



Earned Income Credit (EIC)



Introduction

This lesson covers the earned income credit (EIC). There are several common errors associated with claiming this credit on the return. The Volunteer Resource Guide and the intake and interview sheet are critical tools in avoiding these mistakes.

Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer is eligible for the earned income credit
- Calculate the earned income credit

What do I need?

- Form 13614-C
 - Publication 4012
 - Publication 17
 - Form 1040 and Instructions
 - Form 8862
- Optional:**
- Publication 596
 - Schedule EIC

What is the EIC?

The earned income credit (EIC) is a refundable tax credit for most people who work but do not earn high incomes. The purpose of the EIC is to reduce the tax burden and to supplement the wages of working families whose earnings are less than the maximums for their filing status. Eligible taxpayers can receive a refund with this credit, even if they have no filing requirement, owe no tax, and had no income tax withheld. All taxpayers and dependents must have valid Social Security numbers by the due date of the return (including extensions) to claim the credit. The refund for taxpayers claiming the EIC will not be issued prior to February 15.

The EIC can be a very valuable credit. The EIC was permanently expanded to allow families to claim credit for three or more children. The EIC amounts are adjusted for inflation every year.

The EIC is reported on its own line on the tax return.

How does a taxpayer qualify for the EIC?

There are general sets of rules for claiming the earned income credit:

- Rules for everyone
- Rules for taxpayers with a qualifying child
- Rules for taxpayers who do not have a qualifying child

What rules apply to everyone?

The taxpayer must meet all the rules to qualify for the earned income credit. Turn to the chart titled Summary of EIC Eligibility Requirements in the Volunteer Resource Guide, Tab I, Earned Income Credit. Review Part A, Rules for Everyone, and Part D, Earned Income and AGI Limitations.



Both earned income and adjusted gross income must be below the income limits in order for the taxpayer to qualify for the EIC. These amounts are adjusted for inflation every year.



Individual Taxpayer Identification Numbers (ITINs) and Adoption Taxpayer Identification Numbers (ATINs) cannot be used when claiming the EIC. If a couple is filing a joint return, both spouses and all qualifying children must have an SSN that is valid for work by the due date of the return. Taxpayers cannot file an amended return retroactively for any year in which they did not have a valid Social Security number by the due date of the return (including extensions).

example

James and Jill are filing a joint return and both have valid SSNs. They have two daughters; Susie has a valid SSN and Sally has an ITIN. Only the daughter with the valid SSN may qualify the tax return for EIC.



There is a limit to the amount of investment income a person can receive and still qualify for the EIC. See the Volunteer Resource Guide, Tab I, Earned Income Credit, Summary of EIC Eligibility Requirements for the investment income limit. Investment income includes such items as taxable interest and dividends, tax-exempt interest, capital gain net income, and income from residential rental property.

What is “earned” income for EIC purposes?

Earned income includes wages, salaries, tips, and other taxable employee pay. Turn to the Earned Income Table in the Volunteer Resource Guide, Tab I, Earned Income Credit, for examples of earned income.

One type of payment considered earned income is “taxable long-term disability benefits received prior to minimum retirement age.” Refer to the Retirement Income lesson earlier for additional information.



Tax Software Hint: Volunteers using software must check the box in the Rollover or Disability section of the Form 1099-R input screen to report disability as wages. To review information on reporting disability income for a person under retirement age, go to the Volunteer Resource Guide, Tab D, Income.

What about combat pay?

Combat pay is never taxable to most soldiers. Members of the U.S. Armed Forces who served in a combat zone may elect to include their nontaxable combat pay in their earned income for the purposes of computing this credit. Doing this may increase or decrease the taxpayer’s EIC. Figure the EIC amount with and without the pay before making the election. If the election is made, *all* of the nontaxable combat pay must be included. If both spouses filing a joint return have combat pay, they can individually choose to make the election on the tax return.



Tax Software Hint: If a taxpayer has combat pay listed in Box 12 of Form W-2 marked with code Q, the software will determine if the combat pay should or should not be added to the taxpayer’s income.

What about self-employment income?

Net earnings from self-employment are considered earned income. For most taxpayers within the scope of the VITA/TCE programs, “net earnings” for EIC purposes will be the amount reported as business income minus the deductible portion of the self-employment tax that is reported on Form 1040, Schedule 1.

example

Jeff’s self-employment income reported on Form 1040 is \$2,000. The deductible portion of his self-employment tax, which is recorded on Schedule 1 of Form 1040, is \$142.

His income for EIC purposes is $\$2,000 - \$142 = \$1,858$.

Reminder: Nonwage income received for doing work (such as for side jobs or contract labor) is self-employment income, even for taxpayers who do not think of themselves as “self-employed.” **All self-employment income and expenses are required** to be reported on Schedule C, Profit or Loss from Business. Taxpayers not meeting the VITA/TCE programs’ requirements for filing Schedule C will need to seek the assistance of a professional tax preparer.



An IRS certified volunteer tax preparer must exercise due diligence when preparing or assisting in the preparation of, approving, and filing tax returns. Although a volunteer tax preparer may rely on good faith on information provided by the taxpayer without requiring documentation as verification, the tax preparer must ask questions if the information furnished appears to be incorrect, inconsistent, or incomplete.

What about household employee income?

Domestic employees such as housekeepers are only issued Form W-2 if their earnings are more than a certain amount. Refer to Publication 926, Household Employer’s Guide, for tax year amounts. The income should be added to wages on Form 1040. This income should also be included when calculating the EIC.

What about Medicaid waiver payments?

Certain Medicaid waiver payments may be excluded from income under Notice 2014-7. Refer to the Wages, Interest, Etc. lesson for details. Even though excluded, these payments may be included in earned income if there is benefit from the inclusion.

Earned income not qualifying for the EIC

One income item that is reported on Form W-2 but does not qualify as earned income for EIC purposes, is income received for work performed while an inmate in a penal institution. Generally, excluded income is not earned income for EIC purposes – an exception is made for Medicaid waiver payments as noted above. Refer to the Volunteer Resource Guide, Tab I, Earned Income Credit.



Tax Software Hint: Income received for work while an inmate is in a penal institution must be entered in the Less Common Income, Other Compensation, then Prisoner Earned Income line.



EXERCISES

Use the Summary of EIC Eligibility Requirements Chart in the Volunteer Resource Guide, Tab I, Earned Income Credit, to answer the following questions. Answers follow the lesson summary.

Question 1: A taxpayer is filing as Married Filing Separately. Does this taxpayer qualify for the EIC?

Yes No

Question 2: A taxpayer has interest income of \$4,500. His earned income is only \$7,000. He is single, has a valid Social Security number and is not the qualifying child of anyone else. Does he qualify for the EIC? Yes No

What are the rules for taxpayers with qualifying children?

The taxpayer can file Form 1040 to claim the EIC with a qualifying child. The taxpayer has a qualifying child for EIC purposes if the child meets **all** the tests outlined in the Volunteer Resource Guide, Tab I, Earned Income Credit. A short version of the rules is shown in Part B, Rules If You Have a Qualifying Child. A detailed version is on the next page of the Volunteer Resource Guide.

example

Jane, 31, and Todd, 33, have an 8-year-old daughter, Amanda. All are U.S. citizens and have valid SSNs. Jane and Todd have never been married. Jane and Amanda lived together all year in an apartment. Todd lived alone. Jane earned \$15,000 working as a clerk in a clothing store. Todd is an assistant manager of a hardware store and earned \$48,000. He paid over half Jane's rent and utilities, and also gave Jane extra money for groceries.

Todd does not pay any expenses or support for any other family member. Although Todd provided over half the cost of a home for Jane and Amanda, he cannot file Head of Household and he cannot claim the child for EIC, since Amanda did not live with him more than half the year. Jane cannot file as Head of Household either. Review the Filing Status for Head of Household rules in the Volunteer Resource Guide, Tab B, Starting a Return and Filing Status.

Jane is the only one who can claim Amanda as a qualifying child for EIC. Review the Earned Income Credit rules in the Volunteer Resource Guide, Tab I, Earned Income Credit.



For EIC purposes, a qualifying child does *not* have to be the taxpayer's dependent (unless the child is married). In the case of divorced or separated parents, the custodial parent (with whom the child lived for more than half the year) can qualify for the EIC regardless of whether or not they claim the child as a dependent. The noncustodial parent cannot qualify for EIC because the child did not live with them for more than half the year.

What are the rules for a qualifying child of more than one person?

A child who meets the conditions to be a qualifying child of more than one person can only be claimed by one taxpayer for the EIC.

Using the EIC With a Qualifying Child Chart from the Volunteer Resource Guide, Tab I, Earned Income Credit, based on what we have learned so far about Robyn and her family:

example

Robyn is 25 years old. She and her 2-year-old son, Aiden, lived with Robyn's mother all year. Aiden has a valid Social Security number.

Step 1 is YES

Step 2 is YES

Step 3 is YES

Step 4 is NO

Step 5 is YES



Taxpayers have the option to choose which taxpayer will claim the child. The IRS applies tiebreaker rules when the child is claimed by multiple taxpayers.

For Step 6, check to see if Aiden can be anyone else's qualifying child, for EIC purposes.

Who else lived in the house that is related to Aiden? Robyn's mother also lives with them. Go through the steps to see if Aiden can be a qualifying child for Robyn's mother.

If the taxpayer can't claim the EIC because the qualifying child is treated under the tiebreaker rules as the qualifying child of another person, the taxpayer may be able to take the EIC using a different qualifying child, or take the EIC if they qualify using the rules for people who don't have a qualifying child. See the Qualifying Child of More than One Person rules in the Volunteer Resource Guide, Tab I, Earned Income Credit.

What are the rules for taxpayers without qualifying children?

Taxpayers can claim the EIC without a qualifying child. Confirm that the taxpayer and spouse cannot be claimed as dependents by their parents or anyone else. Review the rules in the Volunteer Resource Guide, Tab I, Earned Income Credit, under Part C, Rules If You Don't Have a Qualifying Child.



Taxpayers turning 25 on January 1 are considered to be of age as of December 31. Taxpayers reaching the age of 65 on January 1 are still considered 64 as of December 31. Taxpayers in either of these situations whose return is rejected may need to file a paper return.



For a couple filing a joint return, only one taxpayer has to meet the age requirement.

example

Tom and Martha are a married couple. Tom is 66 and Martha is 58 years old. If all other rules are met, they would qualify for the EIC.



EXERCISES (continued)

Using the EIC charts in the Volunteer Resource Guide, determine if each of these taxpayers has a qualifying child or can claim the EIC. Each taxpayer and child has a valid Social Security number.

Question 3: Maureen's 20-year-old daughter, Angie, lived with her for eight months of the year. Angie is not married and is a full-time college student. Is Angie a qualifying child for the EIC? Yes No

Question 4: Three children live with Mira, who cares for them as her own: Twila, the 3-year-old daughter of Mira's cousin; Chez, Mira's newly adopted 2-year-old son from Europe, who has lived with Mira since November of the tax year; and Dwight, Mira's 20-year-old son, who attends community college part time. Which of them are qualifying children? Twila Chez Dwight None

Question 5: Margie's daughter, Aimee, turned 23 early in the tax year while attending college full time. Margie is filing as Head of Household. Margie has an AGI of \$31,000. Assuming that she and her daughter pass all other tests, can Margie claim the EIC? Yes No

Question 6: Rob and Laura are divorced. Laura is the custodial parent for Dawn, who lived with her all year. Laura signed Form 8332, allowing Rob to claim Dawn as a dependent until she turns 18. Can Rob claim Dawn for the EIC? Yes No

Question 7: Jewel and her daughter lived with Jewel's brother, Emmitt all year. Jewel earns \$20,000 and claims her daughter as the qualifying child for the EIC. Emmitt is 25 years old and earned \$8,500. Is Emmitt able to claim the EIC for a taxpayer without a qualifying child? Yes No

Question 8: Larry is 35 years old and unmarried. Larry lives with his brother, Jeff, who is unmarried and totally and permanently disabled. Jeff receives disability income that is used to pay for more than half of his support. Can Larry claim Jeff as a qualifying child for EIC? Yes No

How should I handle a taxpayer whose EIC was disallowed in a prior year?

The intake and interview sheet asks if the taxpayer was previously disallowed EIC in a prior year because special rules apply. If the taxpayer answers “yes” to this question, refer to the Volunteer Resource Guide, Tab I, Earned Income Credit, Disallowance of Certain Refundable Credits.



Form 8862, Information to Claim Certain Credits After Disallowance, must be completed when required or the return will be rejected.

How is the correct EIC amount calculated?

The software computes EIC using worksheets and the Earned Income Credit tables. The EIC worksheets can be found in Publication 596, Earned Income Credit, or Form 1040 Instructions. The software completes Schedule EIC and EIC worksheets that can be reviewed with the taxpayer if they have questions about how EIC was computed.



When reviewing the Form 1040 Instructions, it is common to mistake the Tax Tables for the EIC tables. Double-check that the heading on the page you are using is “Earned Income Credit (EIC) Table.”

Class Exercise

A taxpayer is filing Head of Household and has one qualifying child. The earned income and AGI is \$19,000. How much EIC is the taxpayer entitled to?

Turn to the first page of the EIC tables. Find the amount in the “At least - But less than” column. Find the correct filing status column: Single, head of household and qualifying widow(er), or in a separate column, married filing jointly. There are subcolumns for the number of qualifying children.

Summary

The earned income credit computation is based on filing status, number of qualifying children, earned income, and adjusted gross income. Certain individuals with no children may also qualify.

By using the intake and interview sheet, the EIC charts in the Volunteer Resource Guide and correctly entering the taxpayer’s data in the software, most of the errors that result from incorrectly computing the EIC can be avoided.

The EIC is entered on its own line of the return.



TAX LAW APPLICATION

To gain a better understanding of the tax law, complete the practice return(s) for your course of study using the Practice Lab on L<.



EXERCISE ANSWERS

Answer 1: No. Married Filing Separately does not qualify for the EIC.

Answer 2: No. His investment income exceeds the limit.

Answer 3: Yes. Daughter Angie meets all the eligibility tests to be a qualifying child.

Answer 4: None of the children under Mira's care are qualifying children for the EIC. Twila does not meet the relationship test, Chez does not meet the residency test, and Dwight does not meet the age test.

Answer 5: Yes. Margie meets the general eligibility requirements and Aimee meets the Qualifying Child rules.

Answer 6: No. While Rob can claim his daughter as a dependent, the daughter did not live with him for more than half the year, so she fails the residency test. Dawn is the qualifying child of Laura.

Answer 7: Yes. Jewel's daughter is not the qualifying child of Emmitt, but he can claim the EIC for a taxpayer without a qualifying child.

Answer 8: Yes, Jeff is Larry's qualifying child for EIC. Jeff is not Larry's dependent because he provides more than half of his own support; but the support test does not apply for EIC.

