

Taxpayers with Kids:

How to Make the Most Out of Your Annual Tax Return

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Are you raising a child? You probably have some significant expenses. Food, clothing, health care, education expenses...they add up quickly. Wouldn't it be great to have a little extra cash?

Help may be closer than you think! It turns out that the federal government makes several special credits available to parents and guardians of children.² Two of these credits—the [Additional Child Tax Credit](#) and the [Earned Income Tax Credit](#)—are refundable. This means that qualifying taxpayers can receive a refund from the federal government, even if they paid no tax at all!

Interested? [Read on to learn more!](#)

DEPENDENCY EXEMPTION

The first step toward maximizing your federal tax benefits is to properly identify your dependents. IRS allows you to claim one dependency exemption for each "qualifying child." You list each child's name and social security number or ITIN on **Form 1040**, line 6(c); you add these dependency exemptions to your personal and spousal exemption (if applicable), and you use that number to figure your total allowance on line 42. For tax year 2014, these exemptions could reduce your taxable income by \$3,950 each!



But what exactly does IRS mean by "qualifying child?"

A qualifying child must satisfy a series of tests. First among these is the "relationship test."³ A qualifying child must be your son or daughter⁴, stepchild or foster child, sibling, half sibling, or stepsibling. Children, stepchildren, and foster children of these persons will also satisfy the "relationship test."⁵

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² If you are caring for a dependent other than a qualifying child, you may be able to claim that dependent as a "qualifying relative." See **Publication 501** to learn more: <http://www.irs.gov/publications/p501>.

³ A "qualifying relative" need not satisfy the "relationship test," but must satisfy additional tests concerning household residence, gross income, and support. See **Publication 501**.

⁴ Adopted children qualify too!

⁵ Descendants (children, grandchildren, etc.) of these persons will also qualify.

A qualifying child must also satisfy the “age test”: she must be under 19 in general, under 24 if a full-time student, or any age if permanently disabled. A qualifying child must live with the taxpayer for more than half of the year (“residency test”) and must not have provided more than half of her own support (“support test”).⁶ Finally, a qualifying child must not have filed a joint return—unless she did so to claim a refund.

For children of divorced parents, separated parents, or parents living apart, special rules may apply. Generally speaking, the custodial parent should claim the dependency exemption. However, the noncustodial parent may be entitled to the exemption if the custodial parent releases her claim in writing. IRS has a special form for such releases: **Form 8332**.⁷

Note: **Publication 501** is a great resource for taxpayers who seek to better understand exemption regulations; it’s especially helpful for taxpayers with unique living situations. The publication is long, but it’s well worth a read: <http://www.irs.gov/publications/p501>.

CHILD TAX CREDIT, ADDITIONAL CHILD TAX CREDIT

Imagine it’s early March, and you’re filling out your **Form 1040**. On line 43, you identify your taxable income; using that income and the tax tables, you figure your tax.

Whoa. that’s a large number. Can you really owe so much tax for one year?



Fear not! The **Child Tax Credit** may substantially reduce your liability.⁸ For each qualifying child under age 17 at the end of the tax year, you may decrease your tax by up to \$1000. For most taxpayers, there is no need to fill out an additional schedule.⁹

Here’s an interesting situation: say you owe \$1600 of tax per line 44, but you have two qualifying children. The **Child Tax Credit** zeroes out your liability with \$400 left over. What happens to the extra \$400?

That’s where the **Additional Child Tax Credit** may come in. If you find yourself in a situation like this, complete **Schedule 8812** to determine whether you qualify for the additional credit. The additional credit is equal to the lesser of the leftover **Child Tax Credit** or 15% of earned income above \$3,000. Qualifying taxpayers should record the additional credit on **Form 1040**, line 65.

IRS **Publication 972** explains all the ins-and-outs of the Child Tax Credit:

<http://www.irs.gov/pub/irs-pdf/p972.pdf>.

CHILD AND DEPENDENT CARE CREDIT

⁶ This isn’t usually a problem with kids!

⁷ For divorce decrees or separation agreements arranged between 1984 and 2009, the noncustodial parent may attach relevant pages from the decree/agreement in lieu of **Form 8832**.

⁸ The **Child Tax Credit** phases out for high income families. If you file jointly with your spouse, the phase-out begins at \$110,000 AGI. If you file as single or head of household, the phase-out begins at \$75,000 AGI.

⁹ If you identified your dependent with an ITIN rather than an SSN, you should complete **Schedule 8812** Part I. Other exceptions apply; see the **Instructions for Schedule 8812**.

Do you pay someone to care for your children while you work? Perhaps you pay for daycare or after-school services? Perhaps you employ a babysitter or a nanny?¹⁰ Taxpayers with children ages 12 and under may take a credit worth up to 35% of qualifying dependent care expenses.¹¹



Qualifying expenses are presently capped at \$3,000 for one child or \$6,000 for two or more children.

Taxpayers with earned income of \$15,000 or less may take advantage of the full 35% of qualifying expenses.

The credit decreases as income increases; taxpayers who earn \$43,000 or more can take a maximum of 20% of qualifying expenses.

To claim the [Child and Dependent Care Credit](#), complete **Form 2441**; carry the figure from line 11 to **Form 1040**, line 48.

EARNED INCOME TAX CREDIT (EIC)

The [EIC](#) was originally enacted in 1975 to provide a small subsidy for very low-income workers. The credit has expanded over the years; for 2015, it is worth up to \$6,242 in refundable cash based on family size and income level. Yet, surprisingly, 20% of qualifying taxpayers overlook the credit!¹² Don't be one of these taxpayers! Find out whether you qualify.

In order to claim the [EIC](#), you must satisfy a series of criteria.¹³ You (and your spouse, if you file jointly) must be a U.S. citizen or full-year resident alien with a social security number; you must have earned income, your status must not be married filing separately, and you must satisfy certain income requirements.¹⁴

You may claim [EIC](#) with one or more qualifying children (see the discussion of the dependency exemption above). You may also claim [EIC](#) without a qualifying child, but there are additional rules: you must satisfy the "age test" (at least 25 but under 65), the "residency test" (live in the United States for at least six months of the year), and the "dependency test" (can't qualify as someone else's dependent).

IRS features a handy [EIC Assistant](#) at <http://apps.irs.gov/app/eitc2014/>. Use this tool first to gain a sense of whether you qualify. If you file a paper return, you will need to calculate the amount

¹⁰ Keep in mind that if you pay someone to visit your home and care for you children, you may be required to issue an annual **1099-MISC** (for independent contractors) or **W-2** (for employees). See **Publication 926** for more information: <http://www.irs.gov/publications/p926/>.

¹¹ You may also qualify for a credit if your spouse is physically or mentally incapable of self-care. See <http://www.irs.gov/uac/Ten-Things-to-Know-About-the-Child-and-Dependent-Care-Credit>.

¹² See <http://newsle.com/article/0/58051330/>.

¹³ Additional criteria: you must not be a qualifying child of another person; you must not file Form 2555; you must not exceed the investment income ceiling, \$3300 for tax year 2013.

¹⁴ See <http://www.irs.gov/Individuals/Preview-of-2012-EITC-Income-Limits-Maximum-Credit-Amounts-and-Tax-Law-Updates>.

of your credit using the worksheet provided in the **Instructions for Form 1040**. Alternatively, you can ask IRS to figure the credit for you: just enter “EIC” on the dotted line beside line 64a.

If you file your taxes using tax preparation software, the software will perform many of the actual EIC calculations for you. IRS Volunteer Income Tax Assistance (VITA)¹⁵ sites are also equipped to calculate the EIC.

Regardless of how you figure the credit, if you are claiming qualifying children, you need to attach **Schedule EIC** to your tax return. It’s pretty straightforward and easy to complete.

Caution: The EIC is a wonderful resource, but it is also a potential red flag. Around 43% of all individual taxpayer audits are EIC audits. That doesn’t mean you should shy away from this credit: if you qualify, take advantage of it! Just be sure to fill out the forms carefully, and be prepared to demonstrate your child’s dependency if asked.¹⁶

CONCLUSION

Raising a family is an expensive venture, but your **Form 1040** may just be your best friend. Take full advantage of the benefits available to you as a taxpayer with kids.

Are you facing a dispute with IRS? Have you received notice of an examination or a levy? The LITC at Indiana Legal Services, Inc. assists low income taxpayers with IRS controversies, including matters pertaining to accounts, collections, examinations, and appeals.¹⁷ We represent clients before the United States Tax Court, and we provide assistance for non-filers. Call us to learn more: **(800) 822-4774**. We may be able to assist you.

DISCLAIMER: The information contained herein is provided as a service to low income people and other Internet users, including members of the general public. It is not intended as legal advice or as a substitute for the particularized advice of an attorney. People seeking specific legal advice or assistance should contact an attorney.

¹⁵ See <http://www.irs.gov/Individuals/Free-Tax-Return-Preparation-for-You-by-Volunteers>.

¹⁶ See <http://www.irs.gov/pub/irs-soi/07resconfwilson.pdf>.

¹⁷ Please note that the LITC is not a tax preparation agency. For assistance with current year returns, contact VITA or a local tax preparer.