

Rule 6.
Earned Income**Rule 6** You Must Have Earned Income

This credit is called the “earned income credit” because, to qualify, you must work and have earned income. If you are married and file a joint return, you meet this rule if at least one spouse works and has earned income. Earned income includes all the income you get from working — even if it is not taxable. You will figure your earned income in chapter 4 by adding your taxable and nontaxable earned income. *Worksheet 2* on page 21 will help you figure these amounts.

Taxable Earned Income

Taxable earned income includes:

- 1) Wages, salaries, and tips,
- 2) Net earnings from self-employment, and
- 3) Gross income received as a statutory employee.

Wages, salaries, and tips. Wages, salaries, and tips you receive for working are reported to you on Form W–2, box 1. You should report these on line 1 (Form 1040EZ) or line 7 (Forms 1040A and 1040).

Net earnings from self-employment. You may have net earnings from self-employment if:

- You own your business, or
- You are a minister or member of a religious order.

Statutory employee. You are a statutory employee if you receive a Form W–2 on which the “Statutory employee” box (box 15) is checked. You report your income and expenses as a statutory employee on Schedule C or C–EZ (Form 1040).

Nontaxable Earned Income

This includes anything of value (money, goods, or services) that is not taxable that you received from your employer for your work. Common types of nontaxable earned income are listed in the following paragraphs.

Salary deferrals and reductions.

- Salary deferrals. These are contributions from your pay to certain retirement plans (such as a 401(k) plan or the Federal Thrift Savings Plan). These amounts are shown in box 13 of your Form W–2. The “Deferred compensation” box (box 15) of your Form W–2 should be checked.
- Salary reductions, such as under a cafeteria plan, unless they are included in box 1 of your Form W–2. A cafeteria plan is a benefit plan offered by your employer that allows you to choose among two or more benefits consisting of cash and benefits that are not taxed. If you choose a benefit that is not taxed (such as accident and health insurance), the amount of the salary reduction is nontaxable earned income when figuring the EIC.
- Mandatory contributions to a state or local retirement plan.

Meals and lodging.

- Military employee basic housing and subsistence allowances, the value of in-kind housing and subsistence, and combat zone compensation. These amounts are shown in box 13 of your Form W–2 with code “Q.” See Publication 3, *Armed Forces’ Tax Guide*, for detailed information.

- Meals and lodging provided for the convenience of your employer.
- Housing allowance or rental value of a parsonage for the clergy.

Excludable employer-provided benefits.

- Dependent care benefits (line 18 of Form 2441 or Schedule 2 (Form 1040A)).
- Adoption benefits (Form 8839, line 26).
- Educational assistance benefits (these may be shown in box 14 of your Form W-2).

Native Americans

If you are a Native American and received amounts for services performed as an employee that are exempt from federal income tax under the Internal Revenue Code or because of a treaty, agreement, Act of Congress, or other federal law, these amounts are nontaxable earned income when figuring the EIC. (However, any tax-exempt income you received for performing services as a self-employed individual is not earned income when figuring the EIC.)

Approved Form 4361 or Form 4029

This section is for persons who have an approved:

- Form 4361, *Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners*, or
- Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*.

Each approved form exempts certain income from social security taxes. Each form is discussed in this section in terms of what is or is not earned income for purposes of the EIC.

Form 4361. Even if you have an approved Form 4361, amounts you received for performing ministerial duties as an employee count as earned income. This includes wages, salaries, tips, and “other employee compensation.” “Other employee compensation” includes nontaxable compensation such as housing allowances or the rental value of a parsonage that you receive for services as an employee. Amounts you received for performing ministerial duties, but not as an employee, do not count as earned income. Examples include fees for performing marriages and honoraria for delivering speeches.

Form 4029. Even if you have an approved Form 4029, all wages, salaries, tips, and other employee compensation count as earned income. However, amounts you received as a self-employed individual do not count as earned income. Also, in figuring earned income, do not subtract losses on Schedule C, C-EZ, or F from wages on line 7 of Form 1040.

Disability Benefits

If you retired on disability, benefits you receive under your employer’s disability retirement plan are considered earned income until you reach minimum retirement age. Minimum retirement age generally is the earliest age at which you could have received a pension or annuity if you were not disabled. You must report your taxable disability payments on line 7 of either Form 1040 or Form 1040A until you reach minimum retirement age.

Beginning on the day after you reach minimum retirement age, payments you receive are taxable as a pension and are not considered earned income. Report taxable pension payments on Form 1040, lines 16a and 16b, or Form 1040A, lines 12a and 12b.

Disability insurance payments. Payments you received from a disability insurance policy that you paid the premiums for are not earned income. It does not matter whether you have reached minimum retirement age. If this policy is through your employer, the amount may be shown in box 13 of your Form W–2 with code “J.”

Income That Is Not Earned Income

Examples of items that are **NOT** earned income include interest and dividends, pensions and annuities, social security and railroad retirement benefits, alimony and child support, welfare benefits, workers’ compensation benefits, unemployment compensation (insurance), nontaxable foster care payments, and veterans’ benefits, including VA rehabilitation payments. Do **NOT** include any of these items in your nontaxable or taxable earned income.

Earnings while an inmate. Amounts received for work performed while an inmate in a penal institution are not earned income when figuring the earned income credit. These amounts include amounts received through a work release program or while in a halfway house.

Workfare payments. Nontaxable workfare payments are not earned income for the EIC. These are cash payments certain people receive from a state or local agency that administers public assistance programs funded under the federal Temporary Assistance for Needy Families (TANF) program in return for certain work activities such as (1) work experience activities (including remodeling or repairing public housing) if sufficient private sector employment is not available, or (2) community service program activities.

Community property. If you are married, but qualify to file as head of household under special rules for married taxpayers living apart (see *Rule 2*), and live in a state that has community property laws, your earned income for the EIC does not include any amount earned by your spouse that is treated as belonging to you under those laws. That amount is not earned income for the EIC, even though you must include it in your gross income on your income tax return. Your earned income includes the entire amount you earned, even if part of it is treated as belonging to your spouse under your state’s community property laws.