

# CRS Report for Congress

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## Tax Benefits for Families: Changes in the Definition of a Child

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### Summary

Beginning with tax year 2005, there is a new definition of a child for tax purposes as a result of changes made by the Working Family Tax Relief Act of 2004 (P.L. 108-311), and technical changes to this act made by the Gulf Opportunity Zone Act of 2005 (P.L. 109-135). The new definition affected taxpayers claiming certain tax provisions, including five tax benefits widely used by families — the personal exemption for dependents, the dependent care tax credit and exclusion for dependent care assistance programs, the child tax credit, the head of household filing status, and the earned income credit.

P.L. 108-311 provided a more uniform definition of a child for these tax provisions. The changes provided specific requirements for an individual to be either a qualifying child or a qualifying relative for the personal exemption for dependents. The tax provisions used by families are linked to new definitions of a qualifying child or qualifying relative. For example, for the child credit, an individual must be a qualifying child under the new definitions and meet, as under the pre-2005 rules, the age limitation (17) and be claimed by the taxpayer as a dependent for the personal exemption.

This report will be updated as warranted for legislative activity.

### Tax Years 2004 and Earlier

For tax years 2004 and earlier, the two major definitions under which a child may qualify a taxpayer to claim a specific tax benefit were the definitions in the personal exemption and the earned income credit.

A dependent for the personal exemption had to meet five requirements (or tests):

- Financial support (the taxpayer must provide more than 50% of the dependent's support);
- Residency or relationship (the dependent must live with the taxpayer all of the tax year, or be related to the taxpayer);

- Citizenship (the dependent must be a U.S. citizen or resident, or a resident of Canada or Mexico);
- Income (a dependent cannot have an income that is higher than the personal exemption amount); and
- Marital status (generally a dependent must not file a joint return).

The taxpayer's son, daughter, stepson, or stepdaughter is defined as a child for purposes of the personal exemption, and is exempt from two of the requirements: residency (or relationship) and income (if under age 19, or if a student under age 24). However, the child must still meet the other three requirements to be claimed as a dependent by the taxpayer.

For the earned income credit, a qualified child must meet three criteria:

- relationship — the child must be a son, daughter, stepson, stepdaughter, or descendent of such a relative; a brother, sister, stepbrother, stepsister, or descendent of such a relative cared for by the tax filer as his/her own child; or a foster child;
- residence — the child must live with the tax filer for more than half the year; and
- age — the child must be under age 19 (or age 24, if a full-time student) or be permanently and totally disabled.

The dependent care expense tax provisions, and the head of household filing status relied on the definition of a dependent for the personal exemption. The child tax credit required a child to meet the relationship requirements of the earned income credit, and be claimed as a dependent for the personal exemption.

Special rules existed for divorce or separation, and when more than one taxpayer could claim a child for a tax benefit. Generally, in cases of divorce or separation, the custodial parent would take the personal exemption for a child. However, a custodial parent could waive the personal exemption to the non-custodial parent. In that case, the child tax credit would also be waived to the non-custodial parent. In cases where more than one taxpayer provides support for the child, and no one person provides more than one-half of the child's financial support, if all parties agree, one person providing more than 10% of the child's support could claim the child for the personal exemption.

For the earned income credit, the custodial parent could claim the child. If more than one person claimed the child for the earned income credit, there is a specific order for claiming the child. If one taxpayer is the parent — the parent claims the qualifying child; if both taxpayers are parents — the parent the child lived with longest during the tax year claims the child; if the child lived with both parents for the same amount of time — the parent with the higher adjusted gross income claims the child; in all other cases — the taxpayer with the higher adjusted gross income claims the child.

## Tax Years 2005 and Later

The Working Family Tax Relief Act of 2004, P.L. 108-311, replaced the definition of a dependent for the personal exemption with specific requirements (or tests) that define two categories of dependents: qualifying child and qualifying relative. Other tax provisions used by families with children are linked to the new definitions. The general requirements (or tests) for each category are shown in **Table 1**.

**Table 1. Requirements for a Qualifying Child or Qualifying Relative**

	Qualifying child	Qualifying relative
<i>Relationship</i>	Child or descendant of a child of the taxpayer; brother, sister, stepbrother, stepsister, or descendant of such a relative; individual adopted by the taxpayer or lawfully placed for adoption by the taxpayer; foster child placed with the taxpayer by authorized placement agency, judgment, decree, or court order.	— Child or descendant of a child of the taxpayer; — Brother, sister, stepbrother, or stepsister; father, mother, or ancestor of either; — Stepfather or stepmother; niece or nephew; aunt or uncle; — Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; — Any individual, other than a spouse, who lived with the taxpayer as a member of the taxpayer's household for all of the tax year.
<i>Residence</i>	Child must live with the taxpayer for at least half the tax year. Certain temporary absences, such as due to education, illness, or military service, are not treated as absences from living with the taxpayer.	No requirement.
<i>Age</i>	Child must be under age 19 at the end of the tax year, (24 if a full-time student). There is no age limit for a permanently and totally disabled individual meeting the other requirements for a qualifying child.	No requirement.
<i>Support</i>	Child cannot provide more than one-half of his or her support.	Taxpayer must provide more than half of the financial support of the qualifying relative for the tax year. Educational scholarships are not included in determining support.
<i>Income</i>	No requirement.	The gross income of the qualifying relative must be less than the personal exemption amount for the tax year. For a permanently and totally disabled individual, income from services performed at a sheltered workshop is not included in gross income.
<i>Qualifying Child</i>	Cannot be the qualifying relative of another taxpayer.	The qualifying relative cannot be the qualifying child of the taxpayer or any other taxpayer.

**Source:** Table prepared by the Congressional Research Service (CRS).

**Personal Exemption.** An individual (other than a spouse) must meet the requirements to be either a qualifying child or qualifying relative in order for the taxpayer to claim the individual as a dependent for the personal exemption.

For qualifying children, P.L. 108-311, retained certain pre-2005 rules applicable for dependents: (1) children that are U.S. citizens living abroad, or non-U.S. citizens living in Canada or Mexico may be qualifying children; (2) legally adopted children not meeting the residency or citizenship requirement may be qualifying children if the child lives with the taxpayer and the taxpayer is a U.S. citizen or national.

As under pre-2005 rules, in cases of legal separation or divorce, a custodial parent could waive the personal exemption for a child to the non-custodial parent, and the child tax credit would also be waived. The waiver of a child as a qualifying child would not carry over to the other tax provisions.

P.L. 108-311 established tie-breaker rules (when more than one party claims a qualifying child) for the personal exemption which are the same as the pre-2005 rules for the earned income credit. If one taxpayer is the parent — the parent claims the qualifying child; if both taxpayers are parents — the parent the child lived with longest during the tax year claims the child; if the child lived with both parents for the same amount of time — the parent with the higher adjusted gross income claims the child; in all other cases — the taxpayer with the higher adjusted gross income claims the child.

**Earned Income Credit.** To be eligible for the earned income credit, a taxpayer must have a qualifying child as defined by the personal exemption. The qualifying child cannot be married, and the principal place of abode (when the child lives with the parent to be a qualifying child for the personal exemption) must be the United States. However, an exception to the definition exists in that the qualifying child may provide more than one-half of his or her own support. In addition, an individual is the qualifying child of the custodial parent, as the determination for the earned income credit disregards a waiver of the personal exemption and child tax credit to a non-custodial parent.

**Child Tax Credit.** To be eligible for the child tax credit, a taxpayer must have a qualifying child, as defined for the personal exemption, who is under age 17 and is a resident of the United States. As under pre-2005 rules, a waiver (transfer) of the personal exemption for a qualifying child to a non-custodial parent also is a waiver of any potential child tax credit associated with the qualifying child. As a result, a child will be claimed for the child tax credit by the parent claiming the child for the personal exemption.

**Head of Household Filing Status.** To be eligible for head of household filing status, an unmarried taxpayer must maintain a household that has, as a member of the household, a qualifying child as defined for the personal exemption. Like the earned income credit, an individual is the qualifying child of the custodial parent, as the determination for head of household filing status disregards the waiver of the personal exemption and child tax credit to a non-custodial parent.

**Dependent Care Expenses.** The dependent care expense provisions (dependent care tax credit and income exclusion for employer provided dependent care expenses) are linked to both the definition of a qualifying child, and the general definition of a dependent. To qualify for the provisions, a taxpayer must have: (1) a qualifying child, as

defined by the personal exemption, under age 13; (2) a dependent (may be a qualifying child over 13 or a qualifying relative) who is physically or mentally incapable of caring for themselves and has lived with the taxpayer for more than one-half of the tax year; or (3) a spouse who is physically or mentally incapable of taking care of themselves who has lived with the taxpayer for more than one-half of the tax year. The new rules remove the pre-2005 requirement for the dependent care tax credit, that the taxpayer maintain a household in which the qualifying individual lives.

**Other Tax Provisions.** In addition to the changes for the above tax provisions used by families, technical amendments were made to a number of tax provisions to conform them to the new definitions in the personal exemption.

The Joint Committee on Taxation estimated that the changes made by the new law for a more uniform definition of a child will result in a revenue loss of \$942 million over the FY2005-FY2009 period.<sup>1</sup>

**Current Issues.** On February 6, 2006, the National Association of Enrolled Agents sent a letter to the Commissioner of the Internal Revenue Service expressing concern about ambiguities and uncertainties with respect to the definition of a child in certain cases.<sup>2</sup> The letter outlined, through examples, specific taxpayer circumstances in which a literal interpretation of the new definition could lead to unintended consequences that may be contrary to the intent of the law for the new definition of a child.

One of the examples cited is that of a married couple with two children (aged 14 and 22) living at home, with an adjusted gross income (AGI) of \$400,000 on their joint tax return. The couple's 22-year-old child is not a student and has \$15,000 a year in wage income. The older child can not be claimed as a dependent by the couple under prior law and must file his own tax return. Under prior law, the minor child (14) would be claimed as a dependent by the couple on their joint tax return, but because of the couple's AGI level the personal exemption for the child would be phased out (they would receive no tax benefit), and the child tax credit would not be available to them. The Association notes that under current law (with the new definition), the minor child (14) could be the qualifying child of the older child (22), enabling the older child to claim a personal exemption for the minor child, the child credit, and earned income credit, resulting in a significant tax refund.

The Administration, as part of its FY2007 budget, proposed two clarifications to the definition of a child: (1) that a taxpayer could not be the qualifying child of another individual if the taxpayer is older than the individual; and (2) if a parent resides with a child for over half of the tax year, only the parent would claim the child as a qualifying child. The Administration estimates that these clarifications would raise \$1.1 billion over the FY2007-FY2011 period.

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<sup>1</sup> Joint Committee on Taxation, *Estimated Revenue Effects of the Conference Agreement for H.R. 1308, The "Working Families Tax Relief Act of 2004"*, JCX-80-04, Sept. 2004

<sup>2</sup> National Association of Enrolled Agents, letter to Commissioner Mark Everson, Feb. 6, 2006, at [[http://www.naea.org/MemberPortal/Advocacy/Comments/Everson\\_Letter\\_Feb\\_2006.htm](http://www.naea.org/MemberPortal/Advocacy/Comments/Everson_Letter_Feb_2006.htm)].