

Financial Issues Regarding Senate Bill 23 and Divorced Families

Non custodial parents¹ **under current law** are already financially burdened.

- Non custodial parents cannot deduct child support; they pay full taxes on the child support provided to the custodial parent
- Non custodial parents cannot file as Head of Household²
- Non custodial parents cannot take the Earned Income Credit³
- Non custodial parents cannot take the Child and Dependent Care Tax Credit⁴
- Non custodial parents cannot use Section 125 Day Care Flex Spending accounts⁵
- Non custodial parents have to pay all of the expenses of raising the children in their own home, which is at least 50% of the amount required to raise the children in the custodial home⁶
- A non custodial parent who makes twice the gross income of a custodial parent pays 78% of the expenses of raising the child in both homes⁷
- Child support obligations are calculated using gross income and most non custodial parents make a higher gross income than the custodial parent, but they often have **disposable** incomes lower than the custodial parent after taxes, child support and other state mandated child related expenses are deducted⁸
- Non custodial parents are required to pay 50% of the custodial parent's day care costs, but are not allowed to deduct any costs of day care for tax purposes

- Custodial parents do not pay taxes on child support, it is tax free income
- Custodial parents can file as Head of Household even if they do not claim any child as a dependant
- Custodial parents can take the Earned Income Credit even if they do not claim any child as a dependant
- Custodial parents can take the Child and Dependent Care Tax Credit even if they do not claim any child as a dependant
- Custodial parents can use the Section 125 Day Care Flex Spending accounts even if they do not claim any child as a dependant
- Most custodial parents make a lower gross wage than the non custodial parent, but after tax credits, child support receipts and other state mandated child related reimbursements, often have disposable incomes higher than the non custodial parent
- Custodial parents receiving Child and Dependent Care Tax Credit are reimbursed for up to 35% of day care costs in addition to the 50% paid for by the non custodial parent, leaving them with as little as 15% of their day care costs⁹

Senate Bill 23 increases the burden for non custodial families beyond what is listed above by increasing child support obligations and child care costs. It also has the potential to reduce or eliminate the only tax breaks they are eligible to receive (the dependent exemption and child tax credit).

¹ For purposes of this document, and for simplicity, divorced parents are defined as single parents who are not remarried or cohabitating, and have no dependents other than their children in common from their former marriage to each other.

² According to IRS rules the child of a non custodial parent is not a qualifying child for purposes of the Head of Household filing status, Earned Income Credit, and Child and Dependant Care Expense Credit. See appendix A.

³ See note 2.

⁴ See note 2.

⁵ According to IRS rules a child of a non custodial parent is not a qualifying child for the Section 125 dependent care flex spending account. See appendix A.

⁶ Utah State law provides for a 50% reduction of child support for periods of time when the child spends only visitation time in the custodial home, during extended visitation time, indicating that 50% of the child support costs are fixed and not dependant on time the child spends in the home (costs for shelter, utilities, etc are not flexible enough to be reduced or eliminated during the child's absence).

⁷ E.G. the non custodial parent pays 67% of the child support in the custodial home plus all of the support costs in the non custodial home (estimated at 50% of the cost for the custodial home). The custodial parent pays 33% of the support costs in the custodial home. The non custodial share is thus $(67+50)/(67+50+33) = 117/150 = 78\%$.

⁸ E.G. Custodial gross income of \$1500/month and a non custodial income of \$3000/month. After taxes, health insurance, day care, and child support the custodial disposable income is \$2036/month and the non custodial income is \$1504/month. See Appendix B.

⁹ See Appendix A.

Appendix A

In addition to the snippets and references below, I have confirmed with IRS representatives the Federal tax related points listed above.

Instructions for form 1040 2006 page 21

If conditions (1) through (4) apply, only the non custodial parent can claim the child for purposes of the dependency exemption (line 6c) and the child tax credits (lines 53 and 68). However, this special rule does not apply to head of household filing status, the credit for child and dependent care expenses, the exclusion for dependent care benefits, or the earned income credit.

<http://www.irs.gov/faqs/faq-kw80.html>

I am divorced with one dependent child. This year my ex-spouse will claim the child as an exemption. Does this mean I cannot qualify as head of household?

You can file as head of household even though you do not claim your unmarried dependent child as an exemption if you meet all of the following requirements:

1. You are unmarried or considered unmarried on the last day of the year.
2. You paid more than half the cost of keeping up a home for the year.
3. A qualifying person must live with you in the home for more than half the year (except for temporary absences such as school).

<http://www.irs.gov/pub/irs-pdf/p4449.pdf>

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a tax credit for certain people who work and have earned income. It usually means more money in your pocket as it reduces the amount of tax you owe, but you must be eligible!

Don't Guess Whether You Qualify For EITC-KNOW!* Here are some important rules to remember....

- You and your child must have shared the same principal place of abode for more than one-half of the tax year (183 days or more) or you may not take the credit, *even if you meet all the other requirements*.
- As the non-custodial parent of a child, you may not claim the EITC based on this child, even if you may claim a dependency exemption for this child.

<http://www.irs.gov/newsroom/article/0,,id=106189,00.html>

IRS Tax Tip 2006-46

If you paid someone to care for a child or a dependent so you could work or look for work, you may be able to reduce your tax by claiming the Child and Dependent Care Credit on your federal income tax return. You may also be able to claim the credit if you pay someone to care for your dependent who is under age 13 or for a spouse or a dependent of any age who is physically or mentally incapable of self-care.

The credit is a percentage of the amount of work-related child and dependent care expenses you paid to a care provider. The credit can be up to 35 percent of your qualifying expenses, depending upon your income.

For 2005, you may use up to \$3,000 of the expenses paid in a year for one qualifying individual, or \$6,000 for two or more qualifying individuals. These dollar limits must be reduced by the amount of any dependent care benefits provided by your employer that you exclude from your income.

To claim the credit for child and dependent care expenses, you must meet the following conditions:

- Income You must have earned income from wages, salaries, tips or other taxable employee compensation, or net earnings from self-

employment

- Payee The payments for care cannot be paid to someone you can claim as your dependent on your return or to your child who is under age 19
- Filing Status Your filing status must be single, head of household, qualifying widow(er) with a dependent child or married filing jointly
- Care The care must have been provided for one or more qualifying persons
- Home The qualifying person must live with you for more than half of 2005

<http://www.washingtonwatchdog.org/documents/usc/ttl26/subttlA/ch1/subchA/ptIV/subptA/sec21.html>

Sec. 21. Expenses for household and dependent care services necessary for gainful employment

...

(5) Special dependency test in case of divorced parents, etc.

If -

(A) paragraph (2) or (4) of section 152(e) applies to any child with respect to any calendar year, and

(B) such child is under the age of 13 or is physically or mentally incapable of caring for himself, in the case of any taxable year beginning in such calendar year, such child shall be treated as a qualifying individual described in subparagraph (A) or (B) of subsection (b)(1) (whichever is appropriate) with respect to the custodial parent (within the meaning of section 152(e)(1)), and shall not be treated as a qualifying individual with respect to the noncustodial parent.

Utah Code

78-45-7.11. Reduction for extended parent-time.

(1) The base child support award shall be:

(a) reduced by 50% for each child for time periods during which the child is with the noncustodial parent by order of the court or by written agreement of the parties for at least 25 of any 30 consecutive days of extended parent-time;

IRS Publication 503, 2005 Child and Dependent Care Expenses, page 10

Amount of Credit

To determine the amount of your credit, multiply your work-related expenses (after applying the earned income and dollar limits) by a percentage. This percentage de-

depends on your adjusted gross income shown on Form 1040, line 38, or Form 1040A, line 22. The following table shows the percentage to use based on adjusted gross income.

<u>IF your adjusted gross income is:</u>		<u>THEN the</u>
<u>Over:</u>	<u>But not</u>	<u>percentage is:</u>
	<u>over:</u>	
\$ 0	— \$15,000	35%
15,000	— 17,000	34%
17,000	— 19,000	33%
19,000	— 21,000	32%
21,000	— 23,000	31%
23,000	— 25,000	30%
25,000	— 27,000	29%
27,000	— 29,000	28%
29,000	— 31,000	27%
31,000	— 33,000	26%
33,000	— 35,000	25%
35,000	— 37,000	24%
37,000	— 39,000	23%
39,000	— 41,000	22%
41,000	— 43,000	21%
43,000	— No limit	20%

Appendix B

The calculations for disposable income were made using the following scenario:

- 2005 tax laws, forms, and schedules
- All figures are monthly unless otherwise noted
- Total combined family income (custodial + non custodial) is set at \$4500, which is very close to the US Census Bureau's 2005 Utah median family income of \$54,595 per year
- The custodial parent's gross income is twice as high as the non-custodial parent's gross income
- There are two children from the parents' former marriage to each other and no other dependents
- The parents are not remarried or cohabitating with anyone
- Both children are eligible for the child tax credit and each parent takes one child as a dependent exemption
- The base combined child support obligation is calculated using the **current** support guidelines table and worksheet for a combined income of \$4500 which yields \$936
- The non custodial obligation is calculated at 67% of \$936 which yields \$627
- The non-custodial parent provides medical/dental insurance for the children as is normally ordered by the court
- Medical/dental insurance premiums are from an actual business case, assuming equal benefits for both parents, \$58/month for a single person (custodial parent), \$158/month for a parent with two children (non custodial parent)
- The non-custodial parent gets credit for ½ of the children's health insurance premiums by reducing the child support amount as is normally ordered by the court
- The reduction in child support for the children's health insurance premiums is \$53, calculated on a per capita basis using the standard ORS worksheet for calculating the health insurance reduction, yielding a final child support amount of $\$627 - \$53 = \mathbf{\$574}$
- There are \$500 in day care expenses for the two children during the custodial parent's working hours
- No day care expenses for the children that may be needed during the non-custodial parenting time have been included.
- Both children are eligible for the Earned Income Credit (for the custodial parent) even though only one child is being taken as a deduction (provided for in current tax law)
- Due to refundable tax credits, the custodial parent receives a net refund of federal taxes
- The 1040A tax form was used to calculate both parent's taxes
- The relative income percentages represent the percentage of combined (custodial + non custodial) income that each parent receives

Table 1					
Custodial Annual Income = \$18,000, Non-Custodial Annual Income = \$36,000					
Current Law	Custodial Monthly Amounts			Non-Custodial Monthly Amounts	
	Gross Income	\$1,500		Gross Income	\$3,000
	Relative Gross Income	33%		Relative Gross Income	67%
	Federal Income Tax	\$394		Federal Income Tax	-\$170
	State Income Tax	-\$14		State Income Tax	-\$126
	Social Security/Medicare	-\$110		Social Security/Medicare	-\$217
	Total Taxes	\$270		Total Taxes	-\$513
	Day Care	-\$250		Day Care	-\$250
	Child Support	\$574		Child Support	-\$574
	Health Insurance	-\$58		Health Insurance	-\$158
	Total Income Adjustments	\$536		Total Income Adjustments	-\$1,496
Disposable Income	\$2,036		Disposable Income	\$1,504	
Relative Disposable Income	58%		Relative Disposable Income	42%	

Even though the non custodial parent's gross income is double that of the custodial parent, the **custodial parent's disposable income is 35% higher** than the non custodial parent's disposable income.

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