

Uniform Definition of a Child for Dependency Exemption Tax Benefits

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With the elimination of the support test and the expansion of relationships in electing the dependency exemption and other child-related tax benefits, there is an opportunity to maximize the household's tax savings.

The Working Families Tax Relief Act of 2004 established a new definition of a "qualifying child" for purposes of the dependency exemption, child tax credit, the earned income tax credit, the dependent care credit and head of household filing status. The most significant changes from prior law were the elimination of the support test and the income test. Under the uniform definition an individual to qualify as a "qualifying child" must:

1. Bear a specific relationship to the taxpayer;
2. Reside with or have the same principal residence as the taxpayer for more than half of the tax year;
3. Be under 19 years of age or, if a full time student, under 24 years of age, unless the individual is permanently and totally disabled;
4. Not provide more than half of the individual's support;
5. Not have filed a joint return for the taxable year which coincides or includes any part of the taxpayer's taxable year; and
6. Be younger than the taxpayer claiming the individual as a "qualifying child."

Relationship Test

Under the relationship test, an individual must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister or a descendant of any one of those individuals. The relationship may be by adoption or by placement as foster care.

Age Test

At the end of the tax year the individual must be under 19 or if a full-time student under 24. There are no age requirements for an individual who is permanently and totally disabled to be a qualifying child.

In order to qualify as a “student” the individual must be enrolled at least five months during the calendar year as a full time student at a qualified educational institution or be pursuing a full-time course of institutional on-farm training. The five-month period allows a graduating student to still qualify as a qualifying child in the year of graduation.

For the child tax credit an individual must be under 17 years of age and for the child and dependent care credit under 13 years of age (or permanently and totally disabled).

Principal Place of Abode Test

An individual must have the same principal place of abode as the taxpayer for more than half of the tax year in order to qualify as a qualifying child. Temporary absences due to school, vacation medical care etc. are not treated as absences as long as it is reasonable to assume that the individual will return to the taxpayer’s abode.

A kidnapped child, who had the same abode as the taxpayer for more than one-half of the portion of the year before the date of the kidnapping, is presumed to satisfying the principal place of abode test while missing. A missing child is presumed to cease satisfy the principal place of abode test in the first tax year beginning after the year in which the child would have turned 18 years of age or is determined to be dead.

Finally, an individual must be younger than the taxpayer claiming the individual as a qualifying child.

Support Test

Under prior law, a taxpayer had to supply more than 50 percent of the support of an individual in order to claim that individual as a dependent. Congress enacted the uniform definition of a qualifying child focusing on the individual’s support of himself or herself. To be a qualifying child, the individual must not have provided more than half of his or her own support.

The support test that is part of the definition of a qualifying child does not apply with respect to the earned income tax credit. It also differs from the support requirements for head of household status. To claim head-of-household status based on a child, the taxpayer must have contributed over half of the cost of maintaining the household that is the principal place of abode of the child.

Marital Status

A married individual must not have filed a joint return with the individual’s spouse for the same taxable year that the taxpayer is claiming the individual as a qualifying child. However, for head-of-household status, a qualifying child must not be married as of the close of the taxable year.

Tie-breaking Tests

With the elimination of the support test, there is an increased likelihood that more than one taxpayer could claim an individual as a qualifying child. As a result, certain tie-breaking rules apply when two taxpayers are eligible to claim the individual as a qualifying child. If one of the taxpayer's claiming the individual is the individual's parent and the other is not, the individual is treated as the qualifying child of the parent. If none of the taxpayers who are eligible to claim the child individual are the individual's parents, the individual is treated as the qualifying child of the taxpayer with the highest adjusted gross income (AGI).

If the taxpayers who may claim the individual are the individual's parents, the parent with which the child resided with for the longest period of time during the tax year may claim the child. If the child resided with both parents for the same amount of time during the tax year, the parent with the highest AGI may claim the individual. If the parents of an individual may claim an individual as a qualifying child but neither parent does, the individual may be claimed as the qualifying child of another taxpayer but only if the AGI of such taxpayer is higher than the highest adjusted gross income of either parent of the individual.

Room for Planning

The elimination of the support test and the substitution of the residency test, together with the increase in the number of relationships that constitute a "qualifying child," there are planning opportunities to maximize the tax benefit of child related tax benefits among members of a taxpayer's household. This is especially so considering the phase out of the dependent exemption and other child related tax benefits for high income taxpayers and also for taxpayers subject to the alternative minimum tax (AMT). An often cited example is a family consisting of high income parents, a minor daughter and a 22-year-old son who is not a student and who earns \$15,000 of income. Because the parents by claiming the daughter as a qualifying child would receive little or no benefit from the dependency exemption and other child related tax benefits and the daughter is a qualifying child of the son, the maximum tax benefits for the household can be achieved if the son claims his sister as a dependent and also claims the child tax credit and even the earned income tax credit (EIC). If the son was a full-time student and provided more than half of his support or did not intend to return home, the son would not be considered a qualifying child of his parents or his sister and therefore could claim his sister as a dependent.

Conclusion

Every high-income taxpayer with a child living at home or a child away at school should review the tax benefits from claiming a dependency exemption and the other child related tax benefits before filing his or her income tax return. This is especially so for 2009 and 2010, where the child tax credit remains at \$1,000 for each child under the age of 17, but the earned income floor upon which the refundable amount of the credit is computed has been reduced from \$8,500 to \$3,000, and where the earned income credit percentage has been increased for three or more qualifying children.

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