

2002



Department of the Treasury
Internal Revenue Service

Instructions for Form 1040-SS

U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)

Section references are to the Internal Revenue Code.

General Instructions

A Change To Note

For 2002, the maximum amount of self-employment income subject to social security tax is \$84,900.

Purpose of Form

Residents of the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and Puerto Rico use Form 1040-SS to:

- Report net earnings from self-employment and pay self-employment (SE) tax. The Social Security Administration uses this information to figure your benefits under the social security program. SE tax applies no matter how old you are and even if you already are receiving social security or Medicare benefits.
- Report and pay household employment taxes.
- Report and pay employee social security and Medicare tax on unreported tips or uncollected social security and Medicare tax on tips or group-term life insurance (see the instructions on page 4 for Part I, line 5).
- Claim excess social security tax withheld.
- Claim the additional child tax credit (bona fide residents of Puerto Rico only).

You may also be required to file an income tax return with the government of Guam, American Samoa, the Virgin Islands, the Commonwealth of the Northern Mariana Islands (CNMI), or Puerto Rico. Check with your local tax office for more details.

Additional Information

For more details, see **Pub. 533**, Self-Employment Tax, available from most IRS offices. See the instructions for **Schedules C and F (Form 1040)** for information on business and farm income and expenses.

For details on 2002 tax law changes, see **Pub. 553**, Highlights of 2002 Tax Changes.

If you expect to owe SE tax of \$1,000 or more for 2003, you may have to make estimated tax payments. Use **Form 1040-ES**, Estimated Tax for Individuals, to make estimated tax payments.

Who Must File

You **must** file Form 1040-SS if:

1. You, or your spouse if filing a joint return, had net earnings from self-employment (from other than church employee income) of \$400 or more (or you had church employee income of \$108.28 or more—see **Church Employees** on page 2); **and**
2. You do not have to file Form 1040 with the United States; **and**
3. You are a resident of:
 - Guam,
 - American Samoa,
 - The Virgin Islands,
 - The CNMI, or
 - Puerto Rico. (You may file either Form 1040-PR or Form 1040-SS.)

Note: *Even if you have a loss or little income from self-employment, it may benefit you to file Form 1040-SS and use either “optional method” in Part VI. See page 7.*

If **2 and 3** above apply, you also **must** file Form 1040-SS (or Form 1040-PR in Spanish if you are a resident of Puerto Rico) to:

- Report and pay household employment taxes.
- Report and pay employee social security and Medicare tax on unreported tips or uncollected social security and Medicare tax on tips or group-term life insurance (see the instructions on page 4 for Part I, line 5).
- Claim excess social security tax withheld.
- Claim the additional child tax credit (bona fide residents of Puerto Rico only).

When To File

If you file on a calendar year basis, file by April 15, 2003. If you file on a fiscal year basis, file by the 15th day of the

4th month after the close of your fiscal year.

Where To File

Internal Revenue Service Center,
Philadelphia, PA 19255.

Amount You Owe

Enclose your check or money order for the full amount with Form 1040-SS. Make it payable to the “United States Treasury.” **Do not send cash.** Write “2002 Form 1040-SS” and your name, address, daytime phone number, and social security number (SSN) on your payment. If you are filing a joint return, enter the SSN shown first on your Form 1040-SS.

To help process your payment, enter the amount on the right side of the check like this: \$ XXX.XX. Do not use dashes or lines (for example, do not enter “\$ XXX-” or “\$ XXX^{00/100}”).

Third Party Designee

If you want to allow a friend, family member, or any other person you choose to discuss your 2002 tax return with the IRS, check the “Yes” box in the “Third Party Designee” area on page 1 of Form 1040-SS. Also enter the designee’s name, phone number, and any five numbers the designee chooses as his or her personal identification number (PIN). **But** if you want to allow the paid preparer who signed your return to discuss it with the IRS, just enter “Preparer” in the space for the designee’s name. You do not have to provide the other information requested.

If you check the “Yes” box, you, and your spouse if filing a joint return, are authorizing the IRS to call the designee to answer any questions that may arise during the processing of your return. You are also authorizing the designee to:

- Give the IRS any information that is missing from your return,
- Call the IRS for information about the processing of your return or the status of your refund or payment(s), and

- Respond to certain IRS notices that you have shared with the designee about math errors, offsets, and return preparation. The notices will not be sent to the designee.

You are not authorizing the designee to receive any refund check, bind you to anything (including any additional tax liability), or otherwise represent you before the IRS. If you want to expand the designee's authorization, see **Pub. 947**, Practice Before the IRS and Power of Attorney.

The authorization cannot be revoked. However, the authorization will automatically end no later than the due date (without regard to extensions) for filing your 2003 tax return. This is April 15, 2004, for most people.

Signature and Date

Sign and date your return. It is not valid unless you sign it. If you are filing a joint return, your spouse must also sign.

Generally, anyone you pay to prepare your return must sign it by hand in the space provided. Signature stamps or labels cannot be used. The preparer must give you a copy of the return for your records. Someone who prepares your return but does not charge you should not sign your return.

Daytime Phone Number

Providing your daytime phone number may help speed the processing of your return. If we have questions about items on your return and you can answer our questions over the phone, we may be able to continue processing your return without mailing you a letter. If you are filing a joint return, you may enter either your or your spouse's daytime phone number.

How To Get Forms and Publications

By Personal Computer

You can access the IRS Web Site 24 hours a day, 7 days a week, at www.irs.gov to download forms, instructions, and publications. You can also reach us using File Transfer Protocol at [ftp.irs.gov](ftp://ftp.irs.gov).

By Phone

If you are a resident of the Virgin Islands or Puerto Rico, you can order forms and publications 24 hours a day, 7 days a week, by calling **1-800-TAX-FORM** (1-800-829-3676).

In Person

Puerto Rico. U.S. Internal Revenue Service, 7 Tabonuco Street, Suite 120, San Patricio Office Center, Guaynabo, PR 00966; or send your order to

Eastern Area Distribution Center, P.O. Box 25866, Richmond, VA 23289-5866.

Virgin Islands. Federal Building, Room 216, 5500 Veterans Drive, Charlotte Amalie, St. Thomas, VI 00802; V.I. Bureau of Internal Revenue, 9601 Estate Thomas, Charlotte Amalie, St. Thomas, VI 00802; or V.I. Bureau of Internal Revenue, 4008 Estate Diamond, Christiansted, St. Croix, VI 00820.

Guam. Internal Revenue Service, Pacific Daily News Bldg., 230 O'Hara St., Suite 902, Agana, GU 96910.

American Samoa. American Samoa Government, Tax Division, Suite 111, Pago Plaza, Pago Pago, AS 96799; or Tax Office, EOB Building, Utulei, AS 96799.

CNMI. Division of Revenue and Taxation, CNMI, Central Office, Civic Center, Saipan, MP 96950.

Name and SSN

To ensure proper credit to your social security account, enter your name and social security number (SSN), and your spouse's if filing a joint return, exactly as shown on your social security card. If you do not have an SSN, get **Form SS-5**, Application for a Social Security Card, from an SSA district office.

Who Must Pay SE Tax?

Self-Employed Persons

You must pay SE tax if you had net earnings of \$400 or more as a self-employed person. If you are in business for yourself or you are a farmer, you are self-employed.

You must also pay SE tax on your share of certain partnership income and your guaranteed payments. See **Partnership Income or Loss** on page 6.

Church Employees

If you had church employee income of \$108.28 or more, you must pay SE tax on that income. **Church employee income** is wages you received as an employee (other than as a minister or member of a religious order) of a church or qualified church-controlled organization that has a certificate in effect electing exemption from employer social security and Medicare taxes.

If your only income subject to self-employment tax is church employee income, skip lines 1 through 4b in Part V. Enter zero on line 4c and go to line 5a.

Ministers and Members of Religious Orders

In most cases, you must pay SE tax on salaries and other income for services you performed as a minister, a member of a religious order who has not taken a vow of poverty, or a Christian Science practitioner. But if you filed **Form 4361**, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, and received IRS approval, you will be exempt from paying SE tax on those net earnings. If you had no other income subject to SE tax, you are not required to file Form 1040-SS. But if you had other earnings of \$400 or more subject to SE tax, see line A in Part V.

If you must pay SE tax, include this income on Part IV, line 1. But **do not** report it on line 5a of Part V; it is not considered church employee income. Also, include on Part IV, line 1:

- The rental value of or allowance for a home furnished to you (including payments for utilities) and
- The value of meals and lodging provided to you, your spouse, and your dependents for your employer's convenience.

Do not include on Part IV, line 1:

- Retirement benefits you received from a church plan after retirement or
- The rental value of or allowance for a home furnished to you (including payments for utilities) after retirement.

If you were a duly ordained minister who was a church employee and you must pay SE tax, report in Part IV your income and expenses from performing services as a minister. Enter the net amount on Part V, line 2.

For details, see **Pub. 517**, Social Security and Other Information for Members of the Clergy and Religious Workers.

Note: *If you have ever filed Form 2031 to elect social security coverage on your earnings as a minister, you cannot revoke that election.*

Members of Certain Religious Sects

If you have conscientious objections to social security insurance because of your membership in and belief in the teachings of a religious sect recognized as being in existence at all times since December 31, 1950, and which has provided a reasonable level of living for its dependent members, you can request exemption from SE tax by filing **Form 4029**, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits. If you filed Form 4029 and have received IRS approval, do not file Form 1040-SS. See Pub. 517 for details.

Employees of Foreign Governments or International Organizations

You must pay SE tax on income you earned as a U.S. citizen or a resident of Puerto Rico employed by a foreign government (or, in certain cases, by a wholly owned instrumentality of a foreign government or an international organization under the International Organizations Immunities Act) for services performed in the United States, Puerto Rico, Guam, American Samoa, the CNMI, or the Virgin Islands. Report income from this employment on Part IV, line 1. If you performed services elsewhere as an employee of a foreign government or an international organization, those earnings are exempt from SE tax.

Commonwealth or Territory Residents Living Abroad

If you are a resident of Guam, American Samoa, the Virgin Islands, the CNMI, or Puerto Rico living abroad, in most cases you must pay SE tax.

Exception. The United States has social security agreements with many countries to eliminate dual taxes under two social security systems. Under these agreements, you must generally pay social security and Medicare taxes only to the country you live in.

The United States now has social security agreements with the following countries: Australia, Austria, Belgium, Canada, Chile, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, South Korea, Spain, Sweden, Switzerland, and the United Kingdom. Additional agreements are expected in the future.

If you have questions about international social security agreements, you can:

- Visit the Social Security Administration (SSA) Web Site at www.ssa.gov/international,
- Call the SSA Office of International Programs at (410) 965-3544 or (410) 965-3554 (these are not toll-free numbers), or
- Write to Social Security Administration, Office of International Programs, P.O. Box 17741, Baltimore, MD 21235-7741. (**Do not** send Form 1040-SS to this address.)

Even if you do not have to pay self-employment tax because of a social security agreement, you may still have to file a tax return with the Internal Revenue Service.

More Than One Business

If you were a farmer and had at least one other business or you had two or more businesses, your net earnings from self-employment are the combined net earnings from all of your businesses. If you had a loss in one business, it reduces the income from another. Complete and file only one Form 1040-SS for any 1 year. Attach a profit and loss statement for each trade or business, and include the net earnings in Part V.

Joint returns. If both you and your spouse have self-employment income from a farm or nonfarm business, each of you must complete and file a separate Part III or Part IV. Be sure to enter at the top of each Part III or Part IV the name and social security number of the spouse who owns the business. Each of you must also complete a separate Part V.

Community Income

In most cases, if any of the income from a business, including farming, is community income, all of the income from that business is considered self-employment earnings of the spouse who carried on the trade or business. The identity of the spouse who carried on the trade or business is determined by the facts in each situation. If you and your spouse are partners in a partnership, see **Partnership Income or Loss** on page 6.

Fiscal Year Filers

If your tax year is a fiscal year, use the tax rate and earnings base that apply at the time the fiscal year begins. Do not prorate the tax or earnings base for a fiscal year that overlaps the date of a rate or earnings base change.

Specific Instructions

The accounting method you used to record your farm income determines whether you complete Section A or C of Part III.

Cash method. Include all of your income in the year you actually get it. Generally, you deduct your expenses when you pay them.

Accrual method. Include your income in the year you earned it. It does not matter when you get it. You deduct your expenses when you incur them.

Part I—Total Tax and Credits

Line 1

Check the filing status that applies to you.

Single. Your filing status is single if:

- On the last day of the year, you are unmarried or legally separated from your spouse under a divorce or separate maintenance decree or
- You meet **all five** of the following conditions.

1. You lived apart from your spouse for the **last 6 months** of 2002. Temporary absences for special circumstances, such as business, medical care, school, or military service, count as time lived in the home.

2. You file a separate return from your spouse.

3. You paid over half the cost of keeping up your home for 2002.

4. Your home was the main home of your child, adopted child, stepchild, or foster child for more than half of 2002.

5. You could claim the child as a dependent (see **Pub. 501**, Exemptions, Standard Deduction, and Filing Information).

Married filing jointly. You can choose this filing status if you were married and both you and your spouse agree to file a joint return. If you choose to file a joint return, check the box for married filing jointly and be sure to include your spouse's name and social security number (SSN) on the lines provided below your name and SSN. If your spouse also had self-employment income, complete and attach a separate Part V and, if applicable, Part VI. If necessary, attach a separate Part III or Part IV for your spouse's farm or nonfarm business.

Joint and several tax liability. If you file a joint return, both you and your spouse are generally responsible for the tax and any interest or penalties due on the return. This means that if one spouse does not pay the tax due, the other may have to.

Married filing separately. You can choose this filing status if you were married. This method may benefit you if you want to be responsible only for your own tax.

Line 4

If **either** of the following applies, see **Schedule H (Form 1040)**, Household Employment Taxes, and its instructions to find out if you owe these taxes.

1. You paid **any one** household employee cash wages of \$1,300 or more in 2002.

2. You paid **total** cash wages of \$1,000 or more in **any** calendar **quarter** of 2001 or 2002 to household employees.

Line 5

Employee social security and Medicare tax on tips not reported to employer. Complete Form 4137 if you received cash and charge tips of \$20 or more in any month and did not report all of those tips to your employer. On the dotted line next to line 5, write "Tax on Tips," and the amount of tax due (from Form 4137, line 12). Be sure to include this tax in the total for line 5. Attach to Form 1040-SS the completed Form 4137 and **Schedule U (Form 1040)** (found at the bottom of Form 4137).

Uncollected employee social security and Medicare tax on tips. If you did not have enough wages to cover the social security and Medicare tax due on tips you reported to your employer, the amount of tax due should be identified with codes **A** and **B** in box 12 of your Form W-2AS, W-2GU, or W-2VI. Include this tax in the total for line 5. Enter the amount of this tax and "Uncollected Tax" on the dotted line next to line 5.

Uncollected employee social security and Medicare tax on group-term life insurance. If you had group-term life insurance through a former employer, you may have to pay social security and Medicare tax on part of the cost of the life insurance. The amount of tax due should be identified with codes **M** and **N** in box 12 of your Form W-2AS, W-2GU, or W-2VI. Include this tax in the total for line 5. Enter the amount of this tax and "Uncollected Tax" on the dotted line next to line 5.

Line 6

Enter any estimated tax payments you made for 2002 including any overpayment from your 2001 return that you applied to your 2002 estimated tax. If you or your spouse paid separate estimated tax but are now filing a joint return, add the amounts you each paid and enter the total on line 6. If you and your spouse paid joint estimated tax but are now filing separate returns, you can divide the amount paid in any way you

choose as long as you both agree. If you cannot agree, you must divide the payments in proportion to each spouse's individual tax as shown on your separate returns for 2002. For an example of how to do this, see **Pub. 505**, Tax Withholding and Estimated Tax.

Line 7

If you, or your spouse if filing a joint return, had more than one employer for 2002 and total wages of more than \$84,900, too much social security tax may have been withheld. You can take a credit on this line for the amount withheld in excess of \$5,263.80. But if any one employer withheld more than \$5,263.80, you must ask that employer to refund the excess to you. You cannot claim it on Form 1040-SS. Figure this amount separately for you and your spouse. You must attach Form W-2AS, W-2CM, W-2GU, W-2VI, or 499R-2/W-2PR.

Part II—Bona Fide Residents of Puerto Rico Claiming Additional Child Tax Credit

If you were a bona fide resident of Puerto Rico and you qualify to claim the additional child tax credit, complete Part I, line 2; Part II; and the worksheet on page 5 of these instructions to figure the amount of your credit.



*You must have **three or more** qualifying children to claim the additional child tax credit.*

Qualifying for the Credit

You may be able to claim the additional child tax credit if **all three** of the following apply.

1. You were a bona fide resident of Puerto Rico.
2. Social security and Medicare taxes were withheld from your wages or you paid self-employment tax.
3. You had **three or more** qualifying children (defined below).

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

- Would qualify as your dependent (explained on this page), **and**

- Was **under age 17** at the end of 2002, **and**
- Is **(a)** your son, daughter, adopted child, stepchild, or grandchild; **(b)** your brother, sister, stepbrother, stepsister, or a descendant of your brother, sister, stepbrother, or stepsister (for example, your niece or nephew), whom you cared for as your own child; or **(c)** a foster child (that is, any child placed with you by an authorized placement agency whom you cared for as your own child), **and**
- Is a U.S. citizen or resident alien.

A child placed with you by an authorized placement agency for legal adoption is an **adopted child** even if the adoption is not final. An authorized placement agency includes any person authorized by state law to place children for legal adoption.

A **grandchild** is any descendant of your son, daughter, adopted child, or stepchild and includes your great-grandchild, great-great-grandchild, etc.

Qualifying as your dependent.

Generally, a child would qualify as your dependent if you provided over half of the child's support in 2002. However, special rules apply for children of divorced or separated parents and to married children. For details, see Pub. 501.

Information about your qualifying child. On Part I, line 2, enter the qualifying child's name, social security number, and relationship to you. If you have **more than six** qualifying children, attach a statement to Form 1040-SS with the required information.

Line 1

For purposes of the additional child tax credit, you must report all of your income derived from sources within Puerto Rico that is excluded from U.S. tax because you were a bona fide resident of Puerto Rico. This includes items such as wages, interest, dividends, taxable pensions and annuities, and taxable social security benefits. Also include any profit or (loss) from Part III, line 36, and Part IV, line 27. For more information on these and other types of income to include on line 1, see the Form 1040 instructions.

Additional Child Tax Credit Worksheet—Part II, Line 3

Keep for Your Records

1. Do you have three or more qualifying children?
No. Stop. You cannot claim the credit.
Yes. Go to line 2.

2. Number of qualifying children: _____ × \$600. Enter the result **2.** _____

3. Enter the amount from Part II, line 1 **3.** _____

4. Enter the amount shown below for your filing status **4.** _____

- Married filing jointly — \$110,000
- Single — \$75,000
- Married filing separately — \$55,000

5. Is the amount on line 3 more than the amount on line 4?
No. Leave line 5 blank. Enter -0- on line 6.
Yes. Subtract line 4 from line 3. If the result is not a multiple of \$1,000, increase it to the next multiple of \$1,000 (for example, increase \$425 to \$1,000, increase \$1,025 to \$2,000, etc.) **5.** _____

6. Multiply the amount on line 5 by 5% (.05) **6.** _____

7. Is the amount on line 2 more than the amount on line 6?
No. Stop. You cannot claim the credit.
Yes. Subtract line 6 from line 2 **7.** _____

8. Enter **one-half** of the amount from Part V, line 12, here **8.** _____

9. Enter the total of any:
 • Amount from Part II, line 2, plus
 • Employee social security and Medicare tax on tips not reported to employer and shown on the dotted line next to Part I, line 5, plus
 • Uncollected employee social security and Medicare tax shown on the dotted line next to Part I, line 5 **9.** _____

10. Add lines 8 and 9 **10.** _____

11. Enter the amount, if any, from Part I, line 7 **11.** _____

12. Is the amount on line 10 more than the amount on line 11?
No. Stop. You cannot claim the credit.
Yes. Subtract line 11 from line 10 **12.** _____

13. **Additional child tax credit.** Enter the **smaller** of line 7 or line 12 here and on Form 1040-SS, Part II, line 3 **13.** _____

Part V—Self-Employment Tax



*If you are filing a joint return and both you and your spouse have income subject to self-employment tax, you must **each** complete a **separate** Part V.*

What Is Included in Net Earnings From Self-Employment

Generally, net earnings include your net profit from a farm or nonfarm business. If you were a partner in a partnership, see the following instructions.

Partnership Income or Loss

When figuring your total net earnings from self-employment, include your share of partnership income or loss attributable to a trade or business and any guaranteed payments for services or the use of capital. However, if you were a limited partner, include only guaranteed payments for services you actually rendered to or on behalf of the partnership.

If you were a general partner, reduce lines 1 and 2 of Part V for any section 179 expense deduction, oil or gas depletion, and unreimbursed partnership expenses.

If your partnership was engaged solely in the operation of a group investment program, earnings from the operation are not self-employment earnings for either the general or limited partners.

If a partner died and the partnership continued, include in self-employment income the deceased partner's distributive share of the partnership's ordinary income or loss through the end of the month in which he or she died. See section 1402(f).

If you were married and both you and your spouse were partners in a partnership, each of you must pay SE tax on your own share of the partnership income. If you are filing jointly, you must each complete a separate Part V. Otherwise, each of you must file a separate Form 1040-SS.

Share Farming

You are considered self-employed if you produced crops or livestock on someone else's land for a share of the crops or livestock produced (or a share of the proceeds from the sale of them). For details, see **Pub. 225**, *Farmer's Tax Guide*.

Other Income and Losses Included in Net Earnings From Self-Employment

- Rental income from a farm if, as landlord, you materially participated in the production or management of the production of farm products on this land. This income is farm earnings. To determine if you materially participated in farm management or production, do not consider the activities of any agent who acted for you. The material participation tests are explained in Pub. 225.
- Cash or a payment-in-kind from the Department of Agriculture for participating in a land diversion program.
- Payments for the use of rooms or other space when you also provided substantial services. Examples are hotel rooms, boarding houses, tourist camps or homes, parking lots, warehouses, and storage garages.
- Income from the retail sale of newspapers and magazines if you were age 18 or older and kept the profits.
- Amounts received by current or former self-employed insurance agents and salespersons that are:

1. Paid after retirement but figured as a percentage of commissions received from the paying company before retirement,
2. Renewal commissions, or
3. Deferred commissions paid after retirement for sales made before retirement.

However, certain termination payments received by former insurance salespersons are not included in net earnings from self-employment (as explained under **Termination payments** on page 7).

- Income of certain crew members of fishing vessels with crews of normally fewer than 10 people. See **Pub. 595**, *Tax Highlights for Commercial Fishermen*, for details.
- Fees as a state or local government employee if you were paid only on a fee basis and the job was not covered under a Federal-state social security coverage agreement.
- Interest received in the course of any trade or business, such as interest on notes or accounts receivable.
- Fees and other payments received by you for services as a director of a corporation.
- Recapture amounts under sections 179 and 280F included in gross income because the business use of the property dropped to 50% or less. Do not include amounts recaptured on the disposition of property. See **Form 4797**, *Sales of Business Property*.
- Fees you received as a professional fiduciary. This may also apply to fees paid to you as a nonprofessional

fiduciary if the fees relate to active participation in the operation of the estate's trade or business or the management of an estate that required extensive management activities over a long period of time.

- Gain or loss from section 1256 contracts or related property by an options or commodities dealer in the normal course of dealing in or trading section 1256 contracts.

Income and Losses Not Included in Net Earnings From Self-Employment

- Salaries, fees, etc., subject to social security or Medicare tax that you received for performing services as an employee, including services performed as a public official (except as a fee basis government employee as explained under **Other Income and Losses Included in Net Earnings From Self-Employment** on this page).
- Fees received for services performed as a notary public. If you have other earnings of \$400 or more subject to SE tax, on the dotted line next to line 3 of Part V, write "Exempt-Notary" and, in parentheses, the amount of your net profit as a notary public from line 2. Subtract that amount from the total of lines 1 and 2 and enter the result on line 3.
- Income you received as a retired partner under a written partnership plan that provides lifelong periodic retirement payments if you had no other interest in the partnership and did not perform services for it during the year.
- Income from real estate rentals if you did not receive the income in the course of your trade or business as a real estate dealer.
- Income from farm rentals (including rentals paid in crop shares) if, as landlord, you did not materially participate in the production or management of the production of farm products on the land. See Pub. 225 for details.
- Dividends on shares of stock and interest on bonds, notes, etc., if you did not receive the income in the course of your trade or business as a dealer in stocks or securities.
- Gain or loss from:
 1. The sale or exchange of a capital asset;
 2. The sale, exchange, involuntary conversion, or other disposition of property unless the property is stock in trade or other property that would be includible in inventory, or held mainly for sale to customers in the ordinary course of the business; or
 3. Certain transactions in timber, coal, or domestic iron ore.

- Net operating losses from other years.
- **Termination payments** you received as a former insurance salesperson if **all** of the following conditions are met.

1. The payment was received from an insurance company because of services you performed as an insurance salesperson for the company.
2. The payment was received after termination of your agreement to perform services for the company.
3. You did not perform any services for the company after termination and before the end of the year in which you received the payment.
4. You entered into a covenant not to compete against the company for at least a 1-year period beginning on the date of termination.
5. The amount of the payment depended primarily on policies sold by or credited to your account during the last year of the agreement, or the extent to which those policies remain in force for some period after termination, or both.
6. The amount of the payment did not depend to any extent on length of service or overall earnings from services performed for the company (regardless of whether eligibility for the payment depended on length of service).

Line 8b

If you received tips of \$20 or more in any month and did not report the full amount to your employer, you **must** file **Form 4137**, Social Security and Medicare Tax on Unreported Tip Income. Disregard the references to Form 1040 shown on Form 4137. Also see the instructions for Part I, line 5, on page 4. Enter on line 8b the amount from Form 4137, line 9.

Part VI—Optional Methods To Figure Net Earnings

The optional methods may give you credit toward your social security coverage even though you have a loss or a small amount of income from self-employment. But the optional

methods may require you to pay SE tax when you would otherwise not be required to pay.

If you are filing a joint return and both you and your spouse choose to use an optional method to figure net earnings from self-employment, you **must each** complete and attach a **separate** Part VI.

Note: *Using the optional methods may qualify bona fide residents of Puerto Rico to claim the additional child tax credit or give them a larger credit.*

Farm Optional Method

You may use this method to figure your net earnings from farm self-employment if your gross farm income was \$2,400 or less **or** your net farm profits (defined on this page) were less than \$1,733. There is no limit on how many years you can use this method.

Under this method, you report on line 2, two-thirds of your gross farm income, up to \$1,600, as your net earnings. This method can increase or decrease your net self-employment farm earnings even if the farming business had a loss.

You may change the method after you file your return. That is, you can change from the regular to the optional method or from the optional to the regular method.

For a farm partnership, figure your share of gross income based on the partnership agreement. With guaranteed payments, your share of the partnership's gross income is your guaranteed payments plus your share of the gross income after it is reduced by all guaranteed payments made by the partnership. If you were a limited partner, include only guaranteed payments for services you actually rendered to or on behalf of the partnership.

Net farm profits is the total of the amounts from Part III, line 36, and your distributive share from farm partnerships.

Nonfarm Optional Method

You may be able to use this method to figure your net earnings from nonfarm

self-employment if your net nonfarm profits (defined on this page) were less than \$1,733 and also less than 72.189% of your gross nonfarm income. To use this method, you also must be regularly self-employed. You meet this requirement if your actual net earnings from self-employment were \$400 or more in 2 of the 3 years preceding the year you use the nonfarm method. The net earnings of \$400 or more could be from either farm or nonfarm earnings or both. The net earnings include your distributive share of partnership income or loss subject to SE tax. Use of this method is limited to 5 years, which do not have to be consecutive.

Under this method, you report on line 4, two-thirds of your gross nonfarm income, up to \$1,600, as your net earnings. **But you may not report less than your actual net earnings** from nonfarm self-employment.

You may change the method after you file your return. That is, you can change from the regular to the optional method or from the optional to the regular method.

Figure your share of gross income from a nonfarm partnership in the same manner as a farm partnership. See **Farm Optional Method** on this page for details.

Net nonfarm profits is the total of the amounts from Part IV, line 27, and your distributive share from other than farm partnerships.

Using Both Optional Methods

If you can use both methods, you may report less than your total actual net earnings from farm and nonfarm self-employment, but you **cannot** report less than your actual net earnings from nonfarm self-employment alone.

If you use both methods to figure net earnings from self-employment, you **cannot** report more than \$1,600 of net earnings from self-employment.

Disclosure, Privacy Act, and Paperwork Reduction Act Notice.

The IRS Restructuring and Reform Act of 1998, the Privacy Act of 1974, and Paperwork Reduction Act of 1980 require that when we ask you for information we must first tell you our legal right to ask for the information, why we are asking for it, and how it will be used. We must also tell you what could happen if we do not receive it and whether your response is voluntary, required to obtain a benefit, or mandatory under the law.

This notice applies to all papers you file with us, including this tax return. It also applies to any questions we need to ask you so we can complete, correct, or process your return; figure your tax; and collect tax, interest, or penalties.

Our legal right to ask for information is sections 6001, 6011, and 7651 and their regulations. They say that you must file a return or statement with the IRS and pay to the United States Treasury any tax for which you are liable. Your response is mandatory under these sections. Section 6109 requires that you provide your SSN on what you file. This is so we know who you are, and can process your return and other papers. You must fill in all parts of the tax form that apply to you.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law.

We ask for tax return information to carry out the tax laws of the United States. We need it to figure and collect the right amount of tax.

If you do not file a return, do not provide the information we ask for, or provide fraudulent information, you may be charged penalties and be subject to criminal prosecution. We may also have to disallow any deductions shown on the tax return. This could make the tax higher or delay any refund, and the calculation of your social security benefits may be affected. Interest may also be charged.

Generally, tax returns and return information are confidential, as stated in section 6103. However, section 6103 allows or requires the IRS to disclose or give the information shown on your tax return to others as described in the Code. For example, we may disclose your tax information to the SSA for use in calculating your social security benefits; to the Department of Justice, to enforce the tax laws, both civil and criminal; and to cities, states, the District of Columbia, U.S. commonwealths or possessions, and certain foreign governments to carry out their tax laws.

We may disclose your tax information to other persons as necessary to obtain information which we cannot get in any other way in order to determine the amount of or to collect the tax you owe. We may disclose your tax information to the Comptroller General of the United States to permit the Comptroller General to review the Internal Revenue Service. We may

disclose your tax information to Committees of Congress; Federal, state, and local child support agencies; and to other Federal agencies for the purposes of determining entitlement for benefits or the eligibility for and the repayment of loans. We may also disclose this information to other countries under a tax treaty, or to Federal and state agencies to enforce Federal nontax criminal laws and to combat terrorism.

Keep this notice with your records. It may help you if we ask you for other information. If you have questions about the rules for filing and giving information, call or visit any IRS office.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	7 hr., 38 min.
Learning about the law or the form	37 min.
Preparing the form	3 hr., 20 min.
Copying, assembling, and sending the form to the IRS	1 hr., 3 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **Do not** send the form to this address. Instead, see **Where To File** on page 1.
