
Proposal for Uniform Definition of a Qualifying Child



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UNIFORM DEFINITION OF A QUALIFYING CHILD

Current Law

The tax code provides assistance to families with children through the dependent exemption, head-of-household filing status, child tax credit, child and dependent care tax credit, and earned income tax credit (EITC). However, each of these provisions has a unique definition of eligible child. These are described below.

Dependent Exemption: To qualify as a dependent, an individual must satisfy five tests. First, he or she must either be a qualifying relative or meet certain residency requirements. Qualifying relatives include the taxpayer's (1) son or daughter or a descendant of either (e.g., grandchildren, great-grandchildren); (2) stepson or stepdaughter; (3) sibling or stepsibling; (4) parent or ancestor of parent (e.g., grandparent, great-grandparent); (5) stepparent; (6) son or daughter of a sibling; (7) a parent's sibling; or (8) father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law. If the individual is not a qualifying relative, the taxpayer's home must be his or her principal place of abode for the full tax year, and the individual must be a member of the taxpayer's household.¹

Second, the individual must also receive more than half of his or her support from the taxpayer.² Third, he or she must be a citizen or resident of the United States or a resident of a contiguous country (Canada or Mexico). Fourth, if the individual is married, he or she cannot file a joint tax return with his or her spouse, except to receive a refund of withheld taxes. Fifth, a taxpayer cannot claim a dependent if the dependent's gross income exceeds the exemption amount (\$3,000 in 2002). This test does not apply if the dependent is the taxpayer's child (son, daughter, stepson, stepdaughter, or foster child) and is under the age of 19 at the close of the calendar year (under 24 if a full-time student). A foster child is defined to mean an individual for whom the taxpayer "cares for as the taxpayer's own child." A foster child must reside with the taxpayer for the entire year.

Special rules apply to more complicated family situations. For example, in the event of divorce or separation, the custodial parent is generally entitled to the dependent exemption if the parents, in combination, provide over half the support of the child. To qualify as the custodial parent, the taxpayer must reside with his or her child for over half the year. The noncustodial parent may claim the exemption only if the custodial parent provides him or her with a written waiver to be attached to the tax return.

There are other circumstances, in addition to divorce or separation, when more than one taxpayer helps support an individual. If each taxpayer provides less than half of the person's support, but in combination, they provide over half of the person's support, then one of the taxpayers can claim the dependent exemption if three additional tests are met. First, the taxpayer meets all the requirements, other than support, for claiming the person as a dependent. Second, the taxpayer contributes over ten percent of the person's support. Third, each of the other taxpayers who

¹ A taxpayer or another individual may still be considered to be a member of the household despite a temporary absence due to special circumstances, such as illness, education, work, military service, or vacation.

² Public assistance payments are taken into account as support payments made by a government entity.

provide at least ten percent of the person's support signs a waiver, which the taxpayer claiming the exemption then attaches to his or her tax return.

An exemption is not allowed for any dependent unless a taxpayer identification number for the dependent is included on the taxpayer's tax return.

Head of Household Filing Status: Unmarried taxpayers may be considered heads of households if they maintain as their home a household that constitutes for more than half of the tax year the principal place of abode for (1) unmarried sons, daughters, stepchildren, or descendants of the taxpayers' sons or daughters; (2) married sons, daughters, stepchildren, or descendants of the taxpayers' sons or daughters, who the taxpayers can claim as dependents; or (3) relatives whom they can claim as dependents (as defined above). Unmarried taxpayers may also claim head of household filing status if they maintain a separate household for dependent parents for the tax year.

Child Tax Credit: Taxpayers can claim the child tax credit for qualifying individuals who meet three tests, in addition to the five tests that qualify them as dependents. The qualifying individual must be under the age of 17. Further, the child must be the taxpayer's son, daughter, grandchild, sibling, niece, nephew, or foster child. Stepchildren, stepsiblings, *and* their descendants are also qualifying children. If the child is the taxpayer's sibling, niece or nephew, the taxpayer must care for the child as if the child were his or her own child. Finally, the child must be a citizen or resident of the United States (that is, the contiguous country rule, which applies to the dependent exemption, does not pertain to the child tax credit).

The definition of foster child for the child tax credit differs from that used for dependents. As under the definition of a dependent, a foster child is an individual for whom the taxpayer "cares for as the taxpayer's own child" and who resides with the taxpayer for the entire year. However, the foster child must also be a child placed with the taxpayer by an authorized placement agency.

Tax Benefits Related to Child Care: Taxpayers may be eligible for the child and dependent care tax credit and the exclusion for employer-provided child care if they provide over half the costs of maintaining a home in which they and a qualifying individual reside. Qualifying individuals include dependents (as defined above) under the age of 13. Custodial parents may also claim children under the age of 13 whom they would be entitled to claim as dependents if they had not waived the exemption to the noncustodial parents. Qualifying individuals can also include dependents (of any age) or spouses who are physically or mentally incapable of caring for themselves.

To qualify for the CDCTC, a taxpayer must maintain the household in which the taxpayer and the qualifying individual reside. The household maintenance test applies to both married and unmarried filers. A taxpayer must provide over half the cost of maintaining the household for the period during the year in which he or she resides in the home with the qualifying individual.

Earned Income Tax Credit (EITC): A child is a qualifying child if the following three requirements are met: (1) the child must be the taxpayer's son, daughter, grandchild, sibling, niece, nephew, or foster child; (2) the child must generally reside with the taxpayer in the same

principle place of abode in the United States for over half the year; and (3) the child must be under the age of 19 (or under 24 if a full-time student). Stepchildren, stepsiblings, *and* their descendants are also qualifying children. If the child is the taxpayer's sibling, niece or nephew, the taxpayer must care for the child as if the child were his or her own child. The definition of foster child is the same as under the child tax credit, except that the residency test is over six months rather than twelve months.

If more than one taxpayer claims the same child for purposes of the EITC, the following rules apply. If each claimant satisfies the age, relationship, and residence tests with respect to the same child, only the taxpayer with the highest adjusted gross income (AGI) can claim the child. However, the parent's claim supercedes the claims of other taxpayers, regardless of the outcome of the AGI tiebreaker test. If both parents file separate returns claiming the child, then the parent who resides with the child the longest is deemed entitled to the EITC. In the event that both parents reside with the child for the same amount of time, then the parent with the highest AGI is entitled to the credit.

Both the taxpayer (including his or her spouse, if married) and qualifying child must have a social security number that is valid for employment in the United States (that is, they are U.S. citizens, permanent residents, or have certain types of temporary visas that allow them to work in the United States).

Reasons for Change

Taxpayers with children may receive a number of tax benefits to help offset the costs of raising a family. In tax year 2003, there will be over 52 million taxpayers with children. Of these, 49 million taxpayers will claim child dependents, while millions will claim one or more other child-related tax benefits.

Tax Year 2003

Child-Related Tax Benefit	Number of Returns (millions)
Dependent Exemption	52.5
With Child	49.4
Head of Household Filing Status	24.4
With Child	22.4
Child Tax Credit	30.8
Child and Dependent Care Tax Credit	6.1
Earned Income Tax Credit	19.8
With Child	16.5

In many cases, taxpayers will claim more than one of these benefits. For example, 30.8 million taxpayers will claim both child dependent exemptions and the child tax credit, 16.3 million taxpayers will claim both child dependent exemptions and the EITC, and 10.6 million taxpayers will claim all three. Over a million taxpayers will claim all five of the child-related tax benefits.

But to obtain these benefits, taxpayers must wade through pages of bewildering rules and instructions because each provision defines an eligible “child” differently. For example, to claim the dependent exemption and the child tax credit, a taxpayer must demonstrate that he or she provides most of the support of the child. To claim the EITC, the taxpayer must demonstrate that he or she resides with the child for a specified period of time. Having different definitions for as simple a concept as one’s child may confuse taxpayers and lead to erroneous claims of one or more child-related tax benefits. As a recent EITC compliance study found, nearly one in five children claimed as dependents and EITC qualifying children in 1999 were disallowed for one, but not both, tax benefits.

Taxpayer confusion and errors may also be linked to some of the criteria used to determine eligibility for the child-related tax benefits. A 1993 General Accounting Office study found that in 1988, taxpayers erroneously claimed exemptions for an estimated nine million dependents.³ Nearly three-quarters of erroneous claims were attributable to taxpayers’ failure to meet the dependent support test. Among those who did not meet the support test, taxpayers did not provide financial support for 57 percent of the claimed dependents. In the remaining cases, taxpayers lacked adequate records to demonstrate that they had met the support test. Replacing the support test, which is difficult to understand and to administer in the absence of an intrusive audit, with a uniform residency test would reduce both compliance and administrative costs.

Proposal

Uniform definition of qualifying child

A uniform definition of qualifying child would be adopted for purposes of determining eligibility for the dependency exemption, the child tax credit, the child and dependent care tax credit, head of household filing status, and the EITC. A qualifying child would have to meet the following three tests:

- Relationship – The child must be the taxpayer’s son, daughter, stepchild, sibling, stepsibling, or a descendant of such individuals. Foster children placed with the taxpayer by authorized placement agencies would satisfy the relationship test. If the child is the taxpayer’s sibling or stepsibling or a descendant of any such individual, the taxpayer must care for the child as if the child were his or her own child.
- Residence – The child must live with the taxpayer in the same principal place of abode in the United States for over half the year. Military personnel on extended active duty outside the United States would be considered to be residing in the United States. As under current law, the taxpayer and child are considered to live together even if one or both are temporarily absent due to special circumstances such as illness, education, business, vacation, or military service.
- Age – The child must be under the age of 19, a full-time student if over age 18 and under age 24, or totally and permanently disabled. However, as under current law, qualifying children

³ United State General Accounting Office. Tax Administration: Erroneous Dependent and Filing Status Claims. Report GAO/GGD-93-60, March 1993.

(who are not disabled) must be under age 13 for purposes of the child and dependent care tax credit and under 17 (whether or not disabled) to qualify for the child tax credit.

Neither the support nor gross income tests would apply to qualifying children who meet the relationship, residence, and age tests. In addition, taxpayers would no longer be required to meet a household maintenance test when claiming the child and dependent care tax credit.

If more than one taxpayer claims the same qualifying child, then the following tiebreaker rules would apply:

- If only one of the claimants is the child's parent, then he or she would receive the tax benefit.
- If the child's parents do not file a joint return and both claim the child on separate returns, then the tax benefit would accrue to the parent with whom the child resides the longest. If both parents reside with the child for the same length of time, then the benefit would accrue to the parent with the highest adjusted gross income.
- If the child's parents do not claim the child, then the tax benefit would accrue to the claimant with the highest adjusted gross income.

Custodial parents generally could not release the claim to a dependent exemption to a noncustodial parent. However, if there is a child support instrument between the parents that applies to the dependent and that is in effect as of the date of the announcement of a legislative proposal, then current law will pertain. That is, in such cases, a custodial parent could release the claim to a dependent exemption (and, by extension, the child tax credit) to the noncustodial parent.⁴

Taxpayers could continue to claim individuals who do not meet the proposed relationship, residency, or age tests as dependents if they meet the requirements under current law (with the exception of the rules governing divorced parents). Thus, taxpayers would still be able to claim parents as dependents if they meet the support and gross income tests. As under current law, taxpayers would also be able to claim a distantly related or unrelated child as a dependent if the child resides in the taxpayer's home for the full year and meets the current law dependency tests. Further, such children would still not qualify the taxpayer for the child tax credit or the EITC unless placed in the home by a state agency. However, if more than one taxpayer claims a child as a dependent, then the proposed residency-based tests would supercede current law.

Taxpayers would be required to provide a valid taxpayer identification number for each qualifying child. An EITC qualifying child, however, would be required to have a social security

⁴ Current law specifies that noncustodial parents cannot claim the dependent exemption for a child without receiving a waiver from the child's custodial parent. However, according to the National Taxpayer Advocate's FY 2001 Annual Report to Congress (Publication 2104, December 31, 2001) the courts in 35 states have held that they have the authority to allocate the dependency exemption between spouses who are before them in a divorce or custody case. Current law may need to be clarified in order to ensure that family courts are correctly interpreting Congressional intent regarding the release of the dependency exemption by the custodial parent.

number that is valid for employment in the United States (that is, they are U.S. citizens, permanent residents, or have certain types of temporary visas).

Discussion:

By harmonizing the definition of qualifying child across five related tax benefits, the proposal would reduce both compliance and administrative burdens. By eliminating sources of taxpayer confusion and replacing the complicated support test with a simpler residency requirement, the proposal may also reduce erroneous claims of child-related tax benefits. Eliminating the support test would permit some parents who are making the transition from welfare to work to claim exemptions for their qualifying children as well as the child tax credit. Under current law, they may not be eligible to claim their child as a dependent, even though they work, if they received substantial government assistance before they entered the workforce.

The proposal would more closely conform the rules for dependent children to those used for EITC qualifying children. Under current law, taxpayers may be confused by the different definitions of eligible children.⁵ Further, the taxpayer would no longer be required to demonstrate, and retain the records to prove, that he or she provides over half the support of the child. A uniform definition of qualifying child would reduce IRS administrative costs as well. Currently, the IRS must ask taxpayers undergoing an audit to supply one set of documents to confirm that they support the child they claim as a dependent and another set of documents to prove that they reside with the same child in order to qualify for the EITC. Under the proposal, the IRS would request only documentation of residency.

The proposal would also clarify who may claim the child for tax benefits in extended families and other complicated living arrangements. Under current law, it is possible for three different family members, who live together for a full year, to claim the same child for at least four different tax benefits:

- The grandmother who provides more than half the costs of maintaining the home in which the child resides could claim head of household filing status;
- The child's aunt who provides over half the child's support and cares for the child as her own may claim the dependency exemption and the child tax credit; and
- The child's mother may claim the EITC.

Yet, none of these women may claim the child and dependent care tax credit, even if they work and pay for the care of the child. To claim that credit, one taxpayer must both support the child and maintain the household in which she and the child reside. Under the proposal, the child's mother (or if the family prefers, the grandmother or aunt) could claim all four tax benefits.

⁵ For example, the custodial parent who waives the dependent exemption to the child's noncustodial parent may not understand that he or she still qualifies for the EITC. Or a parent who claims the EITC may erroneously believe he or she can also claim the dependent exemption for the child even though most of the child's support comes from government assistance programs. Under the proposal, the taxpayer would be able to claim the same child for all child-related tax benefits.

Another source of complexity arises from the household maintenance test that is applicable to the child and dependent care tax credit. Under current law, single taxpayers are required to meet two separate household maintenance tests for head of household filing status and for the CDCTC. Married couples are generally not required to meet a household maintenance test, except to claim the CDCTC. Eliminating the household maintenance test for the child and dependent care tax credit would reduce record-keeping for both single and married workers with children. It would also expand eligibility for the credit to taxpayers who do not maintain the home in which they and their child live but who also incur child care expenses in order to work. For example, a young working mother who lives with her parents could qualify for the credit under the proposal if she pays for child care, regardless of whether she maintains the home in which she, her parents, and her child reside.

Summary of Simplification Gains: Over 52 million taxpayers would benefit from simplifying the definition of qualifying child for the five related child tax benefits. The proposal would reduce taxpayer confusion over differing definitions of qualifying children. It would also reduce record-keeping burdens, as taxpayers would no longer have to demonstrate that they support their children. Further, the proposal could result in the elimination of the six-line Schedule EIC and the page of instructions that accompanies it. Many taxpayers would no longer have to bother reading the four pages of instructions in Publication 501 that explain the support tests or complete the 22-line worksheet to calculate their share of a child's support.

Under the proposal, the IRS would also receive additional information on the tax return to verify head of household filing status. Under current law, taxpayers are not required to provide the taxpayer identification number (TIN) of children who qualify them for head of household filing status but not for a dependent exemption. Under the proposal, all qualifying children – for purposes of the five child-related tax benefits – would be required to have a TIN.

Comparison of Key Provisions Relating to Qualifying Children under Current Law and the Proposal

	----- Current Law -----					Proposal
	Dependency Exemption	Head of Household Filing Status	Child Tax Credit	Child and Dependent Care Tax Credit	Earned Income Tax Credit	
1. Relationship test						
Sons, daughters, grandchildren	Yes	Yes	Yes	Yes	Yes	Yes
Brothers, sisters, nieces, nephews	Yes	Yes, if qualifies as a dependent	Yes, if qualifies as a dependent and taxpayer cares for child as his or her own	Same as dependency exemption	Yes, if taxpayer cares for child as his or her own	Yes, if taxpayer cares for child as his or her own
Foster children (which may include relatives and unrelated children)	Any child may be treated as own child if lives with taxpayer for entire year and the taxpayer cares for the child as his or her own	Yes, if qualifies as a dependent	Yes, if lives with taxpayer for entire year, is placed by an authorized placement agency, and taxpayer cares for the child as his or her own	Same as dependency exemption	Yes, if lives with taxpayer for over half the year, is placed by an authorized placement agency, and taxpayer cares for the child as his or her own	Yes, if lives with taxpayer for over half the year and is placed by an authorized placement agency
2. Age limit	Under 19 or under 24 if full-time student	No age limit for unmarried sons, daughters, grandchildren, and stepchildren. Otherwise, same as dependency exemption.	Under 17	Under 13 (no age limit for disabled dependent)	Same as dependency exemption, but no age limit for disabled children	Under 19, under 24 if full-time student, and no age limit for disabled children (however, under 17 for child tax credit and under 13 for child and dependent care tax credit)
3. Gross income limit	Individual cannot be claimed as a dependent if earns more than the exemption amount, except if son, daughter, stepson, stepdaughter, or foster child under age limit	No limit for unmarried sons, daughters, grandchildren, and stepchildren regardless of age; otherwise, same as dependency exemption	Same as dependency exemption	Same as dependency exemption	No limit	No limit
4. Residency requirements	Certain related children do not have to live with the taxpayer, otherwise entire year	Child must live with the taxpayer for over one half of the year	Same as dependency exemption	Child must live with the taxpayer for the period during which the expenses were incurred	Child must live with taxpayer for over one half of the year	Child must live with the taxpayer for over one half of the year
5. Support test	Taxpayer must provide over one half of the child's support.	No support test for unmarried sons, daughters, grandchildren, and stepchildren; otherwise, same as dependency exemption	Same as dependency exemption	Same as dependency exemption	None	None
6. Household maintenance test	None	Taxpayer must provide over one half of the costs of maintaining the household	None	Taxpayer must provide over one half of the costs of maintaining the household for the period during which child lived with taxpayer	None	None