July 24, 2006

The Honorable Charles E. Grassley  
Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Bldg.  
Washington, DC  20515

The Honorable Max S. Baucus  
Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Bldg.  
Washington, DC  20515

The Honorable William M. Thomas  
Chairman  
House Committee on Ways and Means  
1102 Longworth House Office Bldg.  
Washington, DC  20515

The Honorable Charles B. Rangel  
Ranking Member  
House Committee on Ways and Means  
1106 Longworth House Office Bldg.  
Washington, DC  20515

Re: Report on the Uniform Definition of Qualifying Child

Gentlemen:

Enclosed is a report on the Uniform Definition of Qualifying Child. This report represents the views of the American Bar Association Section of Taxation. It has not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

[Signature]

Dennis B. Drapkin  
Chair, Section of Taxation

Enclosure
REPORT REGARDING THE UNIFORM DEFINITION OF QUALIFYING CHILD

This report (“Report”) is submitted on behalf of the Section of Taxation of the American Bar Association (“Tax Section”). It has not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, it should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing this Report was exercised by Joseph Barry Schimmel of the Tax Section’s Low Income Taxpayers Committee. Substantive contributions were made by Claudia Hill, Cindi Lepow, Diana Leyden and Annette Nellen of the Low Income Taxpayers Committee, and by Gail L. Richmond of the Committee on Individual Income Tax. This Report was reviewed by Elizabeth J. Atkinson, Chair of the Low Income Taxpayers Committee, Roberta F. Mann, Chair of the Tax Section’s Committee on Individual Income Tax, William H. Lyons of the Tax Section’s Committee on Government Submissions, and Sharon Stern Gerstman, Council Director for the Low Income Taxpayers Committee and the Committee on Individual Income Tax.

Although some of the members of the Tax Section who participated in preparing this Report have clients who would be affected by the federal tax principles addressed by this Report or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of this Report.

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Date: July 24, 2006
EXECUTIVE SUMMARY

The Working Families Tax Relief Act of 2004 (Pub. L. No. 108-311) (the “2004 Act”) replaced multiple definitions of “child” utilized for child-related tax benefits within the Code with a uniform definition of “qualifying child” (“UDOC”). An additional change to the UDOC was made as part of the Gulf Opportunity Zone Act of 2005 (P.L. 109-135) (the “2005 Act”). The UDOC had been sought by the National Taxpayer Advocate (“NTA”), the staff of the Joint Committee on Taxation, and some professional organizations. The primary purpose of the UDOC (aside from simplifying the definitions themselves) was to make many child-related tax benefits rise or fall together as a single group.

Some commentators have expressed concerns that the new definition and certain related changes have not truly led to simplification. Although it had been known from the start of the simplification process that this change would create some winners and losers, these commentators argued that several winner/loser scenarios were unintended. Some of these concerns can be attributed to the mere fact that the law changed. Taxpayers and tax practitioners had become comfortable with applying the different rules for the variety of child-related tax benefits and were suddenly forced to apply a new definition. However, other concerns raise questions about whether the move to a single definition substantively changed who does or does not qualify for the benefits. Those concerns deserve study, and are the subject of this Report.

We view these concerns from two perspectives: (i) overall simplification and (ii) the tax policies behind the benefits concerned. Where we have concluded that the concerns warrant legislative or regulatory changes, we have suggested such changes. Any changes should generally have as their top priority the continued simplification of laws and the ease of their administration. Thus, generally we do not recommend using waivers to change how benefits can be claimed because often neither party to the waiver will have sufficient information to make the correct choice at the time the waiver must be filed. Further, we do not recommend that additional tests, such as “caring for a child as your own,” be reinstated because of the complexity in interpreting and administering those tests.

“Winners” and “losers” are the unavoidable result of simplification; we believe that the price of this result is warranted in the case of the UDOC.

Summary of Recommendations

We recommend that Congress proceed cautiously with any proposed changes to the UDOC. Each change risks undoing prior simplification efforts, as well as unintended consequences. Simplification inevitably creates “winners” and “losers.” Some of the changes to the UDOC proposed by the NTA and the Administration will create additional “winners” or “losers” without furthering simplification or other policy goals. These situations are discussed below.

To the extent Congress deems it desirable to further change the UDOC, we suggest that the legislative recommendations in this Report be given careful consideration:

- If a parent resides with his or her qualifying child for more than one-half of the year, a taxpayer who is not the qualifying child’s parent shall not be eligible to claim the child as

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1 References herein to the “Code” refer to the Internal Revenue Code of 1986, as amended.
2 Throughout this Report, the term “winners” refers to taxpayers in a particular situation who qualify for one or more benefits as a result of the UDOC (and did not qualify prior to the UDOC), and the term “losers” refers to taxpayers in a particular situation who no longer qualify for one or more benefits as a result of UDOC. This Report assumes that simplification was the principal policy objective of the UDOC.
a qualifying child or qualifying relative unless the taxpayer is eligible to claim the child’s parent for the dependency exemption (parent-preference without waiver).

- If two individuals may (but for this provision) be claimed as the qualifying child of each other, then neither individual may claim the other individual as a qualifying child.
- The “cost of maintaining the household” test of section 7703(b)(3) should be eliminated.
- Consider consolidation of the child tax benefits in future simplification efforts.

The existing Treasury regulations contain many provisions worthy of retention. We recommend that the Service promulgate additional regulations and take other actions needed to address the issues described in this Report, including:

- Clarify the meaning of “eligible foster child.” Specifically, address the effect of legal guardianship and legal custody.
- Provide that a foster child is treated as a child by blood.
- Continue the rule that a relationship of affinity once existing will not terminate by divorce or the death of a spouse.
- Clarify the circumstances in which affinity through a taxpayer’s spouse will create a relationship with the taxpayer, or cease the use of ambiguous relationships (e.g., niece or nephew) in IRS Forms and Publications.
- Provide definitions of “in-laws,” particularly “brother-in-law” and “sister-in-law.”
- Define “taxpayer” to be synonymous with “individual,” or conform the use of these terms to the UDOC in forms, instructions and publications.
- Clarify the “in violation of local law” rule.
- Expand the use of public records to confirm relationships.
- Clarify and publicize the documentation acceptable to prove “place of abode.”

3 Unless otherwise stated, references herein to “sections” are to sections of the Code.
Background on the Uniform Definition of a Child

The NTA’s 2001 Report to Congress\(^4\) (“2001 NTA Report”) and the Joint Committee on Taxation’s 2001 simplification study (“JCT Simplification Study”)\(^5\) discussed the need for a uniform definition of a child, and presented a possible definition and related changes that would be needed for the new definition to work with various child-related tax benefits. The Tax Section and the tax division of the American Institute of Certified Public Accountants also recommended these changes. The NTA noted a variety of challenges faced by taxpayers in dealing with six provisions of the law. These provisions and the approximate number of filers who claimed them in 2001 are as follows:\(^6\)

- Dependency exemption \(44\) million
- Earned income tax credit (“EITC”) \(19\) million
- Child and dependent care credit \(6\) million
- Child tax credit (“CTC”) \(26\) million
- Head-of-household filing status \(18\) million
- Definition of “not married” not stated

The NTA found that high EITC error rates, duplicate dependency exemption claims, and head-of-household status issues were each due to the complexity underlying the provisions that serve to identify the qualifying child or dependent. For example, prior to the 2004 Act change, a child for EITC purposes had to meet three basic tests – relationship, age and residency, while the same child for purposes of the dependency exemption had to meet five tests – relationship, support, citizenship, filing status, and gross income.

The 2004 Act tried to create one definition of qualifying child which would enable a taxpayer to claim many of the “child-related tax benefits” – the dependency exemption, CTC, EITC, child and dependent care credit, and (for unmarried taxpayers) head-of-household status – as a package. Because the EITC had the more simple definition of child and was one of the more valuable benefits, the new definition of qualifying child started with the EITC. The new UDOC, located in section 152, establishes three primary criteria for a qualifying child:

1. Relationship – the individual is (i) a child or descendent of the taxpayer (including adopted, foster or step-child), or (ii) a brother, sister, stepbrother, stepsister or a descendant of any such relative;\(^7\)
2. Age – generally the individual is under age 19 or is a student under age 24;\(^8\) and
3. Abode – the individual has the same principal place of abode as the taxpayer for more than one-half of the tax year.\(^9\)

The prior support test requirement in the dependency exemption area, which required that the taxpayer have provided over one-half of the individual’s support,\(^10\) was eliminated, and for all benefits except the


\(^6\) *FY 2001 Annual Report to Congress*, *supra* note 4, at 78-82.

\(^7\) Section 152(c)(1)(A).

\(^8\) Section 152(c)(1)(C).

\(^9\) Section 152(c)(1)(B).

\(^10\) Section 152(a).
EITC\textsuperscript{11} the UDOC added a fourth criterion – that the individual not have provided over one-half of his or her own support. It was apparent that once the support test was eliminated, a child might be a qualifying child of more than one taxpayer. Thus, as in the case of the EITC, tie-breaking rules were provided to address situations where more than one taxpayer may have the same qualifying child.

Under prior law, a taxpayer had been permitted to claim the dependency exemption for a group of “dependents” defined more broadly than that used for the “qualifying child.” In order to retain the dependency exemption for this broader group of dependents, section 152 permits an individual who is not a “qualifying child” to be a “qualifying relative,”\textsuperscript{12} making the taxpayer eligible for certain child-related tax benefits with respect to those kinds of dependents.

**Understanding Simplification**

The federal income tax is complex. For decades, taxpayers, practitioners, policymakers and tax administrators have called attention to this reality and the problems caused by complexity. As recently stated by the chair of the Tax Section in testimony before a House Ways and Means subcommittee: “complexity is at the root of many significant obstacles to efficient and effective administration of the tax laws.”\textsuperscript{13} The JCT Simplification Study identified a number of problems stemming from complexity, including:

- Lower compliance levels.
- Increased taxpayer costs.
- Reduced perceptions of fairness in the tax system.
- Increased difficulties in administration.
- Impaired quality of tax assistance and administration.\textsuperscript{14}

Efforts to simplify the law have been challenging because of the reasons underlying complexity. The JCT Simplification Study identified a number of sources of complexity, including:

- Lack of clarity and readability of the law.
- Increased complexity in the economy.
- Use of the tax system to advance social and economic policies.
- The interaction of federal tax laws with state tax laws, other federal laws and standards (such as securities laws, labor laws, and generally accepted accounting principles), the laws of foreign countries, and tax treaties.\textsuperscript{15}

These factors make simplification difficult and result in continued growth of complex rules. For example, when tax benefits are added to the law, they are frequently available only to individuals with income below a stated amount – with a phase-out range of income provided as well. Such benefits require detailed rules and definitions. In addition, the complexity leads taxpayers to be uncertain as to whether or not they are entitled to the tax benefit and if so, in what amount.

As recently explained by the chair of the Tax Section in testimony before a House Ways and Means subcommittee:

\textsuperscript{11} Section 32(c)(3)(A).
\textsuperscript{12} Section 152(d).
\textsuperscript{13} Dennis B. Drapkin, Testimony on behalf of the ABA before the Subcommittee on Oversight, House Committee on Ways and Means, Apr. 6, 2006, available at http://www.abanet.org/tax/pubpolicy/2006/060406testimony.pdf.
\textsuperscript{14} Staff of the Joint Committee on Taxation, *supra* note 5, vol. I, at 6.
\textsuperscript{15} *Id.* vol. I, at 5.
Simplification is not easy. The new issues regarding the definition of child, for example, illustrate the difficulties inherent in balancing simplification, on the one hand, against addressing a multitude of perceived inequities, on the other. In addition to requiring careful examination of possible unintended consequences, simplification frequently requires either foregoing revenue or making choices that benefit some taxpayers and adversely affect other taxpayers. But simplification is worth the cost. Simplification pays dividends in terms of easing the burden of compliance for all taxpayers, simplifying the tasks of taxpayer education and law enforcement for the IRS, and improving taxpayer morale by making it easier to understand how the law operates.\textsuperscript{16}

While simplification has been a goal of many policymakers, practitioners and taxpayers for decades, some taxpayers will decide the simplified provisions provide unfavorable results. True simplification may result in some winners and losers (for example, taxpayers whose qualification for benefits changed under the UDOC), but if the vast majority of taxpayers enjoy reduced compliance burdens, greater transparency, and the same tax results, then simplification should be viewed as a success. Of course, the number of winners and losers should be kept to a minimum; with respect to the UDOC, some additional technical changes are needed to reach that point – a point that can still be attained in a simple manner, as explained in this Report.

How the Uniform Definition Contributed to Simplification

Two of the sources of complexity identified by the JCT Simplification Study were applicable to the Code’s provisions dealing with children and dependents: (i) lack of clarity in the law and (ii) use of the tax system to advance social and economic policies.\textsuperscript{17} Policy decisions made long ago resulted in the use of the tax law to address social and economic policies related to supporting children. However, the complexity stemming from the lack of clarity in the Code provisions dealing with children and dependents was an issue the NTA, Congress and others wanted to address. Clearly, the use of multiple definitions for the same term led to lack of clarity. Providing a uniform definition of a child for key tax provisions thus reduced a source of complexity affecting many taxpayers.

Today, the majority of taxpayers need only consider a single definition – the UDOC – to determine if their child is a “qualifying child” for the tax benefits noted earlier. Providing a single definition for a term used in several tax provisions addressed a major cause of complexity and brought about greater simplification and transparency for taxpayers and practitioners.

The Intended Results of the New Uniform Definition of Qualifying Child

In enacting the UDOC, the intent was that the same taxpayer would be able to claim the following tax benefits with respect to a child who met the age, relationship and residency requirements: (i) dependency exemption; (ii) CTC; (iii) EITC; (iv) head of household filing status; and (v) child and dependent care credit.\textsuperscript{18} While the child tax credit and child and dependent care credit had differing age thresholds which were not changed, the underlying policy was the same – to permit the taxpayer who lived with the child and had an appropriate relationship to the child – e.g., parent, stepparent, or grandparent – to claim the benefit. Where two or more taxpayers (e.g., a mother and grandmother) lived together with two children, the UDOC will in some cases allow each taxpayer to claim one child; however, the UDOC will not allow different taxpayers to claim benefits with respect to the same child. The central policy behind the UDOC was to try to use one definition to group the benefits together.

However, practical concerns prevented this in all cases. For example, in the case of divorced parents, the long standing rule permitting the custodial parent to allow the noncustodial parent to claim the

\textsuperscript{16} Dennis B. Drapkin, supra note 13.
\textsuperscript{17} Staff of the Joint Committee on Taxation, \textit{supra} note 5, vol I, at 68.
dependency exemption and CTC was deemed important enough to be retained. As we discuss below, the concept of allowing two taxpayers to essentially contract as to who gets to claim a tax benefit is somewhat attractive, but may reduce the aim of simplification. As reflected in our analysis below, we believe that any further changes to the child-related tax benefits should first be tested against the rubric of simplification rather than result. Thus, if we determine that the new rule adds unintended winners or losers, we should carefully measure legislative or regulatory fixes to determine if they will reduce simplification and if so, reject them.

Examples of “Problems” – Evaluations and Suggested Solutions

As known from the start of efforts to unify the various child tax benefits, there would be winners and losers. However, as the NTA reiterated earlier this year, “the UDOC, on balance, constitutes a vast improvement over the rules that existed previously.” Nevertheless, the 2005 income tax filing season focused tax return preparers’ attention for the first time on the UDOC and prompted public comment on some particular examples of winners and losers.

On February 6, 2006, Francis X. Degan, EA, President of the National Association of Enrolled Agents (the “NAEA”), submitted a letter to Mark W. Everson, Commissioner of Internal Revenue, describing five examples of “unintended consequences” from the UDOC, and requesting guidance (the “NAEA letter”). On March 21, 2006, Sandra L. Kopta, Chief, Individual Forms and Publications Branch, responded to the NAEA letter on behalf of the Internal Revenue Service (the “Service”).

On March 1, 2006, the Wall Street Journal published an article subtitled Congress’s Move to Simplify the Tax Code Creates Loophole for Some Wealthy Families, which quoted the NAEA letter and highlighted other issues with the UDOC (“WSJ article”).

On March 20, 2006, John Buckley, the chief Democratic tax counsel for the House Ways and Means Committee, criticized the substantial unintended consequences of the UDOC.

Finally, in response to the criticism of the UDOC, the NTA provided a commentary to Tax Notes, which appeared April 10, 2006 (“NTA commentary”).

Most of the situations discussed below are drawn from examples in the NAEA letter, WSJ article or NTA commentary. For each situation, we describe the perceived unintended result, proposed recommendations made by other commentators, and our recommendation.

Situation #1: High-income parents share a household with their low-income adult son and no-income minor daughter. The son claims his sister as his dependent, and also claims the CTC and EITC.

19 But not other child-related tax benefits. See sections 2(b)(1)(A)(i) (head-of-household), 21(e)(5) (child and dependent care credit), and 32(c)(3)(A) (EITC).
20 Section 152(e).
21 Nina E. Olson, Uniform Qualifying Child Definition: Uniformity for Most Taxpayers, 111 Tax Notes (TA) 225 (Apr. 10, 2006). Even this opinion is not universally shared. See, e.g., Tom Daley, Unintelligent Design: The Evolution of the Uniform Definition of Child, 111 Tax Notes (TA) 813 (May 15, 2006) (arguing that the UDOC was ill-conceived, and complicates rather than simplifies the law).
26 Nina E. Olson, supra note 21.
27 Appendix B elaborates on each of these situations.
This example suggests that the new definition of qualifying child enables two taxpayers to claim the tax benefits in a way to minimize tax, something that was not intended. The NAEA letter and WSJ article both characterize Situation #1 as a “loophole” for the wealthy.

NTA Recommendation

The NTA addressed Situation #1 in the NTA commentary. The NTA commentary observes that if the parents and adult son had both tried to claim the minor daughter as their dependent, under the section 152(c)(4) tie-breaker rule only the parents would have been entitled to do so. However, the tie-breaker rule only applies if a qualifying child is actually claimed by two taxpayers.28

The NTA commentary identifies several possible solutions for Situation #1. One is to restore the “cared-for” test for siblings. Under prior law, a taxpayer claiming as a qualifying child a brother, sister, stepbrother, stepsister, or descendant of any of them, must care for the child as the taxpayer’s own child. A second solution would be to apply the “cared-for” test only when the qualifying child lives with the sibling and another taxpayer could also claim the child as a qualifying child. In other words, the “cared-for” test would be the new tie-breaker rule. As the NTA commentary points out, any version of the “cared-for” test creates far more difficult administrative problems. The test is vague, difficult to administer, and requires a showing of activities and support.

Administration Recommendation

In the Administration’s Fiscal Year 2007 Budget (“FY2007 Budget”), President Bush proposed to clarify the UDOC.29 These proposals are set forth in Appendix A to this Report. One proposal would directly address Situation #1. This proposal states that if a parent resides with his or her child for over one-half the year, only the parent would be eligible to claim the child as a qualifying child (the “parent-preference”). However, the parent could waive the child-related tax benefits to another member of the household who has higher adjusted gross income (“AGI”) and is otherwise eligible for the child tax benefits (the “parent-preference waiver”). In Situation #1, only the parents would be eligible to claim the daughter under the parent-preference waiver proposal.

The FY2007 Budget thus addresses Situation #1. The son would be on notice that he could not claim his sister, unless his parents explicitly waive their benefits and unless his AGI is higher than theirs. For compliance purposes, the Service would need to confirm the son’s relationship and place of abode, but would not need to apply the tie-breaker rule.

Our Response and Recommendation

We believe the question presented by this example is whether the simplification was intended to generate new tax benefits for individuals for whom the provisions were never intended to apply. One policy reason justifying tax benefits for those who support children is to recognize the need for the income tax law to address the concern that working taxpayers cannot afford to support their households. Here, the son does not support his sister, so this policy would not justify granting child tax benefits to him.

It should be noted though, that the motivation for the son to claim his sister results not from the UDOC, but from the phase-outs and the alternative minimum tax that preclude the parents from claiming child tax benefits for their daughter. The unintended result in this example can easily be fixed through a simple modification to the UDOC; however, it would also be resolved by changing the law to address the complexities of phase-outs and the alternative minimum tax.

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28 This result was confirmed by the Service in IRS Volunteer Quality Alert 2006-04 – Guidance for Determining a Qualifying Child, Qualifying Relative, and Qualifying Person (updated March 2, 2006) (“If the taxpayers have the same qualifying child, they may decide among themselves who will claim the child. If they cannot agree, and more than one taxpayer files a return using the same child, the Service will use the tie-breaker rules . . . .”).

We believe that any reliance on the existing tie-breaker rule, as recommended by the NTA, creates problems of administration and decreases simplification. Assume that the parents do not discuss financial matters with their son. The son learns that if his parents do not claim his sister, he may do so. The son does not know whether his parents will claim his sister as their qualifying child. If the son is a typical low-income taxpayer, he will file his return early in the filing season and await his refund. The parents, on the other hand, may obtain an automatic six-month extension of time to file their return. Thus, the Service may not know whether to apply the tie-breaker rule until long after the son has received his refund.

We believe the waiver rule within the FY2007 Budget also adds an undesirable level of complexity. The Tax Section has previously submitted recommendations regarding section 152(e) and waivers between parents. The 2005 Act implemented the Tax Section’s recommendations by amending section 152(e). The Service has placed section 152(e) on its 2005-2006 Priority Guidance Plan. The problems with section 152(e) illustrate the potential complications of implementing any waiver rule.

In addition, by burdening the waiver rule with the requirement that the non-parent have a higher AGI, the FY2007 Budget proposal would require the non-parent and the Service to determine the AGI of both the parents and the non-parent. While this determination is possible for the Service, it would delay the determination of eligibility. The parents’ AGI information is not, of course, available to the non-parent (and is subject to change upon audit). Reference to AGI returns the system to the old challenges of the “support” test, where taxpayers had to guess at who provided the majority of a child’s support.

Situation #1 illustrates why allowing waiver to a lower-AGI taxpayer may be inappropriate. However, there would seem to be few situations in which it would be inequitable to prohibit waiver to a higher-AGI taxpayer. The most likely would be where the child, parent and grandparent live together in a single household, and the grandparent works to support the parent and child. However, in this situation existing law may permit the grandparent to claim the child. Section 152(b)(1) provides that an individual who is the dependent of another individual shall be treated as having no dependents. If the parent were under age 19 (or under age 24 and a full-time student), the parent would be the grandparent’s qualifying child, and therefore would be treated as having no dependents. In that case, the grandparent could claim both the parent and the child. If the parent were not under age 19 (and if a full time student, were not under age 24), the parent would be the grandparent’s qualifying relative, and the same result would be obtained. This reduces the inequitable situations to those in which the parent is not a qualifying child, has income in excess of the exemption amount (or income sufficient to provide more than one-half of the parent’s own support), and has too little income to benefit from the EITC.

We recommend that Congress reject the proposals within the NTA commentary and within the FY2007 Budget. If Congress desires to address Situation #1, we recommend that section 152(c)(4)(A) be amended to incorporate the following parent-preference rule:

If a parent resides with his or her qualifying child for more than one-half of the year, a taxpayer who is not the child’s parent shall not be eligible to claim the child as a qualifying child. The foregoing rule shall not apply to a taxpayer who is not the child’s

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31 The First Periodic Update of the 2005-2006 Priority Guidance Plan (March 6, 2006) includes two guidance items (under “General Tax Issues”):


17. Proposed regulations under section 152 regarding the release of a claim for exemption for a child of divorced or separated parents.

32 At least “support” is measurable. AGI encompasses sources of income, such as non-qualified deferred compensation or pass-through income from partnerships and S corporations, which have no effect on household support.
parent, if the taxpayer is eligible to claim the child’s parent for the dependency exemption.

We believe our recommendation provides an appropriate trade-off between increased complexity and precision. Section 152(c)(4)(A)(i) provides a tie-breaker rule where an individual may be and is claimed as a qualifying child by two or more taxpayers, at least one of whom is a parent of the individual. The first sentence of our recommendation would eliminate the “claimed as” requirement, without substituting a new waiver requirement. In the applicable situation, each taxpayer’s eligibility to claim a qualifying child could be determined without reference to another taxpayer’s tax return information. We believe this sentence does not increase complexity.

Section 152(b)(1) prohibits an individual who is a dependent of another taxpayer from claiming any dependents. Although the second sentence of our recommendation increases complexity, it ensures that, in situations where section 152(b)(1) precludes a parent from claiming a qualifying child, a non-parent can claim the qualifying child.

Situation #2: Twin minor children reside with and are supported by the taxpayer who is not their parent or sibling. Each child qualifies as the other child’s qualifying child, although neither can claim the other as a dependent (a situation we will refer to as the “qualifying child paradox”). Because each twin is the qualifying child of the other, neither child can be the taxpayer’s qualifying relative.

In the “qualifying child paradox,” the perceived problem is that by definition two children who are the potential dependents of another taxpayer can, by definition, claim each other as a qualifying child, thereby precluding another taxpayer who cares for the children from claiming benefits that, as a matter of policy, should be claimed by the taxpayer.33

NTA Recommendation

The NTA commentary suggests that Situation #2 can be solved by adding the words “claimed as” to section 152(d)(1)(D), so that the term “qualifying relative” means an individual “who is not claimed as a qualifying child of such taxpayer or of any other taxpayer . . . .” The NTA commentary states, “this change would treat taxpayers as mature individuals who are able to structure their affairs rationally and decide among themselves who is the “right” person to claim various family status benefits.”

Administration Recommendation

The FY2007 Budget includes another proposal that would solve the qualifying child paradox. The proposal would specify that a taxpayer is not a qualifying child of another individual if the taxpayer is older than the other individual (unless the taxpayer is permanently and totally disabled, and the other individual is a younger sibling) (the “age-preference”).

Our Response and Recommendation

Situation #2 reflects a problem that the UDOC simply did not address—the qualifying child paradox. The pre-UDOC support test averted the problem by permitting only the taxpayer who provided more than one-half of the other’s support (or who by contract was considered as providing more than one-half of the support) to claim the dependency exemption (and, accordingly, the child tax credit). Most people would agree that the taxpayer providing support should receive the dependent deduction and credits.

33 The NAEA letter observes that if the twins lived with separate taxpayers, then neither twin would be the qualifying child of the other (so the qualifying child paradox would not apply), and each taxpayer could claim one twin as a dependent.

34 Pre-UDOC section 152(c) permitted taxpayers who collectively provided over one-half of the support of a dependent and individually provided more than 10% of the support to sign a multiple support agreement that awarded the benefit to one of the taxpayers. UDOC retained this provision, substantively unchanged, as section 152(d)(3).
Unfortunately, the change proposed by the NTA assumes that every member of a family will act as a mature, rational individual. This is often not the case. Further, as indicated in the 2001 NTA Report, the state court system is often an independent actor in these matters. Section 152(e) provides special rules permitting the custodial parent to release the dependency exemption to the non-custodial parent. According to the 2001 Annual Report, the courts of 35 states have held that they have legal authority to allocate the dependency exemption between spouses who are before them in a divorce or custody case, by requiring the custodial parent to release the dependency exemption under section 152(e). The 2001 NTA Report recommended that section 152(e) prohibit state courts from allocating the dependency exemption or from ordering taxpayers to relinquish the dependency exemption; this recommendation was not adopted in either the 2004 Act or the 2005 Act. The addition of the words “claimed as” to section 152(d)(1)(D) will only increase the opportunity for state court involvement.

Finally, the solution suggested in the NTA commentary raises the same problems of administration as the “waiver rule” proposed in the FY2007 Budget. Neither the taxpayer nor the Service can easily determine whether the taxpayer will qualify when qualification rests on the filing decisions of another individual (in this case, the twins).

The age-preference rule proposed within the FY2007 Budget can be easily applied by the taxpayer. In most cases it is also electronically verifiable by the Service. However, in the case of twins, the Service cannot electronically verify which child is older.

The age-preference rule is also totally arbitrary. In addition, the proposed exception for disabled siblings creates the same qualifying child paradox in the case of a disabled older child. There may be many situations in which the older child should be preferred over the younger child; however, when the older child is the younger child’s twin, the age-preference is difficult to justify.

We note that the qualifying child paradox occurs only when neither child provides more than one-half of his or her own support. We question whether, in such a case, either child should be treated as the other child’s qualifying child. Section 152 could be amended to provide that if two individuals fail to provide one-half of their own support, then neither will be the qualifying individual of the other. In this case, both individuals could be the “qualifying relative” of another taxpayer. Under the EITC, “qualifying child” is determined without regard to section 152(c)(1)(D). It would, therefore, be necessary to apply this new support rule to section 32(c)(3)(A). Another option is to take no action, recognizing that the taxpayer could resolve Situation #2 by obtaining legal custody of the twins. In either case, the solution to Situation #1 would then take over – assuming that a parental tie-breaker is instituted, the twins would each be the qualifying child of the taxpayer.

We recommend that Congress reject the proposals within the NTA commentary and within the FY2007 Budget, and we reiterate our recommendation that the UDOC not be changed to increase the use of “waivers” (by any name). If Congress desires to address Situation #2, we recommend that section 152(c) be amended to incorporate the following rule:

If two individuals may (but for this provision) be claimed as the qualifying child of each other, then neither individual may claim the other individual as a qualifying child.

This rule would preclude either twin from claiming the other, which would allow the taxpayer to claim both twins. Section 152(c) does not currently address the qualifying child paradox. This

\[36\] Although section 152(e) was amended by both the 2004 Act and 2005 Act, its general function remains unchanged.
\[37\] Discussed in Situation #1, *supra*, page 7.
\[38\] Section 32(c)(3)(A).
recommendation provides a precise method of addressing the situation. In addition, we recommend that regulations be issued clarifying the meaning of “eligible foster child,” as more fully discussed below.\footnote{See “Foster Child,” infra, pages 17-18}

\textit{Situation #3: Twin children attend college and share a residence. The twins are supported by several relatives who are not their parents or siblings. The twins cannot be claimed by each other or by any other taxpayer.}

Compared with Situation #2, note that there are two additional obstacles facing the twins (and the taxpayers supporting them). Because the twins do not live with another adult, they cannot be the qualifying children of anyone other than each other. Because no single taxpayer provides more than one-half of the twins’ support, the taxpayers must enter into a “multiple support agreement” under section 152(d)(3).

\textbf{NTA Recommendation}

The NTA commentary suggests that Situation #3 can be solved by adding the words “claimed as” to section 152(d)(1)(D), so that the term “qualifying relative” means an individual “who is not claimed as a qualifying child of such taxpayer or of any other taxpayer . . . .” This recommendation would allow either twin to claim the other, or would allow one of the contributing taxpayers to claim the twins (provided that they enter into a multiple support agreement).

\textbf{Administration Recommendation}

Situation #3 would also be solved by the age-preference proposal within the FY2007 Budget. This recommendation would allow the older twin to claim the younger twin, or would allow one of the contributing taxpayers to claim the twins (provided that they enter into a multiple support agreement).

\textbf{Our Response and Recommendation}

The assumption in the NTA commentary is that someone should be entitled to claim the twins – i.e., one of the taxpayers who contribute to their support. If this assumption is correct one must next ask who that someone should be – one of the twins, or one of the taxpayers contributing to their support. If the twins could waive their right to claim each other as a qualifying child, or if the qualifying relative rule applied if the twins are not “claimed as” qualifying children, then the twins could be claimed by one of the contributing taxpayers. An “age-preference” solution would allow the older twin to claim the younger, or (if not so claimed) would allow one of the contributing taxpayers to claim both twins. The support test would preclude either twin from claiming the other, but would allow one of the contributing taxpayers to claim both twins. The “custody” test would not allow anyone to claim either twin, as neither twin has a “custodian.”

We recommend that no change be made specifically to address Situation #3. However, we note that our recommendation in Situation #2 would resolve Situation #3, and would allow one of the contributing taxpayers to claim both twins.

\textit{Situation #4: A 20-year-old woman attends school full-time, has been named legal guardian for her younger brother, and supports herself and her brother. The woman can claim her brother as her dependent, but is ineligible to claim the EITC.}

This scenario is similar to Situation #3, except that section 152(c)(1)(D) will prevent the sister from being the brother’s qualifying child (because she provided over one-half of her own support), and consequently will permit the sister to claim her brother as her dependent but preclude the brother from claiming the sister as a dependent. However, under section 32(c)(3)(A), for purposes of the EITC “qualifying child” is determined without regard to section 152(c)(1)(D) – the “support of oneself” test.\footnote{Section 32(c)(3)(A).}
Therefore, as currently defined for purposes of the EITC, the sister and brother will be the qualifying child of each other (the qualifying child paradox), and the sister cannot claim the EITC with respect to her brother. This decoupling of the dependency exemption and EITC does, of course, increase complexity.

**NTA Recommendation**

Although this scenario was not specifically addressed by the NTA commentary, the “claimed as” proposal in the NTA commentary would allow the sister to claim the EITC with respect to her brother.

**Administration Recommendation**

The age-preference proposal within the FY2007 Budget would also address Situation #4, and would allow the sister to claim the EITC with respect to her brother.

**Our Response and Recommendation**

In the EITC, “qualifying child” plays two separate roles:

- If a taxpayer has a qualifying child, the taxpayer is eligible to claim the EITC (subject to the earned income limitations).\(^{42}\) In this role, section 32(c)(3)(A) allows a taxpayer to claim an individual who satisfies the relationship, age and abode tests, even if the individual provides more than one-half of his or her own support. It is unclear what policy is served by section 32(c)(3)(A) in this role. One could argue that a taxpayer should not be eligible to claim his or her child for the EITC if the child provides more than one-half of his or her own support.

- If an individual is the qualifying child of another taxpayer, the individual is ineligible to claim the EITC.\(^{43}\) In this role, section 32(c)(3)(A) precludes any individual who satisfies the relationship, age and abode tests from claiming the EITC. It is unclear what policy is served by section 32(c)(3)(A) in this role. One could argue that a young parent (under age 19, or a full-time student under age 24) who provides more than one-half of his or her own support should not be precluded from claiming the EITC, even if the parent’s own father or mother lives in the same home. It is in this role that section 32(c)(3)(A) applies to Situation #4.

Situation #4 could be addressed simply by deleting section 32(c)(3)(A). However, it is apparent that this change would apply to many other situations.

Either the “claimed as” proposal in the NTA commentary or the age-preference proposal in the FY2007 Budget would address Situation #4, with the problems described above. The age-preference could also create additional problems under facts similar to Situation #4. In Situation #4 (unlike in Situation #2 and Situation #3), one child actually supports the other. Suppose that an 18-year old woman is working full-time to support herself and her 20-year old brother, who is a college sophomore. The age-preference would prevent the brother from being the sister’s qualifying child.

Note another difference between Situation #4 and Situation #2. In Situation #4, the sister is the brother’s legal guardian. This suggests that, rather than rely upon the age-preference, one could use “legal custody” as an equivalent to the parent tie-breaker. As with age, legal custody can be definitively established.

We recommend that Congress reject the age-preference proposal within the FY2007 Budget. If Congress desires to address Situation #4, we recommend that our parent-preference proposal described in Situation #1 be adopted:

If a parent resides with his or her qualifying child for more than one-half of the year, a taxpayer who is not the child’s parent shall not be eligible to claim the child as a qualifying child. The foregoing rule shall not apply to a taxpayer who is not the child’s parent, if the taxpayer is eligible to claim the child’s parent for the dependency exemption.

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\(^{42}\) Section 32(c)(1)(A)(i).

\(^{43}\) Section 32(c)(1)(B).
In addition, we make the same recommendation that we made in Situation #2 – that regulations be issued defining “eligible foster child” in terms of legal custody. If the parent-preference proposal is adopted and the term “eligible foster child” includes legal custody, the brother will be a qualifying relative as the sister’s “eligible foster child”).\textsuperscript{44}

\textit{Situation #5: An Adult and her Minor Son Share a Household with Another Adult, who is the Sole Source of Income for the Household}

Under this scenario, the adult providing support can claim the other adult as a qualifying relative under section 152(d)(2)(H). The adult providing support cannot claim the other adult’s son as a qualifying relative, if the current law is interpreted to prevent the qualifying relative rules from applying if the son is a qualifying child of his parent, regardless of whether or not the son is “claimed by” his parent as a dependent.

The NAEA letter raises another issue, focusing on the son’s status as his parent’s qualifying child. It points out that section 152(d)(1)(D) only applies to an individual who is “a qualifying child of the taxpayer or of any other taxpayer.” If his parent – who has no income – is not a “taxpayer,” then her son is not her qualifying child, and the son can be the qualifying relative of the adult providing support.

\textbf{NTA Recommendation}

The NTA commentary observes that if the relationship between the two adults violates local law, then one could not be a qualifying relative of the other.\textsuperscript{45} However, Situation #5 applies to many relationships that clearly do not violate local law.

The NTA commentary further states that Situation #5 (as well as Situation #2) can be “solved” by adding the words “claimed as” to section 152(d)(1)(D). Because the parent would not claim her son, the adult providing support could claim the son as his qualifying relative.

\textbf{Administration Recommendation}

The same FY2007 Budget proposal that would address Situation #1 (the parent-preference with waiver) would address Situation #5 – the parent could waive to the adult providing support her right to claim her son, who would then be the other adult’s qualifying relative.

\textbf{Our Response and Recommendation}

With respect to the NAEA comment as to whether the current law might be interpreted to already avoid this problem, see our discussion below regarding the definitional issues of “taxpayer” and “person.”\textsuperscript{46}

With respect to the NTA observation regarding “violation of local law,” this rule creates substantial issues of its own (as discussed below).\textsuperscript{47}

For the reasons stated in our discussion of the preceding situations, we recommend that Congress reject any proposal offered to address Situation #5.

\textit{Situation #6: Nonresident Parent Provides Support for Minor Child Living with Grandparents}

This situation suggests that a biological father who provides for the support of his son, who happens to live with another biological relative – grandfather – can no longer claim the dependency

\textsuperscript{44} See “Foster Child,” infra, pages 17-18.
\textsuperscript{45} Section 152(f)(3).
\textsuperscript{46} See “Taxpayer or Person,” infra, page 16.
\textsuperscript{47} See “Violation of Local Law,” infra, pages 19-20.
exemption. This, it is suggested, happens because the son meets the definition of “qualifying child” as to the grandfather thereby preventing him from being a “qualifying relative” of his father.

**NTA Recommendation**

The NTA commentary proposes that Situation #6 be “solved” by adding the words “claimed as” to section 152(d)(1)(D).

**Administration Recommendation**

The FY2007 Budget does not address Situation #6.

**Our Response and Recommendation**

We believe that this scenario is not a “problem” to be solved. In fact, this is an example of the simplification provided by the UDOC. The UDOC has provided clarity and certainty for the grandparents and the father, as well as for the Service. All of the qualifying child requirements can be easily tested and, for the most part, easily proven.

We recommend that Congress reject any proposal offered to address Situation #6.

**Situation #7: Separated Custodial Parent Receives Public Assistance for Household**

This example illustrates a problem identified in the 2001 NTA report and which we believe illustrates the need for further simplification. The Code denies the EITC to a taxpayer whose filing status is “married filing separately.” Section 7703(b), which in certain circumstances permits a married taxpayer to file as “head of household” (and thus to claim the EITC without filing a joint return) requires the taxpayer to provide more than one-half of the “cost of maintaining a home.”

**NTA Recommendation**

As the NTA commentary observes, the UDOC allows the custodial parent to receive an additional tax benefit (the dependency exemption) unavailable under prior law. However, the “cost of maintaining the household” test of section 7703(b) denies the custodial parent the benefit of head-of-household status and the EITC.

The 2001 NTA Report recommended elimination of the “cost of maintaining the household” test of section 7703(b) with regard to a qualifying child.

Married persons are required to file jointly to enjoy many of the benefits available under the Code. The Code should continue to limit the ability of married persons to avoid this requirement by filing as “single” or “head of household.” However, the UDOC explicitly recognized and addressed the problems inherent in any “support” test. The “cost of maintaining the household” test of section 7703(b) is now the sole vestige of the “support” test relating to qualifying children.

**Administration Recommendation**

The FY2007 Budget proposal would eliminate the “cost of maintaining the household test” in section 7703(b).

**Our Response and Recommendation**

We recommend that Congress eliminate the “cost of maintaining the household” test in section 7703(b). Its elimination would result in much-needed simplification in the head of household filing status and EITC benefits areas.

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48 Section 32(d).
Situation #8: Taxpayer Supports Minor Child of Deceased Wife’s Sister, who Lives with Deceased Wife’s Brother

Although the UDOC includes “brother-in-law” and “sister-in-law” as qualifying relationships,\(^{49}\) it does not include the descendants of a brother-in-law or sister-in-law. This example illustrates problems or ambiguities with the relationship tests that lead to unexpected results.

NTA Recommendation

None

Administration Recommendation

None

Our Recommendation

The UDOC includes a number of familial relationships. Many of these have commonly understood (although perhaps legally imprecise) meanings, such as “stepson” or “mother-in-law.” Others, like “brother-in-law,” can have a number of meanings. The UDOC does not include the terms “aunt,” “uncle,” “niece” or “nephew,” instead referring, e.g., to a descendant of a brother or sister (for a “qualifying child”), or to a son or daughter of a brother or sister (for a “qualifying relative”).\(^{50}\) Neither of these terms describes the descendant of a spouse’s sister, although it is a common experience for a child’s parents to name the child’s aunt and uncle, jointly, as the child’s guardian in the event the child is orphaned.

Treas. Reg. § 1.152-2(d) currently provides that a relationship of affinity once existing will not terminate by divorce or the death of a spouse. It then gives as an example the widower who may continue to claim his deceased wife’s father (his father-in-law) as a dependent. Treas. Reg. § 1.152-2(d) also provides that, in the case of a joint return, it is not necessary that the prescribed relationship exist between the person claimed as a dependent and the spouse who furnishes the support. It then gives as an example the husband and wife making a joint return who may claim as a dependent a daughter of the wife’s brother (the wife’s niece) even though the husband furnishes the chief support. Under the UDOC, the taxpayer’s furnishing of support is generally not relevant. However, this regulation may indirectly address Situation #8.

We recommend that Treas. Reg. § 1.152-2(d) be conformed to the UDOC, but that it retain the rule that a relationship of affinity once existing will not terminate by divorce or the death of a spouse. We further recommend clarification of the circumstances in which affinity through a taxpayer’s spouse will create a relationship (e.g., niece or nephew) with the taxpayer. Specifically, we recommend that once a taxpayer and the taxpayer’s spouse have claimed a descendant of the spouse’s brother or sister (the spouse’s niece or nephew) on a joint return, the divorce or death of the taxpayer’s spouse will not preclude the taxpayer from claiming the niece or nephew on the taxpayer’s return.

Additional Problems and Our Recommendations

The foregoing situations illustrate many – but not all – of the “problems” under the UDOC. Some of these problems require a more in-depth discussion.

\(^{49}\) Section 152(d)(2)(G).

\(^{50}\) However, the IRS uses the terms “niece” and “nephew” in connection with the UDOC. See, e.g., IRS Form 8867, Paid Preparer’s Earned Income Credit Checklist (Rev. 11/2002) (“A niece or nephew is also considered a descendant of the taxpayer”); Schedule EIC (Rev. 2005), line 5 (giving “niece” and “nephew” as examples of qualifying relationships); IRS Pub. No. 596, Earned Income Credit (Rev. 2005) at 14 (also giving “niece” and “nephew” as examples of qualifying relationships).
Section 152(d)(1)(D) states that a qualifying relative cannot be the qualifying child of the taxpayer or any other taxpayer. As indicated in Situation #5, “taxpayer” is not synonymous with “person.” The 2001 NTA Report makes the same observation. “. . . Internal Revenue Code sections pertaining to the family status provisions utilize the terms “individual” and “taxpayer” interchangeably. Congress may want to consider conforming these terms in future tax law.” For purposes of UDOC, “individual” and “person” are interchangeable. But are “individual” and “taxpayer” truly interchangeable?

One interpretation of “taxpayer” would be “any person having a return filing requirement.” Section 6011(a) generally imposes a filing requirement on any person made liable for any tax imposed by the Code. Sections 6012(a)(1) and 6012(a)(8) set forth specific filing requirements for income tax returns filed by individuals. Although there are numerous exceptions, as a general matter an unmarried individual does not have a filing requirement if the individual has gross income less than the exemption amount under section 151(d). Under this interpretation, an unmarried individual having gross income less than the exemption amount is not a “taxpayer.”

Section 7701(a)(14) states “[t]he term ‘taxpayer’ means any person subject to any internal revenue tax.” “Subject to any internal revenue tax” is not defined; however, it appears to be synonymous with “upon whom any internal revenue tax is imposed.” Section 1 imposes income tax only upon “taxable income.” Therefore, another interpretation of “taxpayer,” at least for purposes of the federal income tax, would be “any person having taxable income.” Section 63(a) defines “taxable income” as “gross income minus the deductions allowed . . . .” Under this interpretation, an individual having no gross income is not a “taxpayer.”

As the NAEA letter notes, the Service treats the two terms interchangeably. For example, IRS Publication 501 states, “The person cannot be your qualifying child or the qualifying child of anyone else.” IRS Publication 596 states that in order to qualify for the EITC, the taxpayer cannot be the qualifying child of another “person” (again, section 32(c)(1)(B) states that the taxpayer cannot be the qualifying child of another “taxpayer”).

The need for simplification indicates that the reference to “taxpayer” under section 152(d)(1)(D) should be interpreted as “individual.” Any other use of “taxpayer” would require its own set of definitions; any such definitions would require an investigation into the gross income (and perhaps the deductions) of another individual.

We recommend that the regulations define “taxpayer” to mean “individual” for purposes of section 152(d)(1)(D). We further recommend that Congress consider the 2001 NTA Report’s recommendation that the terms “individual” and “taxpayer” be conformed throughout the family status provisions.

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51 Subsections (a), (b), (c), (d) and (e) of section 1 each begin “[t]here is hereby imposed on the taxable income of . . . .”
52 IRS Pub. No. 501, Exemptions, Standard Deduction, and Filing Information (Rev. 2005), at 10, Table 5, “Tests to be a Qualifying Relative.” Publication 501 also states, “A child is not your qualifying relative if the child is your qualifying child or the qualifying child of anyone else.” *Id.* at 13.
53 IRS Pub. No. 596, *supra* note 50, at 20 & 22. Publication 596 also states that, if a taxpayer does not have a qualifying child, the taxpayer cannot be the dependent of another “person” (section 32(c)(1)(A)(ii)(II) states that the taxpayer cannot be “a dependent for whom a deduction is allowable to another taxpayer”). *Id.* at 21. See also Instructions to Form 1040, U.S. Individual Income Tax Return (Rev. 2005), at 20 (stating that a qualifying relative is someone “who was not [a] qualifying child . . . of any person for 2005”). That same page also makes reference to a “taxpayer” in providing instructions for identifying a “qualifying child” for the “qualifying relative” determination.
Child

We recommend that the regulations provide the definition of a child. Treas. Reg. § 1.151-3(a) currently provides that for purposes of section 152, the term “child” means a son, stepson, daughter, stepdaughter, adopted son, adopted daughter, or (under certain circumstances) a foster child or child placed for legal adoption.

We recommend that the regulations update the definition of child to conform to the UDOC. In addition, we recommend that the regulations address the meanings of “son,” “daughter,” “stepson” and “stepdaughter.” A birth certificate will usually specify a child’s mother and father. However, the father of a child born out-of-wedlock may not be identified on the child’s birth certificate – even if both the father and mother have acknowledged the child’s paternity. State law may limit an unmarried father’s ability to legally establish paternity in the absence of the mother’s consent. We recommend that the regulations specify the conditions under which a child will be treated as the “son” or “daughter” of a parent who is not identified as the child’s parent on the child’s birth certificate.

Foster Child

We recommend that the regulations also address the treatment of a foster child. Under prior law, for purposes of the EITC and CTC, an “eligible foster child” was a child the taxpayer cared for as his or her own child, who lived with the taxpayer for the entire year, and who was the taxpayer’s brother/stepbrother or sister/stepsister (or the descendant of any of them), was a stepchild, or was placed by an authorized placement agency. The 2001 NTA Report recommended conformation of the definition of “foster child,” and expansion to include a child placed in the home under a state court decree (including an order of temporary custody), or whose caretaker is recognized as the custodian (in a generic sense) of the child by a public agency providing benefits based (after investigation) upon the custodial relationship. The UDOC partially implemented the recommendations in the 2001 NTA Report by conforming the definition of “foster child” and by including a child placed with the taxpayer by judgment, decree or other order.

The UDOC does not adequately define “placed with the taxpayer.” Note that “placed with the taxpayer,” as used in section 152(f)(1)(C), may not be interchangeable with “placed in the home” (as used in the 2001 NTA Report). “Placed with the taxpayer” emphasizes the legal relationship, rather than the “lived with the taxpayer” requirement of prior law.

We note that “custody” has different meanings in different states, and under different circumstances even in the same state. For example, custody is commonly awarded to parents jointly, and often varies as the needs of the child or parents change. In addition, courts may award sole physical custody to one parent but joint legal custody to both parents, or joint legal and physical custody. A teenage child may choose to reside with the parent who has neither legal custody nor the legal right to physical custody.

Where neither parent has custody (for example, where the child has been orphaned), the child may have a “guardian of the property” (possibly a bank or trust company), another “guardian of the person” (perhaps a grandparent), and yet reside with another person (perhaps an aunt or uncle with minor children).

We recommend that the regulations clarify whether a “legal guardian” (as in Situation #4) or “legal custodian” has the required relationship. Providing that a legal guardian has the required relationship would insure that a ward, even if not resident in the guardian’s own home, would satisfy the relationship test as the guardian’s qualifying relative.

As an additional concern, many states terminate a foster child’s placement upon the child reaching the age of majority. Section 152 gives no indication of when a foster child’s status should terminate. We recommend that regulations clarify when a foster child’s status will terminate. As discussed above, Treas. Reg. § 1.152-2(d) currently provides that a relationship of affinity once existing
will not terminate by divorce or the death of a spouse. We recommend that a similar rule provide that reaching the age of majority will not terminate a child’s status as a foster child. We also recommend that regulations address the termination of a placement for reasons other than the child’s age, although we acknowledge that different results may be indicated in different situations (e.g., the adoption of a child should terminate the child’s status as an eligible foster child).

Treas. Reg. § 1.152-2(c)(4) currently provides a definition of “foster child,” and states that the foster child will be treated as a child by blood. Much of this regulation is inconsistent with sections 152(f)(1)(A)(ii) and 152(f)(1)(C). Most of Treas. Reg. § 1.152-2(c)(4) is no longer required, and much of it is inappropriate. However, we recommend that any new regulations retain the rule that a foster child will be treated as a child by blood. Such a provision would, for example, allow the foster child of a taxpayer’s daughter to be treated as the taxpayer’s descendant. We recognize that section 152(f)(1)(C) does not provide that a foster-child will be treated as a child by blood, although section 152(f)(1)(B) provides that an adopted child will be treated as a child by blood. A legislative change may, therefore, be required to address the proper treatment of a foster child.

In-Laws

We recommend that the regulations clarify the meaning of “in-laws” – particularly brother- and sister-in-law. For example, most dictionaries define brother-in-law as (i) the brother of one’s spouse, (ii) the husband of one’s sister, and (iii) the husband of one’s spouse’s sister.54 Under this third definition, the husband of a taxpayer’s spouse’s sister will have the relationship described in section 152(d)(2)(E), although the child of a taxpayer’s spouse’s sister (the taxpayer’s niece or nephew) will not. There does not appear to be a “right” way to define “brother-in-law.”

We recommend that the regulations address which of the possible definitions apply. As stated above, the current regulations provide that a spouse’s death or divorce will not terminate a relationship of affinity. We recommend that the regulations address whether and how the “no termination” rule applies to in-laws.

Audit Issues and Proof of Eligibility

As stated above, the UDOC has met its goal of simplifying the burden on most taxpayers in determining whether they qualify for the family status provisions. Another important goal of simplification is to simplify the audit process. The Service should be able to determine whether (and which) taxpayers are entitled to claim a child – preferably without correspondence, and without the need for “tie-breakers.” The NTA’s 2002 Report to Congress (“2002 NTA Report”) identified “EITC Eligibility Determinations” as one of the most serious problems facing taxpayers.55 Each of the three basic requirements for eligibility – age, relationship, and principal place of abode – should be evaluated on this basis.

According to the 2002 NTA Report, the Service has access to Social Security Administration information that includes: (i) taxpayer name, (ii) date and place of birth, (iii) other names used, (iv) citizenship information, (v) legal alien – authorized to work, (vi) legal alien – not authorized to work, (vii) disability status, (viii) date of death, and (ix) names of biological parents including mother’s maiden name.56 The 2002 NTA Report indicated that, beginning in 2003, the Service would stop requesting taxpayers to furnish birth certificates of their children, including adopted children, to prove relationship.57 However,

56 Id. at 49.
57 Id.
examiners would still request birth certificates to verify biological grandparent and other familial relationships.

Age

The easiest requirement for the Service to resolve is age. Based upon the Service’s access to Social Security Administration Information, it should be unnecessary for the Service to request evidence of a child’s age.

Relationship

The relationship between the taxpayer and the qualifying child or qualifying relative is generally obvious. However, relationships can be difficult to prove to a revenue agent. We recommend that the Service’s publications, forms and instructions use terms consistent with statutory language. We further recommend that the regulations clarify certain terms, such as “brother-in-law” and “foster child.” We recommend that the Service’s verification procedures acknowledge that, except in the case of a parent, the taxpayer seldom has access to the legal documents (marriage license or birth certificate) necessary to establish status. In many states, these documents are protected by privacy laws and cannot be accessed by the general public.

According to the 2002 NTA Report, the Service does not use Social Security Administration information to verify biological relationships other than parent-child. If the Service has access to this information, we recommend that the Service use this information, both to facilitate detection of erroneously reported relationships, and to obviate the need to prove correctly reported relationships.

The Service tracks taxpayers’ marital status from year to year. It identifies changes from married status to single or head-of-household. The Service could also track taxpayers’ familial relationships from year to year, and we recommend that it consider doing so. A taxpayer’s “child” generally remains his or her child. Under Treas. Reg. § 1.152-2(d), a taxpayer’s in-laws, stepsiblings and stepchildren also generally retain their relationship, even following a spouse’s divorce or death. Once the Service has associated a child with a taxpayer, this identification might be retained in the Service’s master file. Thereafter, the Service could quickly confirm (or challenge) many other relationships, including grandchildren, brothers, sisters, and descendants of brothers and sisters. Even without retaining this information, it is apparent that the Service could use Social Security Administration records to confirm blood relationships, and we recommend that it do so.

Violation of Local Law

Section 152(f)(3) provides, “An individual shall not be treated as a member of the taxpayer’s household if at any time during the taxable year of the taxpayer the relationship between such individual and the taxpayer is in violation of local law.” This limitation was added to the Code in 1958, and codified a Tax Court decision of the previous year. Since enactment, section 152(f)(3) has forced federal courts to consider matters of an unfortunately personal nature, including whether a couple had engaged in “habitual sexual conduct.” More unfortunate is that the Service’s “presumption of correctness” bestows

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58 See “In-Laws” and Foster Child,” supra, pages 17-18.
59 Id.
62 See, e.g., Nicholas v. Commissioner, TC Memo 1991-393, 62 T.C.M. (CCH) 467, T.C.M. (RIA) ¶ 91,393 (taxpayer admitted he cohabited and had sexual relations during the tax year); In re Shackelford, 45 A.F.T.R. 2d 80-1074, 80-1 U.S.T.C. ¶ 9275 (Bankr. W.D. Mo.) (answering in the negative whether
upon couples the impossible task of proving that they have not engaged in sexual conduct.\textsuperscript{63} The Fourth
Circuit has held that the Tax Court may not consider the constitutionality of local law, “in the absence of
any authoritative declaration of its invalidity.”\textsuperscript{64}

We recommend that, in recognition of the difficulty posed by determinations of a relationship’s
illegality, the regulations provide that a taxpayer’s relationship with another individual will be in violation
of local law only if a violation has been found by a court of local jurisdiction (e.g., criminal court or
family court).

Principal Place of Abode

“Place of abode” may have replaced “support” as the most difficult audit issue for both the
Service and the taxpayer. For the Service, there are few means to independently confirm place of abode.
However, the Service does not appear to use even these few means. Families claiming the earned income
tax credit are often receiving other public assistance. Common forms of public assistance include federal
benefits, such as supplemental security income (“SSI”), state benefits, such as food stamps, temporary aid
to needy families (“TANF”) and Medicaid, and local benefits such as subsidized housing assistance.
These programs generally require much of the same information requested at audit by the Service. The
Service should request access to SSI information, and should consider entering into compacts to obtain
information from state and local sources. We recommend that the Service exploit these sources of
information, both to confirm place of abode, and to detect fraud.

The Service implemented residency certification tests during 2004, 2005 and 2006. These tests
required the use of Form 8836, Qualifying Child Residency Statement, which identifies many forms of
documentation acceptable for proving that the taxpayer has satisfied the principal place of abode test.
However, in examinations, the Service continues to limit the documentation acceptable for proving place
of abode.\textsuperscript{65}

Although taxpayers often have records establishing their own place of abode (leases, utility bills,
bank statements, copies of income tax returns), and may even retain these, records of a child’s place of
abode are rarely present. Those records currently suggested by the Service – school records, medical
records, child care provider records, and copies of leases, often lack the necessary information. Although
physicians and schools may maintain current address records, they have no need to keep historic address
information; with electronic records generally replacing paper, such information may be non-existent.
Leases often indicate only the number of children, and not their names or ages.

\textit{State v. Bess}, 20 Mo. 420 (1855), and in \textit{dicta} finding section 152(f)(3) discriminatory.
\textsuperscript{63} See, \textit{e.g.}, \textit{Ensminger v. Commissioner}, TC Memo 1977–224, 36 T.C.M. (CCH) 934, T.C.M. (P-H) ¶ 77,224 aff’d, 610 F.2d 189, 45 A.F.T.R.2d 80-373, 79-2 U.S.T.C. ¶ 9734 (4\textsuperscript{th} Cir. 1979) (where the record lacked evidence pertaining to habitual sexual intercourse, the taxpayer failed to carry his burden of proof); \textit{Peacock v. Commissioner}, TC Memo 1978-30, 37 T.C.M. (CCH) 177, T.C.M. (P-H) ¶ 78,030 (taxpayer failed to show that his relationship was not open and notorious cohabitation).
\textsuperscript{64} \textit{Ensminger}, 610 F.2d 189, 191.
\textsuperscript{65} See, \textit{e.g.}, Internal Revenue Manual (“IRM”), § 4.13.7-6 (rev. 02-01-2003) (¶ B.3. – for head-of-household, provide school records, driver’s license and medical bills); IRM sec. 4.19.1.5.3.6 (rev. 10-01-2001) (school records, lease (if children are listed on document), statement from child care provider, or statement from health care provider). The Service provides taxpayers with Form 886-H, requesting
school records or administrative statement from a school official, statement from a child care provider, medical records or administrative statement from a health care provider.
A major reason that public assistance programs can provide accurate information is that they are requesting it on a current basis, while the Service requests information from one or more years in the past. Obviously, current records are easier to obtain.

We recommend that the Service make greater and more consistent efforts to advise taxpayers of the documentation required to establish place of abode. We recommend that IRS Publication 596 and the Instructions to Schedule EIC be revised to identify all acceptable documentation for establishing place of abode, consistent with Form 8836.

**Structural Complexity**

We also note that the complexity inherent in the tax benefits for taxpayers with children also results from the sheer number of benefits.

We recommend that in future tax simplification discussions, consideration be given to consolidation of related tax provisions. The NTA’s 2005 Report to Congress makes a similar recommendation, which should be considered in future simplification discussions.\(^{66}\)

The General Explanations of the Administration’s Fiscal Year 2007 Revenue Proposal (Dep’t of Treasury, February 2006), provides several proposals relating to the UDOC (under “Simplify the Tax Laws for Families”), effective for tax years beginning after December 31, 2006. The proposals relating to the UDOC are:

**Definition of Qualifying Child.** The proposal would stipulate that a taxpayer is not a qualifying child of another individual if the taxpayer is older than that individual. However, an individual could be a qualifying child of a younger sibling if that individual is permanently and totally disabled. In addition, an individual who is married and files a joint return (unless that return is filed only as a claim for a refund) would not be considered a qualifying child for the child-related tax benefits, including the child tax credit.67

**Eligibility of Taxpayer for Child-Related Tax Benefits.** If a parent resides with his or her child for over one-half the year, only the parent would be eligible to claim the child as a qualifying child. However, the parent could waive the child-related tax benefits to another member of the household who has higher AGI and is otherwise eligible for the child tax benefits. In addition, dependent filers would not be eligible for child-related tax benefits.68

**Allow separated spouses to claim EITC.** Married taxpayers who file separate returns would be allowed to claim the EITC if they live with a qualifying child for over half the year. They must also live apart from their spouse for the last six months of the tax year. However, they would not be required to provide over one-half the cost of maintaining the household in which they reside.69

**Simplify rules regarding presence of qualifying child.** A taxpayer with a qualifying child who lives in an extended family would be eligible to claim the EITC for workers without children even if another member of the family claims the taxpayer’s qualifying child. However, if unmarried parents reside together with their child, then one parent can claim the EITC for qualifying children, but neither can claim the EITC for workers without children.

Taxpayers would be eligible to receive the EITC for workers without children if their child does not have a valid social security number. As under current law, the taxpayer (and spouse, if married) must have a valid social security number.70

**Clarify When a Social Security Number is Valid for EITC Purposes.** To qualify for the EITC, a taxpayer (including his or her spouse, if married) 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).17 The Treasury Department and the IRS will develop an outreach strategy to ensure that taxpayers, including those whose immigration and work status has changed since they received social security numbers, are aware of the new requirements.71

17Taxpayers who initially received a social security number for non-work reasons, but who subsequently became authorized to work in the United States (i.e., they became permanent residents or citizens), would be eligible to receive the EITC. [footnote in original]
APPENDIX B
Examples of Unintended Winners and Losers

Situation #1: High-income parents share a household with their low-income adult son and no-income minor daughter. The son claims his sister as his dependent, and also claims the CTC and EITC

The following scenario appears in the NAEA letter and in the WSJ article. A couple with two children living at home – a 14-year-old daughter and a 22-year-old son – files a joint return with adjusted gross income of $400,000. At that income level, the couple could claim their daughter as their dependent, but would receive no tax benefit. The son is not a full-time student, and his only income is $15,000 of wages. Under section 152(c)(1), the daughter is her brother’s qualifying child, so if the couple does not claim their daughter as their dependent, her brother may claim her as his dependent and thus could claim the CTC as well as the EITC.

Under prior law, the support test under section 152(a) would have prohibited the son from claiming his sister as his dependent.

Situation #2: Twin minor children reside with and are supported by the taxpayer who is not their parent or sibling. Each child qualifies as the other child’s qualifying child, although neither can claim the other as a dependent (a situation we will refer to as the “qualifying child paradox”). Because each twin is the qualifying child of the other, neither child can be the taxpayer’s qualifying relative

The NAEA letter provides the following scenario. Teenage twins live with their adult cousin, who provides all of their support. Their parents are deceased. The twins do not provide more than one-half of their own support. Each twin is the qualifying child of the other; therefore neither is the cousin’s qualifying relative. Assuming that each is able to claim the other as a dependent, then each is the dependent of another taxpayer, and neither is eligible to claim the other as a dependent. The NTA commentary provides a variation of this scenario, substituting an adult neighbor for the cousin. The analysis is the same.

Situation #3: Twin children attend college and share a residence. The twins are supported by several relatives who are not their parents or siblings. The twins cannot be claimed by each other or by any other taxpayer

The NAEA letter provides another scenario, expanding upon Situation #2. Twin nineteen-year old brothers live together in their home and attend school full-time. Their parents are deceased. The brothers do not provide more than one-half of their own support. Their principal support comes from their five aunts and uncles (who do not live with the brothers). Each brother is the qualifying child of the other. Assuming that each is able to claim the other as a dependent, then each is the dependent of another taxpayer, and neither is eligible to claim the other as a dependent.

Situation #4: A 20-year-old woman attends school full-time, has been named legal guardian for her younger sibling, and supports herself and her sibling. The woman can claim her sibling as her dependent, but is ineligible to claim the EITC

The WSJ article and the Treasury Blue Book provide the following scenario. A 20-year old woman attends school full-time, works at a minimum-wage job, and is the legal guardian of her 15-year

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72 Section 152(d)(1)(D).
73 Section 152(b)(1).
74 Section 152(b)(1).
75 Section 152(d)(1)(D).
old brother. This scenario is similar to Situation #3, except that section 152(c)(1)(D) will prevent the sister from being the brother’s qualifying child (because she provided over one-half of her own support), and consequently will permit the sister to claim her brother as her dependent. However, for purposes of the EITC “qualifying child” is determined without regard to section 152(c)(1)(D). Therefore, for purposes of the EITC, the sister and brother will be the qualifying child of each other, and the sister will be ineligible for the EITC.

Situation #5: An Adult and her Minor Child Share a Household with Another Adult, who is the Sole Source of Income for the Household

The NAEA letter and NTA commentary each provide the following scenario. A boyfriend (age 30) lives with and completely supports his girlfriend (age 28) and her son (age 5). The boyfriend can claim the girlfriend as a qualifying relative under section 152(d)(2)(H) as a member of the boyfriend’s household. The boyfriend cannot claim the girlfriend’s son as a qualifying relative, because the son is a qualifying child of the girlfriend.

Situation #6: Nonresident Parent Provides Support for Minor Child Living with Grandparents

The NTA commentary provides the following scenario. A six-year-old boy lives with his grandparents, who are married and have $12,000 of pension income for the year. During the year, the boy’s father sent payments totaling $25,000 for the boy’s support. The boy is the qualifying child of the grandparents. Although the father provided more than one-half of his son’s support, he cannot claim his son as a qualifying child, because they did not have the same principal place of abode. The father cannot claim his son as a qualifying relative, because the son is a qualifying child of someone else. One can change the facts so that the grandparents have $40,000 of pension income, and the father sends $40,000 to support the child (and to pay for private school and summer camp).

Situation #7: Separated Parent Receives Public Assistance for Household

The NTA commentary provides the following scenario. A mother who lived separate from her spouse for two years is raising their three young children on her own. She earns $7,500 a year as part of her state’s welfare-to-work program. She also receives food stamps, section 8 housing benefits, and state fuel assistance, and her children receive Medicaid benefits. Under the old law, she could not claim the dependency exemption or head-of-household status because the government provided more than one-half the cost of supporting her children; she also could not claim head-of-household status because she was considered married under section 7703. Under UDOC, she can claim the dependency exemption. However, she still does not meet the “not married” test of section 7703(b) because she does not provide more than one-half the cost of maintaining the household. Because she must file married filing separately, she is ineligible for the EITC.

Situation #8: Taxpayer Supports Minor Child of Deceased Wife’s Sister, who Lives with Deceased Wife’s Brother

In this situation, an orphaned child lives with her mother’s brother (her “uncle”), but is supported by her mother’s sister and the sister’s husband (the child’s “aunt” and “uncle”). Upon the aunt’s death, the aunt’s husband continues to support the child. Under the UDOC, the child is neither a qualifying child nor a qualifying relative of her deceased aunt’s husband, because she does not pass either relationship test.

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76 Section 32(c)(3)(A).
77 Section 7703(b)(2).
78 Section 32(d).