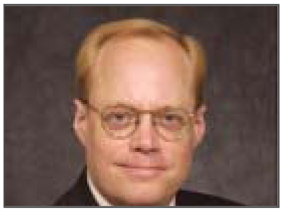
Forbes



Robert W. Wood
THE TAX LAWYER

Jan. 28 2011 — 8:43 am

Kids Spawn (Limited) Tax Benefits

You may remember the 1950 movie, "Cheaper by the Dozen" or the 2003 Steve Martin remake, and maybe some of it is even true. But for parents, kids are expensive, ***very*** expensive. They are worth it we hasten to add, but still.... The cost of raising a child up through age 17 has reputedly grown to $222,360.

As a parent and tax lawyer, I can't say I've ever thought that kids bring tax benefits, but the IRS just listed some. Here are tax tips to mollify you about the outsize cost:

Dependency Exemptions. In most cases, you can claim your child as a dependent in the year of his birth even if born in December! For 2010, it's $3,650 per qualifying child. That includes a child or stepchild, foster child, sibling or step-sibling, or descendants of any of these, such as your grandchild. The child must live with you more than half the year and be under 19 at the end of 2010, or under 24 and a full-time student.

You no longer have to show you provide more than half of the child's support, as was previously required. (However, the child can't provide more than half of his or her *own* support.) Even the phase-outs for high income taxpayers have been eliminated for 2010. That means you no longer lose part of your deduction for personal exemptions (as well as itemized deductions), regardless of the size of your adjusted gross income. But if you pay Alternative Minimum Tax (AMT), you cannot deduct personal or dependent exemptions. See IRS Publication 501, Exemptions, Standard Deduction, and Filing Information.

Child Tax Credit. You may be able to take this credit (up to $1,000) for each of your children under age 17. But if your adjusted gross income is too high ($110,000 or more on a joint return), your credit is reduced or eliminated. See IRS Publication 972, Child Tax Credit.

Child and Dependent Care Credit. You may be able to claim this credit if you pay someone to care for your child under age 13 so you can work or look for work. Expenses for a child in nursery school, pre-school, or similar programs for children below kindergarten generally qualify for the credit. However, expenses to attend kindergarten or a higher grade do not. The IRS has a list of the Top Ten Facts about this credit. See IRS Publication 503, Child and Dependent Care Expenses.

Adoption Credit. You may be able to take a tax credit for qualifying expenses paid to adopt a child. If you claim the adoption credit you must file a paper tax return, not electronic, because adoption-related documentation must be included. (Hey, since I still like paper filing, the ability to file a paper return might be an additional reason to adopt!) The recent health care bill increased this credit from $12,170 to $13,170 for adoptions occurring after January 2010. See the instructions for IRS Form 8839, Qualified Adoption Expenses.

Children With Investment Income. Be careful if your children have income ***earned*** from working—they may be required to file their own tax return. Under certain circumstances a child's ***investment*** income is taxed at the parent's tax rate. While this "Kiddie Tax" once affected only children under age 14, it can now be imposed on the investment income of children up to age 23 in some cases. See IRS Publication 929, Tax Rules for Children and Dependents.

Higher Education Credits. The American Opportunity and the Lifetime Learning Credit are education credits of $2,500 and $2,000, respectively. Only one of the two credits is available even if you or your children qualify for both. See chapter 2 of Publication 970, Tax Benefits for Education.

Student Loan Interest. You may be able to deduct interest paid on a qualified student loan. The deduction is claimed as an adjustment to income so you do not need to itemize. For tax year 2010, the maximum benefit is a reduction in income subject to tax of up to $2,500, but phase outs begin at $75,000 ($150,000 if filing a joint return). See IRS Publication 970.

Self-employed Health Insurance. If you were self-employed and paid for health insurance, you may be able to deduct premiums on insurance for your kids too. The coverage must be after March 29, 2010, and your children must be under age 27 at the end of 2010, but a child can qualify even if the child was not your dependent. See IRS Publication 502.

Clearly, kids are no tax shelter. Still, at tax filing time, remember that your children may provide tax benefits beyond their love and devotion.

Robert W. Wood practices law with Wood & Porter, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009, Tax Institute), he can be reached at wood@woodporter.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.