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## SECTION G

### FAMILY TAXATION ISSUES

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DEFINITION OF A CHILD – DEPENDENTS REDEFINED

The Working Families Tax Relief Act of 2004 attempted to simplify tax law by providing a uniform definition of a qualifying child. To accomplish this goal, the statutory definition of a dependent was rewritten to categorize each dependent as either a “qualifying child” or “qualifying relative”.

QUALIFYING CHILD

For tax years beginning in 2005 and after, the definition of a qualifying child for dependency exemption purposes will be determined under IRC §152(c) by the following tests relating to relationship, age, support and abode (residency).

NOTE: The new definition eliminated the gross income test and redefined the support test.

♦ Relationship Test: A qualifying child must be the taxpayer’s child or a descendant of the taxpayer’s child (i.e., grandchild); or the taxpayer’s sibling (including half-brothers and half-sisters) or step-sibling, or a descendant of the taxpayer’s sibling or step-sibling. IRC §152(c)(2). Legally adopted or foster children also meet the qualifying child test.

♦ Age Test: As of the close of the calendar year in which the taxpayer’s tax year begins, a qualifying child must not have attained the age of 19, or must be a full-time student (at least 12 semester hours during 5 months of year) who has not attained the age of 24. This age test does not apply to a child who is permanently and totally disabled at any time during the calendar year. IRC §152(c)(3).

NOTE: For an individual to be treated as a taxpayer’s qualifying child, the individual must be younger than the taxpayer (unless the individual is permanently and totally disabled). IRC §152(c)(3)(A).

♦ Support Test: A qualifying child must not have provided more than one-half of his or her own support during the calendar year in which the taxpayer’s tax year begins. IRC §152(c)(1)(D).

NOTE: If the child is the taxpayer’s child and is a full-time student, amounts received as scholarships are not considered support. IRC §152(f)(5).

♦ Abode (Residency) Test: A qualifying child must have the same principal place of abode as the taxpayer for more than one-half of the taxpayer’s tax year (greater number of nights). IRC §152(c)(1)(B) and IRC Reg. §1.152-4(d). See discussion below.

NOTE – BIRTH OR DEATH OF CHILD: A child who was born or died during the year is treated as having lived with the taxpayer all year if the taxpayer’s home was the child’s home the entire time he or she was alive during the year.

NOTE – MISSING/KIDNAPPED CHILD: If a taxpayer’s child is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family of the child or the taxpayer, and the child shared the same principal place of abode as the taxpayer for more than half of the portion of the tax year preceding the kidnapping, the child satisfies the abode test for all tax years ending during the period in which the child is missing. A missing child ceases
to satisfy the abode test in the taxpayer’s first tax year beginning after the
calendar year in which the child is determined to be dead or, if earlier, in
which the child would have attained the age of 18. These rules for missing
children also apply for purposes of determining the child tax credit, the earned
income credit and the taxpayer’s eligibility for head of household filing status.
IRC §152(f)(6).

GREATER NUMBER OF NIGHTS – CUSTODIAL PARENT/CUSTODIAL TAXPAYER:

NOTE: While the discussion below references “parent”, the greater number of
nights test applies for all custodial caregivers, whether parent, grandparent,
relative, etc.

A child is deemed to reside with a parent (taxpayer) for a night if the child
sleeps at the residence of that parent (whether or not the parent is present); or
is in the company of the parent when the child does not sleep at the parent’s
residence (e.g. on vacation, etc.). IRC Reg. §1.152-4(d). Temporary absences of
a parent due to special circumstances, including absences due to illness,
education, business, military service, vacation, etc. are not treated as absences
from the residence. IRC Reg. §1.152-1(b).

- ABSENCES OF CHILD: If the child is temporarily absent from a parent’s
  home for a night (e.g. visiting friend), the child is considered to be
  residing with the parent with whom the child would have resided for the
  night. Also, if a child does not reside with either parent for a night
  (e.g. attending summer camp, etc.), the child is treated as not residing
  with either parent for that night.

  If it cannot be determined which parent the child would have resided
  with for the night, the child is deemed to be residing with neither
  parent for that night.

- EXCEPTION – PARENT WORKING NIGHTS: If a child resides with one parent
  for a greater number of days, but not a greater number of nights (due to
  a parent’s nighttime work schedule), the “greater number of nights test”
  applies to the child’s day. On a school day, the child is deemed to be
  residing at the primary residence that is registered with the child’s
  school.

- OVERLAPPING NIGHT: If a night overlaps two taxable years, such as
  December 31st, the night is counted towards the year in which it begins.

- EMANCIPATION: Starting with the date the child is emancipated under
  state law (e.g. reaches the age of majority), a child is not considered
  to be residing with either parent. Therefore a child who reaches the
  age of majority on or before the day after the half-way point of the tax
  year (normally July 3) will not be in the custody of either parent for
  more than one-half of the year.

TIE-BREAKER RULES (only apply in the event of a disagreement between eligible
parties as to who can claim the dependency exemption):

1. If one of the individuals is the child’s parent, the child is
   considered the qualifying child of the parent. IRC §152(c)(4)(A).
(2) If both parents claim the child and do not file a joint return, the child is considered a qualifying child of:

(a) The parent with whom the child resided for the longest period of time (greater number of nights) during the year; or

(b) The parent with the highest AGI, if the child resided with both parents for the same number of nights during the tax year. IRC §152(c)(4)(B).

(3) If none of the taxpayers claiming the child as a qualifying child is the child’s parent, the child is considered a qualifying child of the taxpayer with the highest AGI. IRC §152(c)(4)(A)(ii).

NOTE: When neither parent claims a child as a qualifying child, that child cannot be treated as another taxpayer’s qualifying child unless that other taxpayer’s AGI is higher than either parent’s AGI. IRC §152(c)(4)(C).

NOTE: As long as the parties agree, any one of the individuals eligible to claim the dependency exemption may do so.

QUALIFYING RELATIVE

A qualifying relative must satisfy tests relating to relationship, gross income and support. IRC §152(d)(1). The rules of qualifying relatives generally absorb the relationship, support and gross income tests under prior law.

• Not a Qualifying Child: A qualifying relative cannot be a qualifying child for the taxpayer or for any other taxpayer for any tax year beginning in the calendar year in which the taxpayer’s tax year begins. IRC §152(d)(1)(D).

NOTICE 2008-5 CLARIFICATION: A taxpayer otherwise eligible to claim a dependency exemption for an unrelated child is not prohibited from claiming the deduction if the child’s parent (or other person with respect to whom the child is defined as a qualifying child) is not required to file an income tax return and either does not file a return or files a return only to obtain a refund of tax withholding.

• Relationship Test: As under prior law, persons qualifying as relatives are the taxpayer’s children and their descendants; the taxpayer’s siblings (including half-brothers and half-sisters) and their children; the taxpayer’s parents, and their ancestors and siblings; the taxpayer’s step-parents and step-siblings; and the taxpayer’s son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law and sister-in-law. IRC §152(d)(2).

Others: Qualifying relatives also include individuals, other than the taxpayer’s spouse, who had the same abode as the taxpayer and were members of the taxpayer’s household during the taxpayer’s entire tax year. IRC §152(d)(2)(H). An individual is not a member of the
taxpayer’s household if, at any time during the taxpayer’s tax year, the relationship between the individual and the taxpayer violated local law. IRC §152(f)(3).

**COMMENT:** Although these dependents are called “qualifying relatives,” this last category includes persons who have no family relationship to the taxpayer (e.g. domestic partner, etc.).

- **Gross Income Test:** As under prior law, a qualifying relative’s gross income for the calendar year in which the taxpayer’s tax year begins must be less than the exemption amount ($4,000 for 2015). IRC §152(d)(1)(B). Also as under prior law, if a dependent is permanently and totally disabled at any time during the tax year, the dependent’s gross income does not include income attributable to services performed at a sheltered workshop, if the availability of medical care at the workshop is the principal reason for the dependent’s presence there, and the income arises from activities that are incident to the medical care. IRC §152(d)(4).

- **Support Test:** As under prior law, the taxpayer must provide more than one-half of a qualifying relative’s support during the calendar year in which the taxpayer’s tax year begins. IRC §152(d)(1)(C).

  **NOTE:** As under prior law, alimony payments are not treated as payments for support; and, in the case of remarriage, a child’s support that is provided by a parent’s spouse is treated as provided by the parent. IRC §152(d)(5).

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**CHILDREN OF DIVORCED OR SEPARATED PARENTS:** An exception to the support test applies for children of divorced or separated parents if the parents are divorced, separated, or live apart at all times during the last six months of the calendar year; they jointly or singly have custody of the child for at least six months of the year; and they jointly or singly provide at least half of the child’s support.

However, the exception no longer presumes that the custodial parent is entitled to the child’s dependency exemption. Instead, it spells out the tests that must be satisfied before the noncustodial parent can claim the exemption.

The child is treated as the qualifying child or qualifying relative of the noncustodial parent **only if** the parents’ divorce or separation instrument provides that the noncustodial parent is entitled to the dependency exemption, or the custodial parent provides the IRS with a signed, written declaration waiving the child’s dependency exemption (Form 8332).

If the parents’ divorce or separation instrument was executed before 1985, the noncustodial parent must also provide at least $600 in support during the calendar year. To be a custodial parent, the parent and the child must have shared the same principal place of abode for the greater portion of the tax year (greater number of nights). As under current law, this exception does not apply if the child is the subject of a multiple support agreement. IRC §152(e).

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MULTIPLE SUPPORT AGREEMENTS: If two or more persons provide a total of over one-half of the dependent’s support, but no one person provides at least one-half of the dependent’s support, the taxpayer is treated as providing more than half of the dependent’s support if the other persons who provided at least 10% of the dependent’s support waive the dependency exemption by filing a written declaration (Form 2120) with the IRS. IRC §152(d)(3).

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GENERAL RULES: Several provisions are applicable to all dependents whether a qualifying child or qualifying relative.

(1) **Uniform Definition of a Child:** A taxpayer’s children include the taxpayer’s natural children, step-children, adopted children and eligible foster children.

   (a) **Adopted Child:** A taxpayer’s adopted child is a child who has been legally adopted by the taxpayer, or a child who has been lawfully placed with the taxpayer for legal adoption by the taxpayer.

   (b) **Foster Child:** A taxpayer’s eligible foster child is a child who has been placed with the taxpayer by an authorized agency, or by a judgment, Decree or other Order of any Court of competent jurisdiction. IRC 152(f)(1).

(2) **Student:** A student is an individual who, during five calendar months of the calendar year in which the taxpayer’s tax year begins, is a full-time student (12 semester hours) at an educational organization, or is pursuing a full-time course of instructional on-farm training. IRC §152(f)(2).

(3) **Citizenship Test:** A dependent generally must be a U.S. citizen, resident alien or national, or a resident of the United States, Canada or Mexico for some part of the year. This test does not apply to a taxpayer’s legally adopted child (as defined above) if the taxpayer is a U.S. citizen or national and if, for the taxpayer’s entire tax year, the child had the same place of abode as the taxpayer and was a member of the taxpayer’s household. IRC §152(b)(3)(B). This test also applies if the child was lawfully placed with the taxpayer for legal adoption.

   (a) **Child’s Place of Residence:** Children usually are citizens or residents of their parents’ country. Any child born of a U.S. citizen meets the residency test even if he is born outside the United States and the other parent is a nonresident alien.

   (b) **U.S. National:** A U.S. national is an individual who, although not a U.S. citizen, owes his allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. nationals instead of U.S. citizens.

(4) **Joint Return Test:** An individual will not generally qualify as a dependent if he or she files a joint return in any tax year that begins in the same calendar year as the tax year for which the
taxpayer claimed the dependency exemption. IRC §152(b)(2).

**EXCEPTION:** The joint return test **does not apply** if a joint return is filed by a dependent and their spouse **solely to claim a refund, and no tax liability** would exist for either spouse on separate returns. A joint return **cannot be filed for any other purpose** (e.g. earned income credits, etc.).

(5) **Dependent’s Dependents:** If an individual can be claimed as a dependent on another’s return, that individual **cannot** claim any dependents (including himself) on his own tax return for any tax year that begins in the same calendar year as the tax year for which the individual was claimed as a dependent by another. IRC §152(b)(1).

**NOTE:** This rule applies to prohibit an individual who can be claimed as a dependent on another’s return from claiming a dependency exemption on their own return for an otherwise qualifying child or qualifying relative. **This rule remains true even if the taxpayer who is eligible to claim a dependency deduction does not claim it, or if the phase-out rules for personal exemptions reduce the benefit of the dependency exemption.**

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DEPENDENCY EXEMPTIONS – Form 8332

General: A dependency exemption generally is allowed for the parent with whom a child resides for more than one-half of the tax year (greater number of nights).

IRC §152(e) sets forth a special support test that allows the parent with custody for a greater portion of the year to be treated as providing more than one-half of the support of a child if the child receives more than one-half of total support for the year from either or both parents who:

1. Are divorced or legally separated,
2. Are separated under a written separation agreement, or
3. Live apart at all times during the last six months of the calendar year.

The custodial parent is allowed to release the dependency claim to the non-custodial parent by using Form 8332. IRC §152(e)(2)(A). NOTE: The release of the dependency exemption claim also applies for the child tax credit, American Opportunity, Hope and LLC credit, tuition and fees deduction and the student loan interest deduction. The release does not apply for purposes of the earned income credit, dependent care credit, or head of household filing status.

Form 8332 – Release of Dependency Exemption (Never-Married Parents): The IRS has revised Form 8332 to permit a never-married non-custodial parent to claim a dependency exemption when the custodial parent has waived this exemption.

Alternative to Filing Form 8332 for Divorced or Legally Separated Parents - IRC §152(e)(2) and IRC Regs. §1.152-4: The regulations now stipulate that any written declaration not made on Form 8332 must conform to the substance of Form 8332, including an unconditional signed statement that the custodial parent will not claim the child as a dependent for the specified year or years. The document executed must be for the sole purpose of releasing the dependency claim. IRC Regs. §1.152-4(e).

- The final regulations specify that a court order, decree or a separation agreement may not serve as the written declaration. However, written declarations executed on or before 7/2/08 will be accepted as long as they complied with the rules in effect at that time. IRC Regs. §152-4(a).

- The final regulations allow a taxpayer to attach a copy of a declaration (rather than the original) to a tax return in the first year the release is effective, as well as, subsequent years. IRC Regs. §1.152-4(e)(2).

Custodial Parent – Unilateral Revocation Rule: Under IRC Regs. §1.152-4(e)(3), starting January 1, 2009, a custodial parent can unilaterally revoke a prior dependency exemption release to a noncustodial parent (prior years and future years), with or without cause. A unilateral revocation is allowed even when a divorce decree or separation agreement clearly states that the custodial parent must release to the noncustodial parent the right to claim the designated child as a dependent. IRC Regs. §1.152-4(g), Example 20.

REVOCATION PROCEDURES/NOTIFICATION REQUIREMENT: The custodial parent must provide the noncustodial parent with written notice of the revocation, or make reasonable efforts to provide such notice. The revocation cannot take effect any
earlier than the year after the year in which the custodial parent provides notice to the noncustodial parent (or makes reasonable efforts to provide such notice). A reasonable attempt is determined by facts and circumstances, but mailing a copy of the written revocation to the noncustodial parent at the last known address or at an address reasonably calculated to ensure receipt apparently satisfies this requirement.

The custodial parent must keep a copy of the revocation and evidence of delivery of the required notice to the noncustodial parent (or attempts to deliver such notice). Attempted revocations that fail to meet all requirements will have no effect. Once the notification stage is complete, the custodial parent must attach the revocation to their Form 1040 (or Form 1040X) for each year to which the revocation is to apply.

Consistent with the requirements for a release, the final regulations provide:

1. A revocation may be made on Form 8332, or successor form designated by the IRS;
2. A revocation not on the designated form must conform to the substance of the form, and be in a document executed for the sole purpose of revoking a release; and
3. A taxpayer revoking a release may attach a copy rather than an original to the taxpayer’s return for the first taxable year the revocation is effective, as well as for later years.

**TAX PLANNING NOTE:** Dissolution attorneys should consider adding provisions to Stipulations and Decrees indicating that a party will be held “in contempt” if Form 8332 filings are not complied with in the manner specified in a divorce stipulation or decree.
A. **Tax Credit Eligibility:** Entitlement to a child dependency exemption is a prerequisite to the following tax credits/deductions.

- **Child Tax Credit** -- The parent who claims the child as a dependent is entitled to this credit.

- **American Opportunity/Hope/Lifetime Learning Credits (also Tuition and Fees deduction)** -- The parent who claims the child as a dependent is entitled to these credits (deduction).

- **Student Loan Interest Deduction** -- The parent who claims the child as a dependent is entitled to this deduction.

B. The custodial parent only is entitled to the following tax credits. The custodial waiver rules (Form 8332) do not effect eligibility with respect to these credits.

- **Dependent Child Care Credit** -- This credit is allowed only to the parent who had custody for the greater part of the year, regardless of who gets the dependency exemption for the child.

- **Earned Income Credit** -- This credit is allowed only to the custodial parent, regardless of who gets the dependency exemption for the child.

C. **Other Tax Breaks:** IRC Regs. §1.152-4(f) and Rev. Proc. 2008-48 stipulate that when the noncustodial parent rule applies to a child, both parents can claim the following tax breaks.

- Itemized deductions for that child’s medical expenses under IRC §213(d)(5).

- Tax-free reimbursements for that child’s medical expenses under IRC §105(b).

- Tax-free treatment for employee discounts and no-additional-cost services provided to that child under IRC §132(h)(2)(B).

- Tax-free employer-provided coverage for the dependent under a health plan. IRC §106(a).

- Tax-free distributions from medical savings accounts (MSAs) when the distribution is used to pay qualified medical expenses of the dependent. IRC §220(d)(2).

- Tax-free distributions from health savings accounts (HSAs) when the distribution is used to pay qualified medical expenses of the dependent. IRC §223(d)(2).

D. **Automatic Allocations- Dissolution:** The ACA Premium Tax Credit for children will be automatically allocated 50% to each spouse if filing separate returns in the year of separation unless otherwise agreed to by the parties.
HEAD OF HOUSEHOLD (HOH) – FILING STATUS

A taxpayer may claim HOH filing status if the taxpayer is unmarried or considered unmarried on the last day of the tax year (and not a surviving spouse) and pays more than one-half of the cost of maintaining a household which is the principal place of abode for more than one-half the year of the following:

a. A qualifying child, or
b. An individual (qualifying relative) for whom the taxpayer may claim a dependency exemption.

CONSIDERED UNMARRIED: A taxpayer is considered unmarried at the end of the tax year if they meet the above test and the following tests:

- They file a separate return.
- Their spouse did not live in their home during the last six months of the tax year, or the couple is separated under a decree of separate maintenance.

NOTE – BIRTH/DEATH: Birth or death of an otherwise qualifying individual will not disqualify HOH status if the qualifying individual lived in the household for the part of the tax year during which they were alive.

NOTE – SEPARATE HOUSEHOLD FOR PARENT: An individual may also qualify for HOH filing status if they maintain a "separate" household for a parent for the entire tax year and the parent qualifies as their dependent. The "separate" household for the parent must be the parent’s principal place of abode (including a residence, rest home or home for the aged).

NOTE – HOH Exception: Non-relative individuals who otherwise qualify for a dependency exemption because they lived with the taxpayer the entire year as a member of the taxpayer’s household (domestic partner and their children, etc.) cannot be used for HOH eligibility. Similarly, dependents derived from multiple support agreements cannot be used to obtain HOH status. IRC §2(b)(3)(B).

ITEMIZED DEDUCTIONS – HOH/MFS RULES FOR FILING: IRC §63(c)(6)(A) provides that if married individuals file separate returns and either spouse itemizes deductions, the spouse not electing to itemize will have a standard deduction of zero ($-0-). Thus, the general rule is that if one spouse itemizes, the other spouse must also itemize to claim any additional tax benefit. However, under IRC §7703(b), a spouse who qualifies for head of household status may be treated as unmarried for the taxable year even though the other spouse is treated as married for that same year.

In SCA 200030023, the National Office concluded that the IRC §63 limitation does not apply to a spouse who qualifies for and files as head of household because the spouse with head of household status is not considered a married individual. Therefore, the spouse who files as head of household may use the full standard deduction and is not limited by the other spouse’s election to itemize deductions. If the spouse with head of household status elects to itemize deductions, however, the IRC §63 limitation continues to apply to the other spouse because that other spouse is a married individual filing a separate return.

AMENDING RETURNS AND SECTION 6013(B): A taxpayer may amend in order to file a joint return for a prior year, if the taxpayer filed separately but could have
filed jointly. Prior to 2015, the Tax Court ruled that a head of household return was a separate return and therefore if a notice of deficiency was sent to either spouse, amendments were prohibited. NEW FOR 2015, A taxpayer can now change his filing status from head of household to married filing jointly after receiving and challenging a notice of deficiency. See Ibrahim v. Comm., 115 AFTR 2d 2015-2126, CA-8, 2015 rev’g TC Memo 2014-8. Essentially the Court held that a head of household return is not a “separate” return for purposes of Section 6013(b).

NEVER MARRIED PARENTS
HEAD OF HOUSEHOLD / DEPENDENCY EXEMPTION
(Joint Physical Custody – Equal Nights)

Dear Father:

As we previously discussed, this correspondence will provide you and your child’s mother, with income tax information each of you can retain with your records to document your agreed procedure for claiming your child on your yearly income tax returns. By following this procedure, each of you will receive the maximum income tax benefits (child tax credit, earned income credit, dependent care benefits, etc.) available to the two of you as *(child’s name)*’s parents.

<table>
<thead>
<tr>
<th>FATHER</th>
<th>MOTHER</th>
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<tbody>
<tr>
<td>2015 &amp; odd numbered yrs.</td>
<td>Filing status: Head of Household (if &gt;one-half custodial care)</td>
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<tr>
<td></td>
<td>Dependency Exemption: Will <strong>not</strong> claim <em>(child’s name)</em></td>
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<tr>
<th>2016 &amp; even numbered yrs.</th>
<th>Filing status: Single</th>
<th>Filing status: Head of Household (if &gt;one-half custodial care)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dependency Exemption: Will claim <em>(child’s name)</em></td>
<td>Dependency Exemption: Will <strong>not</strong> claim <em>(child’s name)</em></td>
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The IRS has modified their procedures so that parents who were never married can utilize Form 8332 (Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent) to document their intent with regard to claiming dependency exemptions for their children. Accordingly, I have completed a Form 8332 for signature by you on the appropriate line denoted above your typewritten name for the 2015 tax year. A similar form will be prepared next year for signature by your child’s mother releasing the dependency exemption to you for tax year 2016.

If you have any questions with regard to this procedure, please contact the office at your earliest convenience.

The following chart is intended to provide you with a list of other yearly tax benefits available to the individual who claims the dependency exemption and/or who provides greater than one-half of custodial care.

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<th>Must Provide Greater Than One-half of Custodial Care to Claim Benefits of:</th>
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<td>Tuition and fees deduction</td>
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<td>Student loan interest deduction</td>
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MARRIED FILING SEPARATELY -- LIMITATIONS

The taxpayer cannot:

- Take the credit for child and dependent care expenses in most cases.
- Take the earned income credit.
- Take the exclusion or credit for adoption expenses in most instances.
- Take the Hope or Lifetime Learning Credit (or Tuition and Fees Deduction) for higher education expenses or the deduction for student loan interest.
- Exclude interest from qualified savings bonds used for higher education expenses.

If the taxpayer lived with his or her spouse at any time during the tax year:

- The taxpayer cannot claim the credit for the elderly or disabled.
- The taxpayer will have to include up to 85% of any social security or equivalent railroad retirement benefits received.

The taxpayer will become subject to AGI phase-out limits for the child tax credit, retirement savings contribution credit, mortgage insurance premium deduction, passive loss rental exclusion and alternative minimum tax (AMT) exemption at income levels that are one-half of those for a joint return. In addition, the phase-out rules for itemized deductions and personal exemptions begin at levels that are one-half of those for a joint return.

AGI contribution limits for traditional and/or Roth IRAs are significantly reduced ($0 - $10,000). The capital loss deduction amount is $1,500 (instead of $3,000 on a joint return).

NOTE: Married taxpayers who file separately can amend their returns and file jointly within three years of the due date (not including extensions) of the separate returns. However, once a joint return is filed, married taxpayers cannot change from filing jointly to filing separately after the time for filing a return has expired. IRC Reg. §1.6013-1(b). Thus, it is the actual filing of a joint return that makes the act of married filing jointly irrevocable. See, IRC Reg. §1.6013-1(d)(5) for the right of an executor to file a late separate return for a deceased spouse, thereby disaffirming a timely joint return made by the surviving spouse.

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Form 4868 (EXTENSION OF TIME TO FILE)

An extension of time to file is not an extension of time to pay. However, in certain instances, extending the time in which you have to file your initial return can be useful. For example, if you have clients with marital issues, pending settlements, etc., you may wish to have your client file for an extension to make it possible to resolve lingering tax issues.

DESIGNATION OF FILING STATUS ON FORM 4868: If married taxpayers request an extension of time to file, the extension request can be made on a married filing jointly basis or married filing separately without initially closing any filing options. It is the act of actually filing a married filing joint return that limits the taxpayers’ option of married filing separately as discussed above.

NOTE: If spouses jointly filed Form 4868 but later file separate returns, they may enter the total amount paid with Form 4868 on either of the separate returns. In the alternative, the spouses may divide all payments in any manner agreed.

For clients with marital issues, it might be a better practice to file extensions using the “married filing separately” designation, since this filing status allows a longer time frame during which your clients might change their mind.
SAME-SEX MARRIAGE – FEDERAL TAX ISSUES

BACKGROUND: Prior to the U.S. Supreme Court decision in U.S. v. Windsor (6/26/13), The Defense of Marriage Act (P.L. 104-199) DOMA defined “marriage” for purposes of administering federal law (including federal tax laws) as the legal union between one man and one woman as husband and wife. It further defined “spouse” as a person of the opposite sex who is a husband or wife. Thus, prior to Windsor, only married individuals under this definition could elect to file a joint tax return. Even though a state recognized a union of two people of the same-sex as a legal marriage for the purposes within that state's authority, a taxpayer in such a relationship could not claim the status of a married person on a federal income tax return. Also, a taxpayer could not file as head of household (HOW) based solely on his or her same-sex partner.

Subsequent to the Windsor decision, the IRS issued Rev. Rul. 2013-17 and two sets of FAQs providing guidance on federal tax issues faced by same-sex couples.


FAQS FOR REGISTERED DOMESTIC PARTNERS AND INDIVIDUALS IN CIVIL UNIONS: The IRS also issued an updated set of 27 FAQs for registered domestic partners and members of civil unions. While these individuals are still considered unmarried for federal tax purposes, the FAQs do provide useful clarifications of the rules in certain situations such as those involving children (FAQs 3, 5, and 6) and those involving residents of community property states (FAQs 9-27). See: www.irs.gov – search for “domestic partners”.

NEW LAW: On June 26, 2015, the Supreme Court in Obergefell v. Hodges, ruled that the Fourteenth Amendment requires a State to license a marriage between two people of the same sex and to recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-State.

MARRIAGE - UNIFORM RULE OF RECOGNITION: The term marriage now includes persons of the same sex if they are lawfully married. No state may refuse to marry same-sex couples and no state may refuse to recognize the marriage of a same-sex couple who was married in another state or jurisdiction. Same-sex individuals who are married under the laws of any domestic or foreign jurisdictions will be considered married for federal tax purposes.

FILING GUIDANCE UNDER REV. RUL. 2013-17/FAQs: Effective 9/16/13 and after, legally married same-sex couples must generally file their federal income tax returns using a MFJ or MFS filing status. The head of household filing status may also be utilized if eligibility requirements are met. NOTE: All calendar year 2013 and after returns will be required to follow this guidance.

NOTE: For returns filed before 9/16/13, legally married same-sex couples can file amended returns to change their filing status to married filing separate or married filing jointly. However, they are not required to change their filing status on a prior return, even if they amend that return for another reason. Either way, their amended return must be consistent with the filing status they have chosen. News Release IR-2014-56.

TAX PLANNING CAUTION: While there are many tax benefits to be derived from filing under a joint filing status, one of the biggest tax detriments of marriage
is the marriage tax penalty itself; particularly for two higher income individuals. The greater the amount of taxable income, the more compressed the tax brackets become for joint filers relative to single filers. In addition, among other inequities, the 3.8% Medicare surtax on net investment income, and the new 20% tax rate on qualified dividends and long-term capital gains, have created a progressive tax rate structure for investment income that previously did not exist.

EMPLOYMENT FRINGE BENEFITS: The guidance in Rev. Rul. 2013-17 (See also, IRC Notice 2014-1) will apply to any employee benefit plan or arrangement, with respect to employer-provided benefits that are potentially excludable from income, based on the employee’s marital status. These benefits would include, but not be limited, to the following:

- Spousal coverage under employer-provided health plans on a before tax basis.
- Health plan coverage entitlement under COBRA continuation rules for spouses and dependent children.

For open tax years, employers can claim federal employment tax refunds for employment taxes (FICA/MED taxes) previously paid on benefits provided to an employee’s same-sex spouse if the benefits would have been tax-free had the employee and same-sex spouse been considered married. (FAQ 12).

NOTICE 2013-61 (10/15/13): This notice provides guidance for employers who wish to file refund claims for payroll taxes paid on previously taxed health insurance and fringe benefits which were provided to same-sex spouses, but taxed as compensation.

2013 AND PRIOR YEAR OVERPAYMENTS. File one Form 941-X for the fourth quarter to claim a FICA/MED tax refund for all four quarters of an applicable calendar year. The notation “WINDSOR” should be written in bold across the top margin of the first page of Form 941X.

RETIREMENT PLAN BENEFITS: Qualified retirement plans must comply with the rules in Rev. Rul. 2013-17, starting on 9/16/13 (FAQs 16-18). Thus, the following will now apply to legally married same-sex couples:

- **Qualified joint and survivor annuity rights from pension plans.** Pension plans generally must pay benefits to a married participant in the form of a qualified joint and survivor annuity; the spouse must consent in writing if an election out is made.

- **Required consent for qualified retirement plan balance to non-spouse beneficiary.** If a participant in a qualified retirement plan leaves the account balance to a non-spouse beneficiary, the participant’s spouse must consent in writing.

- **Other retirement plan spousal consent areas.** Spousal consent is required for several actions in a qualified retirement plan, particularly pertaining to plan loans and lump-sum distributions.

- **Spousal distribution options from retirement plans.** The Required Minimum Distribution (RMD) rules are generally less rigid for married participants than those participants who are unmarried, including the rollover rules to the spouse of a deceased employee.

- **Qualified Domestic Relations Order (QDRO).** Eligibility for marital dissolutions.
CHILD TAX CREDIT
(IRC §24)

The child tax credit is available for qualifying children of the taxpayer under the age of 17, for which the taxpayer is allowed a dependency deduction under IRC §151. See: IRC §152(c).

The American Tax Relief Act of 2012 (ATRA) made permanent the $1,000 (per eligible child) credit provision. The credit is allowable to offset both regular tax and AMT.

TAX PLANNING - DISSOLUTIONS: A release of the dependency exemption by the custodial parent to the noncustodial parent enables the noncustodial parent to claim both the dependency exemption and the child tax credit for the child.

AGI PHASEOUT RANGE: Due to the increase in the credit in 2003 and after, the AGI phaseout ranges for claiming the child tax credit also increased as follows:

<table>
<thead>
<tr>
<th>MFJ</th>
<th>MFS</th>
<th>SINGLE/HOH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phaseout begins</td>
<td>$110,000</td>
<td>$55,000</td>
</tr>
<tr>
<td>Phaseout end (1 child)</td>
<td>129,001</td>
<td>74,001</td>
</tr>
<tr>
<td>Phaseout ends (2 children)</td>
<td>149,001</td>
<td>94,001</td>
</tr>
<tr>
<td>Phaseout ends (3 children)</td>
<td>169,001</td>
<td>114,001</td>
</tr>
</tbody>
</table>

(Phaseout rate = $50 of credit/$1,000 of AGI (or fraction thereof))

FORM 8812 – Additional Child Tax Credit: While the child tax credit is generally nonrefundable, lower income taxpayers may be eligible for a refund of the credit if their income tax liability does not fully offset the credit. The child tax credit was refundable for 2008 to the extent of 15% of the taxpayer’s earned income in excess of $8,500; and is refundable for 2009-2017 to the extent of 15% of the taxpayer’s earned income in excess of $3,000 (adjusted annually for inflation). For tax years beginning after 2017, the earned income threshold is scheduled to revert to $10,000, adjusted for inflation. By reducing the earned income threshold, more low-income taxpayers became eligible for the refundable child tax credit. IRC §24(d)(4). Form 8812 is used to compute the credit available for refund.

NONTAXABLE COMBAT PAY: Military families should include otherwise excludable combat zone pay in their earned income when calculating the refundable portion of the credit. IRC §24(d)(1).

3 OR MORE CHILDREN: Taxpayers with three or more children may use an alternative method to calculate their refundable child tax credit to help offset some of their social security tax. Under this method, the refundable credit is the excess of the taxpayer’s share of social security taxes (including one-half of any self-employment tax) over his/her earned income credit for the tax year. IRC §24(d)(2).

EFFECT OF ADDITIONAL CHILD TAX CREDIT ON WELFARE BENEFITS: Any refund received as a result of taking the additional child tax credit will not be used to determine eligibility for Temporary Assistance for Needy Families (TANF), Medicaid and supplemental security income (SSI), Food stamps and low-income housing or how much can be received from them. However, if the refund received because of additional child tax credit is not spent within a certain period of time, it may count as an asset (or resource) and affect eligibility.
Part I  Filers Who Have Certain Child Dependent(s) with an ITIN (Individual Taxpayer Identification Number)

Complete this part only for each dependent who has an ITIN and for whom you are claiming the child tax credit. If your dependent is not a qualifying child for the credit, you cannot include that dependent in the calculation of this credit.

Answer the following questions for each dependent listed on Form 1040, line 6c; Form 1040A, line 6c; or Form 1040NR, line 7c, who has an ITIN (Individual Taxpayer Identification Number) and that you indicated is a qualifying child for the child tax credit by checking column (4) for that dependent.

A. For the first dependent identified with an ITIN and listed as a qualifying child for the child tax credit, did this child meet the substantial presence test? See separate instructions.

☐ Yes  ☐ No

B. For the second dependent identified with an ITIN and listed as a qualifying child for the child tax credit, did this child meet the substantial presence test? See separate instructions.

☐ Yes  ☐ No

C. For the third dependent identified with an ITIN and listed as a qualifying child for the child tax credit, did this child meet the substantial presence test? See separate instructions.

☐ Yes  ☐ No

D. For the fourth dependent identified with an ITIN and listed as a qualifying child for the child tax credit, did this child meet the substantial presence test? See separate instructions.

☐ Yes  ☐ No

Note: If you have more than four dependents identified with an ITIN and listed as a qualifying child for the child tax credit, see separate instructions and check here: ☐

Part II  Additional Child Tax Credit Filers

1. If you file Form 2555 or 2555-EZ, stop here; you cannot claim the additional child tax credit.

If you are required to use the worksheet in Pub. 972, enter the amount from line 6 of the Child Tax Credit Worksheet in the publication. Otherwise:

1040 filers: Enter the amount from line 6 of your Child Tax Credit Worksheet (see the Instructions for Form 1040, line 52).

1040A filers: Enter the amount from line 6 of your Child Tax Credit Worksheet (see the Instructions for Form 1040A, line 35).

1040NR filers: Enter the amount from line 6 of your Child Tax Credit Worksheet (see the Instructions for Form 1040NR, line 49).

2. Enter the amount from Form 1040, line 52; Form 1040A, line 35; or Form 1040NR, line 49.

3. Subtract line 2 from line 1. If zero, stop; you cannot take this credit.

4a. Earned income (see separate instructions)

4b. Non-taxable combat pay (see separate instructions)

5. Is the amount on line 4a more than $3,000?

☐ No. Leave line 5 blank and enter -0- on line 6.

☐ Yes. Subtract $3,000 from the amount on line 4a. Enter the result.

6. Multiply the amount on line 5 by 15% (.15) and enter the result.

Next. Do you have three or more qualifying children?

☐ No. If line 6 is zero, stop; you cannot take this credit. Otherwise, skip Part III and enter the smaller of line 3 or line 6 on line 13.

☐ Yes. If line 6 is equal to or more than line 3, skip Part III and enter the amount from line 3 on line 13. Otherwise, go to line 7.
### Part III  Certain Filers Who Have Three or More Qualifying Children

7  Withheld social security, Medicare, and Additional Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If your employer withheld or you paid Additional Medicare Tax or tier 1 RRTA taxes, see separate instructions.

8  **1040 filers:** Enter the total of the amounts from Form 1040, lines 27 and 58, plus any taxes that you identified using code "UT" and entered on line 62.

1040A filers: Enter 0.
1040NR filers: Enter the total of the amounts from Form 1040NR, lines 27 and 56, plus any taxes that you identified using code "UT" and entered on line 60.

9  Add lines 7 and 8.

10  **1040 filers:** Enter the total of the amounts from Form 1040, lines 66a and 71.

1040A filers: Enter the total of the amount from Form 1040A, line 42a, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 46 (see separate instructions).

1040NR filers: Enter the amount from Form 1040NR, line 67.

11  Subtract line 10 from line 9. If zero or less, enter 0.

12  Enter the larger of line 6 or line 11.
Next, enter the smaller of line 3 or line 12 on line 13.

### Part IV  Additional Child Tax Credit

13  This is your additional child tax credit.

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Enter this amount on Form 1040, line 67, Form 1040A, line 43, or Form 1040NR, line 64.
CHILD AND DEPENDENT CARE EXPENSES
(FORM 2441)
(IRC §21)

CREDIT AMOUNT: The child and dependent care credit is available to all taxpayers who qualify, and is not subject to phase-out rules for higher income taxpayers. The credit can be as much as 35% of qualified child care expenses (increased from 30% maximum for 2002 and prior), and made permanent by the American Taxpayer Relief Act of 2012 (ATRA).

CREDIT RANGE (SLIDING SCALE): The maximum AGI amount that qualifies for the highest percentage child and dependent care credit (35% in 2003 and after) is the first $15,000 of AGI (up from $10,000 for 2002 and prior). The minimum child and dependent care credit percentage (20%) will be reached when AGI = $43,000. (Reduction = 1% for each $2,000 of AGI over $15,000).

QUALIFYING EXPENSES: The dollar limit on the amount of qualifying expenses per qualifying individual is $3,000 (for one) and $6,000 (for two or more) qualifying individuals (up from $2,400/$4,800 for 2002 and prior). IRC §21(c).

FORM 2441 INSTRUCTIONS/CLARIFICATION – QUALIFYING EXPENSES: It is possible that a qualifying child could have $-0- expenses for the year, with a second child having expenses exceeding $3,000. Reporting of child and dependent care expenses should list $-0- for the first child, and the actual amount of expense for the second child. The $6,000 limit would still be used to compute the child and dependent care credit unless the taxpayer has excluded dependency benefits (reported on Form 2441, part III) which were reimbursed to the taxpayer by an employer.

NOTE – SALARY REDUCTION FRINGE BENEFIT: The maximum per year salary reduction benefit that can be obtained under an employer's flexible spending plan is $5,000 per family. The child and dependent care credit would be available for expenses in excess of this limit, subject to the qualifying expense limits under IRC §21 (e.g. $6,000 for two or more children).

**********************************************************************

A) Qualifying Person Test: To be eligible for the child and dependent care credit, child and dependent care expenses must be paid for the care of one or more qualifying persons, defined as follows:

- A dependent who is under age 13 when the care is provided and for whom the taxpayer can claim an exemption.

- A spouse who is physically or mentally not able to care for himself or herself and who has the same principal place of abode as the taxpayer for over one-half of the tax year.

- A dependent who is physically or mentally not able to care for himself or herself, who has the same principal place of abode as the taxpayer for over one-half of the tax year and for whom the taxpayer can claim an exemption (or could claim an exemption except the person had $4,000 or more of gross income for 2015; $4,050 for 2016).
NOTE -- Physically or Mentally Not Able to Care for Oneself: Persons who cannot dress, clean, or feed themselves because of physical or mental problems are considered not able to care for themselves. Also included are persons who require constant attention to prevent them from injuring themselves or others.

Children of Divorced or Separated Parents: Married couples claiming the child and dependent care credit generally must file a joint return. IRC §21(e)(2). However, a custodial parent who is divorced, legally separated, or living apart from the other parent during the last 6 months of the tax year may be able to claim the child and dependent care credit even if the child is not claimed as their dependent. IRC §21(e)(4). To claim the credit, the custodial parent must meet all of the following tests:

1) Had custody of the child for a longer time (greater number of nights) during the tax year than the other parent (i.e. is the custodial parent), and maintained a household as a principal place of abode for the qualifying person. IRC Reg. §1.21-1(b)(5)(ii).

2) One or both of the parents provided over one-half of the cost of maintaining the household during the taxable year.

3) The child was under age 13 or disabled and could not care for themselves.

4) The non-custodial parent claims the child as a dependent because:

   (a) The taxpayer, as custodial parent, signed Form 8332 or a similar statement agreeing not to claim the child’s exemption or

   (b) The parent’s divorce Decree or written agreement went into effect before 1985 and states that the non-custodial parent can claim the child as a dependent; and the non-custodial parent gave at least $600 for the child’s support during the tax year. NOTE: Thus rule does not apply if your Decree or agreement was changed after 1984 to say that the non-custodial parent cannot claim the child as a dependent.

CAUTION: If this exception applies, the non-custodial parent cannot treat the child as a qualifying person and claim dependent care expenses even though the non-custodial parent claims the child as a dependent.

B. Work-Related Expense Test: The child and dependent care expenses must be "work related" to qualify for the credit. Work related expenses must meet both of the following tests:

1) Expense allows the taxpayer (and a spouse if married) to work or look for work.

2) Expense is for qualifying person's care.

NOTE: The term "work" includes employment, self-employment, and partnership activities. Work can be either full-time or part-time.

NOTE: Nursery and preschool expense, below the kindergarten level, as well as, the cost of day camps may be eligible for the credit. The cost of a day camp or similar program may qualify even if the day camp specializes in a sports or educational activity. IRC Reg. §1.21-1(d)(7).
Expenses for attending kindergarten and higher grade levels are not eligible, although before or after-school care of a child is generally eligible for the credit. The cost of tutoring programs and/or attending summer school are not eligible for the credit. IRC Reg. §1.21-1(d)(7).

NOTE: Taxpayers that work part-time must allocate expenses between days worked and not worked, unless they are required to pay for dependent care on a weekly or longer basis. In this case, no allocation is required and the entire care may be eligible for the credit.

***************************************************

EARNED INCOME LIMITATION RULES: For married taxpayers, expenses eligible for the child and dependent care credit are limited to the earned income of the lower-earning spouse. Generally, if one spouse is not working, no credit is allowed. Exceptions:

EXCEPTION: If the nonworking spouse is physically or mentally incapable of caring for himself/herself; or is a full-time student (12 semester hours for five (5) calendar months during the year) they are assumed to have an earned income as follows:

- $250 -- for each month of disability or school attendance (one qualifying child)
- $500 -- for each month of disability or school attendance (two or more qualifying children)

NOTE: Full-time night school will qualify. IRC Reg. §1.21-2(b)(3).

NOTE: If the taxpayer and spouse are married at year-end, the spouse’s earned income for the entire year is considered (even if earned prior to the marriage). However, the income of a spouse who died or was divorced or separated from the taxpayer during the year does not have to be considered.

NOTE – SELF-EMPLOYED TAXPAYERS (OPTIONAL EARNINGS): Self-employed taxpayers with low earnings or a net loss who compute their self-employed tax using the optional method may utilize the optional earnings amount in computing their child and dependent care credit. Self-employed individuals are required to reduce their net earnings by the one-half of self-employed tax deduction in calculating earned income.

***************************************************

RELATED PARTY PAYMENTS: Payments made to certain related individuals for child and dependent care are not permitted for the credit. The regulations now define a related caregiver as: (1) an individual for which a dependency exemption is allowed; (2) a child of the taxpayer age 18 or under at the close of the tax year; (3) an individual who was the spouse of the taxpayer at any time during the year; and/or (4) a parent of the child. IRC Reg. §1.21-4(a).
**Form 2441**

**Child and Dependent Care Expenses**

Attach to Form 1040, Form 1040A, or Form 1040NR.

Information about Form 2441 and its separate instructions is at www.irs.gov/form2441.

Your social security number

**Part I**

Persons or Organizations Who Provided the Care — You must complete this part.

<table>
<thead>
<tr>
<th>(a) Care provider’s name</th>
<th>(b) Address (number, street, apt. no., city, state, and ZIP code)</th>
<th>(c) Identifying number (SDV or EIN)</th>
<th>(d) Amount paid (see instructions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Did you receive dependent care benefits?

- Yes
- No

Complete only Part II below.

Complete Part III on the back next.

Caution: If the care was provided in your home, you may owe employment taxes. If you do, you cannot file Form 1040A. For details, see the instructions for Form 1040, line 60a, or Form 1040NR, line 60a.

**Part II**

Credit for Child and Dependent Care Expenses

2 Information about your qualifying persons. If you have more than two qualifying persons, see the instructions.

<table>
<thead>
<tr>
<th>(a) Qualifying person’s name</th>
<th>(b) Qualifying person’s social security number</th>
<th>(c) Qualified expenses you incurred and paid in 2015 for the person listed in column (a)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3 Add the amounts in column (c) of line 2. Do not enter more than $3,000 for one qualifying person or $6,000 for two or more persons. If you completed Part III, enter the amount from line 31

4 Enter your earned income. See instructions.

5 If married filing jointly, enter your spouse’s earned income (if you or your spouse was a student or was disabled, see the instructions); all others, enter the amount from line 4.

6 Enter the smallest of line 3, 4, or 5.

7 Enter the amount from Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 37.

8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7.

   If line 7 is:  
   - But not over  
   - Decimal amount is
   - Over  
   - But not over  
   - Decimal amount is

   $1—15,000  .35  
   15,000—17,000  .34  
   17,000—19,000  .33  
   19,000—21,000  .32  
   21,000—23,000  .31  
   23,000—25,000  .30  
   25,000—27,000  .29  
   27,000—29,000  .28  
   29,000—31,000  .27  
   31,000—33,000  .26  
   33,000—35,000  .25  
   35,000—37,000  .24  
   37,000—39,000  .23  
   39,000—41,000  .22  
   41,000—43,000  .21  
   43,000—45,000  .20  
   45,000—47,000  .19  
   47,000—49,000  .18  
   49,000—51,000  .17  
   51,000—53,000  .16  
   53,000—55,000  .15  
   55,000—57,000  .14  
   57,000—59,000  .13  
   59,000—61,000  .12  
   61,000—63,000  .11  
   63,000—65,000  .10  
   65,000—67,000  .09  
   67,000—69,000  .08  
   69,000—71,000  .07  
   71,000—73,000  .06  
   73,000—75,000  .05  
   75,000—77,000  .04  
   77,000—79,000  .03  
   79,000—81,000  .02  
   81,000—83,000  .01  
   83,000—85,000  .00  
   Over 85,000  .00  

9 Multiply line 6 by the decimal amount on line 8. If you paid 2014 expenses in 2015, see the instructions.

10 Tax liability limit. Enter the amount from the Credit Limit Worksheet in the instructions.

11 Credit for child and dependent care expenses. Enter the smaller of line 9 or line 10 here and on Form 1040, line 49; Form 1040A, line 31; or Form 1040NR, line 47.

For Paperwork Reduction Act Notice, see your tax return instructions.
Part III  Dependent Care Benefits

12 Enter the total amount of dependent care benefits you received in 2015. Amounts you received as an employee should be shown in box 10 of your Form(s) W-2. Do not include amounts reported as wages in box 1 of Form(s) W-2. If you were self-employed or a partner, include amounts you received under a dependent care assistance program from your sole proprietorship or partnership.

13 Enter the amount, if any, you carried over from 2014 and used in 2015 during the grace period. See instructions.

14 Enter the amount, if any, you forfeited or carried forward to 2016. See instructions.

15 Combine lines 12 through 14. See instructions.

16 Enter the total amount of qualified expenses incurred in 2015 for the care of the qualifying person(s).

17 Enter the smaller of line 15 or 16.

18 Enter your earned income. See instructions.

19 Enter the amount shown below that applies to you.
   • If married filing jointly, enter your spouse’s earned income (if you or your spouse was a student or was disabled, see the instructions for line 5).
   • If married filing separately, see instructions.
   • All others, enter the amount from line 18.

20 Enter the smallest of line 17, 18, or 19.

21 Enter $5,000 ($2,500 if married filing separately and you were required to enter your spouse’s earned income on line 19).

22 Is any amount on line 12 from your sole proprietorship or partnership? (Form 1040A filers go to line 25.)
   [ ] No. Enter 0.
   [ ] Yes. Enter the amount here.

23 Subtract line 22 from line 15.

24 Deductible benefits. Enter the smallest of line 20, 21, or 22. Also, include this amount on the appropriate line(s) of your return. See instructions.

25 Excluded benefits. Form 1040 and 1040NR filers: If you checked “No” on line 22, enter the smaller of line 20 or 21. Otherwise, subtract line 24 from the smaller of line 20 or line 21. If zero or less, enter 0. Form 1040A filers: Enter the smaller of line 20 or line 21.

26 Taxable benefits. Form 1040 and 1040NR filers: Subtract line 26 from line 23. If zero or less, enter 0. Also, include this amount on Form 1040, line 7, or Form 1040NR, line 8. On the dotted line next to Form 1040, line 7, or Form 1040NR, line 8, enter “DCB.” Form 1040A filers: Subtract line 25 from line 15. Also, include this amount on Form 1040A, line 7. In the space to the left of line 7, enter “DCB.”

To claim the child and dependent care credit, complete lines 27 through 31 below.

27 Enter $3,000 ($6,000 if two or more qualifying persons).

28 Form 1040 and 1040NR filers: Add lines 24 and 25. Form 1040A filers: Enter the amount from line 25.

29 Subtract line 28 from line 27. If zero or less, stop. You cannot take the credit.

Exception. If you paid 2014 expenses in 2015, see the instructions for line 9.

30 Complete line 2 on the front of this form. Do not include in column (c) any benefits shown on line 28 above. Then, add the amounts in column (c) and enter the total here.

31 Enter the smaller of line 29 or 30. Also, enter this amount on line 3 on the front of this form and complete lines 4 through 11.
EARNED INCOME TAX CREDIT

For tax years beginning in 2002 and thereafter, six changes were implemented to streamline and simplify the computation of earned income credit (EIC). The changes are as follows:

1. New definition of qualifying foster child;
2. New rules for taxpayers claiming the same qualifying child (tie-breaker rules);
3. New definition of earned income;
4. Marriage tax penalty relief - separate EIC phase-out tables for joint filers;
5. Reduction of EIC by elimination of AMT; and
6. Elimination of modified adjusted gross income computation for EIC.

I. QUALIFYING CHILD: For tax years beginning after 2001, a qualifying child for EIC is one who meets all of the following tests:

- **Relationship Test:** The 2001 Tax Act expanded the relationship test to include descendants of a stepchild, and also include siblings or their descendants. Eligible individuals are now defined as the taxpayer’s:
  
  (A) Child (including a legally adopted child), stepchild, or a descendant of those individuals;
  
  (B) Brother, sister, stepbrother, or stepsister, or a descendant of those individuals, who the taxpayer cares for as his or her own child; or
  
  (C) Eligible foster child, defined as an individual who is placed with the taxpayer by an authorized placement agency. IRC §32(c)(3)(B).

- **Residency Test:** The child (or foster child) lives with the taxpayer for more than one-half of the year (greater number of nights). Periods of temporary absence for special circumstances are ignored for this purpose. **Note:** The 2001 Tax Act amended the residency test to drop the prior special full-year residency requirement for foster children.

  **TIE-BREAKING RULES:** For tax years beginning after 2001, the tie breaking rules (applicable when a qualifying child can be claimed by more than one taxpayer for EIC purposes) are as follows:

  1. If one of the individuals is the child’s parent, the child is considered the qualifying child of the parent.
  2. If both parents claim the child and do not file a joint return, the child is considered a qualifying child of:

     (a) The parent with whom the child resided for the longest period of time (greater number of nights) during the year; or
(b) The parent with the highest AGI, if the child resided with both parents for the same amount of time during the tax year.

(3) If none of the taxpayers claiming the child as a qualifying child is the child’s parent, the child is considered a qualifying child of the taxpayer with the highest AGI.

- **Age Test:** The child is under age 19, a full-time student under age 24, or permanently and totally disabled. IRC §32(c)(3).

II. **DEFINITION OF EARNED INCOME:** Earned income currently includes wages, salaries, tips and net earnings from self-employment (reduced by the one-half of SE tax deduction). IRC §32(c)(2).

**NOTE:** For tax years beginning after 2001, the definition of earned income was simplified by excluding all nontaxable earned income amounts from the definition of earned income for EIC purposes (e.g. voluntary salary deferrals (401(k), etc.); excludible dependent care benefits; cafeteria plan benefits; clergy housing allowance; etc.).

**TAX PLANNING NOTE – MILITARY COMBAT PAY:** Military families can elect to include nontaxable combat pay in earned income for EIC purposes. Taxpayers should compute their EITC with and without combat pay to determine the best tax result. Either all or none of the combat pay must be used in the calculation.

III. **APPLICATION OF EIC:** Beginning in 1994, the earned income tax credit (EIC) was expanded to extend availability to individuals without children.

**Eligible individuals.** The EIC is available to individuals without children if:

1. The individual has a principal residence in the United States for more than one-half of the taxable year;

2. The individual (or if married, either the individual or the individual's spouse) is at least 25 years old and not more than 64 years old at the end of the taxable year; and

3. The individual is not claimed as a dependent for any taxable year beginning in the same calendar year as the taxable year for which the credit is claimed.

**NOTE:** Married individual defined. An individual is considered married for purposes of the EIC if he or she is married at the end of the tax year. If the individual's spouse dies during the year, the individual is considered married up to the date of death. An individual legally separated from his or her spouse is not considered to be married.
For tax years beginning after 2001, the beginning and ending phase-out thresholds for taxpayers whose filing status is married filing jointly were increased (in addition to normal inflation adjustments) as follows:

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Increase in Beginning &amp; Ending EIC Phase-out for MFJ Filers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-2004</td>
<td>$1,000</td>
</tr>
<tr>
<td>2005-2007</td>
<td>2,000</td>
</tr>
<tr>
<td>2008</td>
<td>3,000</td>
</tr>
<tr>
<td>2009-2017</td>
<td>5,000</td>
</tr>
</tbody>
</table>

The $5,000 amount is adjusted annually for inflation after 2010.

The American Recovery and Reinvestment Tax Act of 2009 increased the applicable EIC percentage for taxpayers with 3 or more children from 40% to 45%. This provision was extended through 2012 by the 2010 Tax Relief Act; and was further extended through 2017 by the American Taxpayer Relief Act of 2012 (ATRA). This increase yields not only a higher maximum credit amount but also a broader AGI phase-out range for all taxpayers. IRC §32(b)(3).

<table>
<thead>
<tr>
<th>EIC PERCENTAGE INCREASE</th>
<th>PHASE-OUT PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>No qualifying children</td>
<td>7.65%</td>
</tr>
<tr>
<td>One qualifying child</td>
<td>34.00%</td>
</tr>
<tr>
<td>Two qualifying children</td>
<td>40.00%</td>
</tr>
<tr>
<td>Three or more qualifying children</td>
<td>45.00%</td>
</tr>
</tbody>
</table>

Phase-out increase: The EIC is fully phased-out when AGI (or earned income, if greater), reaches:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No qualifying children</td>
<td>14,820</td>
<td>20,330</td>
<td>14,880</td>
<td>20,430</td>
</tr>
<tr>
<td>One qualifying child</td>
<td>39,131</td>
<td>44,651</td>
<td>39,296</td>
<td>44,846</td>
</tr>
<tr>
<td>Two qualifying children</td>
<td>44,454</td>
<td>49,974</td>
<td>44,648</td>
<td>50,198</td>
</tr>
<tr>
<td>Three or more qualifying children</td>
<td>47,747</td>
<td>53,267</td>
<td>47,955</td>
<td>53,505</td>
</tr>
</tbody>
</table>

Maximum EIC:

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>No qualifying children</td>
<td>503</td>
<td>506</td>
</tr>
<tr>
<td>One qualifying child</td>
<td>3,359</td>
<td>3,373</td>
</tr>
<tr>
<td>Two qualifying children</td>
<td>5,548</td>
<td>5,572</td>
</tr>
<tr>
<td>Three or more qualifying children</td>
<td>6,242</td>
<td>6,269</td>
</tr>
</tbody>
</table>

Maximum earned income credit range:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No qualifying children</td>
<td>6,580-8,240</td>
<td>6,580-13,750</td>
<td>6,610-8,270</td>
<td>6,610-13,820</td>
</tr>
<tr>
<td>One qualifying child</td>
<td>9,880-18,110</td>
<td>9,880-23,630</td>
<td>9,920-18,190</td>
<td>9,920-23,740</td>
</tr>
<tr>
<td>Two qualifying children</td>
<td>13,870-18,110</td>
<td>13,870-23,630</td>
<td>13,930-18,190</td>
<td>13,930-23,740</td>
</tr>
<tr>
<td>Three or more qualifying children</td>
<td>13,870-18,110</td>
<td>13,870-23,630</td>
<td>13,930-18,190</td>
<td>13,930-23,740</td>
</tr>
</tbody>
</table>
NOTE: EIC income and phase-out amounts are indexed for inflation in taxable years beginning after 1994.

**********************************************************************************

IV. AMT EFFECT -- TAX LAW CHANGE - 2002 (AMT): For tax years beginning after 2001, EIC is no longer reduced by an individual’s AMT.

**********************************************************************************

V. EARNED INCOME TAX CREDIT -- INVESTMENT INCOME DISQUALIFICATION

There is no change to the “disqualified income” threshold for EIC eligibility under any new law provisions. This provision will still create havoc for those otherwise eligible for earned income credit.

A taxpayer is not eligible for earned income credit if the aggregate amount of "disqualified income" exceeds $3,400 for the 2015 tax year (also $3,400 for 2016). No phase-out provision applies. IRC §32(i).

DISQUALIFIED INCOME. The sum of:

(1) Interest and dividends includible in gross income;
(2) Tax-exempt interest received or accrued;
(3) Net income (losses not considered) from rents and royalties not derived in the ordinary course of business (thus, rental losses cannot be utilized to offset interest & dividends);
(4) Net passive activity income; and
(5) Net capital gain income (as defined in IRC §1222).

SELF-RENTAL INCOME: Under the self-rental rule of IRC Reg. 1.469-2(f)(6), when a taxpayer rents property to his own business, the net rental income can be recharacterized as nonpassive for the passive loss rules. The IRS has determined that since the underlying activity is still passive, the net rent is still included in investment income for EIC purposes. FSA 200120036 and SCA 200120037.

CAPITAL GAIN FROM SALE OF T/B ASSETS (1998 TAX LAW CHANGE): The IRS had taken the position in 1996 that capital gains resulting from the sale of assets used in a trade or business (IRC §1231 (Form 4797) -- sales of dairy and breeding stock) were included in the "net capital gain" income definition; thus, denying EIC applicability. The IRS has conceded that this position was incorrect. Rev. Rul. 98-56 (November 10, 1998).

NOTE: Because there is no phase-out of earned income credit as "disqualified income" approaches the current $3,400 for 2015 threshold tax planning is necessary. Taxpayers may wish to shift investments to growth stocks, mutual funds or annuity investments to avoid exceeding the threshold.

**********************************************************************************
VI. EARNED INCOME TAX CREDIT -- PHASE-OUT BASED ON AGI

**TAX LAW CHANGE - 2002:** For tax years beginning after 2001, the calculation of EIC is based solely on the taxpayer’s adjusted gross income (AGI) rather than modified adjusted gross income. This means that none of the pre-2002 increases to AGI (e.g. 75% of the net loss from T/B) need to be added to adjusted gross income for purposes of determining the earned income credit.

**************************************************

**OTHER PROVISIONS**

**ADVANCE PAYMENT OF EIC:** The advance payment EIC option has been eliminated under a provision of the Education Jobs Act of 2010, effective for taxable years beginning after 12-31-10.

**FORM 8862 - INFORMATION TO CLAIM EIC AFTER DISALLOWANCE:** The IRS may deny a taxpayer the benefit of claiming EIC, in whole or part, if the taxpayer receives an EIC deficiency assessment that is not the result of a math or clerical error. The taxpayer will then be ineligible to file a return claiming EIC until the taxpayer once again establishes eligibility for EIC. This can be accomplished by filing Form 8862.

A taxpayer who has received an EIC deficiency assessment is ineligible to file Form 8862 until the following time constraints have been satisfied:

1. For **2 years** after the date of determination if the error was due to reckless or intentional disregard of the EIC rules; or
2. For **10 years** after the date of determination if the taxpayer fraudulently claimed the EIC.

If the taxpayer correctly files Form 8862 and demonstrates EIC eligibility for a taxable year, no further Form 8862 filings are necessary unless IRS later denies EIC for the taxpayer through another deficiency procedure. IRC Reg. 1.32-3.

**NOTE:** In CSA 200245051, the IRS concluded that a taxpayer’s failure to respond (or failure to provide an adequate response) to a request for substantiation and verification of EIC does not, in and of itself, constitute reckless or intentional disregard of the rules and regulations, thereby prohibiting the taxpayer from claiming the EIC for the next two tax years under IRC §32(k)(1)(B)(ii).

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**FORM 8867 – PAID PREPARER’S EARNED INCOME CREDIT CHECKLIST (DUE DILIGENCE REQUIREMENTS):** An EIC preparer penalty of $500 per occurrence can be assessed for each failure by a preparer to comply with the EIC due diligence requirements with respect to the amount of, or a determination of a taxpayer’s eligibility for EIC. IRC §6695(g). The penalty may be imposed in addition to any other applicable penalty. IRC §6696(a).

IRC Reg. §1.6695-2(b) provides revised EIC due diligence requirements, as follows:
(1) **Eligibility Checklist:** Beginning with 2011 calendar year returns, preparers are required to file Form 8867 with each return claiming EIC. IRS hopes the requirement to file Form 8867 (with Form 1040, etc.) rather than just maintain information will help ensure compliance.

In July 2012, the IRS began sending letters to paid preparers who submitted tax year 2011 returns claiming EIC without attaching Form 8867. This letter was a warning for paid preparers because no penalties were assessed for 2011 returns. Starting with 2012 tax returns, paid preparers have been subject to a due diligence penalty of $500 for each EIC return submitted without Form 8867.

(2) **EIC Worksheet:** Complete the earned income credit worksheet in the Instructions to Form 1040; or maintain office records containing this information. **NOTE:** Most electronic tax preparation software provides this type of worksheet with the preparation of the return.

(3) **Knowledge:** The preparer must **not** be aware of any incorrect information used in determining the taxpayer’s eligibility for, or the amount of, the earned income credit. The preparer must make reasonable inquiries if the information furnished to, or known by, the preparer appears to be incorrect, inconsistent or incomplete.

(4) **Retention of Records:** The above information regarding a taxpayer’s earned income credit eligibility and/or claim must be **retained for three (3) years after the later of (1) the due date of the return (ignoring extensions); or the date the tax return or claim for refund was filed.** Records may be retained in paper or electronic form.

**NOTE:** There is no reasonable cause exception to the penalty for failing to comply with the EIC due diligence requirements. However, a return preparer is only required to make “reasonable inquiries” if the information “appears” to be incorrect, inconsistent, or incomplete. IRC Reg §1.6695-2(b)(3)(i).

**NOTE:** Firms employing a preparer subject to a penalty under IRC §6695(g) also would be subject to penalty if (1) one or more members of the principal management (or principal officers) of the firm or a branch office participated in or knew of the failure to comply with the due diligence requirements; (2) the firm failed to establish reasonable and appropriate procedures to ensure compliance with the due diligence requirements; or (3) the firm disregarded its reasonable and appropriate compliance procedures through willfulness, recklessness, or gross indifference in the preparation of the tax return or claim for refund.

*********************************************************************
**EITC Assistant (IR 2004-122)**
*********************************************************************

**EITC Assistant can be accessed at www.irs.gov.** This tool is available to help tax professionals determine if their clients are eligible for the earned income tax credit (EIC) and is in **both English and Spanish.** Currently, the EITC Assistant helps determine (1) eligibility for the credit, (2) filing status of the taxpayers, (3) whether the taxpayers’ children meet the definition of qualifying children, and (4) provides an estimate of the EITC the taxpayer may receive.
Information To Claim Earned Income Credit After Disallowance

Before you begin:

See your tax return instructions or Pub. 506, Earned Income Credit (EIC), for the year for which you are filing this form to make sure you can take the earned income credit (EIC) and to find out who is a qualifying child.

You have a qualifying child, complete Schedule EIC before you fill in this form.

Do not file this form if you are taking the EIC without a qualifying child and the only reason your EIC was reduced or disallowed in the earlier year was because it was determined that a child listed on Schedule EIC was not your qualifying child.

Part I All Filers

1. Enter the year for which you are filing this form (for example, 2012).

2. If the only reason your EIC was reduced or disallowed in the earlier year was because you incorrectly reported your earned income or investment income, check “Yes.” Otherwise, check “No.”

Caution: If you checked “Yes,” stop. Do not fill in the rest of this form. But you must attach it to your tax return to take the EIC. If you checked “No,” continue.

3. Could you (or your spouse if filing jointly) be claimed as a qualifying child of another taxpayer for the year shown on line 1? See the instructions before answering.

Caution: If you checked “Yes,” stop. You cannot take the EIC. If you checked “No,” continue.

Part II Filers With a Qualifying Child or Children

Note. Child 1, Child 2, and Child 3 are the same children you listed as Child 1, Child 2, and Child 3 on Schedule EIC for the year shown on line 1 above.

4. Enter the number of days each child lived with you in the United States during the year shown on line 1 above:
   a. Child 1
   b. Child 2
   c. Child 3

Caution: If you entered less than 183 (184 if the year on line 1 is a leap year) for any child, you cannot take the EIC based on that child, unless the special rule for a child who was born or died during the year shown on line 1 applies. See the instructions.

5. If your child was born or died during the year shown on line 1, enter the month and day the child was born or died. Otherwise, skip this line.
   a. Child 1
   b. Child 2
   c. Child 3

6. Enter the address where you and the child lived together during the year shown on line 1. If you lived with the child at more than one address during the year, attach a list of the addresses where you lived:
   a. Child 1
   b. Child 2
   c. Child 3

7. Did any other person (except your spouse, if filing jointly, and your dependents under age 19) live with child 1, child 2, or child 3 for more than half the year shown on line 1?

Caution. The IRS may ask you to provide additional information to verify your eligibility to claim the EIC.
**Part III Filers Without a Qualifying Child**

8. Enter the number of days during the year shown on line 1 that you lived in the United States.

   Caution: If you entered less than 183 (184 if the year on line 1 is a leap year), stop. You cannot take the EIC. See the instructions.

9. If married filing a joint return, enter the number of days during the year shown on line 1 that your spouse lived in the United States.

   Caution: If you entered less than 183 (184 if the year on line 1 is a leap year), stop. You cannot take the EIC. See the instructions.

---

**Form 8867 Paid Preparer’s Earned Income Credit Checklist**

**Part I All Taxpayers**

1. Enter preparer’s name and PTIN.

2. Is the taxpayer’s filing status married filing separately?

   ▶ If you checked “Yes” on line 2, stop; the taxpayer cannot take the EIC. Otherwise, continue.

3. Does the taxpayer (and the taxpayer’s spouse if filing jointly) have a social security number (SSN) that allows him or her to work and is valid for EIC purposes? See the instructions before answering.

   ▶ If you checked “No” on line 3, stop; the taxpayer cannot take the EIC. Otherwise, continue.

4. Is the taxpayer (or the taxpayer’s spouse if filing jointly) filing Form 2555 or 2555-EZ (relating to the exclusion of foreign earned income)?

   ▶ If you checked “Yes” on line 4, stop; the taxpayer cannot take the EIC. Otherwise, continue.

5a. Was the taxpayer (or the taxpayer’s spouse) a nonresident alien for any part of 2015?

   ▶ If you checked “Yes” on line 5a, go to line 5b. Otherwise, skip line 5b and go to line 6.

5b. Is the taxpayer’s filing status married filing jointly?

   ▶ If you checked “Yes” on line 5a and “No” on line 5b, stop; the taxpayer cannot take the EIC. Otherwise, continue.

6. Is the taxpayer’s investment income more than $3,400? See the instructions before answering.

   ▶ If you checked “Yes” on line 6, stop; the taxpayer cannot take the EIC. Otherwise, continue.

7. Could the taxpayer be a qualifying child of another person for 2015? If the taxpayer’s filing status is married filing jointly, check “No.” Otherwise, see instructions before answering.

   ▶ If you checked “Yes” on line 7, stop; the taxpayer cannot take the EIC. Otherwise, go to Part II or Part III, whichever applies.
## Part II: Taxpayers With a Child

### Caution: If there is more than one child, complete lines 8 through 14 for one child before going to the next column.

<table>
<thead>
<tr>
<th>Child 1</th>
<th>Child 2</th>
<th>Child 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was the child unmarried at the end of 2015?</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>Did the child live with the taxpayer in the United States for over half of 2015?</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>Was the child (at the end of 2015)—</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>• Under age 19 and younger than the taxpayer (or the taxpayer’s spouse, if the taxpayer files jointly).</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>• Age 24, a student defined in the instructions, and younger than the taxpayer (or the taxpayer’s spouse, if the taxpayer files jointly)</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>• Under age 24 and permanently and totally disabled?</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>Do you or the taxpayer know of another person who could check “Yes” on lines 9, 10, 11, and 12 for the child? (If the only other person is the taxpayer’s spouse, see the instructions before answering.)</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>Enter the child’s relationship to the other person(s)</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>Under the tiebreaker rules, is the child treated as the taxpayer’s qualifying child?</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>Does the qualifying child have an SSN that allows him or her to work and is valid for EIC purposes?</td>
<td>Yes □ No □</td>
<td>Yes □ No □</td>
</tr>
<tr>
<td>Are the taxpayer’s earned income and adjusted gross income each less than the limit that applies to the taxpayer for 2015?</td>
<td>Yes □ No □</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** If there is more than one child, complete lines 8 through 14 for one child before going to the next column (but for no more than three qualifying children).
### Part III  Taxpayers Without a Qualifying Child

16. Was the taxpayer’s main home, and the main home of the taxpayer’s spouse if filing jointly, in the United States for more than half the year? (Military personnel on extended active duty outside the United States are considered to be living in the United States during that duty period.) See the instructions before answering.

   - If you checked “No” on line 16, stop; the taxpayer cannot take the EIC. Otherwise, continue.

17. Was the taxpayer, or the taxpayer’s spouse if filing jointly, at least age 25 but under age 65 at the end of 2015? See the instructions before answering.

   - If you checked “No” on line 17, stop; the taxpayer cannot take the EIC. Otherwise, continue.

18. Is the taxpayer eligible to be claimed as a dependent on anyone else’s federal income tax return for 2015? If the taxpayer’s filing status is married filing jointly, check “No”.

   - If you checked “Yes” on line 18, stop; the taxpayer cannot take the EIC. If you checked “Yes” on line 19, the taxpayer can take the EIC. If the taxpayer’s EIC was reduced or disallowed for all years after 1996, see Pub. 596 to find out if Form 8862 must be filed. Go to line 20.

19. Are the taxpayer’s earned income and adjusted gross income each less than the limit that applies to the taxpayer for 2015? See instructions.

   - If you checked “No” on line 19, stop; the taxpayer cannot take the EIC. If you checked “Yes” on line 19, the taxpayer can take the EIC. If the taxpayer’s EIC was reduced or disallowed for all years after 1996, see Pub. 596 to find out if Form 8862 must be filed. Go to line 20.

### Part IV  Due Diligence Requirements

20. Did you complete Form 8867 based on current information provided by the taxpayer or reasonably obtained by you?

   - Yes  ☐  No  ☐

21. Did you complete the EIC worksheet found in the Form 1040, 1040A, or 1040EZ instructions (or your own worksheet that provides the same information as the 1040, 1040A, or 1040EZ worksheet)?

   - Yes  ☐  No  ☐

22. If any qualifying child was not the taxpayer’s son or daughter, do you know or did you ask why the parents were not claiming the child?

   - Yes  ☐  No  ☐

23. If the answer to question 13a is “Yes” (indicating that the child lived for more than half the year with someone else who could claim the child for the EIC), did you explain the tiebreaker rules and possible consequences of another person claiming your client’s qualifying child?

   - Yes  ☐  No  ☐

24. Did you ask this taxpayer any additional questions that are necessary to meet your knowledge requirement? See the instructions before answering.

   - Yes  ☐  No  ☐

   To comply with the EIC knowledge requirement, you must not know or have reason to know that any information you used to determine the taxpayer's eligibility for, and the amount of, the EIC is incorrect. You may not ignore the implications of information furnished to you or known by you, and you must make reasonable inquiries if the information furnished to you appears to be incorrect, inconsistent, or incomplete. At the time you make these inquiries, you must document in your files the inquiries you made and the taxpayer's responses.

25. Did you document (a) the taxpayer’s answer to question 22 (if applicable), (b) whether you explained the tiebreaker rules to the taxpayer and any additional information you got from the taxpayer as a result, and (c) any additional questions you asked and the taxpayer’s answers?

   - Yes  ☐  No  ☐

   You have complied with all the due diligence requirements if you:
   1. Completed the actions described on lines 20 and 21 and checked “Yes” on those lines,
   2. Completed the actions described on lines 22, 23, 24, and 25 (if they apply) and checked “Yes” (or “Does not apply”) on those lines,
   3. Submit Form 8867 in the manner required, and
   4. Keep all five of the following records for 3 years from the latest of the dates specified in the instructions under Document Retention:
   a. Form 8867,
   b. The EIC worksheet(s) or your own worksheet(s),
   c. Copies of any taxpayer documents you relied on to determine eligibility for or amount of EIC,
   d. A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained, and
   e. A record of any additional questions you asked and your client’s answers.

   You have not complied with all the due diligence requirements if you checked “No” on line 20, 21, 22, 23, 24, or 25. You may have to pay a $500 penalty for each failure to comply.
Part V  Documents Provided to You

26 Identify below any document that the taxpayer provided to you and that you relied on to determine the taxpayer’s EIC eligibility. Check all that apply. **Keep a copy of any documents you relied on.** See the instructions before answering. If there is no qualifying child, check box a. If there is no disabled child, check box o.

<table>
<thead>
<tr>
<th>Residency of Qualifying Child(ren)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>☐ a</strong> No qualifying child</td>
</tr>
<tr>
<td><strong>☐ b</strong> School records or statement</td>
</tr>
<tr>
<td><strong>☐ c</strong> Landlord or property management statement</td>
</tr>
<tr>
<td><strong>☐ d</strong> Health care provider statement</td>
</tr>
<tr>
<td><strong>☐ e</strong> Medical records</td>
</tr>
<tr>
<td><strong>☐ f</strong> Child care provider records</td>
</tr>
<tr>
<td><strong>☐ g</strong> Placement agency statement</td>
</tr>
<tr>
<td><strong>☐ h</strong> Social service records or statement</td>
</tr>
<tr>
<td><strong>☐ i</strong> Place of worship statement</td>
</tr>
<tr>
<td><strong>☐ j</strong> Indian tribal official statement</td>
</tr>
<tr>
<td><strong>☐ k</strong> Employer statement</td>
</tr>
<tr>
<td><strong>☐ l</strong> Other (specify)</td>
</tr>
</tbody>
</table>

| Did not rely on any documents, but made notes in file |
| Did not rely on any documents |

<table>
<thead>
<tr>
<th>Disability of Qualifying Child(ren)</th>
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</thead>
<tbody>
<tr>
<td><strong>☐ o</strong> No disabled child</td>
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<tr>
<td><strong>☐ p</strong> Doctor statement</td>
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<tr>
<td><strong>☐ q</strong> Other health care provider statement</td>
</tr>
<tr>
<td><strong>☐ r</strong> Social services agency or program statement</td>
</tr>
<tr>
<td><strong>☐ s</strong> Other (specify)</td>
</tr>
</tbody>
</table>

| Did not rely on any documents, but made notes in file |
| Did not rely on any documents |

27 If a Schedule C is included with this return, identify below the information that the taxpayer provided to you and that you relied on to prepare the Schedule C. Check all that apply. **Keep a copy of any documents you relied on.** See the instructions before answering. If there is no Schedule C, check box a.

<table>
<thead>
<tr>
<th>Documents or Other Information</th>
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<tbody>
<tr>
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<td><strong>☐ b</strong> Business license</td>
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<tr>
<td><strong>☐ c</strong> Forms 1099</td>
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<tr>
<td><strong>☐ d</strong> Records of gross receipts provided by taxpayer</td>
</tr>
<tr>
<td><strong>☐ e</strong> Taxpayer summary of income</td>
</tr>
<tr>
<td><strong>☐ f</strong> Records of expenses provided by taxpayer</td>
</tr>
<tr>
<td><strong>☐ g</strong> Taxpayer summary of expenses</td>
</tr>
<tr>
<td><strong>☐ h</strong> Bank statements</td>
</tr>
<tr>
<td><strong>☐ i</strong> Reconstruction of income and expenses</td>
</tr>
<tr>
<td><strong>☐ j</strong> Other (specify)</td>
</tr>
</tbody>
</table>

| Did not rely on any documents, but made notes in file |
| Did not rely on any documents |

Form 8867 (2015)
KIDDIE TAX RULES  
IRC §1(g)(2)(A)

For tax years prior to 1/1/06, the kiddie tax only applied to the unearned income of a child under age 14. In 2006, Congress extended these rules, effective for the 2006-2007 tax years, to apply to children who had not attained age 18 by the end of the calendar year.

2008 EXPANSION OF KIDDIE TAX: Congress again extended the kiddie tax rules through provisions adopted in the Small Business and Work Opportunity Act of 2007 (signed 5/25/07). For tax years beginning after May 25, 2007 (e.g. generally, 2008 and after), the kiddie tax will apply to individuals, age 18-23, who meet all five of the following tests:

A. Age Test:
   (1) Child who has attained age 18 before close of tax year (whether a student or not); or
   (2) Child, age 19-23 during the year, who is a full-time student (12 semester hrs. or more) during at least 5 months of the year.

B. Support Test:
   Child, age 18-23, who does not have earned income that exceeds one-half of the amount of the individual’s support for the year. The kiddie tax rules do not apply to children whose earned income exceeds one-half of their annual support.

   NOTE: In measuring support, amounts received as a scholarship by a student are not taken into account.

C. Unearned Income Test:
   Child’s unearned income for the year exceeds the annual threshold, $2,100 (for 2015-2016); $2,000 (for 2013-2014); $1,900 (2009-2012).

   NOTE: Unearned income includes interest, dividends, rents, income from sale of gifted property (e.g. gifts of commodities), etc. If a child’s unearned income exceeds the threshold, only the amount in excess of the threshold is subject to the kiddie tax (e.g. taxed at parent’s higher marginal rate).

D. Living Parent Test:
   One or both of the child’s parents are alive at year-end and are in a higher marginal federal income tax bracket than the child.

E. Joint Return Filing Test:
   The child does not file a joint return for the tax year.
Definition of Support: Support includes food, shelter, clothing, medical care, cost of education (tuition, room, board and books), recreational activities, etc. Only amounts actually expended during the year are considered in testing support. Rev. Rul. 58-404.

Student loan proceeds used to pay for education count as support from the child if the child is the obligor under the loan. McCauley v. Comm., 56 TC 48, 1971.

Generally, the amount of support will equal the expense incurred in furnishing the item of support. However, if the item of support is in the form of property or lodging, the item is measured in terms of its fair market value. IRC §1.152-1(a)(2)(i).

A vehicle purchased and owned by a parent (but used by the child) is not an item of support, other than out-of-pocket costs associated with the vehicle and provided by the parent. A vehicle purchased and titled in the name of the child is an item of support of that child in an amount equal to its cost whether provided by the parent or the child. Rev. Rul. 77-282.

Computation of Kiddie Tax:

(1) Dependent child allowed a standard deduction that offsets the first $1,050 (for 2015-2016); $1,000 (for 2013-2014); $950 (2009-2012) of unearned income;

(2) Next $1,050 (for 2015-2016); $1,000 (for 2013-2014); $950 (2009-2012) of unearned income is subject to tax at the child’s (single) marginal tax rate of 10%; and

(3) Child’s unearned income in excess of $2,100 (for 2015-2016); $2,000 (for 2013-2014); $1,900 (2009-2012) is taxed at the parent(s) highest marginal tax rate.

Reporting Requirements (Form 8615 / Form 8814): Taxpayers have a choice of reporting the income of the child and calculating tax with the child’s return (Form 8615); or completing Form 8814, which is used to report the child’s unearned income on the parents’ return.

NOTE: Form 8615 requires the disclosure of the parents’ taxable income within the child’s return. The child would also require his parent’s SSNs.

NOTE – TAX PLANNING: Form 8814 cannot be used if the child has any W-2 or self-employment income; if the child’s 2015 unearned income is less than $1,050; or if the child’s 2015 gross income is $10,500 or higher. Even if a parent could file Form 8814 and report the child’s income on their return, it is generally not advisable for the following reasons:

(1) The second $1,050 of a child’s unearned income is taxed at a 10% marginal rate. Unless the parent’s tax rate is 0%, no better tax result can be obtained.

(2) If the child’s unearned income is reported on the parent’s return, the additional income will likely be taxed at higher marginal brackets and could have an effect on any AGI sensitive items reported on the parent’s return (i.e. items subject to AGI phase-out rules, taxable social security, etc.).
**PARENT(S) INCOME – DIVORCED/SEPARATED/REMARIED:** IRC Reg. §1.1(i)-1T provides the following guidance regarding parental taxable income when the parents of a child subject to the kiddie tax file separate returns or are divorced, separated, or remarried:

- **Divorced.** If the parents are divorced, legally separated, or treated as not married, use the taxable income of the parent with custody of the child to compute kiddie tax.

- **Married Filing Separately.** If the child’s parents are married and file separate returns, the **greatest taxable income** of the two is used to compute kiddie tax.

- **Remarried.** If the parent whose taxable income must be used for the kiddie tax (e.g. divorced parent with custody of the child) files a joint return with a spouse who is not the child’s parent, use the **total taxable income shown on the joint return** to compute kiddie tax.

**FORM 8615 – INFORMATION REPORTING:** If a taxpayer is unable to obtain information from either the parents’ or child’s tax return to properly compute kiddie tax, a written request should be made to IRS for sufficient tax information. IRC §6103(e)(1). In the alternative, an extension of time to file may be requested if the required information is not obtained before the due date of the return(s).

Alternatively, a reasonable estimate could be made and the return amended when the correct information becomes available.

(a) **No penalties will be assessed for reasonable estimates.**

(b) According to the IRS, a reasonable estimate would be the amount of the parents’ taxable income or a sibling’s investment income from the previous year’s income tax return, or any other estimate that is reasonable. Ann. 88-70.

**ALTERNATIVE MINIMUM TAX OF CHILD.** If the kiddie tax applies, the AMT of the child is computed in the same manner as any other individual. However, the AMT exemption cannot exceed the sum of:

1. The child’s **earned income** for the tax year; **plus**

**TAX PLANNING NOTE – PROBLEM:** The kiddie tax rules are independent of the dependency exemption rules. Therefore, the kiddie tax rules apply whether or **not** the child is claimed as a dependent by a parent (or by anyone else). The unearned income of an emancipated child (age 18 – 23) who claims their own dependency exemption independent of their parents would still be subject to kiddie tax in 2008 and after if the child meets the kiddie tax criteria.

Excess unearned income (over $2,050 for 2015-2016) will be taxed at the parent(s) top tax rate (custodial parent if unmarried).
NOTE – CUSTODIAL PARENT: For divorced parents, if the kiddie tax rules apply, this is another reason (besides FAFSA considerations) to have the designated custodial parent be the parent with the lowest AGI (taxable income).

NOTE: Clients should be advised that children’s tax returns can no longer be prepared separately and filed early if there is a possibility that the child’s unearned income will exceed $2,050 for 2015-2016.

AUTHOR’S NOTE: IRS enforcement of the kiddie tax rules in this situation should prove challenging. If a child is truly independent (not communicating with parents) will the parents be required to file their return with a note indicating their inability to obtain tax information from their child? Will IRS computers be able to link the two returns?

EXAMPLE – AGRICULTURAL SETTING: Monica is a college student, age 21, with several scholarships. During 2015, items expended for her support include tuition, room, board, entertainment, costs of operating a vehicle owned by her parents, etc. These items total $24,000.

Monica received $8,000 in scholarships that reduced the total outlay for her college tuition. Accordingly, Monica’s total support for 2015 is $16,000.

Monica’s college employment yields W-2 income of $6,000. If Monica’s unearned income exceeds $2,100 in 2015, she will be subject to the kiddie tax with regard to any unearned income in excess of $2,100 regardless of whether her parent(s) claim a dependency exemption for her in 2015.

NOTE: If Monica’s earned income was greater than $8,000, she would not be subject to the kiddie tax.

QUERY: Would it be beneficial for Monica’s parents, (father is a sole proprietor farmer) to compensate her for summer work at their farm? If a reasonable wage exceeded $2,000, Monica would have provided greater than one-half of her support for 2015 and she would not be subject to the kiddie tax.

NOTE: If Monica was not a full-time student in 2015, she would be exempt from the kiddie tax. COMMENT: Part-time student status may be desirable to Monica if funded by her parents.

NOTE – EARNED INCOME EXCEEDS ONE-HALF SUPPORT: If Monica’s earned income (above example) exceeded one-half of her support for 2015, the above scenario would also present an opportunity for Monica’s parents to make commodity gifts to her for sale in 2015. Monica could recognize the unearned income from the commodity sale but not utilize the proceeds for her support needs until 2016. If commodity sale proceeds were handled in this manner, unearned income from the commodity sale would not be subjected to kiddie tax.

The above result is reached because the application of the kiddie tax to those age 18-23 compares earned income to the individual’s items of support for the year, and ignores the amount of unearned income in the computation. As such, it appears possible to recognize significant amounts of unearned income and still have a child exempt from kiddie tax if the child’s earned income exceeds one-half of support expenditures for the year in question.
NOTE: The top of the 15% tax bracket for single individuals for 2015 = $37,450. Taxable income beyond this amount may not achieve significant tax benefit compared to 2015 kiddie tax rates.

**TAX PLANNING OPPORTUNITY – FARM COMMODITY GIFTING (2015 AND AFTER):** Since a donee of gifted property is able to tack the donor’s holding period for sale purposes, consider making a gift of 2015 grain in 2016, and then having the donee sell gifted commodities after a “total” 12-month holding period (donor plus donee) has transpired. This transaction should achieve capital gain tax treatment on the sale. **Sale at long-term capital gain rates will avoid the ordinary income rates of the parent (even if kiddie tax rules apply); and, also, allow the farm proprietor to avoid self-employment social security tax on the sale of the gifted commodity.**

**CAUTION:** Gifted commodities will need to derive from a crop growing season prior to the current crop year to avoid the requirement of offsetting the expense of production from the gifted commodity. See: Rev. Rul. 55-138.

Additional Tax Planning Strategies:

- **529 Plans:** State sponsored IRC §529 plans should be even more attractive as vehicles to fund higher education since they produce tax-free withdrawals if used for higher educational purposes, are excellent grandparent gifting vehicles, allow for parent/owner retained control of the account even though considered completed gift to child, and allow for beneficiary shifting of funds as educational needs are determined.

- **Traditional and/or ROTH IRA investments:** Traditional IRA withdrawals are **not** subject to the 10% early withdrawal penalty if used for higher education expenses (tuition, books, etc.). IRC §72(t)(2)(F).

  Roth IRA withdrawals are taken first from contributions to the Roth IRA account; therefore, no tax and/or penalties result.

- **Gifts of long-term capital gain property to fund higher education:** Taxpayers may still find these gifts advantageous as shifting gain to the child’s return may diminish AGI-based phaseouts on the parents’ return. The child may be able to take advantage of American Opportunity/Hope/LLC credits to offset tax if not claimed as a dependent by parent(s).
EGTRRA 2001 extended adoption credit/exclusion benefits to taxpayers for tax years beginning after January 1, 2002. Both the maximum credit amount and the phase-out ranges are adjusted for inflation after 2002. These provisions were made permanent by the American Taxpayer Relief Act of 2012 (ATRA), and the credit is allowable to offset both regular tax and AMT. Accordingly, the maximum credit for 2015 will be $13,400 (adjusted for inflation) and will be phased out for taxpayers with MAGI between $201,010 and $241,010 (adjusted for inflation). The credit is not refundable for taxable years after 2011.

NOTICE 2010-66 DOCUMENTATION REQUIREMENTS: In Notice 2010-66, the IRS issued interim guidance for claiming an adoption credit on Form 8839. Taxpayers must now include one or more adoption related documents (adoption order or decree, state determination of special needs (if applicable), placement agency home study (if adoption not finalized), etc.), which are detailed in the Notice. Additional guidance is provided with respect to the substantiation requirements for:

(a) Foreign and domestic adoptions that have been finalized;

(b) Domestic adoptions that have not been finalized; and

(c) Adoption of special needs children.

See relevant provisions of Notice 2010-66 at the end of this discussion.

NOTE: Because of the documentation requirements, taxpayers claiming the credit may have to file paper returns, which lengthens the time for receipt of refunds.

2010-11 TAX LAW: The Patriot Protection and Affordable Care Act (Health Care Reform Bill) temporarily increased the inflation adjusted adoption credit and expense exclusions by $1,000 for 2010 and 2011 only. The legislation also temporarily changed the adoption credit from a non-refundable credit to a refundable credit (for 2010 and 2011 only), and temporarily redesignated “adoption expenses” as IRC §36C in the Code. Notice 2010-66 clarified that prior year carryovers of adoption credit would be refundable on 2010 returns without regard to any AGI phase-out limitations.

1. General Adoption Credit. For 2015, up to $13,400 (inflation adjusted) of qualified adoption expenses per child (same amount in the case of a child with special needs) can be claimed.

NOTE – Application of Credit (Review). For 2009 and prior years, the credit was a non-refundable tax credit with any unused credit carried forward for up to 5 years. For 2010 and 2011 current year credits and prior year carryover credits were refundable as discussed above. For 2012 and after, the credit is once again a non-refundable tax credit with any
unused credit carried forward for up to 5 years.

The credit is **phased out pro-rata** for taxpayers with "modified" AGI (generally regular AGI plus any IRC §137 adoption exclusion) **between $201,010 and $241,010 for 2015.** IRC §36C(b)(2).

**Qualified Adoption Expenses:** Includes reasonable and necessary adoption fees, court costs, attorney's fees, travel expenses (including meals and lodging) and other expenses directly related to the adoption. **Does not include adoption expenses incurred to adopt a spouse’s child,** or expenses incurred in carrying out a surrogate parenting arrangement.

**ELIGIBLE CHILD:** An individual who is either (1) under the age of 18 at the time of the adoption; **or** (2) one who is a "special needs" child.

**SPECIAL NEEDS CHILD:** Special needs exist if a child is:

1. Physically or mentally incapable of taking care of himself/herself;
2. Cannot or should not return to the parents' home **and/or**;
3. If there is a "specific factor or condition", such as ethnic background, age, medical condition or mental condition, that hinders adoption.

**DOMESTIC (U.S.) ADOPTIONS/SPECIAL NEEDS - CREDIT ALLOWED**

The **adoption credit is allowed in the tax year after the tax year in which the qualified adoption expenses are paid**, with one exception. If the expenses are paid in the year the adoption is finalized, the credit is allowed in that tax year rather than in the subsequent tax year.

**NOTE:** An expense paid or incurred in a taxable year beginning before 1997 is **not** a qualified adoption expense.

**SPECIAL NEEDS ADOPTION:** For 2003 and after, a credit ($13,400 for 2015 - inflation adjusted) **will be allowed in the year a special needs adoption is finalized (to the extent not claimed in prior years), regardless of the amount of qualified adoption expenses.**

Also beginning in 2003, an **exclusion ($13,400 for 2015 - inflation adjusted) will be allowed for assistance with a special needs adoption under an employer’s adoption assistance program in the year the adoption is finalized, regardless of the amount of qualified adoption expenses.**

**CLARIFICATION NOTE:** The 2002 Tax Act clarified that the adoption credit for special needs children was **not** required to be taken **only** in the year the special needs adoption was finalized. Credits are to be taken as expenses are paid using the one-year deferral procedure for domestic (U.S.) adoptions, with the balance of the credit taken in the year the adoption becomes final. IRC §36C(a)(2).

**FOREIGN ADOPTIONS - CREDIT ALLOWED**

The credit is **only available for adoptions that become final.** Qualified adoption expenses paid or incurred in any taxable year before the taxable
year in which the adoption becomes final are treated as paid/incurred in the taxable year in which the adoption becomes final.

Generally, a foreign adoption becomes final based on the child's receipt of an immediate relative (IR) visa from the Department of State. These IR visa's are issued only to foreign-born children who enter the U.S. after a foreign government(court or agency) as approved either an adoption or guardianship decree.

NOTE – Rev. Proc. 2010-31: The IRS announced safe harbors for determining when foreign adoptions are final for claiming the adoption credit or excluding employer reimbursements under IRC §137. The rules differ depending upon whether the adoption is finalized in the U.S. or in another country. Information about foreign adoptions can be accessed through the Department of State website at www.adoption.state.gov.

2. **Exclusion for Adoption Expenses.** For 2015, employer payments of up to $13,400 (inflation adjusted) for qualified adoption assistance (same amount in the case of a child with special needs) can be excluded from an employee's gross income. The $13,400 limit is a **per child limit, not an annual limitation.** The exclusion is phased out pro-rata for taxpayers with modified AGI (generally regular AGI plus any IRC §137 adoption exclusion) between $201,010 and $241,010 for 2015. IRC §137.

NOTE: To be eligible for exclusion, IRC Notice 97-9 indicates that an employer must maintain an adoption assistance program as "a separate written plan of the employer for the exclusive benefit of its employees" that meets the following requirements:

(a) Reasonable notice to employees that the program is available;

(b) Benefits are available to all eligible employees regardless of compensation;

(c) The plan must include a cap of 5% on the amount shareholders or owners receive for adoption assistance reimbursements or expenses paid by the employer during that year; and

(d) The employee must provide the employer with reasonable substantiation that the payments or reimbursements are qualified adoption expenses.

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**TAX PLANNING NOTE:** Individuals may claim both an adoption credit under IRC §23 and exclusion for adoption expenses under IRC §137, but not for the same expense. Total covered expenses = $13,400 + $13,400 = $26,800 (credit plus exclusion).

3. **Filing Requirements – Form 8839.** For federal tax purposes, adoption credits are claimed on Form 8839.

NOTE – TAX IDENTIFICATION REQUIREMENTS: No adoption credit will be allowed with respect to any qualifying individual unless the name, age and TIN of such individual is included on the return claiming the credit. IRC §23(f)(2). If disallowed, the IRS is authorized under IRC §6213(g)(2)(H) to assess the additional tax as if it were a mathematical or clerical error.
A prospective adoptive parent may satisfy the TIN requirement by procuring an Adoption Taxpayer Identification Number (ATIN), Form W-7A (Application for TIN for Pending Adoptions), for a prospective adoptive child. An ATIN expires two years after the date of issuance. When the adoption becomes final a parent must apply for a SSN for the child and, once obtained, must use the SSN, rather than the ATIN on all future returns. See IRC Regs. §301.6109-3.

NOTE: IRS officials have clarified that independent adoptions were intended to be covered by ATIN rules. To be covered by the ATIN rules, a private placement adoption must only be valid under state law.

EXAMPLE: Joe and Kathy went to Russia in October, 2013 to begin the adoption process for a 2-year old Russian boy, Uri. They returned to Russia in late September 2014 to complete the process after Russian authorities approved the adoption. They returned to Iowa in October, 2014 and the State Department issued an IR-3 visa to Uri. A re-adoption degree was entered in Iowa on February, 2015.

Joe and Kathy paid the following qualified adoption expenses: 2013 = $7,500; 2014 = $4,500; 2015 = $800. In 2014, Kathy’s employer reimbursed $3,000 under her company’s employer’s adoption assistance program.

SOLUTION: The adoption is considered final in 2014 (IR-3 visa received). As such Joe and Kathy can claim a credit of $9,000 on their 2014 Form 8839 if they do not exceed AGI income limitations ($12,000 expense – 3,000 exclusion; limited to $13,190 credit). The $800 paid in 2015 can be claimed as a credit on their 2015 Form 8839 since they have not claimed the maximum $13,400 credit limit available for 2015. However, the credit will not be refundable if some or all of the credit exceeds Joe and Kathy’s tax liability. Any unused credit will be carried forward for 5 years.

QUERY: Can Joe and Kathy claim a $3,950 dependency exemption and/or the $1,000 child tax credit for Uri on their 2014 joint return?

ANSWER: Generally, no. Uri does not meet the test for a “qualifying child” under the new “uniform definition of a qualifying child”, because he did not meet the residency test. Uri did not live with his adoptive parents for more than one-half of 2014. However, Uri could still qualify as a dependent under the “qualifying relative” rules if Joe and Kathy provided over 50% of his support during 2014 (compared to others). At Uri’s age, he most likely meets all other tests (gross income, relationship, no joint return, and U.S. citizenship). Uri automatically became a U.S. citizen when Joe and Kathy brought him into the country. He also qualified because he was a resident of the United States during a portion of the year. IRC Regs. §1.152-2(a).

******************************************************************************

IOWA TAX LAW DIFFERENCE

2013 AND PRIOR TAX YEARS: Prior to 2014, Iowa did not provide for an adoption credit. An additional itemized deduction could be claimed for adoption expenses paid during the tax year. This deduction could be claimed in the year that the expenses were paid even if the child was not placed in the home during the tax year. Qualified adoption expenses included:

• Medical costs relating to the child’s birth.
• Any necessary fees and all other costs connected with the adoption procedure.

A separate schedule listing these expenses was required to be attached to Form IA 1040, Schedule A. The deduction was limited to those qualified adoption expenses which exceeded 3% of total Iowa net income from Form IA 1040, line 26.

**2014 AND AFTER – IOWA ADOPTION TAX CREDIT:** For tax years beginning on or after 1/1/14, taxpayers can claim an Adoption Tax Credit of up to $2,500 per adoption for the value of expenses paid or incurred in connection with the adoption of a child during the tax year. However, a **credit may only be claimed** for expenses paid in a tax year in which the taxpayer was eligible for a federal tax credit (i.e. tax year after the tax year in which qualified adoption expenses were paid (US/special needs) or in which the adoption is finalized). Any adoption credit that exceeds the taxpayer’s tax liability will be refundable, or the taxpayer can choose to have any overpayment credited to their next year’s tax liability.

An itemized deduction is still available for expenses not claimed under the credit. Taxpayers claiming the new Adoption Tax Credit must exclude the expenses claimed under the credit when they calculate the value of the remaining itemized deduction available for adoption expenses.

**NOTICE 2010–66: SUBSTANTIATION REQUIREMENTS (FORM 8839)**

For 2010 and after, a taxpayer must provide a copy (unless otherwise specified) of the applicable documents described in paragraph 1 or 2 below to substantiate the taxpayer's adoption or attempted adoption of an eligible child. A taxpayer also must comply with paragraph 3 below for a special needs adoption. Required documentation is attached to Form 8839 for the taxable year that the taxpayer claims the credit.

1. **Domestic and foreign adoptions that have been finalized.**
   
   (a) For a domestic or foreign adoption finalized in the United States, an adoption order or decree.
   
   (b) For a foreign adoption governed by the Hague Convention and finalized in another country:
       
       1. A Hague Adoption Certificate (Immigrating Child);
       2. An IH-3 visa; or
       3. A foreign adoption decree, translated into English.
   
   (c) For a foreign adoption from a country not a party to the Hague Convention:
       
       1. A foreign adoption decree, translated into English; or
       2. An IR-2 or IR-3 visa.

2. **Domestic adoptions that are not final.**
   
   (a) An adoption SSN/TIN, obtained by the taxpayer for the child, included on the taxpayer's income tax return (instead of attached document);
   
   (b) A home study completed by an authorized placement agency;
   
   (c) A placement agreement with an authorized placement agency;
(d) A document signed by a hospital official authorizing the release of a newborn child from the hospital to the taxpayer for legal adoption;

(e) A court document ordering or approving the placement of a child with the taxpayer for legal adoption; or

(f) An original affidavit or notarized statement signed under penalties of perjury from an adoption attorney, government official, or other person, stating that the signor:

1. Placed or is placing a child with the taxpayer for legal adoption; or
2. Is facilitating the adoption process for the taxpayer in an official capacity, summarizing the facilitation.

3. **Adoption of special needs children.**

   In addition to the documentation required under paragraph 1 above, a taxpayer claiming the adoption credit for a child with special needs must attach a copy of the state determination of special needs.

4. **Information to be included in documentation.**

   An order or decree must include information that establishes that the taxpayer's adoption has been finalized and the date finalized. A special needs determination must include information that establishes that the state has made a determination of special needs for the eligible child. **A taxpayer may redact sensitive personal information from an adoption order/decree or a special needs determination.** However, the IRS may require the taxpayer to provide an unredacted copy of the document if needed to substantiate the claim for the credit.
Form 8839

Qualified Adoption Expenses

For information about Form 8839 and its separate instructions, see www.irs.gov/form8839.

Part I Information About Your Eligible Child or Children—You must complete this part. See instructions for details, including what to do if you need more space.

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<th>Child</th>
<th>Child’s name</th>
<th>Child’s year of birth</th>
<th>Check if child was—</th>
<th>Child’s identifying number</th>
<th>Check if adoption became final in 2015 or earlier</th>
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<tr>
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<tr>
<td>Child 3</td>
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</tbody>
</table>

Caution. If the child was a foreign child, see Special rules in the instructions for line 1, column (e), before you complete Part II or Part III. If you received employer-provided adoption benefits, complete Part III on the back next.

Part II Adoption Credit

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<tr>
<th>Child</th>
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</tr>
<tr>
<td>Child 3</td>
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</tbody>
</table>

Did you file Form 8839 for a prior year for the same child?  □ No.  □ Yes.  See instructions for the amount to enter.

Subtract line 3 from line 2.

Caution. Your qualified adoption expenses may not be equal to the adoption expenses you paid in 2015.

Enter the smaller of line 4 or line 5.

Enter modified adjusted gross income (see instructions).

Is line 7 more than $201,010?  □ No.  □ Yes.  Subtract $201,010 from line 7.

Divide line 8 by $40,000. Enter the result as a decimal (rounded to at least three places).

Multiply each amount on line 6 by line 9.

Add the amounts on line 11.

Credit carryforward, if any, from prior years. See your Adoption Credit Carryforward Worksheet in the 2014 Form 8839 instructions.

Add lines 12 and 13.

Enter the amount from line 5 of the Credit Limit Worksheet in the instructions.

Adoption Credit. Enter the smaller of line 14 or line 15 here and on Form 1040, line 54, or Form 1040NR, line 51. Check box c on that line and enter “8839” in the space next to box c. If line 15 is smaller than line 14, you may have a credit carryforward (see instructions).

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 22863L

Form 8839 (2015)
### Part III: Employer-Provided Adoption Benefits

<table>
<thead>
<tr>
<th>Child 1</th>
<th>Child 2</th>
<th>Child 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>$13,400</td>
<td>$13,400</td>
<td>$13,400</td>
</tr>
</tbody>
</table>

17. Maximum exclusion per child
18. Did you receive employer-provided adoption benefits for a prior year for the same child?
   - [ ] No. Enter 0.
   - [ ] Yes. See instructions for the amount to enter.
19. Subtract line 18 from line 17
20. Employer-provided adoption benefits you received in 2015. This amount should be shown in box 12 of your 2015 Form(s) W-2 with code T.
21. Add the amounts on line 20.
22. Enter the lesser of line 19 or line 20. But if the child was a child with special needs and the adoption became final in 2015, enter the amount from line 19.
23. Enter modified adjusted gross income (from the worksheet in the instructions).
24. Is line 23 more than $201,010?
   - [ ] No. Skip lines 24 and 25, and enter 0 on line 26.
   - [ ] Yes. Subtract $201,010 from line 23
25. Divide line 24 by $40,000. Enter the result as a decimal (rounded to at least three places). Do not enter more than 1,000.
26. Multiply each amount on line 22 by line 25.
27. Excluded benefits. Subtract line 26 from line 22.
28. Add the amounts on line 27.
29. Taxable benefits. Is line 28 more than line 21?
   - [ ] No. Subtract line 28 from line 21. Also, include this amount, if more than zero, on line 7 of Form 1040 or line 8 of Form 1040NR. On the dotted line next to line 7 of Form 1040 or line 8 of Form 1040NR, enter "AB."
   - [ ] Yes. Subtract line 21 from line 28. Enter the result as a negative number. Reduce the total you would enter on line 7 of Form 1040 or line 8 of Form 1040NR by the amount on Form 8839, line 28. Enter the result on line 7 of Form 1040 or line 8 of Form 1040NR. Enter "SNE" on the dotted line next to the entry line.

You may be able to claim the adoption credit in Part II on the front of this form if any of the following apply.
- You paid adoption expenses in 2014, those expenses were not fully reimbursed by your employer or otherwise, and the adoption was not final by the end of 2014.
- The total adoption expenses you paid in 2015 were not fully reimbursed by your employer or otherwise, and the adoption became final in 2015 or earlier.
- You adopted a child with special needs and the adoption became final in 2015.