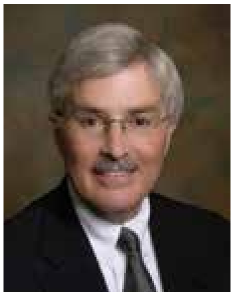

TAX TRENDS AND DEVELOPMENTS

Selected Tax Provisions Related to Children of Divorce – Part 2

By Joseph W. Cunningham, JD, CPA

The following presents basic information regarding two additional federal income tax provisions applicable to divorced or legally separated parents with one (or more) dependent child. Two other such provisions were presented in the April 2014 column.

Earned Income Credit

General Rule

IRC Section 32 provides for a refundable tax credit for taxpayers (1) with adjusted gross incomes (AGIs) under certain limits and (2) who have earned income. As indicated below, the credit increases significantly for taxpayers with one or more qualifying children.

To qualify, a taxpayer's 2014 AGI must be less than:

- $14,590 ($20,020 if married filing jointly) with no qualifying children
- $38,511 ($43,941 if married filing jointly) with one qualifying child
- $43,756 ($49,186 if married filing jointly) with two qualifying children
- $46,997 ($52,427 if married filing jointly) with three or more qualifying children

The credit begins to phase out for taxpayers with one or more qualifying children who have a 2014 AGI of $17,530 or more and an AGI of $7,970 or more if no qualifying children. The phase-out continues from these AGIs through the amounts shown above.

Also, a taxpayer's investment income – interest, dividends, capital gain, etc. – cannot exceed $3,350 in 2014.

The maximum credit for 2014:

- $496 with no qualifying children
- $3,305 with one qualifying child
- $5,460 with two qualifying children
- $6,143 with three or more qualifying children

The requirements for "qualifying child" are essentially the same for claiming a dependency exemption for a child.

"Earned income" includes salaries, wages, other forms of employee compensation, and self-employment income.

The IRS will calculate the credit. For taxpayers who want to calculate the credit, there are tables included in both 1040 and 1040A instructions.

Example

John and Mary, who file jointly, have:

- Earned income of $25,000.
- Investment income of $1,000
- Two qualifying children

Because their $26,000 AGI is less than the $49,186 limit and their $1,000 investment income does not $3,350, they are entitled to the earned income credit (EIC). They refer to the EIC table in the 1040A instructions and find their credit is $4,813.

Practice Pointers

- As shown by the example, the EIC can be considerable for taxpayers with one or more children who have AGIs less than the $38,000 to $47,000 range shown above. Thus, attorneys should alert clients in this stratum to check on qualification for the EIC.
- Since the EIC applies annually provided qualifications are satisfied, it should be considered as a positive post-divorce budget item for clients of modest means.

Child and Dependent Care Credit

General Rule

IRC Section 21 provides for a non-refundable credit against income tax of up to 35% of expenses for the care of a dependent child under age 13 which are incurred to enable the taxpayer to be gainfully employed.

Such expenses are limited to $3,000 per qualifying child. Qualifying expenses include household services and the direct care of a child.

The percentage applied to the credit is 35% for a taxpayer with an AGI of $15,000 or less. The percentage is reduced by

1% for every $2,000 of AGI – or a fraction thereof – above $15,000. As shown on the table at the end of the article, the minimum percentage is 20%, applicable to those with AGIs exceeding $43,000.

Example

A taxpayer spends $5,000 on qualifying child care expenses for two dependent children so that she can work as an assistant manager. Her AGI is $30,000. Her Child care credit is - $5,000 x 27% = $1,350. This amount will reduce her taxes dollar for dollar.

Other Aspects of the Child and Dependent Care Credit

As the name indicates, the credit also applies to qualifying expenses if the dependent is a child or relative 13 of age or older, or a spouse, if he or she is physically or mentally unable to care for himself or herself and resides with the taxpayer more than half the year.

Qualified expenses are considered only to the extent of a taxpayer's earned income. For married taxpayers, qualified expenses are limited to the earned income of the lesser earning spouse.

The credit is claimed by completing IRS Form 2441.

Child and Dependent Care Credit Table

AGI	Credit	One Child	Two or More
$15,000	35%	$1,050	$2,100
$15,001–17,000	34%	$1,020	$2,040
$17,001–19,000	33%	$990	$1,980
$19,001–21,000	32%	$960	$1,920
$21,001–23,000	31%	$930	$1,860
$23,001–25,000	30%	$900	$1,800
$25,001–27,000	29%	$870	$1,740
$27,001–29,000	28%	$840	$1,680
$29,001–31,000	27%	$810	$1,620
$31,001–33,000	26%	$780	$1,560
$33,001–35,000	25%	$750	$1,500
$35,001–37,000	24%	$720	$1,440
$37,001–39,000	23%	$690	$1,380
$39,001–41,000	22%	$660	$1,320
$41,001–43,000	21%	$630	$1,260
$43,001 or more	20%	$600	$1,200