



Navigating the Maze of Dependent-Related Tax Benefits

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I. Introduction and Background

Every year, millions of taxpayers claim a child or other dependent related tax benefits on their federal tax returns. While the benefits are intended to be straightforward, the inconsistency of the eligibility rules makes claiming these benefits complex, as taxpayers are often confused when they are eligible for some benefits but not all.

Tax year 2015 marks the 10th anniversary of the implementation of the uniform definition of child, or UDC, which was introduced by the Working Families Tax Relief Act of 2004 (PL 108-311). As its name implies, the UDC was meant, as far as possible, to apply uniform eligibility rules across five child-related tax benefits:

- The dependent exemption
- The child tax credit
- The child and dependent care credit
- The earned income tax credit (EITC)
- Head of household filing status

The UDC also addresses claiming tax benefits for other individuals who may be, but are not necessarily children, such as parents and other relatives.

Defining a child before and after 2005

Here is an example that illustrates the difference between a taxpayer's experience before and after the UDC was implemented.

Suppose a foster care agency legally places a six-year-old child in the home of a taxpayer. The taxpayer is divorced and lives with her 29-year-old son, who works and pays most of his own expenses. Under the UDC law, the six-year-old child is an "eligible foster child," because an authorized agency legally placed her with the taxpayer. As a result, the child potentially qualifies the foster parent for the dependent exemption and the other four tax benefits. The son does not qualify the taxpayer for any tax benefits.

Before the UDC, the same family configuration would have yielded different results. "Foster child" had a different meaning for the various tax benefits. The child may have qualified the foster parent for the EITC – and nothing else. The son may have qualified the taxpayer for head of household filing status – and nothing else.

The taxpayer might have reasonably asked, "How is it possible that someone can be *my* child for one tax purpose, but not for another purpose?" The answer was that before the UDC, each of the five tax benefits had its own set of eligibility rules. A child meeting one set of rules did not necessarily meet any of the others.

While the UDC created more uniformity in the way that taxpayers claim children and other dependents, it did not completely eliminate complexity or confusion. Eligibility inconsistencies remain across the original five tax benefits considered as part of the UDC, as well as for other benefits, such as higher education and health insurance deductions and credits. In addition, income limits and phase-out levels create additional complexity and confusion. This is especially true for taxpayers with multigenerational, extended family, and nontraditional households.

This paper reviews the current UDC law and how it applies across tax benefits. The paper also provides scenarios that illustrate the complexity and confusion the UDC causes for taxpayers, and provides a navigation guide for determining eligibility for dependent-related tax benefits.

A brief discussion of Affordable Care Act requirements is also provided to show that the new layer of complexity this law introduces for many families with children or other dependents.

II. UDC 101: The Basics

The qualifying child

The definition of a “qualifying child” is a critical component of the UDC law. For a taxpayer to claim the dependent exemption for a child:

- The child must “pass” specific tests, and
- The taxpayer must not be anyone’s dependent for tax purposes.

The qualifying child tests are:

- Age
- Relationship
- Residency
- Support

In addition to these tests defined in the UDC law, a dependent’s citizenship status and marital tax-filing status can also impact a taxpayer’s ability to claim tax benefits for that dependent.

Appendix A contains a Qualifying Child Chart that outlines the various tests for the dependent exemption and the other four child-related tax benefits. As the chart shows, a taxpayer with a qualifying child cannot necessarily claim all five of the child-related tax benefits. That is because:

- Qualifying child tests are not *completely* uniform across the board, and
- Each benefit may come with additional requirements.

UDC rules affect other tax benefits

The UDC law specifically refers to only the five tax benefits mentioned above.

However, other tax benefits also refer to “the taxpayer’s qualifying child or qualifying relative” or “the taxpayer’s dependent under IRC §152” and so on.

A dependent, whether a qualifying child or a qualifying relative, may qualify a taxpayer for other tax benefits, such as education tax benefits, medical expense deductions, the adoption credit, and the Affordable Care Act premium tax credit.

The tie-breaker & no split rule for multiple taxpayers

One area of confusion for taxpayers is when a child is a qualifying child of *more than one taxpayer*.

For example, suppose a child lives with a parent, a grandparent, and an adult sibling, and meets the qualifying child tests for all of them.

If all of them want to claim the child for tax benefits, the tie-breaker rule comes into play. This rule, which is outlined in Appendix D, determines who gets to claim the child for tax benefits. It also dictates if and when a higher-priority taxpayer can allow a lower-priority taxpayer to claim the child.

Ultimately, the “winner” of the tie-breaker can claim the child-related tax benefits that he or she qualifies to claim. The taxpayers who did not “win” the tie-breaker cannot claim *any* tax benefits related to the child. In this way, the tie-breaker rule creates a “no split” rule, which prevents taxpayers from splitting child-related tax benefits.

Exception to the no-split rule: divorced parents

There is one exception to the “no split” rule. It applies when parents are divorced.

By default, the child is the qualifying child of the custodial parent. The custodial parent is defined, under federal tax law, regardless of the divorce decree, as the parent with whom the child resides for the greater number of nights during the year. However, the custodial parent can choose to allow the other parent to claim the dependent exemption. To do so, the custodial parent must complete a Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, and give the form to the other parent, who must attach it to his or her own tax return.

To qualify for the special rule:

- Parents must be divorced, legally separated, or live apart at all times for the last six months of the year.
- One or both parents must have custody of the child for more than half the year.
- One or both parents must provide more than one-half of the child’s support.

By completing the release, the custodial parent attests that he or she will not claim the child’s exemption for a defined timeframe. That may be for one or more years, odd or even years, or all future years.

When the custodial parent releases the exemption, the other parent can claim the child’s dependent exemption and the child tax credit (if the child is under age 17). The custodial parent may still be eligible for the EITC, child and dependent care credit, and head of household filing status.

Note: In practice, most divorced parents have joint legal custody of children, who split their time between parents. Because it is rare for one parent to have sole legal custody of a child, the regulations, as written, add to taxpayers’ confusion about these rules. The IRS regulations about custody do not always mirror taxpayers’ common-sense understanding of custody, or states’ legal systems.

The qualifying relative

A taxpayer may be able to claim the dependent exemption and certain other tax benefits for a child who is *not* the taxpayer’s qualifying child, or for a person who is not a child at all, but is the taxpayer’s parent, grandparent, adult son or daughter, or other family member. This type of dependent is called a qualifying relative.

For a taxpayer to claim the dependent exemption for a qualifying relative:

- The relative must “pass” specific tests, and
- The taxpayer must not be anyone’s dependent for tax purposes.

The qualifying relative tests are:

- Relationship
- Gross income
- Support
- Citizenship
- Joint return
- “Not a qualifying child”

Some of these tests are the same as the qualifying child tests; others are quite different, although they have the same name. The Qualifying Child/Qualifying Relative Chart in Appendix C compares the tests.

If a taxpayer's relative meets all of the tests, the relative is the taxpayer's qualifying relative for the dependent exemption, and possibly the head of household filing status and the dependent care credit. However, taxpayers cannot claim the child tax credit or EITC for a qualifying relative.

III. UDC: a Maze of Confusion

The UDC has specific meaning as a tax law, but the meaning is less clear and far from intuitive for most taxpayers.

Whose child?

A "qualifying child" is not necessarily the taxpayer's son or daughter. Siblings, nieces, nephews, grandchildren, stepchildren, and more could all be the taxpayer's qualifying children.

Also, some taxpayers may not be certain about how family members are related or may wrongly conclude that a relationship is allowed when it is not. For instance, siblings and siblings' children meet the qualifying child relationship test. First cousins and first cousins' children do not.

Unrelated relatives

Similarly, qualifying relative relationships can be confusing. A sister-in-law is on the qualifying relative relationship list; a cousin is not. A step-parent is on the qualifying relative relationship list; the spouse of an aunt or uncle is not.

And *anyone* – even an individual who is not related to the taxpayer in any way – could be the taxpayer's "qualifying relative" if the individual lives with the taxpayer all year and passes the other qualifying relative tests. However, in that case, the taxpayer can claim only the dependent exemption for the individual.

Non-dependent dependents

Before the UDC, to claim an individual as a dependent, a taxpayer had to provide more than half of the dependent's support. The "half support" test is still required for all qualifying relatives.

However, with specific exceptions for children of divorced and separated parents, taxpayers don't have to support a qualifying child at all, as long as the child doesn't provide more than half of his or her *own* support. As a result, a taxpayer's "dependent" qualifying child may not rely on the taxpayer for any support at all.

All or nothing

Taxpayers often do not understand that, to get tax benefits, they must show that qualifying children and qualifying relatives pass *all* tests (not just a few).

For example, a grandmother who supports her grandson could certainly conclude that she's entitled to her grandson's dependent exemption. But if the grandson doesn't live with her (residency test failed), her grandson is not her qualifying child.

Taxpayers who support children, or live with them, or meet some other qualifying child or qualifying relative eligibility requirement, may conclude that the dependent exemption or some other dependent-related tax benefit is theirs to claim when it is not.

Also, as explained above, the UDC does not provide across-the-board uniformity. Thus, even if an individual meets all qualifying child or qualifying relative tests with respect to a taxpayer, it doesn't mean that the taxpayer can claim *all* dependent-related tax benefits. For example, a child could be too old for the child tax credit, or the taxpayer's income could be too high for the EITC. To claim any of the five tax benefits, all requirements *for that benefit* must be met.

One for all (and all for one)

Before the UDC, more than one taxpayer could claim the same child for different tax benefits. Under the UDC "no split" rule – with the exception of divorced parents – the taxpayer who "wins" the tie-breaker rule claims the tax benefits that he or she is eligible for – and no one else can claim benefits with respect to the child.

For example, suppose a child lives with a parent and the parent's brother (the child's uncle) and is a qualifying child for both adults. Either adult could claim the child's dependent exemption and child tax credit. The parent's income is in the EITC range, while the uncle has a higher AGI and meets head of household filing requirements. The parent has the superior claim and would "win" the tie-breaker rule if both adults attempted to claim the child. If the parent agrees to let the uncle claim the child, he may claim only those benefits for which he is eligible. The parent cannot "keep" the child for the EITC. The fact that the uncle's income is out of EITC range is not relevant.

Even the very term "uniform definition of child" is not mentioned in form instructions, publications, fact sheets, and the like. Taxpayers do not necessarily catch on that none of the child-related tax benefits exists in a vacuum, but rather, each is connected to all of the others. Thus, the parent in this example could understandably think she can claim the EITC for her child but let her brother claim other tax benefits.

IV. Scenarios

Millions of taxpayers live in multigenerational, extended family, and other nontraditional households. With complicated family situations, taxpayers may face challenges in claiming child-related tax benefits under the UDC rules. The following scenarios illustrate the reality of the UDC's application.

Scenario 1 – "Any other taxpayer"

Although a taxpayer may support and care for someone as his or her own child, doing so doesn't necessarily mean the taxpayer qualifies for any child-related tax benefits.

The setting

Louis lives all year with his fiancée, Allie, and Allie's three-year-old daughter, Mindy, from a previous relationship. Louis earns \$40,000 a year and pays nearly all household expenses. Allie earns about \$6,000 a year from her part-time job and takes some college classes.

What they expect

Louis wants to claim Mindy as his qualifying child and benefit from the dependent exemption, child tax credit, and head of household filing status. Allie agrees.

The reality

Mindy is not Louis's qualifying child, because she "fails" the relationship test.

She meets some of the tests to be Louis's qualifying relative because she has lived in his household all year, and Louis provides more than half of her support. However, an important qualifying relative test may stand in his way: A qualifying relative may not be a qualifying child of *any other taxpayer*.

Mindy meets all of the qualifying child tests with respect to her mother, but is her mother a "taxpayer"?

An individual is *not* a taxpayer if she a) does not have a tax-filing requirement, and b) files a tax return only to get a refund of all withheld taxes.

The results

Allie meets the first prong of the "not a taxpayer" test, because her income is well below the filing requirement for a single individual. If she doesn't file a tax return, or files one just to get all of her withholding refunded, Louis can claim Mindy as his dependent qualifying relative.

He cannot claim the child tax credit, because it requires him to have a qualifying child. He also cannot use the head of household filing status, because Mindy is his "unrelated relative," that is, a qualifying relative only because she lives in Louis' household all year. Louis must file as single.

Varying this result, suppose Allie decides to file a tax return just to claim the refundable education-related American Opportunity Credit. If Allie does so, Mindy would be a "qualifying child of another taxpayer" *even if Allie isn't claiming Mindy*. That, in turn, would prevent Louis or anyone else from claiming Mindy as a qualifying relative.

If Allie does claim Mindy, Allie would be eligible for the EITC and child tax credit, as well as the American Opportunity Credit. The couple may find this to be more advantageous than having Louis claim Mindy just for the dependent exemption.

Scenario 2 – Divorce decree vs. federal tax law

Divorce decrees may spell out which parent can take dependent exemptions for the couple's children, but the couple must still comply with federal tax law.

The setting

Ronnie and Hank were divorced in 2014, and have joint custody of their two minor children, Mark and Brian. Their divorce decree states that Hank can claim the children's dependent exemptions if Hank is current on his child support, which he is. The children reside with Ronnie the majority of the time, and stay with Hank every other weekend.

What they expect

Hank assumes he can claim exemptions for the two boys. He is wondering whether he gets to claim any other child-related benefits. Ronnie would prefer to claim the boys, but thinks the divorce decree prevents her from doing so.

The reality

Ronnie (the custodial parent) can release children's exemptions to Hank (the noncustodial parent), if:

- The parents are divorced, legally separated, or never married (they are divorced)
- The children are in the custody of one or both parents (the children are in joint custody), and
- One or both parents provide more than half of the children's support (which is true in this case).

IRS regulations and other guidance require the release to be in the "form and manner" acceptable to the IRS – which, for post-2008 divorces, is Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*.

Form 8332:

- Identifies the two parents and the child (a separate release is needed for each child)
- Specifies which year or years the release covers
- Indicates that the custodial parent will not claim the child for that year or years
- Is signed by the custodial parent and furnished to the noncustodial parent

The IRS will accept a statement that is "substantially similar" to Form 8332 but, in practice, most taxpayers probably will not be able to come up with an acceptable release.

Most important, Ronnie and Hank's divorce decree is not an acceptable release for federal tax purposes. While some pre-2009 decrees may have qualified, most did not, and using decrees was problematic for taxpayer and the IRS. Notably, a proper release (under federal law) cannot be contingent on any particular action from the noncustodial parent, such as paying child support (under state law).

The results

If Ronnie completes Form 8332 for each of the children, Hank can claim Mark's and Brian's dependent exemptions and child tax credits (as outlined in the divorce decree). If Ronnie meets the requirements, she can also file as head of household and claim the EITC and child and dependent care credit.

If Ronnie does not complete the Form 8332 releases for the children, Hank cannot claim Mark and Brian. Ronnie and Hank may have some difficulty reconciling this fact with the terms of the divorce decree and wonder how to remedy the situation. However, Ronnie is not compelled by *federal* tax law to release the exemptions. Ronnie and Hank might be advised to consult their respective attorneys regarding this issue.

Scenario 3 – Head of household and the grandchild dilemma

It is difficult for taxpayers who are still legally married to understand that, to be treated as unmarried under the law, their only allowable dependent is their son or daughter.

The setting

Since they were toddlers, Mary and Shirley have lived with their grandparents Jeff and Rose. Now, the girls are both teenagers. The girls' father does not live nearby, and their mother cannot care for them. Jeff moved out of the house last spring. The couple expects to divorce at some point, but, so far, neither of them has taken any legal action. In previous years, Jeff and Rose filed a joint tax return and claimed the girls as their dependents, as well as the child tax credit and the EITC.

What they expect

Jeff does not want to file a joint return. He knows he has to file as married filing separately and is fine with that. Rose plans to file her own return as head of household and claim the girls' dependent exemptions and the EITC.

The reality

A married taxpayer *must* use a married filing status – married filing jointly or married filing separately – unless the taxpayer qualifies to use the head of household filing status.

Ordinarily, to file as head of household, a taxpayer must:

- Be unmarried or considered unmarried.
- Have a qualifying child or qualifying relative who can be claimed as a dependent, and
- Maintain a home (pay more than half of household expenses) that is the also the main home of the dependent for more than half the year.

Rose meets the last two requirements, because she lives with her two granddaughters, who are her qualifying children, and she pays more than half of the household costs. The first requirement presents a problem because Rose *is* still married.

A married person can be considered unmarried if:

- The spouses live apart at all times during the second half of the year, and
- The married individual maintains a home for a son or daughter.

For this purpose, a son or daughter would include an adopted son or daughter, a stepson or stepdaughter, or an eligible foster child – but not a grandchild, sibling, or any other type of relative.

The results

Rose is married and cannot be considered unmarried because her qualifying children are her granddaughters, not her daughters. Although she can claim the girls' dependent exemptions, she is not qualified to file as head of household.

Unless Rose and Jeff change their minds, Rose must use the married filing separately status, which is the least favorable of all filing statuses. She can claim the child tax credit, but the EITC is not allowed for married filing separately status.

Note that the same head of household limitation would apply if Rose's dependents were her parents, siblings, or any other relative.

To change her situation, Rose has a couple of options. She could proceed with the divorce. Once the divorce is final, she would be officially unmarried and not hampered by the "considered unmarried" restriction. Or, she could go to family court and have the children formally and legally placed with her, which would make Mary and Shirley her eligible foster children. However, even if she successfully pursues either option, her tax result would not change until the tax year when the divorce is finalized or she gets the children legally placed with her.

Scenario 4 – The twins

Taxpayers cannot always plan for changes when children unexpectedly age out of child-related tax benefits.

The setting

Martha lives with her twin sons, Ryan and Ben, who are 19 years old. Martha is a widow, and her income is in EITC range. Last year, Martha claimed the boys' dependent exemptions and the EITC. She used the head of household filing status. Ryan is now a full-time student at a nearby community college. He has a job, pays nearly all of his expenses, and helps out with some of the household expenses when he can. Ben made about \$1,500 for the year from a few odd jobs, but Martha still mostly supports him.

What she expects

Because both sons still live with her, Martha expects to have pretty much the same outcome for this year's taxes.

The reality

Unlike the children in the previous scenarios, Ryan's and Ben's circumstances are not the same, and each has different results under the UDC. Ryan cannot be a qualifying child for the dependent exemption because he supports himself. However, because the EITC does not have a support test, Ryan *is* a qualifying child for EITC purposes.

Ben is not a qualifying child for the dependent exemption because he fails the age test. He turned 19 and is not a full-time student. However, Ben does pass all of the qualifying relative tests, notably the gross income and support tests, so Martha can continue to claim his dependent exemption. Ben is also a qualifying relative for head of household purposes. Martha cannot claim the EITC for Ben because he is a qualifying relative.

The results

Martha files as head of household, with Ben as her qualifying relative. She can claim the EITC, but only for Ryan.

Scenario 5 – Three generations under one roof

Taxpayers in multigenerational households often have a conflict of interest at the same time they need to coordinate and communicate when filing their tax returns.

The setting

The following people live in the Lloyd household:

- Myrna Lloyd, 50, widowed, owns the home, earned income/adjusted gross income of \$40,000
- Joan Grant (Myrna's daughter), 24, recently divorced, earned income/AGI of \$20,000
- Betty Grant (Joan's daughter, Myrna's granddaughter), age 2
- Jim Lloyd (Myrna's son, Joan's brother, Betty's uncle), age 16, high school student, no income

Last year, Myrna filed as head of household, claiming Jim as her dependent, as well as the child tax credit. Joan and Betty moved in with them early this year. Myrna continues to pay most of the household expenses for her expanded family, allowing Joan to save money. Joan's major expense is paying a daycare provider to look after Betty so that Joan can work. Joan's ex-husband does not provide any support for Joan or Betty.

What they expect

Myrna expects to file as head of household and claim Jim as her dependent as she did last year. She would like to claim Betty as her dependent, too. She realizes that while her income is out of EITC range for one child, it is within range for two children. She also wonders whether she can claim Joan as her dependent, too, because Myrna pays many of her expenses.

Joan is willing to sign a release form to let Myrna claim the dependent exemption for Betty, but she wants to claim the EITC and child/dependent care credit for herself. She also wonders whether she can claim the child tax credit and EITC for Jim.

The reality

In this type of situation, the tie-breaker rule comes into play. Betty is a qualifying child of Myrna and Joan, but, as the parent, Joan has the superior claim. It is her choice to claim Betty or let Myrna claim her.

Joan does not have to and should not sign Form 8332 (which applies *only* to divorced or legally separated couples) or any other type of release to let Myrna claim Betty. To allow Myrna to claim Betty, all Joan has to do is to *not* claim Betty herself.

The taxpayer who claims Betty claims all of the child-related tax benefits that apply. Myrna and Joan cannot split the tax benefits. If both taxpayers try to claim Betty, Joan would “win” the tie-breaker.

Myrna cannot claim Joan as a dependent because Joan is too old to be a qualifying child, and she fails the gross income test to be a qualifying relative.

Jim is a qualifying child of his mother and his sister, but this time, Myrna has the superior claim. Under the tie-breaker rules, Myrna cannot allow Joan to claim Jim because Joan’s AGI is lower than Myrna’s.

The results

The outcome depends on what Joan decides to do. If she claims Betty, it will be for the dependent exemption, the child tax credit, the EITC, and the child/dependent care credit. If Myrna claims Betty, it will also be for the dependent exemption, child tax credit, and the EITC. Either way, Joan would file as single (because she does not pay household expenses), and Myrna would file as head of household (because she pays the household expenses and Jim is her qualifying dependent).

V. Navigation Guide

The scenarios covered above are not unusual or unique. They illustrate the very real situations that taxpayers with children may have and the challenges they face in trying to take advantage of all dependent-related tax benefits offered by the tax code. The following steps are intended to help navigate the complex rules to ensure the law is properly applied – and applied to the taxpayer’s best advantage.

1. Start by understanding who lives in the household, how long each person has lived there, and how each household member is related to the others, if at all.
 - a. For a child in the home, determine whether all of the qualifying child tests are met with respect to the taxpayer. Remember the “all or nothing” rule. If even one test is failed (Mindy for Louis in Scenario 1, Ben for Martha in Scenario 3) the child is not a qualifying child of that taxpayer.
 - b. If all tests are met except the support test (Ryan in Scenario 3), the child may be a qualifying child for EITC purposes only.
2. If more than one adult lives in the home (aside from married parents who file a joint return), determine whether each child meets the qualifying child tests with respect to anyone else, such as a grandmother (Betty for Myrna in Scenario 5).
 - a. If a child is a qualifying child of more than one taxpayer, the parent has the superior claim. The parent may choose to let another taxpayer claim the child only if that taxpayer’s AGI is higher than the parent’s.
 - b. Remember the “all for one” rule. Whoever claims the child claims all the child-related benefits that apply. Except for the special rule for divorced parents, taxpayers cannot split benefits.

3. If a child is not a qualifying child of any taxpayer, determine whether the taxpayer can claim the child as a qualifying relative, again applying all tests and making sure the child passes all of them.
 - a. An individual who does not have a filing requirement and only files a return to get a refund of all withheld taxes is not a “taxpayer” (Allie in Scenario 1).
 - b. A child can meet the qualifying relative relationship test by being a member of the taxpayer’s household all year (Mindy for Louis in Scenario 1), but qualifies only for the dependent exemption and not for the child tax credit, EITC, or head of household filing status.
4. For divorced, legally separated, or never-married parents, the “special rule” may apply.
 - a. If this rule applies, and regardless of divorce decree language, the custodial parent generally must furnish Form 8332 to the non-custodial parent to release the child’s exemption.
 - b. If the custodial parent releases the child’s exemption, the noncustodial parent can claim the dependent exemption and child tax credit (if the child is under 17). The custodial parent can claim head of household, EITC, and the child and dependent care credit if he or she is eligible.
5. Be aware that each child- or dependent-related benefit has requirements that could be different from or could be in addition to the qualifying child and qualifying relative tests for dependency.
 - a. While the UDC covers five tax benefits for qualifying children (three tax benefits for qualifying relatives), it does not necessarily mean that a taxpayer can claim all of these benefits.
 - b. For a number of reasons, a taxpayer with a dependent may not be able to use the head of household filing status.
 - i. The taxpayer may have a dependent that is not a qualifying person for head of household status (Louis in Scenario 1, Rose in Scenario 3).
 - ii. The taxpayer may not pay the costs of maintaining a home (Joan in Scenario 5).
 - c. Be especially careful with due diligence requirements for the EITC. In tax year 2016, these requirements will apply to the child tax credit and American Opportunity Credit, as well.

If taxpayers are willing, it is often advantageous to “run the numbers” more than one way to see what results in the best possible tax benefit.

VI. Patient Protection and Affordable Care Act (ACA) Considerations

Starting in 2014, the individual responsibility provisions of the ACA require a taxpayer to have minimum essential health insurance coverage for every member of the taxpayer’s tax family.

For families with children or other dependents, ACA requirements often add another layer of complexity to their taxes. Many families face the following considerations.

Tax family

A taxpayer’s tax family may or may not correspond to the taxpayer’s actual living arrangements. The tax family consists of the taxpayer, spouse (if filing jointly) and individuals whom the taxpayer claims, or could claim, as dependents.

For example, a taxpayer may live with a spouse, elderly parent, and an adult self-supporting daughter. The taxpayer files a joint tax return claiming a college-age son who lives at school as a dependent.

Under the ACA, the taxpayer's tax family consists of the taxpayer, spouse, and son. The adult daughter and elderly parent are not part of this taxpayer's tax family even though each lives in the taxpayer's household; each is considered to be a tax family of one.

Tax penalties

If every individual in a taxpayer's tax family does not have qualifying health insurance coverage for the entire tax year, the taxpayer may owe a penalty (unless an exemption applies). Taxpayers are still subject to the penalty even if they do not claim the dependent exemption for an uninsured individual in their tax family.

Insurance family

A taxpayer's insurance family may be different from the taxpayer's tax family or actual household.

For example, if the self-supporting adult daughter in the above example is younger than 26, she may be covered by her parent's insurance policy. However, she is ultimately responsible for her own coverage. If she does not have health insurance for the entire year, she would be subject to the penalty on her own tax return.

Tie-breaker rule

When the tie-breaker rule is involved, generally, the taxpayer who claims the child's dependent exemption is the one responsible for that child's coverage.

If a higher-priority taxpayer relinquishes the child's exemption to a lower-priority taxpayer, the lower-priority taxpayer must ensure that the child has qualifying coverage.

If nobody claims the child, then the responsibility and possible penalty go to the taxpayer who would have won the tie-breaker rule.

Premium tax credit (PTC) recipients

Taxpayers who obtain insurance from the health insurance marketplace and receive PTCs have additional considerations when dependents are involved.

The size of the credit depends on the taxpayer's household income, which includes the taxpayer's and spouse's modified adjusted gross income (MAGI) and the MAGI of dependents required to file a tax return.

If the college-age son in the above example has a job and has to file his own tax return, then his MAGI is added to his parents' MAGI to calculate the premium tax credit.

A particular difficulty can occur in "shared policy allocation" situations. This occurs when:

- There is a marketplace policy and PTCs, and
- Either a taxpayer's policy covers an individual who is not part of the taxpayer's tax family, or a member of the taxpayer's tax family is covered by another taxpayer's policy.

In this situation, PTCs must be carefully allocated between tax families under IRS guidelines. The shared policy problem can occur especially when the special rule for divorced parents or the tie-breaker rule is involved. It can also occur in blended families and in many types of nontraditional households.

With its own set of complications, the ACA can create another layer of complexity at tax time for many families who must also apply the UDC to their specific circumstances to obtain child- and dependent-related tax benefits.

VII. Conclusion

When it comes to claiming child- and dependent-related tax benefits, many families do not have a clear answer. They must navigate the rules and definitions – and apply them to their unique and complex lives – to figure out who can claim a child or other dependent for a tax benefit.

While the UDC created more uniformity in the law, taxpayers often still struggle to apply it, especially in multigenerational, extended family, and nontraditional households. The scenarios presented in this paper are not unusual – and they seek to demonstrate why these concepts can be confusing for so many taxpayers with children and dependents. In addition, millions of these same taxpayers now face new ACA requirements that are different, but often equally as confusing in practice.

Appendix A: Qualifying Child Chart

Qualifying Child Tests	Dependent exemption	Head of household filing status	Child tax credit	Earned income tax credit	Child and dependent care credit
AGE (1) Younger than the taxpayer and under age 19 or under age 24 and a full-time student, or (2) Any age if totally and permanently disabled	√	√	Under age 17	√	Under age 13 or disabled
RELATIONSHIP Taxpayer's son, daughter, stepson, stepdaughter, eligible foster child, brother, sister, half-sibling, stepsibling, or descendant of any of these individuals	√	√	√	√	√
RESIDENCY Child must have same principal place of abode as taxpayer for more than half the year	√	√	√	Residence must be in U.S.	√
SUPPORT Child must not provide more than one-half of own support	√	√	√	No support requirement	√
CITIZENSHIP Child must be U.S. citizen, U.S. national, U.S. resident alien, or resident of Canada or Mexico	√	√	U.S. citizen, national or resident alien only	Same as child tax credit and valid SSN needed	√
MARRIED CHILD May not file a joint return with spouse other than a claim for refund of withheld tax or estimated tax	√	√	√	√	√
TAXPAYER MUST MEET ADDITIONAL REQUIREMENTS TO CLAIM THIS BENEFIT	Must not be claimed (or allowed to be claimed) as a dependent of another taxpayer	Must pay more than half the cost of maintaining home	Must meet AGI limits and must have over \$3,000 in earned income to qualify for the refundable portion of the credit	Must meet earned income, investment income, AGI limits, SSN, U.S. residency, and other tests	Must pay for child or dependent care so taxpayer (and spouse) can work
THIS TAX BENEFIT MAY BE CLAIMED FOR A QUALIFYING RELATIVE	Yes	Yes	No	No	Yes

Appendix B: Income Limits and Phase-outs for Dependent-related Tax Benefits

Note: All numbers are for 2015 tax returns

Filing status abbreviations:

- S – Single
- HOH – Head of household
- MFJ – Married filing jointly
- QW – Qualifying widow(er)
- MFS – Married filing separately

Personal exemption phase-out “PEP” for higher income taxpayers

- The exemption amount is \$4,000 per person
- PEP begins at AGI over:

S	\$258,250
HOH	\$284,050
MFJ/QW	\$309,900
MFS	\$154,950

- The exemption amount and thresholds are inflation-adjusted.
- PEP applies to the total of personal plus dependent exemptions
- Total exemptions are reduced by 2 percent for each \$2,500 (\$1,250 MFS) or part thereof over the AGI limits.
- PEP maxes out at AGI of \$122,500 (\$61,250) over the AGI limits; that is, the reduction is 100 percent of the exemption, so the exemption is \$0.

Child tax credit phase-out

- The child tax credit is \$1,000 per qualifying child.
- Child tax credit phase-out begins at modified AGI:

S/HOH/QW	\$75,000
MFJ	\$110,000
MFS	\$55,000

- The credit and thresholds are *not* inflation-adjusted.
- The total credit is reduced by \$50 for each \$1,000 over the MAGI limits.
 - MAGI is generally AGI plus excluded foreign and certain U.S. possession income.
 - Starting in 2015, the additional child tax credit is disallowed for taxpayers who exclude foreign income.
- Because this is a dollar amount (rather than a percentage) phase-out, the end point will depend on the number of qualifying children claimed for the credit.

EITC phase-out

Number of children	Maximum Credit	Earned Income for Maximum Credit	Phase-out Range Single, HH, or QW	Phase-out Range MFJ
One child	\$3,359	\$9,880	\$18,110–\$39,131	\$23,630–\$44,651
Two children	\$5,548	\$13,870	\$18,110–\$44,454	\$23,630–\$49,974
Three or more children	\$6,242	\$13,870	\$18,110–\$47,747	\$23,630–\$53,267

- EITC depends on the number of qualifying children claimed for the credit.
 - Increases as earned income increases until maximum is reached.
 - Not available for MFS.
 - Small credit (maximum \$503) available for taxpayers with no qualifying children.
- Maximum credit plateaus (stays the same) until phase-out threshold is reached.
 - Phase-out applies to the higher of earned income or AGI.
 - Phases out at 15.98 percent for taxpayers with one qualifying child and 21.06 percent for taxpayers with two or more qualifying children.
- All amounts are inflation-adjusted.

Child and dependent care credit phase-out

- Credit percentage is applied to maximum qualifying expenses of \$3,000 for the care of one dependent and \$6,000 for the care of two or more dependents.
- The percentage decreases as AGI increases.
 - Same percentage applies to all filing statuses.
 - Generally not available for MFS.
- Amounts and percentages are not inflation-adjusted.
- The 20 percent rate applies to AGI over \$43,000 with no complete phase-out.

AGI	Credit percentage
\$0 - \$15,000	35%
\$15,001 - \$17,000	34%
\$17,001 - \$19,000	33%
\$19,001 - \$21,000	32%
\$21,001 - \$23,000	31%
\$23,001 - \$25,000	30%
\$25,001 - \$27,000	29%
\$27,001 - \$29,000	28%
\$29,001 - \$31,000	27%
\$31,001 - \$33,000	26%
\$33,001 - \$35,000	25%
\$35,001 - \$37,000	24%
\$37,001 - \$39,000	23%
\$39,001 - \$41,000	22%
\$41,001 - \$43,000	21%
\$43,001 – no limit	20%

Appendix C: Qualifying Child/Qualifying Relative Chart

Tests	Qualifying Relative (QR) §152(d)	Qualifying Child (QC) §152(c)
AGE	N/A	1)The child must be younger than the taxpayer (or spouse if MFJ) and: -under age 19, or -under age 24 and a full-time student, or 2) Any age if totally and permanently disabled
RELATIONSHIP	The individual must either be: (a) related to the taxpayer in one of the ways listed under below under Relatives who don't have to live with the taxpayer , or (b) an individual (other than a spouse) who is a member of the taxpayer's household the entire tax year ²	Taxpayer's: -son, daughter, stepson, stepdaughter, -eligible foster child, -brother, sister, half brother, half sister, stepbrother, stepsister, or -a descendant of any of these individuals
RESIDENCY	N/A	The child must have lived with the taxpayer for more than one-half the year ²
GROSS INCOME	The individual's gross income subject to tax must be less than the personal exemption amount for the year (\$4,000 in 2015) ³	N/A
SUPPORT	The taxpayer must provide more than one-half of the individual's total support for the year (multiple support agreements are possible)	The child must not provide more than one-half of the child's own support for the year
CITIZENSHIP	Child must be U.S. citizen or U.S. resident alien, U.S. national, or a resident of Canada or Mexico ¹	Child must be U.S. citizen or U.S. resident alien, U.S. national, or a resident of Canada or Mexico ¹
MARRIED DEPENDENTS	The child must not file a joint return with spouse other than to claim a refund of withheld income tax or estimated tax paid	The child must not file a joint return with spouse other than to claim a refund of withheld income tax or estimated tax paid
NOT A QUALIFYING CHILD	The child may not be a qualifying child of the taxpayer or of any other taxpayer	N/A
POTENTIAL TAX BENEFITS		
	Dependency exemption child/dependent care credit head of household filing status	Dependency exemption child/dependent care credit head of household filing status child tax credit EITC

¹ There is an exception for certain adopted children.

² There are exceptions for temporary absences, children who were born or died during the year, children of divorced or separated parents (or parents who live apart), and kidnapped children.

³ There is an exception if the person is disabled and has income from a sheltered workshop.

Relatives who don't have to live with the taxpayer. The taxpayer's: (a) Child, stepchild, eligible foster child, or descendant of any of them (b) Brother, sister, half brother, half sister, stepbrother, stepsister (c) Father, mother, grandparent, or other direct ancestor, but not foster parent (d) Stepfather or stepmother (e) A son or daughter of the taxpayer's brother or sister (f) A son or daughter of the taxpayer's half brother or half sister (g) A brother or sister of the taxpayer's father or mother (h) Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, sister-in-law. Any of these relationships established by marriage aren't ended by death or divorce.

Appendix D: The Tie-breaker Rule

IRC §152(c)(4) Special rule relating to two or more who can claim the same qualifying child.

(A) In general. Except as provided in subparagraphs (B) and (C) , if (but for this paragraph) an individual may be claimed as a qualifying child by 2 or more taxpayers for a taxable year beginning in the same calendar year, such individual shall be treated as the qualifying child of the taxpayer who is—

(i) parent of the individual, or

(ii) if clause (i) does not apply, the taxpayer with the highest adjusted gross income for such taxable year.

(B) More than 1 parent claiming qualifying child. If the parents claiming any qualifying child do not file a joint return together, such child shall be treated as the qualifying child of—

(i) the parent with whom the child resided for the longest period of time during the tax- able year, or

(ii) if the child resides with both parents for the same amount of time during such taxable year, the parent with the highest adjusted gross income.

(C) No parent claiming qualifying child. If the parents of an individual may claim such individual as a qualifying child but no parent so claims the individual, such individual may be claimed as the qualifying child of another taxpayer but only if the adjusted gross income of such taxpayer is higher than the highest adjusted gross income of any parent of the individual.