

Disability Income Treated as Earned Income

Rule: When a taxpayer is receiving disability income (reported on a 1099-R) and the taxpayer is younger than minimum retirement age, that income is generally treated as wage income on line 7 of Form 1040. That means that it is earned income and can be used for the EITC computation, as well as additional child tax credit.

To qualify:

- The income must be received under an employer's disability retirement plan.
- The income must be taxable.
- Payments received under a disability insurance plan paid for by the taxpayer do not qualify to be treated as earned income.
- Minimum retirement age is the earliest age that the taxpayer could have received a pension if the taxpayer were not disabled.

What does this mean for tax preparation? Be on the lookout anytime you see a taxpayer with 1099-R income with distribution code 3 (disability) — particularly if the person seems too young to be retired or checks the disabled box on Form 13614-C. In these situations the preparer needs to start asking questions to determine how the income should be reported.

Example 4: Marjorie, single, age 42, arrived at the tax site in a motorized wheelchair. She had \$20,000 income on a Form 1099-R with distribution code 3. She had retired on disability in 2014 and was qualified to treat the 1099-R income as earned income. This meant that she got some EITC and a bigger refund.

TaxWise: When entering the Form 1099-R, check the box next to, "*Check if disability and taxpayer is disabled,*" under boxes 7 and 8. This will prompt TaxWise to report the income like wages on line 7, Form 1040.