Jul. 14, 2021; IRS Notice 2014-21, 2014-16 IRB 938.

¹⁷⁵. *Explaining the Crypto in Cryptocurrency*. Jan. 25, 2020. Investopedia. [www.investopedia.com/tech/explaining-crypto-cryptocurrency/] Accessed on Jul. 20, 2021.

¹⁷⁶. *Distributed Ledgers*. Investopedia. [www.investopedia.com/terms/d/distributed-ledgers.asp] Accessed on Jul. 19, 2021.

¹⁷⁷. *Virtual Currency*. Investopedia. [www.investopedia.com/terms/v/virtual-currency.asp] Accessed on Jul. 15, 2021.

¹⁷⁸. *China has given away millions in its digital yuan trials. This is how it works*. Mar. 4, 2021. CNBC. [www.cnbc.com/2021/03/05/chinas-digital-yuan-what-is-it-and-how-does-it-work.html] Accessed on Jul. 15, 2021.

¹⁷⁹. IRS Notice 2014-21, 2014-16 IRB 938.

TAX REPORTING

Starting with the 2020 version of the Form 1040 the IRS added a question about whether the taxpayer at any time during the year received, sold, sent, exchanged, or otherwise acquired any financial interest in any virtual currency on page 1. In 2019, the question was on Schedule 1.¹⁸⁰

Form 1040 Department of the Treasury—Internal Revenue Service (99)		2020 OMB No. 1545-0074		IRS Use Only—Do not write or staple in this space.
Filing Status <input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Head of household (HOH) <input type="checkbox"/> Qualifying widow(er) (QW)				
Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶				
Your first name and middle initial		Last name		Your social security number
If joint return, spouse's first name and middle initial		Last name		Spouse's social security number
Home address (number and street). If you have a P.O. box, see instructions.			Apt. no.	Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse
City, town, or post office. If you have a foreign address, also complete spaces below.		State	ZIP code	
Foreign country name		Foreign province/state/county	Foreign postal code	
At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? <input type="checkbox"/> Yes <input type="checkbox"/> No				
Standard Deduction Someone can claim: <input type="checkbox"/> You as a dependent <input type="checkbox"/> Your spouse as a dependent <input type="checkbox"/> Spouse itemizes on a separate return or you were a dual-status alien				

A taxpayer answers “yes” to the question if they engaged in any of the following virtual currency transactions.¹⁸¹

- A receipt or transfer of virtual currency for free (without providing any consideration), including from an airdrop or hard fork (defined later)
- An exchange of virtual currency for goods or services
- A sale of virtual currency
- An exchange of virtual currency for other property, including for another virtual currency
- A disposition of a financial interest in virtual currency

A taxpayer who merely holds virtual currency in a wallet (virtual location to store cybercurrency) or account, or who transfers virtual currency from one wallet or account they control to another wallet or account they control marks the question “no.” Additionally, a taxpayer who purchases virtual currency with real currency (such as the USD) and has no other virtual currency transactions during the year selects “no.”¹⁸²

¹⁸⁰ Instructions for Form 1040.

¹⁸¹ Ibid.

¹⁸² *Frequently Asked Questions on Virtual Currency Transactions*. Jun. 4, 2021. IRS. [www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions] Accessed on Jul. 14, 2021.

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Virtual currency that a taxpayer receives as compensation for services is reported in the same manner as other income of the same types (e.g., Form W-2 wages on Form 1040). The taxpayer recognizes ordinary income on their return. Additionally, the remuneration is subject to income tax withholding, Federal Insurance Contributions Act (FICA) tax, and Federal Unemployment Tax Act (FUTA).

Note. The difficulty with this process is that when each payment is made, the coin value must be converted to USD as of the date the payment is made.¹⁸³

Likewise, any disposal of virtual currency held for sale to customers in a trade or business is reported in the same manner as similar types (e.g., inventory or services from Schedule C).¹⁸⁴

Practitioner Planning Tip

Many of the virtual currency platforms send their customers Forms 1099-MISC, *Miscellaneous Information*, if the customer earned \$600 or more in rewards or fees during the year. Tax practitioners should ask if their client received any Forms 1099-MISC that need to be reported on their tax return.

Gains and Losses¹⁸⁵

If a taxpayer sold, exchanged, or transferred any virtual currency they held as a capital asset (investment) during the year, the capital gain or loss is figured on Form 8949, *Sales and Other Dispositions of Capital Assets*, and reported on Schedule D, *Capital Gains and Losses*, in USD. The gain or loss from the sale of virtual currency is the difference between the taxpayer's adjusted basis in the virtual currency and the amount the taxpayer received in exchange for the virtual currency.

Practitioner Planning Tip

Calculations should most likely be made on the coin value in USD. The USD becomes the common denominator to use in cybercurrency transactions.

Whether the gain or loss is short-term or long-term depends on the holding period of the virtual currency. The holding period begins on the day the individual acquires the virtual currency and ends on the day they dispose of the virtual currency. Currency held for one year or less is a short-term capital gain or loss. If the currency was held for more than one year, long-term capital gain or loss rules apply.

¹⁸³. Ibid.

¹⁸⁴. Ibid.

¹⁸⁵. Ibid.

Because virtual currency is considered property (i.e., a capital asset), a taxpayer who pays for a service or purchases property in virtual currency has a capital gain or loss. The gain or loss is the difference between the fair market value (FMV) and the taxpayer's adjusted basis in the virtual currency (explained later).

Basis. The basis in virtual currency depends on how the individual acquired the currency and how they are using the virtual currency. Additionally, basis depends on whether the virtual currency units are specifically identified. A taxpayer who sells, exchanges, or otherwise disposes of virtual currency has the option to specifically identify which units were disposed, or lacking this procedure, the IRS deems the units disposed of on a first-in, first-out (FIFO) basis.

A specific unit of virtual currency is identified by documenting unique digital identifiers, such as the following.

- Private key
- Public key
- Address
- Records showing the transaction information for all units of a specific virtual currency held in a single account, wallet, or address

The following information must be provided for specific identification.

- The date and time the individual acquired each unit
- Basis and FMV of each unit at the time it was acquired
- The date and time each unit was sold, exchanged, or otherwise disposed
- The FMV of each unit when sold, exchanged, or disposed, and the amount of money or the value of property received for each unit

Note. Depending on which virtual currency platform an individual uses to maintain their virtual currency, the company hosting the wallet (e.g., Coinbase, Cash App, and Binance) may provide a transaction history report. These reports are valuable in establishing basis to calculate gains and losses.

Adjusted basis is basis increased by certain expenditures and decreased by certain deductions.

Note. The IRS has not specified what expenditures and deductions adjust basis in virtual currency. It is likely similar adjustments as those that modify basis for property (e.g., legal fees.)

Virtual Currency Purchased with Real Currency. Cost basis in virtual currency is the amount spent to acquire the virtual currency, including fees, commissions, and other acquisition costs in U.S. dollars. The basis of virtual currency exchanged for other property is the FMV of the property at the time of the exchange.

Virtual Currency Received for Services. The basis for virtual currency received in exchange for services is the FMV of the virtual currency when the individual received it. If the virtual currency is not traded on any exchange and does not have a published value, then the FMV of the virtual currency received is the FMV of the property or services exchanged when the transaction occurred.

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Practitioner Planning Tip

Businesses who accept virtual currency add a layer of complexity which a practitioner may need to sort out to determine the profit or loss for the enterprise. Calculating gross income from payments in BTC is relatively straightforward in that the taxpayer can determine immediately the USD value of BTC received which is likely the amount of payment they received for services rendered in USD. The complication comes into play with the next transaction. For example, the business who received BTC then pays for office supplies with BTC. While the USD value for the supplies received is not at question, how much BTC had to be transferred to purchase the supplies will result in gain or loss to the business.

Virtual Currency Received for Property. The basis in virtual currency an individual receives in exchange for property is the FMV of the virtual currency (in USD) when the taxpayer receives the virtual currency.

Property Received for Virtual Currency. An individual who transfers virtual currency in exchange for property takes a basis in the property equal to the property's FMV at the time of the exchange. The transaction must be at arm's length.

Example 35. Zelda owns and operates a bed and breakfast in Silicon Valley. She accepts payment for services in BTC as well as in cash. Additionally, Zelda compensates her cleaning person, Stella, quarterly in BTC. During 2021, Zelda rents out her house to three separate parties who pay in virtual currency. At the end of the year, Zelda's portfolio management company provides her with the following transaction report.

Timestamp	Transaction Type	Asset	Quantity Transacted	USD Spot Price at Transaction	Total (Inclusive of Fees)	BTC Balance	Notes (Including Transaction Number)
Jan. 1, 2021 1201AM						0.2195916	Opening balance
Feb. 14, 2021 1149AM	Receive	BTC	0.0184737	48717.29	\$ 900 ^a	0.2380653	Washington Family Valentine stay (1CB56C)
Mar. 15, 2021 0908AM	Transfer (capital transaction)	BTC	0.0536604	55907.20	(3,000)	0.1844049	Stella's quarterly payment for services
May 12, 2021 0140PM	Receive	BTC	0.0052543	57095.96	300 ^b	0.1896592	Stevenson overnight stay (4KJ92N)
Jun. 15, 2021 0914AM	Transfer (capital transaction)	BTC	0.0742459	40406.27	(3,000)	0.1154133	Stella's quarterly payment for services
Jul. 6, 2021 1254PM	Receive	BTC	0.0611161	34360.82	2,100 ^c	0.1765294	Walken's weeklong vacation (8YB38R0)
Sep. 15, 2021 0909AM	Transfer (capital transaction)	BTC	0.0924797	32439.54 ^d	(3,000)	0.0840497	Stella's quarterly payment for services
Dec. 15, 2021 0907AM	Transfer (capital transaction)	BTC	0.0753648	39806.41 ^d	(3,000)	0.0086849	Stella's quarterly payment for services

^a Zelda's basis in the BTC from the Washingtons is \$900, the FMV of the BTC when she received it.

^b Zelda's basis in the BTC from Stevenson is \$300, the FMV of the BTC when she received it.

^c Zelda's basis in the BTC from the Walkens is \$2,100, the FMV of the BTC when she received it.

^d Hypothetical amounts.

Zelda reports ordinary income of \$3,300 (\$900 + \$300 + 2,100) from the three transactions, (the \$3,300 is the basis in the BTC received) in addition to her other income paid in cash. She is entitled to an ordinary and necessary business expense of \$12,000 for the amounts paid to Stella.

Note. Zelda needs to recognize gain or loss each time she pays Stella for services with BTC. Assuming she had not held any BTC over one year, the gain or loss would be short term. Stella has basis in the BTC received of \$12,000. Gain or loss is determined when the BTC is disposed (sold or exchanged for property or services). Her holding period began on the date Zelda made the payment and the character of the gain (short- or long- term) is determined from the date of payment by Zelda to Stella.

Charitable Contribution¹⁸⁶

An individual who donates virtual currency to a qualifying charity is eligible for a charitable contribution deduction. The individual does not recognize income, gain, or loss on the donation. The amount of the deduction if the taxpayer held the virtual currency longer than one year is the FMV (in USD) of the virtual currency at the time of the contribution. If the taxpayer held the virtual currency one year or less, the deduction is the lesser of the taxpayer's basis in the virtual currency or the FMV of the virtual currency at the time of the donation.

Gifts¹⁸⁷

An individual who receives virtual currency as a bona fide gift does not recognize income until they sell, exchange, or dispose of the virtual currency. The recipient's basis in the virtual currency depends on whether they have a gain or loss when they dispose of it. For a gain, the basis is the donor's basis plus any gift tax the donor paid on the gift. For a loss, the basis is the lesser of the donor's basis or the FMV of the virtual currency when the individual received the gift. If the recipient does not have any documentation to substantiate the donor's basis, the recipient has zero basis in the gifted virtual currency.

The holding period for gifted virtual currency includes the time the virtual currency was held by the donor. If the recipient does not have substantiation from the donor, the holding period begins on the day after they receive the virtual currency.

Example 36. For Brendan's 10th birthday on April 15, 2021, his uncle sent him 0.00158 BTC (equivalent to \$100 USD). His uncle's basis in the BTC of \$70. This was the only gift his uncle made during the year, and therefore the uncle was not required to pay any gift tax.

Six years later, Brendan sells the BTC to buy a used car. When he sells the 0.00158 BTC on April 15, 2027, it is valued at \$7,500 USD. Because Brendan sold the BTC for a gain, his basis is his uncle's basis of \$70. Brendan held the Bitcoin for more than one year and therefore, his long-term capital gain is \$7,430 (\$7,500 – \$70 basis).

Foreign Reporting

Financial Crimes Enforcement Network (FinCEN). The Bank Secrecy Act (BSA)¹⁸⁸ requires an annual report to the Treasury Secretary¹⁸⁹ from U.S. persons who have financial interests in or signature authority over foreign financial accounts. FinCEN is the bureau within the Treasury Department with the responsibility to implement, administer, and enforce compliance with the BSA.

^{186.} *Frequently Asked Questions on Virtual Currency Transactions*. Jun. 4, 2021. IRS. [www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions] Accessed on Jul. 14, 2021.

^{187.} *Ibid.*

^{188.} Titles I and II of the *Bank Secrecy Act of 1970*, PL 91-508, as amended, codified at 12 USC 1829b, 12 USC 1951–1959, and 31 USC 5311–314 and 5316–5332.

^{189.} 31 CFR 1010.

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FinCEN's purpose is stated as follows.¹⁹⁰

FinCEN's mission is to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.

Under FinCEN regulations, U.S. persons are required to file a Report of Foreign Bank and Financial Accounts (FBAR) with the Treasury Department if:¹⁹¹

- They had a financial interest in or signature authority over at least one financial account located outside of the United States, and
- The aggregate value of all foreign financial accounts exceeded \$10,000 at any time during the calendar year to be reported.

The FBAR regulations originally did not identify foreign accounts containing virtual currency as a reportable account.¹⁹² In 2020, FinCEN issued Notice 2020-2 to amend the regulations to include reporting virtual currency on an FBAR. Additionally, in December 2020, FinCEN issued a Notice of Proposed Rulemaking discussing financial reporting concerns regarding convertible virtual currency (CVC) and legal tender digital assets (LTDA).¹⁹³

On January 1, 2021, the Anti-Money Laundering Act of 2020 (AMLA)¹⁹⁴ became law and amended what “monetary instruments” are covered under the BSA. The definition now defines monetary instruments as “United States coins and currency.” FinCEN considers CVC and LTDA similar to coins and currency of a foreign country, and **therefore holders of virtual currency have a reporting requirement.**

FinCEN anticipates holders of virtual currency report the following information.¹⁹⁵

- Type of CVC or LTDA in the transaction
- Transaction amount
- Assessed transaction value in U.S. dollars
- Date and time of the transaction
- The transaction unique identification number (hash)¹⁹⁶
- CVC or LTDA address involved in the transaction and if they are hosted or unhosted¹⁹⁷
- Name and physical address of each counterparty to the transaction of the financial institution's customer
- Other information readily available to the bank to help identify the specific reported transaction(s), how it was conducted, and the parties involved.

^{190.} *What We Do*. Financial Crimes Enforcement Network. [www.fincen.gov/what-we-do] Accessed on Jul. 15, 2021.

^{191.} 31 CFR 103.27.

^{192.} See 31 CFR 1010.350(c).

^{193.} *Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets*. Jan. 15, 2021. FinCen. [www.federalregister.gov/documents/2021/01/15/2021-01016/requirements-for-certain-transactions-involving-convertible-virtual-currency-or-digital-assets] Accessed on Jul. 16, 2021.

^{194.} *Anti-Money Laundering Act of 2020*, PL 116-283, Div. F.

^{195.} *Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets*. Jan. 15, 2021. FinCen. [www.federalregister.gov/documents/2021/01/15/2021-01016/requirements-for-certain-transactions-involving-convertible-virtual-currency-or-digital-assets] Accessed on Jul. 16, 2021.

^{196.} See definition of transaction hash at *What is a transaction hash/hash ID?* Coinbase. [help.coinbase.com/en/coinbase/getting-started/crypto-education/what-is-a-transaction-hash-hash-id] Accessed on Jul. 16, 2021.

^{197.} Hosted is supported by a financial institution whereas unhosted are not associated with a financial institution. See *FinCEN Extends Comment Period for Rule Aimed at Closing Anti-Money Laundering Regulatory Gaps for Certain Convertible Virtual Currency and Digital Asset Transactions*. Jan. 14, 2021. FinCEN. [www.fincen.gov/news/news-releases/fincen-extends-comment-period-rule-aimed-closing-anti-money-laundering] Accessed on Jul. 16, 2021.

Foreign Account Tax Compliance Act (FATCA). U.S. taxpayers with foreign financial assets with an aggregate value of more than the reporting threshold (at least \$50,000; \$100,000 for MFJ) are required under FATCA to report information for those assets on Form 8938, *Statement of Specified Foreign Financial Assets*. Form 8938 must be attached to the taxpayer's income tax return.¹⁹⁸

As mentioned in the previous section, virtual currency does not currently qualify **under the BSA** as a foreign financial account. However, virtual currency in foreign accounts may qualify **under FATCA** as a foreign financial account. Therefore, FATCA filing requirements apply to taxpayers who hold virtual currency in foreign accounts.¹⁹⁹



Practitioner Planning Tip

Failing to report when a taxpayer has a FATCA obligation can result in substantial penalties, criminal penalties, and intentional violations. Tax practitioners should inquire of their clients whether they meet the FATCA filing thresholds.

HARD FORKS, SOFT FORKS, AND AIRDROPS²⁰⁰

A **hard fork** occurs when a cryptocurrency undergoes a protocol change resulting in a permanent diversion from the legacy distributed ledger. This may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. Essentially, one cryptocurrency becomes two cryptocurrencies, similar to a stock split. In a hard fork, the two new versions of software are not compatible with each other.²⁰¹

If the taxpayer's cryptocurrency goes through a hard fork but the taxpayer did not receive any new cryptocurrency, whether through an **airdrop** (a distribution of cryptocurrency to multiple taxpayers' distributed ledger addresses) or some other kind of transfer, there is no taxable income. If a hard fork is followed by an airdrop and the taxpayer receives new virtual currency, the taxpayer has taxable ordinary income. The ordinary income is the FMV of the new virtual currency when the taxpayer receives it (i.e., when the transaction is recorded on the distributed ledger), assuming the taxpayer has dominion and control over the virtual currency (i.e., can sell, dispose, transfer, or exchange the virtual currency.)

The taxpayer's basis in the virtual currency following a hard fork is the FMV of the cryptocurrency when they receive it.

Example 37. Arden has 50 units of Ethereum when it undergoes a hard fork. The hard fork creates a new virtual currency, Ethereum Classic. Ethereum Classic is not airdropped or otherwise transferred into an account that Arden maintains. Therefore, Arden did not receive any units of Ethereum Classic and does not have any gross income because of the hard fork.²⁰²

¹⁹⁸. *Summary of FATCA Reporting for U.S. Taxpayers*. Jan. 7, 2021. IRS. [www.irs.gov/businesses/corporations/summary-of-fatca-reporting-for-us-taxpayers] Accessed on Jul. 16, 2021.

¹⁹⁹. *FinCEN Seeks to Establish FBAR Requirement for Cryptocurrency Accounts in 2021*. May 27, 2021. The National Law Review. [www.natlawreview.com/article/fincen-seeks-to-establish-fbar-requirement-cryptocurrency-accounts-2021] Accessed on Jul. 16, 2021.

²⁰⁰. *Frequently Asked Questions on Virtual Currency Transactions*. Jun. 4, 2021. IRS. [www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions] Accessed on Jul. 14, 2021.

²⁰¹. *Understanding Hard Forks in Cryptocurrency*. CryptoCurrency Facts. [cryptocurrencyfacts.com/understanding-hard-forks-cryptocurrency] Accessed on Jul. 14, 2021.

²⁰². The facts of this example are based on the situation addressed in Rev. Rul. 2019-24, 2019-44 IRB 1004.

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Example 38. Miles holds 50 units of Cryptomaster. On September 1, 2021, the distributed ledger for Cryptomaster undergoes a hard fork. The hard fork creates ZombieCoin, a type of cryptocurrency. On September 1, 2021, 25 units of ZombieCoin are airdropped into Miles' distributed ledger. Miles can dispose of ZombieCoin immediately following the airdrop. Therefore, Miles owns 50 units of Cryptomaster and 25 units of ZombieCoin.²⁰³

At the time ZombieCoin is reported on the distributed ledger, the FMV of Miles' 25 units is \$50. Because Miles received a new asset in the airdrop after the hard fork, he has ordinary income of \$50 in 2021 once he has dominion and control over ZombieCoin. Miles' basis in the 25 units of ZombieCoin is \$50; the amount of income he recognized.

In a **soft fork**, a distributed ledger undergoes a protocol change that does not result in a diversion of the ledger. This does not create a new cryptocurrency. The taxpayer is in the same position after the soft fork as they were before, and therefore, do not have any income to recognize.

ORGANIZER QUESTIONS

With IRS's increased scrutiny of virtual currency, tax practitioners should consider adding questions to their client organizer to determine if a taxpayer has a reportable virtual currency transaction. The following table outlines sample questions to include.

Question	Answer
Did you buy, sell, or exchange any virtual currencies including cryptocurrency? If yes, please provide details on the transaction(s) including the date, amount in USD, holding period, and any additional relevant information to determine taxability.	
Did you receive any Forms 1099-MISC from a virtual currency platform?	
Did you mine virtual currency during the year? If yes, this is a Schedule C activity and you must provide additional details on the income, expenses, profit motive, and other relevant information. The activity may be subject to self-employment tax.	
Were you paid for goods or services in virtual currency? Conversely, did you pay any employees in virtual currency?	
Did you donate any virtual currency to a charitable organization?	
Did you receive any gifts of virtual currency? Do you have all the necessary basis and holding period information for the donor?	
Did you buy, sell, and maintain any virtual currency held outside of the United States?	
Did you hold any cryptocurrency that underwent a hard or soft fork during the year?	

²⁰³. Ibid.