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Summer 2008 Newsletter for Your Clients

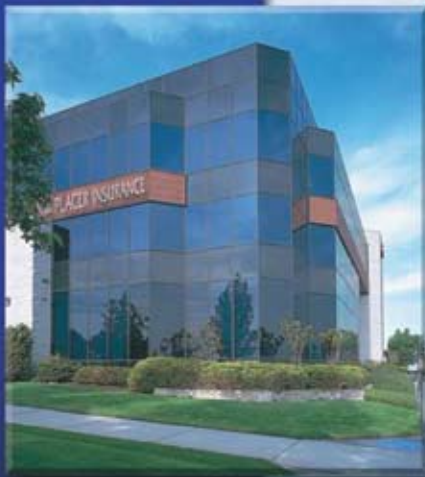
It's amazing how time flies. Another summer has rolled around and hopefully it's vacation time for you and your clients! The topic of the summer 2008 client newsletter is dependents. Determining dependency can be difficult and that's why your clients go to you, the tax expert.

Feel free to duplicate the client newsletter and mail to your clients. If you'd like the text of this newsletter to make it more customizable, please contact NAEA Communications Manager Margaret Mitchell at mmitchell@naea.org. Alternatively, you may use the newsletter as source material for your own client newsletter.

Sincerely,

Karen Yeager, EA, *EA Journal* Editor

Mary R. Mellem, EA, Client Newsletter Editor



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The Dependent Challenge

One of the most confusing issues when filing a tax return is determining who is a dependent and how long can that dependent be claimed. Congress attempted to make the answer more uniform, but in doing so has complicated the process.

A dependent is someone who creates a deduction of \$3,500 (2008) on your return. That person may also make you eligible for the child tax credit (\$1,000), head of household status, education tax benefits, earned income credit (EIC), and the childcare credit.

Congress has established criteria to determine who is a dependent. That sounds easy enough, but here's where the fun starts. There are some general rules that apply to any potential dependent.

1. The dependent must be a citizen or a national of the United States, a resident alien (not a citizen but have lived here long enough to qualify as a resident), or a resident of Canada or Mexico.

2. The dependent, if married, must not file a joint return unless it is for refund purposes only and would not otherwise need to file.

If the prospective dependent is your child, stepchild, adopted child, brother, sister, step-brother, step-sister, or a descendant of any of the foregoing, or a foster child placed by a qualified agency, a "qualified child test" is applied. This test requires an affirmative answer to a number of questions to determine whether the child is your dependent.

Qualified Child Test

1. Is the child under the age of nineteen, under the age of twenty-four if a full-time student, or permanently and totally disabled at any time during the year?

2. Was the child's principal place of abode with you for more than half of the year?

3. Did the child pay no more than one half of his or her support for the year?

If the person you want to claim does not meet the qualified child test, you have one more chance for

some of those benefits listed earlier. The individual must be a qualified relative and affirmatively satisfy the following tests.

Qualified Relative Test

1. Is the person you wish to claim a relative or in-law? (In this test, the definition of a relative includes parents and their ancestors; children and their descendants; brothers, sisters, and their children; aunts and uncles; and step-fathers, step-mothers, step-brothers, and step sisters. In-laws include the following: father-, mother-, brother-, and sister-in-law.)

2. If the person is not a relative, in-law, or spouse, did he/she live as a member of your household for the entire year and make use of it as their principal place of abode?

3. Does the person you wish to claim have income in excess of the exemption amount (\$3,500 for 2008)? Social security income is not taken into consideration for this purpose.

4. Do you pay more than half the cost of supporting the person you wish to claim?

The qualified relative test is not based on age. The person living with you can be a baby or a grandparent, related or not. The important factors are that you must support this person and the person cannot make more than the designated amount of money for that year. If a child meets the qualified child test, that test must be applied before the qualified relative test. And the person cannot be a qualified child of any other taxpayer for the year.

For example, Johnny lives with his mother. Mother has a small part-time job. She and Johnny live with her sister Beth for the entire year. Johnny could be a dependent of

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mom or Aunt Beth. Because Johnny is a qualifying child of mom, Aunt Beth would not be able to claim Johnny as a qualifying relative. But Aunt Beth could claim Johnny as a qualifying child if his mother did not.

When a child goes off to college, the dependency exemption should be examined closely. The child could be a qualifying child while a full-time student and under the age of twenty-four. The definition of a full-time student depends on the institution attended. In many cases, as little as twelve credits per semester can be full time. The important consideration is, did the child support him or herself. Loans are often used to finance education. It is necessary to look at who is responsible for those loans and what other expenses were paid for the child. If the child works and is responsible for the college loans, the child may have provided more than half of his/her own support for the year which would disqualify him or her as a dependent.

The year the child graduates also poses a problem. If the child meets the age test and full-time student test during the year, but graduates and gets a good paying job, the child may have provided more than half of his/her own support for that year.

Support is determined by compiling a list of the expenses paid for the student. This includes the cost of tuition, books, living expenses at

college, medical care and insurance, food, transportation, clothing, and the child's share of the cost to maintain a permanent residence during the non-school year. If the child is receiving scholarships, the scholarships and the expenses paid with those scholarships are ignored for support purposes.

Divorce

Divorce casts another shadow on the dependent process. There is a lot of confusion when divorced parents attempt to claim the child. A child's dependency cannot be shared equally between parents. The law gives the right to claim the child to the custodial parent. That right exists until the child reaches the age of majority (generally age eighteen). The custodial parent is the parent whom the child lives with for the majority of the year. The custodial parent can release the right to claim the child to the noncustodial parent using a Form 8332 (Release of Claim to Exemption for Child of Divorced or Separated Parents). Doing so gives the noncustodial parent the deduction, the child tax credit, and the education tax benefits. The custodial parent still retains the right to the head-of-household status, the child care credit, and the EIC. The noncustodial parent will not receive those benefits. Many people are confused because a judge may have determined that the noncustodial parent should have all the

benefits of the custodial parent and included that in the settlement agreement. Unfortunately, the IRS has not given the judge the right to legislate tax law and IRS is not bound to follow the judge's verdict if it disagrees with tax law. The IRS expects to see a Form 8332 attached to the noncustodial parent's return even when the divorce agreement gives the noncustodial parent the claiming rights.

Other Dependents

When you're considering dependents, do not limit your thoughts only to young people. Mom, dad, or other relatives might be qualified. Age is not a factor for the qualified relative. Support is a big factor. Even if you do not pay more than half your relative's expenses, if a group of you collectively pay over half, you may be able to alternate the deduction.

For example: Gran needed to go to a nursing home but she did not have sufficient resources to pay the bill herself. Gran and her three children each shared one fourth of the bill. Because Gran does not pay over half of her own expenses, the children collectively are paying more than half the bill. The children can file a multiple support agreement and alternate who gets to claim Gran on their tax return.

Dependency is a difficult issue. Understanding the rules will enable you and your tax preparer to make the most of your tax situation. **EA**



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