

# AOC WORKBOOK PRACTICE PROBLEMS

**If there are missing facts like addresses, etc. that do not impact the tax return numbers, make them up.**

## Problem 1

Fred, age 67, and Wilma, age 58, are married. They elect to file Married Filing Jointly. Fred's SSN is 127-00-1111 and his date of birth is 7/15/1954. Wilma's SSN is 128-00-1111 and her date of birth is 1/30/1963.

Fred is retired. He received Social Security benefits of \$9,000 and a pension. Wilma received a Form W-2 for her job as a clerk.

Fred and Wilma have one son, Stephen, age 18. His SSN is 129-00-1111 and his date of birth is 9/3/2003. Stephen is a full-time college student in his second year of study. He is pursuing a degree in Music and does not have a felony drug conviction. He received a Form 1098-T for 2021.

Stephen spent the summer at home with his parents but lived in an apartment near campus during the school year. He had earnings of \$3,500 from a summer job which he saved towards buying a new car.

Stephen received a scholarship. Fred and Wilma paid the cost of Stephen's tuition and course-related books in 2021 not covered by his scholarship. Stephen had to pay \$90 for a parking sticker, \$4,500 for a meal plan, \$500 for textbooks purchased at the college bookstore, and \$100 for access to an online textbook in addition to the amounts shown on his 1098-T. Fred and Wilma provided all of his support not covered by the scholarship.

| <input type="checkbox"/> CORRECTED   |   |  |   | OMB No. 1545-1574  | <b>Tuition Statement</b> |                          |  |
|--|---|--|---|--|--------------------------|--------------------------|--|
| FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number |   | 1 Payments received for qualified tuition and related expenses |   | 2021   |                          |                          |  |
| RUBBLE UNIVERSITY<br>900 COLLEGE BLVD<br>YOUR CITY, YOUR STATE, ZIP  |   | \$ 8,700.00  | 2 |  | Form 1098-T              |                          |  |
| FILER'S employer identification no.  | STUDENT'S TIN   | 3  |   | <b>Copy B For Student</b><br><br><small>This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.</small> |                          |                          |  |
| 89-700XXXX   | 129-00-XXXX   |  |   |  |                          |                          |  |
| STUDENT'S name   |   | 4 Adjustments made for a prior year                            |   |  |                          | 5 Scholarships or grants |  |
| STEPHEN JONES  |   | \$   |   |  |                          | \$ 6,800.00              |  |
| Street address (including apt. no.)  |   | 6 Adjustments to scholarships or grants for a prior year       |   | 7 Checked if the amount in box 1 includes amounts for an academic period beginning January–March 2022 <input type="checkbox"/>   |                          |                          |  |
| 100 STONE STREET   |   | \$   |   |  |                          |                          |  |
| City or town, state or province, country, and ZIP or foreign postal code   |   |  |   |  |                          |                          |  |
| YOUR CITY, YOUR STATE, ZIP   |   |  |   |  |                          |                          |  |
| Service Provider/Acct. No. (see instr.)  | 8 Checked if at least half-time student <input checked="" type="checkbox"/> | 9 Checked if a graduate student <input type="checkbox"/>       |   | 10 Ins. contract reimb./refund   |                          |                          |  |
|  |   |  |   | \$   |                          |                          |  |
| Form 1098-T  |   | (keep for your records)  |   | www.irs.gov/Form1098T Department of the Treasury - Internal Revenue Service  |                          |                          |  |

|   |  |                   |  |                              |   |  |                     |   |                            |  |
|---|--|-------------------|--|------------------------------|---|--|---------------------|---|----------------------------|--|
| a Employee's social security number<br><b>128-00-XXXX</b>   |  | OMB No. 1545-0008 |  | Safe, accurate,<br>FAST! Use |   |  |                     | Visit the IRS website at<br>www.irs.gov/efile |                            |  |
| b Employer identification number (EIN)<br><b>35-600XXXX</b>   |  |                   | 1 Wages, tips, other compensation<br><b>\$42,000.00</b>  |                              | 2 Federal income tax withheld<br><b>\$2,700.00</b>      |  |                     |   |                            |  |
| c Employer's name, address, and ZIP code<br><br><b>STONE STREET MARKET<br/>500 PEBBLES<br/>YOUR CITY, YOUR STATE, ZIP</b>         |  |                   | 3 Social security wages<br><b>\$42,000.00</b>  |                              | 4 Social security tax withheld<br><b>\$2,604.00</b>     |  |                     |   |                            |  |
|   |  |                   | 5 Medicare wages and tips<br><b>\$42,000.00</b>  |                              | 6 Medicare tax withheld<br><b>\$609.00</b>              |  |                     |   |                            |  |
|   |  |                   | 7 Social security tips   |                              | 8 Allocated tips  |  |                     |   |                            |  |
| d Control number  |  |                   | 9  |                              | 10 Dependent care benefits                              |  |                     |   |                            |  |
| e Employee's first name and initial Last name Suff.<br><br><b>WILMA JONES<br/>100 STONE STREET<br/>YOUR CITY, YOUR STATE, ZIP</b> |  |                   | 11 Nonqualified plans  |                              | 12a See instructions for box 12<br><b>DD \$2,300.00</b> |  |                     |   |                            |  |
|   |  |                   | 13 Statutory employee <input type="checkbox"/> Retirement plan <input checked="" type="checkbox"/> Third-party sick pay <input type="checkbox"/> |                              | 12b   |  |                     |   |                            |  |
|   |  |                   | 14 Other   |                              | 12c   |  |                     |   |                            |  |
|   |  |                   |  |                              | 12d   |  |                     |   |                            |  |
| f Employee's address and ZIP code   |  |                   | 15 State Employer's state ID number<br><b>YS 35-600XXXX</b>  |                              | 16 State wages, tips, etc.<br><b>\$42,000.00</b>        |  | 17 State income tax |   | 18 Local wages, tips, etc. |  |
|   |  |                   | 19 Local income tax  |                              | 20 Locality name  |  |                     |   |                            |  |

Form **W-2** Wage and Tax Statement **2021** Department of the Treasury—Internal Revenue Service  
**Copy B—To Be Filed With Employee's FEDERAL Tax Return.**  
This information is being furnished to the Internal Revenue Service.

|  |  |  |  |   |  |  |  |
|--|--|--|--|---|--|--|--|
|  |  | <input type="checkbox"/> CORRECTED (if checked)  |  | OMB No. 1545-0119   |  | Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.  |  |
| PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.<br><br><b>BRADFORD INC.<br/>2605 STATE STREET<br/>YOUR CITY, YOUR STATE, ZIP</b> |  | 1 Gross distribution<br><b>\$ 10,000.00</b>  |  | <b>2021</b>   |  | <b>Copy B</b><br>Report this federal income tax withheld in box 4, attach this copy to your return.<br><br>This information is being furnished to the IRS. |  |
|  |  | 2a Taxable amount<br><b>\$ 10,000.00</b>   |  | Form <b>1099-R</b>  |  |  |  |
|  |  | 2b Taxable amount not determined <input type="checkbox"/>                                  |  | Total distribution <input type="checkbox"/>                         |  |  |  |
| PAYER'S TIN<br><b>40-100XXXX</b>   |  | RECIPIENT'S TIN<br><b>127-00-XXXX</b>  |  | 3 Capital gain (included in box 2a)<br><b>\$</b>                    |  | 4 Federal income tax withheld<br><b>\$ 2,500.00</b>  |  |
| RECIPIENT'S name<br><br><b>FRED JONES</b>  |  | 5 Employee contributions/ Designated Roth contributions or insurance premiums<br><b>\$</b> |  | 6 Net unrealized appreciation in employer's securities<br><b>\$</b> |  |  |  |
| Street address (including apt. no.)<br><b>100 STONE STREET</b>   |  | 7 Distribution code(s)<br><b>7</b>   |  | 8 Other<br><b>\$ %</b>  |  |  |  |
| City or town, state or province, country, and ZIP or foreign postal code<br><b>YOUR CITY, YOUR STATE, ZIP</b>  |  | 9a Your percentage of total distribution<br><b>%</b>                                       |  | 9b Total employee contributions<br><b>\$</b>                        |  |  |  |
| 10 Amount allocable to IRR within 5 years<br><b>\$</b>   |  | 11 1st year of desig. Roth contrib.  |  | 12 FATCA filing requirement<br><input type="checkbox"/>             |  | 14 State tax withheld<br><b>\$</b>   |  |
| 13 Date of payment   |  | 15 State/Payer's state no.   |  | 16 State distribution<br><b>\$</b>                                  |  |  |  |
| Account number (see instructions)  |  | 17 Local tax withheld<br><b>\$</b>   |  | 18 Name of locality   |  | 19 Local distribution<br><b>\$</b>   |  |

Form **1099-R** www.irs.gov/Form1099R Department of the Treasury - Internal Revenue Service

For each scenario, answer the following questions.

1. Who will claim the AOC – Stephen or his parents?
2. What is the amount of Qualified Educational Expenses allocated to the AOC?
3. What is the amount of the nonrefundable AOC, refundable AOC, and total AOC on the tax return where it is claimed?
4. What is the amount of Stephen's scholarship income?
5. Does Stephen have a filing requirement?

**Scenario 1** – The scholarship by its terms must be used for tuition.

**Scenario 2** – The scholarship is a Pell Grant.

**Scenario 3** – The scholarship is a Pell Grant and instead of being for \$6,800 was for \$10,800.

**Scenario 4** – Same as Scenario 2 (scholarship was \$6,800). In addition, rather than earning \$3,500 in his summer job, Stephen earned \$10,000, which was less than half of his total support excluding the scholarship. His parents continued to provide more than half of his support excluding the scholarship.

**Scenario 5** – Same as Scenario 4, except his scholarship amount shown on the 1098-T was \$10,000 and he earned \$9,000, which was still less than half of his total support.

Suggestions for how to approach the problem

- Enter all the tax return information other than education items (AOC or scholarship income) before addressing the scenarios (which you should always do when dealing with Education Credit Optimization).
- Do Scenario 1 using the AOC Workbook and answer the questions.
- I strongly suggest that you clear the yellow boxes after each scenario so you get accustomed to following the Workbook steps. As you get down to Steps 4B and 4C, you must enter more data to get an accurate final answer. Line 19 in Step 4 tells you which option in Step 4 applies (assuming Step 2 didn't apply), so be sure you go to that option and complete all required information. Don't just go back and change a number, such as the scholarship amount, but rather clear the Workbook and start all over.
- It is important that you only enter information in the option in Step 4 to which you are directed. So if Line 19 tells you to go to Option 4B, only enter information in that section and do not enter anything in 4A or 4C.

## ANSWERS TO PROBLEM 1

### Scenario 1

1. Parents
2. \$2,500
3. Nonrefundable - \$1,275; Refundable - \$850 Total - \$2,125
4. \$0
5. No – no scholarship income and \$3,500 of wages for a total of \$3,500

Because it is a restricted scholarship, we must first allocate QEE against the restricted scholarship before we can allocate QEE to the AOC.

### Scenario 2

1. Parents
2. \$4,000
3. Nonrefundable - \$1,500; Refundable - \$1,000; Total - \$2,500
4. \$1,500
5. No - \$3,500 wages + \$1,500 scholarship income

Because the scholarship is unrestricted, we can allocate QEE to the AOC first and then allocate to the scholarship.

### Scenario 3

1. Parents
2. \$4,000
3. Nonrefundable - \$1,500; Refundable - \$1,000; Total - \$2,500
4. \$5,500
5. No - \$3,500 wages + \$5,500 Scholarship Income

In this case, the unrestricted scholarship of \$10,800 exceeds the maximum scholarship income that avoids the Kiddie Tax (\$9,050) by \$1,750. We must first allocate \$1,750 of the QEE to reduce the unrestricted scholarship below the maximum and then are free to allocate up to \$4,000 of the remaining QEE to the AOC. This leaves an additional amount of \$3,550 of QEE that is available to offset more of the scholarship, leaving the student with \$5,550 of scholarship income.

### Scenario 4

1. Parents
2. \$4,000
3. Nonrefundable - \$1,500; Refundable - \$1,000; Total - \$2,500
4. \$1,500
5. No – wages \$10,000 + \$1,500 Scholarship Income

With the increased earnings, the Kiddie Tax maximum scholarship amount falls to \$2,550 so we must allocate more QEE to the scholarship before allocating to the

AOC. We are still able to allocate the full \$4,000 to the AOC, leaving the student with \$1,500 of scholarship income just as in Scenario 2. Thus, the increased earnings had no impact on the results from Scenario 2.

#### Scenario 5

1. Parents
2. \$2,850
3. Nonrefundable - \$1,328; Refundable - \$885; Total - \$2,213
4. \$3,550
5. No – wages \$9,000 + \$3,550 Scholarship Income = \$12,550

In this case, we have more scholarship to offset than Scenarios 2 and 4. His income of \$9,000 reduces the maximum scholarship income amount to avoid the Kiddie Tax down to \$3,550. Therefore, we have to allocate \$6,450 of the QEE (\$10,000 scholarship - \$3,550 maximum) to the scholarship to reduce the scholarship down to the maximum amount to avoid the Kiddie Tax. This leaves us with only \$2,850 of QEE to allocate to the AOC. The scholarship income is reduced to the maximum amount of \$3,550 to avoid the Kiddie Tax.


## Problem 2

Tammy is 22 years old and works part-time as a clerk at a local store. She is also a full-time student at UNCC. She was a Junior at the end of 2021. She spent \$1,000 on books and supplies for school.

Prior to 2021, her parents claimed her as a dependent. They have taken the AOC for 2 prior years with respect to Tammy. She has never been convicted of a drug offense.

She received a Pell Grant which provided additional amounts to cover a portion of her living expenses. Her parents provided nothing towards her support in 2021. She moved out of their house during 2020 and has lived independently ever since with no intention of returning to live with them. She states that she is not being claimed as a dependent on anyone else's return.

| <input type="checkbox"/> CORRECTED (if checked)  |  |  |  | <b>Tuition Statement</b> |  |
|--|--|--|--|--------------------------|--|
| FILER'S name<br>Street address<br>City or town, state or province, country, ZIP or Foreign Postal Code<br>Telephone number<br><br>UNCC<br>9201 UNIVERSITY CITY BLVD<br>CHARLOTTE, NC 28223 |  | 1 Payments received for qualified tuition and related expenses<br><br><div style="text-align: right; font-size: 1.2em;">\$7,200.00</div> | OMB No. 1545-1574<br><br><div style="text-align: center; font-size: 2em; font-weight: bold;">2021</div>                                |                          | <b>Copy B<br/>For Student</b><br><br><small>This is important tax information and is being furnished to the IRS. This form must be used to complete Form 8863 to claim education credits. Give it to the tax preparer or use it to prepare the tax return.</small> |
| FILER'S employer identification no.<br><div style="text-align: center;">65-8885522</div>   |  | STUDENT'S TIN<br><div style="text-align: center;">002-00-1116</div>  | 3 If this box is checked, your educational institution has changed its reporting method for 2021. <input type="checkbox"/>             |                          |  |
| STUDENT'S name<br>Street address (including apt. no.)<br>City or town, state or province, country, ZIP or Foreign Postal Code<br><br>TAMMY JENKINS<br>2 MAIN AVE<br>CHARLOTTE, NC 28262    |  | 4 Adjustments made for a prior year  | 5 Scholarships or grants<br><br><div style="text-align: right; font-size: 1.2em;">\$15,500.00</div>                                    |                          |  |
|  |  | 6 Adjustments to scholarships or grants for a prior year   | 7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January-March 2022. > <input type="checkbox"/> |                          |  |
| Service Provider/Acct No. (see instr.)   | 8. Checked if at least half-time student <input checked="" type="checkbox"/> | 9 Checked if a graduate student <input type="checkbox"/>   | 10 Ins. contract reimb./refund   |                          |  |
| Form <b>1098-T</b>   |  |  |  |                          |  |

|   |                            |   |                      |  |                      |   |  |   |  |
|---|----------------------------|---|----------------------|--|----------------------|---|--|---|--|
|   |                            | a. Employee's social security number<br>123-00-1234 |                      | Save. accurate,<br>FAST! Use   |                      |  |  | Visit the IRS website at<br>www.irs.gov/efile |  |
| b. Employer identification number (EIN)<br>45-6666667   |                            |   |                      | 1. Wages, tips, other compensation<br>\$12,450.00  |                      | 2. Federal income tax withheld<br>\$1,155.00  |  |   |  |
| c. Employer's name, address, and ZIP code<br><br>LOCAL STORE<br>5 CRESCENT ST<br>CHARLOTTE, NC 28262  |                            |   |                      | 3. Social security wages<br>\$12,450.00  |                      | 4. Social security tax withheld<br>771.90   |  |   |  |
|   |                            |   |                      | 5. Medicare wages and tips<br>\$12,450.00  |                      | 6. Medicare tax withheld<br>180.52  |  |   |  |
|   |                            |   |                      | 7. Social security tips  |                      | 8. Allocated tips   |  |   |  |
| d. Control number   |                            |   |                      | 9.   |                      | 10. Dependant care benefits   |  |   |  |
| e. Employee's first name and initial<br>Employee's address and ZIP code   |                            | Last name<br>Suff.                                  |                      | 11. Nonqualified plans   |                      | 12a. See instructions for box 12  |  |   |  |
| TAMMY JENKINS<br>2 MAIN AVE<br>CHARLOTTE, NC 28262  |                            |   |                      | 13. Statutory Employee <input type="checkbox"/> Retirement Plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/> |                      | 12b.  |  |   |  |
|   |                            |   |                      | 14. Other  |                      | 12c.  |  |   |  |
|   |                            |   |                      | -----  |                      | 12d.  |  |   |  |
|   |                            |   |                      | -----  |                      | -----   |  |   |  |
| 15. State   | Employer's state ID number | 16. State wages, tips, etc.                         | 17. State income tax | 18. Local wages, tips, etc.  | 19. Local income tax | 20. Locality name   |  |   |  |
| -----   |                            |   |                      |  |                      |   |  |   |  |
| Form <b>W-2 Wage and Tax Statement</b> <b>2021</b><br><b>Copy B - To Be Filed With Employee's FEDERAL Tax Return.</b><br>This information is being furnished to the Internal Revenue Service. |                            |   |                      |  |                      |   |  |   |  |

For each scenario, answer the following questions.

1. Is the return in scope?
2. If in scope, what is the amount of Qualified Educational Expenses allocated to the AOC?
3. If in scope, what is the amount of the nonrefundable AOC, refundable AOC, and total AOC on the tax return where it is claimed?
4. If in scope, what is the amount of Tammy's scholarship income?

**Scenario 1** – Assume her earned income is more than half of her total support.

**Scenario 2** – Assume her earned income is less than one-half of her total support.

**Scenario 3** – Same as Scenario 2 except her scholarship shown in Box 5 is \$10,000. Don't forget to follow the Workbook carefully, as this requires several changes to the entries you made for Scenario 2.

## ANSWERS TO PROBLEM 2

### Scenario 1

1. In Scope
2. \$4,000
3. Nonrefundable - \$1,148; Refundable - \$1,000; Total - \$2,148
4. \$11,300

Because her earned income is more than half of her support, she is not subject to the Kiddie Tax or the nonrefundable AOC restrictions. Thus, we are free to allocate \$4,000 to the AOC first and then allocate the rest of the QEE against her scholarship.

### Scenario 2

1. Out of Scope! – Because her earned income is less than one-half of her total support, she is potentially subject to the Kiddie Tax. Unless we can limit her scholarship income below the Kiddie Tax maximum scholarship amount, the return will be out-of-scope. Here, her scholarship income exceeds the maximum amount of scholarship income to avoid the Kiddie Tax even before we try to optimize the return. Since the Kiddie Tax applies to the return even without optimizing, the student's return is out-of-scope.

To have gotten this question correct, you should have changed the answer on Line 15 of the AOC Workbook because of the change in facts from Scenario 1 – moves you from Step 4A to Step 4C; you must complete the unoptimized return as instructed at the beginning of Step 4C and enter info on Lines 35-39 to get the correct answer.

### Scenario 3

1. In Scope
2. \$190
3. Nonrefundable - \$190; no ref b/c EI < 1/2 of support; Total \$190
4. \$1,990

This scenario is an example of one where the taxpayer's AOC is nonrefundable, so the Workbook only allocates enough QEE to the AOC to wipe out the tax liability. If you look at the base case, she had \$1,800 of scholarship income, \$1,700 of taxable income, and owed \$171 in tax. By creating a \$190 AOC by allocating \$190 of QEE to the AOC, which then increases the scholarship income by \$190, we wipe out her tax liability without adding more scholarship income than we needed to, thereby avoiding the NC tax on the unnecessary scholarship income.

Don't forget to check the box on TaxSlayer AOC input page to tell TaxSlayer that the AOC is nonrefundable!



And don't forget that you needed to redo the base case (the instructions at the top of Step 4C) and enter the tax return data on Lines 35-39 of the Workbook. By the way, if you enter the data about QEE and the scholarship amount in the Workbook, Line 10 gives you the information you need on completing the return prior to optimizing. If Line 10 is a negative number, this is the amount of scholarship income to put on the return prior to optimizing (enter it as a positive number in TaxSlayer as scholarship income). If Line 10 is a positive number, this is the amount of AOC QEE to input in TaxSlayer prior to optimizing the return.