Low Income Families – Tax Issues

- American Opportunity Tax Credit
  - What is it?
  - Tax credit for up to $2,500 in tuition, fees and course materials (= eligible expenses)
  - 40% ($1,000) is refundable
    - Ex.: Qualified expenses of $4,000, taxpayer owes $1,500 in taxes; AOTC will cover all of $1,500 tax bill and refund $1,000
    - But: Qualified expenses of $4,000, taxpayer owes 0 in taxes; AOTC will refund $1,000.
  - Full credit reduced for taxpayers with AGI of $90,000, married filing jointly up to $180,000

Low Income Families – Tax Issues

- Possible pitfalls:
  - Cannot claim both the lifetime learning credit and the AO credit for the same student in the same year
  - Could apply one to one student and one to another
  - AO credit (or Hope credit) can only be used for 4 years for same student
  - Not eligible if student has completed first 4 years of post-secondary education by year of credit
  - Student must be enrolled at least ½ time

Low Income Families – Tax Issues

- Eligible student: taxpayer, taxpayer's spouse or taxpayer's dependent.
- Can still claim even if paid with loan proceeds.
- Can claim for prior year if pay in prior year but term begins in first 3 months of following year.
  - Example: Pay in Dec. 2013 for semester beginning Feb. 2014; can claim for 2013 taxes.
- Tax free educational assistance will reduce the amount of "qualified" educational expenses available

Low Income Families – Tax Issues

- Child and Dependent Care Expenses Credit
- What is it?
  - A credit in the amount of up to 35% of “qualified expenses” (reduced at higher incomes)
  - “Qualified expenses”
    - Care provided by “qualified person” (generally not spouse or parent of child or other child (even if not dependent); may be organization as well
    - Child must be 12 or younger or disabled (includes spouse)
    - Expenses must be incurred so you could work or look for work
    - Qualified person must live with you for more than ½ the year
    - Qualified expenses reduced by amount of dependent care expenses provided by your employer that you deduct or exclude from income

Low Income Families – Tax Issues

- Earned Income Tax Credit
- What is it?
- A refundable tax credit for those with "earned income" (generally wages or self-employment earnings, certain disability benefits)
- May receive either with or without "qualifying child"
- If without, you must:
  - Be at least 25, but younger than 65 at the end of the year
  - Live in the US for at least ½ the year
  - Not be the dependent of another
  - For 2012, income of single individual with no children could not exceed $13,980

Low Income Families – Tax Issues

- Qualifying child (increases credit up to 3):
  - Age: max 19 (max 23 if full time student) or disabled
  - Relationship: child, including adopted children, step children and qualified foster children (or a descendant of any (ex.: grandchild); or child could be your sibling (including half and step siblings) or a descendant (ex.: niece)
  - Residency: Child must have lived with you for at least ½ the year
  - Joint Return: Child cannot have filed joint return unless did so only to claim a refund

Low Income Families – Tax Issues

- Potential pitfalls:
  - If taxpayer received advance EITC, must file tax return (discontinued for 2011 forward)
  - If denied EITC for reckless or intentional disregard of EITC rules, cannot claim EITC for next 2 years
  - If denied for fraud, cannot claim for next 10 years
  - If EITC denied or reduced (except for math or clerical error) must fill out additional form

Low Income Families – Tax Issues

- IRS estimates 25% of EITC amounts paid in error
- 75% of error related to authenticating qualifying child status
- 25% to misreporting of income
- “Error” may simply be taxpayer’s inability to provide documentation
  - Documentation: school or medical records, day care or other activities
- Approximately 50% of denied cases that went through TAS were found accurate

DEPENDENCY EXEMPTION

Qualifying Child or Qualifying Relative

Qualifying Child Test

- 1. Relationship
- Children, siblings, step-siblings, and their descendants
- Child includes natural child, adopted child, stepchild, and some foster children
- 2. Residence
- Same principal place of abode for half of the tax year excluding temporary absences (school, military service, vacation)

Qualifying Child Test, cont.

- 3. Age
- Under 19 by the end of the tax year, or
- a full time student under age 24 attending a qualifying institution for at least part of 5 calendar months, or
- Permanently disabled
- 4. Joint Return
- “Child” must not have filed a joint return with a spouse (unless the joint return was filed only to obtain a refund of withholding and the tax is zero on the joint return)

Qualifying Child Test, cont.

- 5. <u>Citizenship or residence</u>
- Child must be a U.S. Citizen, a U.S. resident or national, or a resident of Canada or Mexico
- 6. <u>Support</u>
- The child must not have provided more than one half of his or her own support Educational scholarships are not considered support

Qualifying child or relative?

- IF DEPENDENT COULD BE TREATED AS QUALIFYING CHILD OR QUALIFYING RELATIVE, DEPENDENT IS TREATED AS A QUALIFYING CHILD

Tiebreaker Rules

- When a child may be the qualifying child of more than one taxpayer, the following rules apply:
  - -If only one of the taxpayers is the parent, the parent gets to take the exemption
  - -If both the taxpayers are parents and they are not filing a joint return, the parent with whom the child has resided the longest gets the exemption.
  - -If the child has resided with both parents equally, the exemption goes to the parent with the highest adjusted gross income
  - -If none of the taxpayers are the child's parent, the exemption goes to the taxpayer with the highest adjusted gross income

Divorced or Separated Parent

- Includes:
- 1. Legally separated or divorced by a decree of dissolution/ separation
- 2. Separated under a written separation agreement
- 3. Lived apart during the last six months of the calendar year

- The parent who has the child the majority of the time claims the exemption unless:
- The custodial parent releases the exemption for a particular year or a number of years by filling out Form 8332
- Dissolution or separation agreement dated on or before July 2, 2008, the noncustodial parent may attach a copy of the pages granting noncustodial parent the exemption

Qualifying Relative Test

- Qualifying relative: A relative or member of taxpayer's household that depends on taxpayer's support

- 1. <u>Support</u>

  Taxpayer must provide more than half of the dependent's total support. Must establish support for dependent from all sources, including amounts spent by dependent. Look to amount actually spent, not income or other funds available to dependent unless they are actually spent

- 2.   <u>Gross Income</u>
- Gross income of dependent must be less than the personal exemption amount

Qualifying Relative Test, cont.

- 3. <u>Relationship or Member of Household</u>
- Dependent or relative must be a household member for the entire year

- 4. <u>Joint Return</u>
- Dependent must not have filed joint return with his or her spouse (except to get a refund of taxes withheld)

- 5. <u>Citizenship or Residency</u>
- Dependent must be a U.S. citizen, U.S. resident or national or resident of Canada or Mexico

Support for Dependency Exemption

- Includes: Food-shelter-clothing-dental and medical care-education-recreation-transportation

- Support from other sources includes: Welfare benefits-social security benefits to the extent spent to support the dependent

More than Half the Support Requirement

- Assume all other tests for dependency exemption are met
- 1. Taxpayer's sister received support from the following sources during the tax year:
- Support from taxpayer $4000.00
- SSDI benefits $7500.00
- Support from other sibling $600.00
- Total Support: $12,100.00
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- Taxpayer could not claim a dependency exemption for his sister because he did not provide more than half of her support

More than Half the Support Requirement

- 2. Assume the same numbers as above, except that sister is able to put $5000.00 of her SSDI benefits in savings:

- Support from taxpayer: $4000.00
- SSDI benefits spent on support: $2500.00
- Support from other sibling: <u>$600.00</u>
- Total Support: $7100.00

- Taxpayer provided more than half of sister's support, so he can claim the dependency exemption for her

Multiple Support Agreements

- Allows one person to take exemption when support for a qualifying relative is provided by a group, e.g. a group of adult children
- No one individual contributed over half of the support for the qualifying relative
- Over half the support was provided by a group who all are qualifying relatives of the individual to be claimed
- The group may agree to assign the exemption to a group member who contributed more than 10% of the total support
- Each member of the group must sign a declaration that he/she will not claim the exemption then the person who takes the exemption must file Form 2120

HEAD OF HOUSEHOLD

- Unmarried taxpayer or considered unmarried as of last day of the year
- Taxpayer provides more than one half the cost of maintaining a home for a qualifying child or familial relative (qualifying relative that must be related, not an unrelated individual living in the home)
- The qualifying individual must be a dependent of the taxpayer, and must reside in the taxpayer’s home with a couple exceptions:
- 1. Parent that is a dependent does not need to live in the home of taxpayer, but the taxpayer must provide over half of the cost of keeping up the parent’s home
- 2. An unmarried child of taxpayer does not need to be the dependent. This allows custodial parent to file as head of household when the non-custodial parent is claiming the dependency exemption under a divorce decree/ Form 8332

Cost of Maintaining a Household for Head of Household Filing Status

- Includes property taxes-mortgage interest expense-rent-utility charges-repairs/maintenance-property insurance-food consumed on the premises

- Does not include clothing-education expenses-medical expenses-transportation

CHILD TAX CREDIT–ADDITIONAL CHILD TAX CREDIT

- <u>Non refundable credit up to $1000.00 credit per qualifying child</u>
- Qualifying child:
- A child for whom taxpayer claims a dependency exemption
- Can be a child, descendant, stepchild, sibling, descendant of sibling or eligible foster child of taxpayer
- Child must be less than 17 at the end of the tax year

CHILD TAX CREDIT–ADDITIONAL CHILD TAX CREDIT

- Credit phased out when adjusted gross income reaches $75,000 for single taxpayer or $110,000 for married filing jointly, $55,000 married filing separately
- Credit is reduced by $50 for each $1000 that AGI exceeds the threshold
- <u>ADDITIONAL CHILD TAX CREDIT-refundable</u>
- Through 2017 up to 15% of earned income in excess of $3000 is refundable up to the amount per child (Form 8812)

DOCUMENT, DOCUMENT,DOCUMENT

Rent receipts, utility bills, birth certificates, school or medical records, grocery receipts, insurance statements, records from social services providers, statements of ministers, tribal officials, daycare records.