

# Texas CDBG-DR

## IRS Form 1040/AGI Method Calculation Policy

On August 8, 2013, the Texas General Land Office (GLO) approved use of the Internal Revenue Service (IRS) Form 1040 definition of income, as set forth in United States Department of Housing and Urban Development (HUD) regulations, for the purpose of determining applicants' eligibility for the Texas CDBG-DR Round 2.2 program. The IRS Form 1040 method of calculating income is often referred to as the Adjusted Gross Income or AGI method. This policy outlines the AGI method that program subrecipients may use.

Appendix A provides guidance to subrecipients for calculation of the AGI for a household member where the previous year's filed tax return or tax return transcript is unavailable. A tax return includes the IRS Forms 1040, 1040A and 1040 EZ

Since the following guidance is based on the IRS instructions for completing the IRS Form 1040, it is strongly encouraged that all household members who are required to file submit their tax returns to the IRS before the subrecipient completes the income verification portion of the CDBG-DR eligibility process.

The Computing IRS 1040 Series Adjusted Gross Income (AGI) worksheet (Appendix B) replaces the Household Income Certification (HIC) formerly used to document applicant income determinations. The AGI worksheet corresponds to items that are found in the IRS Form 1040. The AGI worksheet identifies each member of the household and calculates the adjusted gross income for the household.

### Determining Household Size

A household consists of all persons living in the household at the time of the initial personal consultation, with the five exceptions provided below. Total household size includes minors as well as adults. Applicants have the option to include permanently absent family members who can be classified as household dependents, such as children attending college or family members in a nursing home. Please refer to the [IRS Personal Exemptions and Dependents](#) publication for particular determinations. If the absent members are included, their income and deductions will be required for calculating household AGI.

*The following are **not** included in household size:*

- Foster children
- Live-in aides that are not family relatives
- Children of live-in aides
- Unborn children
  - Not considered in household size for income eligibility calculation but are considered for bedroom count
- Children being pursued for legal custody or adoption who are not currently living with the household
  - Not considered in household size for income eligibility calculation but are considered for bedroom count

### Determining Household Members' Income to Count

All income and deductions from household members 18 years of age or older and minors with taxable unearned income will be considered when calculating income. Taxable unearned

income includes, but is not limited to, Social Security benefits, interest, and dividends. Refer to [IRS Publication 929](#) for details on dependents' unearned income.

In determining applicant households' AGI the Texas CDBG-DR Round 2.2 program will only include minors' taxable unearned income. Minors' earned income, such as wages from a part-time job, will not be included.

The following documentation is required for identification purposes:

- Current photo ID for applicant and co-applicant
- Documentation satisfactory to the subrecipient of date of birth for all household members.
  - Examples include: birth certificate, passport, driver's license, vaccination/medical records, school records, and tax forms.

### Previous Year Tax Return

Citizens of the United States and resident aliens, except those with gross incomes below a certain level, are required to file an income tax return with the IRS each year. Refer to the [IRS filing requirements](#) for more information and a 2012 Filing Requirements Chart.

All household members included in the AGI calculation must provide a copy of the previous year's filed tax return or tax return transcript, if available, in order to determine the AGI for the household. The Texas CDBG-DR Round 2.2 program will allow the previous tax year's tax return for 12 months beginning January 1<sup>st</sup> and ending December 31<sup>st</sup> of the current year for use in determining household AGI.

For example, an applicant applying for disaster recovery assistance in September 2013 will use the 2012 tax year's tax return or tax return transcript from tax year 2012.

If a household member does not have a copy of the previous year's filed tax return, that does not necessarily mean it is unavailable. He/she must request a copy of the previous year's tax return transcript from the IRS using one of the following two options:

- **Option 1:** Household Member Requests Tax Return Transcript Online
  - The household member may order a tax return transcript directly from the IRS online at <http://www.irs.gov/Individuals/Order-a-Transcript>. The tax return transcript will be mailed directly to the household member's home address, and usually arrives in 5-10 days.
- **Option 2:** Household Member Completes IRS Form 4506-T
  - If a household member's address does not match the home address the IRS has on file, a household member may not be able to request a copy of the tax return transcript online.
  - A household member may complete the [IRS Form 4506-T](#) (*Request for Transcript of Tax Return*) to request by mail a copy of the tax return transcript. The request may ask the IRS to mail the tax return transcript directly to the subrecipient.

The IRS provides tax return transcripts free of charge.

## Calculating Household Adjusted Gross Income

Subrecipients will use the GLO's Computing IRS Series Adjusted Gross Income (AGI) worksheet (Appendix B) to calculate the adjusted gross income for the household.

To calculate the adjusted gross income for the household, enter the following information into the worksheet:

- List the following on lines a-j: names of adults and minors with unearned income, relation to head of household, date of birth, and whether each person is providing a tax return. Then list the minors **without** unearned income and their relation to head of household and date of birth. Minors without unearned income are included for the purpose of determining household size, but are excluded from the household's AGI calculation.
- If a tax return has been filed jointly then subrecipients must enter joint return information in only one column in the household member income and deductions section of the worksheet.
- For each household member included in the household's AGI calculation who provides a tax return or tax return transcript, enter the following:
  - **Income Amounts** (IRS Forms 1040 lines 7-21, 1040A lines 7-14, IRS Form 1040EZ lines 1-4) into the corresponding worksheet line items 1-15.
  - **Deduction Amounts** (IRS Form 1040 lines 23-35, IRS Form 1040A lines 16-19, inapplicable to Form 1040EZ) into the corresponding worksheet line items 17-29.

Worksheet line item 31 states the total AGI for each household member, which is added to each other household member's income to arrive at total household AGI stated in the final column. This household AGI will be used to determine if applicants meet the income eligibility requirements for the Texas CDBG-DR Round 2.2 program.

**Please note the following exclusions from the AGI calculation method:**

1. Child support.
  - Subrecipients must still verify all applicants and co-applicants are current on payments for child support. See the GLO Round 2 Housing Guidelines for further information.
2. Money or property that was inherited, willed or given as a gift.
3. Life insurance proceeds received as a result of someone's death

## Certification/Applicant Signature

Applicants' signatures are required on income documents only when income changes make them ineligible or alter their status from ineligible to eligible. Applicants who are originally classified as eligible and stay that way throughout the income eligibility process do not need to sign income documents.

For example, if updated documentation or use of the AGI income determination method results in classification of applicants as program-eligible persons of low or moderate income (LMI), when those applicants' income was determined by a previously-used non-AGI method of calculation to have exceeded LMI levels, signatures will be required to certify the change in eligibility.

## Previously Filed Tax Return Unavailable

There may be situations where a household member's previous year filed tax return or tax return transcript is unavailable. A household member may have had no obligation to file, have not yet filed a return, or have filed an extension. If the previous year filed tax return or tax return

transcript is unavailable for that household member, then the requirements outlined in Appendix A must be followed to determine the adjusted gross income for that household member.

For example, if a consultation is held on February 1, 2014, the filed tax return for the 2013 tax year will be required. If the applicant, or member of the household, indicates he has not yet filed, has filed an extension, or will not file a return, subrecipients must follow the requirements outlined in Appendix A.

## Appendix A

### AGI Determination Without a Tax Return

#### Overview

The following guidance has been developed to assist subrecipients to calculate the adjusted gross income or AGI for a household member where the previous year's filed tax return is unavailable or unusable to determine income for program eligibility purposes. There may be situations where a household member may have had no obligation to file a return, have not yet filed it, or filed an extension. In addition, if the household member's income has materially changed or is expected to materially change from that stated in the previous year's filed tax return or tax return transcript, any increase or decrease must be considered and verified using the AGI calculation described in this appendix.

Since the following guidance is based on the IRS instructions for completing the IRS Form 1040, it is strongly encouraged that all household members who can do so file their tax return before the subrecipient completes the income verification portion of the CDBG-DR eligibility process.

The GLO and subrecipients are NOT responsible for any applicant's or household member's IRS tax filing. For the purpose of determining household AGI for the Texas CDBG-DR Round 2.2 program, the IRS forms referred to below serve only as guidance.

If the previous year's filed tax return does not exist, or a copy of the return or tax return transcript has been requested but remains unavailable, the income inclusions and deductions used to calculate adjusted gross income must be verified and documented. Many of the tax return income inclusion and deduction line items will not apply to household members. Where items do not apply, subrecipients should leave blank, or enter "\$0" in, the corresponding columns of the Computing IRS 1040 Series Adjusted Gross Income (AGI) worksheet (Appendix B). The applicable time period for calculation of AGI where there is not a tax return is the 12 months prior to application intake.

#### Calculating Adjusted Gross Income

Subrecipients will use the GLO's Computing IRS Series Adjusted Gross Income (AGI) worksheet (Appendix B) to calculate the adjusted gross income for the household member that does not have a previous year's filed tax return or tax return transcript available. If a household member's income has materially changed or will materially change from the previous year, any increases or decreases in AGI must also be calculated using the worksheet method described in this appendix.

#### Previous Filed Tax Return Unavailable

To calculate the adjusted gross income for the household member without a previous year's tax return or tax return transcript, use the worksheet as a tool to review with the household member each item that may or may not be an eligible income inclusion or deduction.

Refer to the *Calculating Income* and *Calculating Deductions* sections of this appendix for a description of each income inclusion and deduction and to determine what documentation is required.

Enter the applicable amounts into the worksheet:

- Income (worksheet line items 1-15)

- Deductions (worksheet line items 17-29)

Worksheet line item 31 states the total AGI for the household member.

Each income inclusion and deduction must be verified and documented according to the guidance provided below.

#### Changes From the Previous Filed Tax Return

If a household member certifies that income has materially changed or will materially change from that stated in the previous year's filed tax return, any increase or decrease will be re-calculated using the worksheet.

- Identify the line item(s) from the previous year's filed tax return that have increased or decreased.
- Document the change(s).
- Enter the revised amount(s) into the worksheet for the household member.
- Worksheet line item 31 states the revised AGI for the household member.

#### Calculating the Household's Adjusted Gross Income

Refer to the Texas CDBG-DR IRS Form 1040/AGI Method Calculation Policy, *Calculating Household's Adjusted Gross Income* section to calculate the household's adjusted gross income.

### Calculating Income

The following is a description of each income line item found in the Computing IRS 1040 Series Adjusted Income (AGI) worksheet (Appendix B). Each of these income line items corresponds to the line items in the IRS Form 1040. Each line item will not necessarily apply to each household member. There may also be instances where income can be categorized as multiple line items. Subrecipients should take care not to double count income items.

**Line 1 - Wages, salaries, tips, etc.:** Wages are calculated through various methods. Please refer to the list of documentation options below. Household members or applicants can provide the following documentation:

- All jobs' W-2 form(s) from the previous calendar year, or
- Paycheck stubs from the most recent 90-day period, which subrecipients must use to project annual income, or
- GLO Form 14.08 Verification of Employment.

**Line 2 & 3 - Taxable interest & dividends:** If a household member indicates receipt of taxable interest or dividends, the amount will be included as income. If there are expected changes, or no previous year's tax return is available, an IRS Form 1099 or documentation from the paying organization will be obtained, and this amount will be included in the income calculation.

- The household member should have received an [IRS Form 1099-INT or 1099-OID](#) from payers.
- Refer to the [IRS Form 1040 Schedule B information resource](#) for more details on interest and ordinary dividends.

**Line 4 - Taxable refunds, credits, or offsets of state and local income taxes:** If applicants received an IRS Form 1099-G, the amount stated should be included in this column.

- Refer to the [IRS instructions for Form 1099-G](#) for more information.

**Line 5 - Alimony received:** Household members will enter amounts received as alimony or separate maintenance. Household members or applicants can provide the following documentation:

- Court order including award amount and pay frequency, or
- One or more current bank statements to verify itemized deposit, or
- GLO Form 14.15, Verification of Alimony.

**Line 6 - Business income (or loss):** If household members have operated a business or practiced a profession as a sole proprietor (self employment), income and expenses should be reported here. Household members or applicants can provide the following documentation:

- Business ledger or similar records, or
- GLO Form 14.09, Verification of Business Income.

If the household member has ceased self-employment, adequate documentation, such as proof of employment or receipt of unemployment compensation, must be provided.

**Line 7 - Capital gains (or loss):** If household members sold a capital asset, such as a stock or bond, they will typically complete [IRS Form 8949](#) and [IRS Form 1040 Schedule D](#). If the forms are not completed or are unavailable, capital gain (or loss) must be calculated in the manner the forms require. If the asset was sold and there was a loss, the loss will be anticipated based on the maximum loss carry forward amounts set by the IRS.

- Refer to [IRS Form 1040 Schedule D](#) for potential loss carry forwards.
- If household members indicate they have a capital gain (or loss) for the current year, obtain proof of asset transfer and the amount of capital gain (or loss).

**Line 8 - Other gains (or loss):** Other gains or losses will be required if applicant sold or exchanged assets used in a trade or business.

- Review the instructions for [IRS Form 4797](#) for information on other gains or losses.
- If household members indicate they have other gain (or loss) for the current year, obtain proof of asset transfer and the amount of gain (or loss).

**Line 9 - IRA distributions:** Household members should receive an [IRS Form 1099-R](#) from the financial institution showing the total amount of any distribution from their IRAs before income tax or other deductions were withheld (box 1 on form).

- If household members received an IRA distribution too recently to have an IRS Form 1099-R, obtain a statement from the financial institution.

**Line 10 - Pensions and annuities:** Using the most recent pensions or annuities benefits statements, locate the “taxable” amount of income. Information can also be determined from a previous year’s IRS Form 1099, current bank statement, or benefit verification form. Anticipated annual income is calculated by multiplying taxable benefit amount by pay frequency. Household members should receive an [IRS Form 1099-R](#) showing the total amount of pensions and annuities payments. Review the [IRS instructions](#) for more information. Household members or applicants can provide the following documentation:

- Current benefit letter including taxable and/or gross award amount and pay frequency, or
- IRS Form 1099, or
- Most current bank statement to verify itemized deposit, or
- GLO Form 14.11, Verification of Pension.

**Line 11 - Rental real estate:** Household members who receive rental real estate income must refer to [IRS Form 1040 Schedule E](#) and provide a current lease for each rental property, if one

exists. The current lease is used to determine the most current rental amount for each rental property. Schedule E can be used to determine annual expenses. The current rental amount is multiplied by applicable pay frequency to calculate the annual gross rental amount, and rental expenses are then subtracted to calculate the anticipated annual income. Household members or applicants can provide the following documentation:

- Current lease, or
- GLO Form 14.16 Verification of Recurring Cash Contributions.

**Line 12 - Farm income (or loss):** If household members have operated a farm, income and expenses should be reported here. Individual household members' farm income (or loss) will be calculated like business income using the [IRS Form 1040 Schedule F](#). Household members or applicants can provide the following documentation:

- GLO Form 14.09, Verification of Income From Business.

**Line 13 - Unemployment compensation:** Household members who are currently receiving unemployment compensation must provide a current statement of unemployment benefit. Household members or applicants can provide the following documentation:

- Current benefit letter with gross benefit amount, or
- Benefit verification form from government provider, or
- Most current bank statement to verify itemized deposit.

**Line 14 - Taxable amount of Social Security benefits:** Household members receiving taxable Social Security benefits must provide a current benefits statement to determine the gross benefit amount. Information can also be determined from a previous year's IRS Form SSA-1099 or benefit verification letter. A Social Security benefits worksheet is provided in the [IRS's Form 1040 instruction manual](#) (lines 20a and 20b) to determine the taxable amount, if any, of benefit payments. Household members or applicants can provide the following documentation:

- Current [benefit verification letter](#) including gross award amount, or
- IRS Form SSA-1099, or
- GLO Form 14.10 Verification of Social Security Benefits.

**Line 15 - Other income:** Report any taxable income not reported elsewhere on the return or other schedules. List the type and amount of income. If necessary, include a statement showing the required information. For more details, see [IRS Miscellaneous Income in IRS Pub. 525](#).

**Note on Cash Income Verification:** Household members who receive cash income must complete GLO Form 14.16 Verification of Recurring Cash Contribution. Projected income will be calculated by multiplying the amount received by the frequency listed on the form.

- **Other Income:** Other income includes prizes and awards, gambling, lottery or raffle winnings, jury duty fees, Alaska Permanent Fund dividends, reimbursements for amounts deducted in previous years, income from the rental of property if not in the business of renting such property and not covered in line 11 of the worksheet, and income from an activity not engaged in for profit. Other income can be documented by the following:
  - GLO Form 14.16 Verification of Recurring Cash Contribution, or
  - Most current bank statement to verify itemized deposit, or

- IRS Form 1099, if available
- **Undocumented Income:** Household members who receive any other recurring or miscellaneous cash deposits or income may document it as follows;
  - GLO Form 14.16 Verification of Recurring Cash Contribution, or
  - Most current bank statement to verify itemized deposit.
- **Disability;** This relates to private disability insurance payments, not to federally-awarded disability benefits (for example, Veteran’s Administration benefits). For more information on disability income, read the [IRS guide](#). The following documents may be used to document this income:
  - Current benefit letter including taxable and/or gross award amount and pay frequency, or
  - Most current bank statement to verify itemized deposit, or
  - Company benefit verification form

**For Household Members with No Income**

- Complete and sign GLO Certification of Zero Income for applicable household members 18 years old and older

**Calculating Deductions**

The following is a description of each deduction line item found in the Computing IRS 1040 Series Adjusted Gross Income (AGI) worksheet (Appendix B). Each of these line items corresponds to the deduction line items in the IRS Form 1040. As with income line items, every deduction need not apply to every household member, and in cases where a deduction can be categorized as multiple line items, it should not be double counted.

**Line 17 - Educator expenses:** If household members are eligible educators, they can deduct up to \$250 (\$500 if married filing jointly and both spouses are educators, but not more than \$250 each) of any unreimbursed expenses. Refer to the IRS website for more information on the [educator expense deduction](#).

- Acceptable documentation for educator expense, for example, may include receipts, canceled checks, credit card statements, etc.

**Line 18 - Certain business expenses:** Fill out for expenses of reservists, performing artists, and fee-basis government officials.

- Review the [IRS instructions form](#) for information. Use [IRS Form 2106](#) if household members were employees deducting ordinary and necessary job expenses. Acceptable documentation, for example, may include receipts, canceled checks, credit card statements, etc.

**Line 19 - Health savings account (HSA) deduction:** Household members may be able to take this deduction if contributions (other than employer contributions, rollovers, and qualified HSA funding distributions from an IRA) were made to their HSA.

- Guidance can be found in [IRS Form 8889](#) and its [instructions](#).
- Household members may document HSA contributions, for example, with a statement from their HSA administrator, a W2, or payroll records, etc.

**Line 20 - Moving expenses:** If household members move in connection with their jobs or business, they may be able to take this deduction if they meet the requirement of the IRS distance test.

- Refer to [IRS publication 521](#) to see who can deduct moving expenses and use [IRS Form 3903](#) to calculate the moving expense deduction. Acceptable documentation, for example, may include receipts, canceled checks, credit card statements, etc.

**Line 21 - Deductible part of self employment tax:** If household members are self-employed and owe self-employment tax, then refer to [IRS Form 1040 Schedule SE](#) to figure the tax due on net earnings from self-employment. The [2012 instructions for IRS Form 1040 Schedule SE](#) also serves as a helpful guide.

**Line 22 - Self-employed SEP, SIMPLE, and qualified plans:** If household members are self-employed or a partner, they may be able to take this deduction. See IRS [Publication 560](#) or, if they were members of the clergy or religious workers, IRS [Publication 517](#). Refer to [IRS publication 560 \(2012\)](#) for information on retirement plans for small business.

- This deduction may be documented, for example, by a financial institution statement.

**Line 23 - Self-employed health insurance deduction:** Self-employed household members will be able to deduct the amount paid for health insurance for themselves, their spouses, and dependents. Refer to [IRS publication 535 \(2012\)](#) to see how household members can qualify.

- Also refer to the [IRS Form 1040 instructions](#) for tax return line 29.
- Household members must provide record of payment in the form, for example, of receipts, canceled checks, or credit card statements.

**Line 24 - Penalty on early withdrawal of savings:** If applicable, household members should have received an IRS Form [1099-INT](#) or Form [1099-OID](#) that will show the amount of any penalty charged.

- Read the [instructions for Forms 1099-INT and 1099-OID](#) for more information.
- If household members have not received a Form 1099-INT or Form 1099-OID, they may document this deduction, for example, with a financial institution statement.

**Line 25 - Alimony paid:** Household members who made payments to or for a spouse or former spouse under a divorce or separation instrument may be eligible to make this deduction.

- Review [IRS Publication 504 \(2012\)](#) for more information on divorced or separated individuals.
- Household members may prove alimony payments, for example, with a court order including award amount and pay frequency, their most current bank statements or other payment records.

**Line 26 - IRA deduction:** If household members made contributions to a traditional IRA, they must have had earned income to do so. For IRA purposes, earned income includes alimony and separate maintenance payments. If household members were age 70 ½ or older at the end of the year, they cannot deduct any contributions made to their traditional IRA for 2012 or treat them as nondeductible contributions. Roth IRA contributions are not deductible.

- Refer to [IRS Publication 590 \(2012\)](#) for more information on Individual Retirement Arrangements (IRAs).
- Also refer to the [IRS Form 1040 instructions](#) for tax return line 32 for more information and the IRA Deductions Worksheet.

- Household members may document this deduction, for example, with a financial institution statement or other records of payment.

**Line 27 - Student loan interest deduction**

- Household members may be able to deduct interest they pay on qualified student loans. Refer to IRS [Topic 456](#) for more information.
- Review the tax return line 33 [IRS Form 1040 instructions](#) to determine if this deduction is available.
- Household members may document this deduction, for example, with a financial institution statement or other records of payment.

**Line 28 - Tuition and fees:** Household members may be able to deduct from AGI qualified tuition and related expenses that they pay for themselves, their spouse, or a dependent.

- Refer to [IRS Publication 970](#) to determine whether expenses are qualified.
- [IRS Form 8917](#) also contains information about who can take this deduction.
- Household members may document this deduction, for example, with a credit card statement, canceled checks, receipts or other records of payment.

**Line 29 - Domestic production activities deduction:** Household members may be able to deduct up to 9% of their qualified production activities income from the list of activities found in the tax return line 35 [IRS Form 1040 instructions](#).

- [IRS Form 8903](#) serves as a guide as well as the [instructions for IRS Form 8903](#).