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This is the story of a taxpayer, and individual – your client!

A taxpayer who is divorced or separated (as defined by **IRC Sec. 7703-see footnote I.**) and is a custodial parent [as defined by **post-2004 WFTRA IRC 152 (e) (3) (A)-see footnote II.**] who wishes to claim a child under the dependency exemption rules [as defined by **post-2004 WFTRA IRC Sec 152 (b) – (c)-see footnote III.**] and further meets the requirements of **pre-WFTRA IRC Sec 152 (e)-see footnote IV.** will be permitted to claim the child as his or her dependent on their tax return. **However**, the custodial parent may not claim the exemption and instead the exemption would go to the non custodial parent if the exceptions to **IRC Sec 152 (e)** are met as defined in **pre-2004 WFTRA IRC Sec 152 (e) (2) – (4)-see footnote V.**

The taxpayer who is entitled to the dependency exemption, as defined above, is entitled to an exemption amount of \$3,200 per child in the year 2005 (**per Rev. Proc. 2004-71 and 2004-50 IRB 970**). The taxpayer is also potentially entitled to several tax credits (tax credits are amounts that are subtracted directly from taxes owed and in some cases tax credits can be refundable even if no tax is due). These tax credits include the Dependent Care Credit [as defined by **IRC Sec 21(a)see footnote VI.**] which is available for qualifying individuals [as defined in **IRC Sec 21 (b) (1) (A) – (C)-see footnote VI.**]. Another potentially available tax credit is the Child Tax Credit [as defined in **IRC Sec 24 (a)-see footnote VII.**] for a qualifying child [as defined in **post-2004 WFTRA IRC Sec 24 (c)-see footnote VIII.**]. A third potential credit is the Educational Credit [as defined in **IRC Sec 25 (A)see footnote IX.**].

It should be noted that the taxpayer's filing status will impact the availability of some of the aforementioned tax credits. In particular, for divorced and separated taxpayers, IRC Sec 2 (b), Head of Household filing status is potentially beneficial.

The Earned Income Credit is another powerful tax credit for lower income taxpayers. (and the topic of yet another seminar)

To ensure compliance with requirements imposed by the IRS, we inform you that (i) any U.S. tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code (ii) and any such tax advice is written in connection with the promotion or marketing of the matters addressed. You should seek advice based on your particular circumstances from an independent tax advisor.

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FOOTNOTES:

I. IRC Sec 7703-Married or Not Married, that is the question.

- A. Marital status determined last day of taxable year, hence, if client/taxpayer is married on December 31, they are married for tax purposes
- B. The Internal Revenue Code (hereinafter, the Code) has exceptions to the above rule, your client/taxpayer may be married at end of year and may still file as unmarried for tax purposes IF:
 - a. Spouses are legally separated under a decree of divorce or separate maintenance agreement
 - b. Decree “expressly and affirmatively” states that spouses live apart in the future
 - c. In the absence of a. or b. above, the “Abandoned Spouse” rule could apply
 - i. Your client files a separate return
 - ii. Your client has maintained a home with a child for more than half the year
 - iii. Your client has paid more than half the costs to maintain said home
 - iv. Your client’s spouse has not lived with your client for more than six consecutive months
- C. Why does this matter? Because your client’s filing status on the tax return can have a tremendous impact on their tax liability, hence determining their filing status, based on their legal status, is important.

II. Post-2004 WFTRA IRC 152 (e) (3) (A)-Defining when client is a Custodial Parent

- A. Parent with whom the child shared same principal place of abode for the greater portion of the calendar year.

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III. Post-2004 WFTRA IRC Sec 152 (b) – (c)-When client can claim child as a Dependent

- A. Child does not file a joint return
- B. Child meets the citizenship/residency rules (extensive)
- C. Child is under the age of 19 or if full time student is under the age of 24
- D. Child lives in the same abode with your client for more than half the year
- E. Child does not provide for more than one half of their own support

IV. Pre-2004 WFTRA IRC Sec 152 (e)-Additional rules to claiming child as dependent while your client is divorcing or divorced

- A. Child get more that one half of their support from both parents
- B. Child is in custody of one or both parents for more than half of the calendar year
- C. Parents meet the requirements of Code section 7703 (b) (see I. B. above)
- D. If no decree or separation instruments exist, dependency exemption for child still possible for client is the parents lived apart at all times for the last six months or more of the year (note I. B. c. above)

V. Pre-2004 WFTRA IRC Sec 152 (e) (2) – (4)-O.K., so your client is not the Custodial parent, your client can still get the child dependency exemption IF:

- A. Custodial parent releases claim to the exemption to the non-custodial parent (your client) with Form 8332 (a copy of which was provided in my packet to you, if packet accidentally ended up in circular file, call me, I've got copies)

VI. IRC Sec 21 (a) and IRC Sec 21 (b) (1) (A) - (C)-Dependent Care Tax Credit, now the good stuff, your client has the child as a dependent, if other provisions are met, your client can obtain a dollar for dollar reduction in their tax liability

- A. Child must be a dependent within the meaning of the Code and as defined above and under the age of 13
- B. Or the child must be incapable of self care if over the age of 13

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- C. Or dependent care tax credit is available for your client caring for an incapacitated spouse (and of course incapacitated spouse or child has definitions to meet too!)
- D. Applicable percentages
 - a. 35% of qualified employment related costs
 - b. reduced by 1% for every \$2,000 over \$15,000
 - c. at \$43,000 applicable percentage is 20%-limited to statutory caps
 - 1.\$3,000 max for one qualifying individual
 - 2.\$6,000 max for two or more qualifying individuals
- E. Must file as Head of Household

VII. IRC Sec 24 (a)- Your client has the dependency exemption and can potentially claim a tax credit, with limits (of course) of \$1,000 per qualifying child

- A. This section of the Code establishes the Child Tax Credit

VIII. POST-WFTRA IRC Sec 24 (c)- Oops, see that above?- “Qualifying Child”, so lets see if your client gets this tax credit by determining if their child (for which they already have the dependency exemption) is also a “Qualifying” child

- A. Child is the child of your client (yes, there are also additional exceptions to this rule, yet another seminar)
- B. Child lives with your client for more than half the year
- C. Child is under the age of 17 as of the end of the tax year
- D. Child did not provide for more than half of their own support
- E. The amount of the credit is determined by:
 - a. maximum credit is \$1,000 per child limits on 3 or more children
 - b. phase out threshold for Head of Household filing status is \$75,000 and the credit is completely gone at \$85,000
 - c. phase out is \$50 for every \$1,000 of income over the threshold
 - d. Alternative Minimum Tax adds considerable complications (yep-you guessed it-another seminar)
 - e. Child Tax Credit is know as a refundable credit, even if you owe no taxes can still get a refund via this tax credit

IX. IRC Sec 25 (A) – Lastly, another potential tax credit for your client, the Educational Credit

- A. Hope Scholarship
 - a. A non-refundable tax credit up to \$1,500 per student (with phase outs, of course) for qualified tuition (yes, lengthy definitions for qualified)

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B. Lifetime Learning Credit

- a. Credit is 20% of up to \$10,000 of qualified tuition for certain individuals including post-graduate work and improving job skills
 1. unlimited number of years
 2. phase outs apply to the credit

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