

LR
#1

Simplify the National Status and Related Requirements for Qualifying Children

PROBLEM

Confusion arises when similar taxpayers receive different deductions or credits depending on the residence or national status of their children. The dependency deduction, child tax credit (CTC), and Earned Income Tax Credit (EITC), all of which relate to the cost of raising children, have different requirements. As explained in more detail below, a child who is not an American (citizen or national):

- May reside in the U.S., Canada, or Mexico for the dependency exemption;
- Must reside in the U.S. for the CTC; and
- Must reside in the U.S. with a Social Security number (SSN) for the EITC.¹

Similarly situated taxpayers may fail to claim the correct benefits due to the inconsistency of these requirements.

EXAMPLE

The residence or national status of a child of a Canadian parent who works across the border in the United States may vary as follows: Even if her child stays in Canada while she commutes back and forth, the parent may claim the dependency deduction for U.S. income tax purposes. If the mother and child take up residence in the American border town where the workplace is located, the woman may claim the CTC in addition to the dependency deduction. If the mother and child are living in the U.S. and have SSNs, then the mother may also claim the EITC (for working parents). In all three situations, the working parent experiences similar obligations to support her child.

RECOMMENDATION

Simplify the three-part children's national status requirements in conformity with overall simplification of the family tax benefits as the National Taxpayer Advocate previously proposed, as follows:²

- Consolidate the dependency deduction and CTC (nonrefundable portion) with head of household filing status into a Family Credit.
- Consolidate and modify the EITC with the refundable portion of the CTC into a Worker Credit not contingent on qualifying children.
- For the Family Credit, apply contiguous country rule encompassing the U.S., Canada, and Mexico.

¹ See Internal Revenue Code (IRC) §§ 152(b), 24(c), 32(c) & (m).

² See National Taxpayer Advocate 2008 Annual Report to Congress 363 (Legislative Recommendation: *Simplify the Family Status Provisions*).

- For the Worker Credit, require an SSN valid for employment.
- Repeal as obsolete the residence rule that requires the child to be a citizen, national, or otherwise in the U.S.

PRESENT LAW

Under pertinent provisions, an independent American taxpayer may claim a dependency deduction for a child (or younger descendant or that of a sibling or step-sibling) who is a U.S. citizen or national, or a resident of the U.S., Canada, or Mexico, and who is under 19 (24 if a full-time student) and sharing the taxpayer's home for over half the year.³ With income below certain phase-outs, the taxpayer may claim a \$1,000 CTC for such a child under 17 who is a citizen, national, or resident of the U.S.⁴ If the taxpayer earns low income, a portion of this credit, known as the additional CTC (ACTC), is refundable in excess of tax owed.⁵

A low income taxpayer may claim the refundable EITC with respect to such a child, if both taxpayer and child reside in the U.S. with SSNs valid for work.⁶ If the taxpayer is married, a joint return reflecting the spouse's work-authorized SSN as well is necessary to claim the EITC.⁷

The return must reflect the child's Taxpayer Identification Number (TIN), satisfied by SSN in the case of the EITC.⁸ In general, the Social Security Administration assigns SSNs to American citizens or work-authorized non-citizens.⁹ An individual who has a U.S. tax filing requirement but who is not eligible for an SSN may apply to the IRS for an Individual Taxpayer Identification Number (ITIN).¹⁰ Generally, citizens and residents of the United States file returns and pay tax on their worldwide income; noncitizens file and pay on earnings from work in the U.S. or certain other U.S. source income.¹¹

³ See IRC §§ 151(c), 152(b), (c). Eligible Canadians, Mexicans, Koreans, and Indians may claim these deductions. See IRC § 873(b); U.S.-Republic of Korea Income Tax Convention, Art. 4(7); U.S.-India Income Tax Convention, Art. 21(2).

⁴ See IRC § 24(a) (\$1,000 in 2012), (b), (c).

⁵ See IRC § 24(d).

⁶ See IRC § 32(c), (m).

⁷ See IRC § 32(d).

⁸ See IRC §§ 24(e); 32(m); 151(e).

⁹ See 42 U.S.C. § 405(c)(2)(B)(i). Generally, U.S. law authorizes work in specified occupations by noncitizens, whose children's immigration status may derive from theirs. See U.S. Citizenship & Immigration Serv. (CIS), Working in the United States (Jan. 26, 2012) available at <http://www.uscis.gov/portal/site/uscis/menuitem.eb1d4c2a3e5b9ac89243c6a7543f6d1a/?vgnnextoid=a39e901bf9873210VgnVCM100000082ca60aRCRD&vgnnextchannel=a39e901bf9873210VgnVCM100000082ca60aRCRD> (last visited Dec. 13, 2012); CIS, *I Am a Permanent Resident: How Do I Help My Relative Become a U.S. Permanent Resident?* No. B1 - M-561 (Aug. 2008).

¹⁰ See Treas. Reg. § 301.6109-1(d).

¹¹ See IRC §§ 61, 861.

REASONS FOR CHANGE

Reports by the Treasury Inspector General for Tax Administration (TIGTA) have attracted headlines with the insinuation that the IRS has paid billions of dollars in invalid ACTC claims, *i.e.*, those with ITINs rather than SSNs.¹² Although the IRS has confirmed that the ACTC law does not require SSNs but permits ITINs, TIGTA asserts that the same legislative intent that applies to EITC should apply to ACTC.¹³ While TIGTA's assertion does not reflect the current state of the law, it does demonstrate the need for additional clarification.

In effect, Congress has reaffirmed the rule that permits ITINs by leaving it intact in substantive amendments of the CTC statute enacted as recently as the American Recovery and Reinvestment Act of 2009.¹⁴ Congress may have had a rational basis for reaffirmation. As then-Commissioner of Internal Revenue Mark Everson (who previously had served as Deputy Commissioner of the Immigration and Naturalization Service) testified to the House of Representatives Committee on Ways and Means in 2006: "ITINs are issued regardless of immigration status because noncitizens may have U.S. tax return and payment responsibilities under the Internal Revenue Code."¹⁵

Nevertheless, confusion leading to erroneous claims or omissions arises because of the inconsistency among the requirements for child-related tax benefits. These requirements reflect a few alternative principles. One principle is ability to pay. The dependency deduction, supplemented by the CTC, reflects the cost of raising children, which reduces the taxpayer's income, or ability to pay tax.¹⁶

Another principle is that of a domestic subsidy. The EITC operates as a wage supplement, which Congress has limited to authorized American workers. To the extent that it enhances earned income, the ACTC is a similar subsidy, which Congress decided to limit by law, generally, to a taxpayer who has a qualifying child who is a citizen, national, or resident of the United States.¹⁷

A third principle is administrability. Limiting dependents to those with a TIN in the U.S. or a contiguous country facilitates IRS verification of the claimed deduction.¹⁸ For clarification, legislation should organize these various principles into simplified provisions that taxpayers can use and the IRS can administer.

¹² See TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the ITIN Program to Detect Fraudulent Applications* 2012-42-081 (Jul. 16, 2012); TIGTA, Ref. No. 2009-40-057, *Actions Are Needed to Ensure Proper Use of ITINs and to Verify or Limit Refundable Credit Claims* 2009-40-057 (Mar. 31, 2009); Josh Lederman, *IRS Discouraged Fraud Detection in ID Program*, Assoc. Press (Aug. 8, 2012).

¹³ See TIGTA, *Actions Are Needed* at 17 ("the language of the law is such that it could be interpreted to apply to the ACTC"), 31 (IRS response).

¹⁴ See Pub. L. No. 111-5, Div. B, § 1003, 123 Stat. 115, 313 (2009).

¹⁵ See *Impacts of Border Security and Immigration on Ways and Means Programs*, Hearing Before the House Comm. on Ways and Means, 109th Cong. 2nd Sess. 16 (2006) (statement of Mark W. Everson, Comm'r of Int. Rev.).

¹⁶ See Boris I. Bittker & Lawrence Lokken, *FEDERAL TAXATION OF INCOME, ESTATES & GIFTS* ¶ 30.1 (Thomson/Res. Inst. of Amer. 2012).

¹⁷ On subsidies, see sources discussed in National Taxpayer Advocate 2010 Annual Report to Congress, Vol. 2 at 101 (Research Study: *Evaluate the Administration of Tax Expenditures*).

¹⁸ See Bittker & Lokken, *FEDERAL TAXATION OF INCOME* ¶ 30.3.

EXPLANATION OF RECOMMENDATION

Originally, the income tax law allowed deductions for personal and dependency exemptions without geographic limits.¹⁹ With the advent of World War II, the Commissioner found there were more claims for European children than the IRS could verify.²⁰ Consequently, the Individual Income Tax Act of 1944 enacted the contiguous country rule.²¹ Subsequently, the Tax Reform Act of 1986 imposed the TIN requirement to facilitate IRS verification of dependency deductions.²² In 1997, the Taxpayer Relief Act created the CTC and ACTC in part to supplement the dependency deduction, reflecting increased costs of raising children.²³

Although a 1924 forerunner credit generally reduced the liability of those who paid income tax, it was not until the Tax Reduction Act of 1975 that Congress enacted the refundable EITC as a targeted anti-poverty measure.²⁴ In 1996, the Personal Responsibility and Work Opportunity Reconciliation Act substantially reformed traditional welfare programs, and in conjunction, required work authorization for an expanded EITC amount.²⁵

Since 2001, the National Taxpayer Advocate has repeatedly recommended simplification of family income tax provisions.²⁶ The Working Families Tax Relief Act of 2004 enacted a Uniform Definition of a Qualifying Child, responding in part to the National Taxpayer Advocate's recommendations.²⁷ This legislation simplified the requirements for the dependency deduction, CTC, and EITC, as well as head of household filing status and child care credit, by generally eliminating the need to document expenses for supporting a child of a prescribed age, relationship, and residence.

In 2008, the National Taxpayer Advocate recommended consolidating the various family-related provisions into a Family and a Worker Credit.²⁸ The Family Credit would reflect the costs of maintaining a household and raising a family. Without income phase-outs, this refundable credit would incorporate all current family provisions based on the composition of the family unit, allowing a claim for every qualifying child. The refundable Worker Credit would subsidize low wages, creating a work incentive for an individual, irrespective of any qualifying children.

¹⁹ See Pub. L. No. 65-50, § 1203 (1917).

²⁰ See *Gitter v. Comm'r*, 13 T.C. 520, 526-27 (1949) (discussing legislative history).

²¹ See Pub. L. No. 78-315, 58 Stat. 231 (1944).

²² See Jt. Comm. on Tax'n, *General Explanation of the Tax Reform Act of 1986*, 99th Cong. 2d Sess. 1286-87 (1987).

²³ See Pub. L. No. 105-34, § 101, 111 Stat. 796 (1997); IRC § 24(d), amended by Pub. L. No. 107-16, § 201 (2001) (expanding refundability); Sen. Rep. 105-33, 105th Cong. 1st Sess. 3 (1997); H. Rep. 105-48, 105th Cong. 1st Sess. 310 (1997).

²⁴ See Pub. L. No. 68-176, § 209, 43 Stat. 253 (1924); Pub. L. No. 94-12, 89 Stat. 26 (1975).

²⁵ See Pub. L. No. 104-193, § 451, 110 Stat. 2105, 2276 (1996).

²⁶ See National Taxpayer Advocate 2001 Annual Report to Congress 76 (Legislative Recommendation: *Family Status Issues*).

²⁷ See Pub. L. No. 108-311, § 201 ff., 118 Stat. 1166 (2004).

²⁸ See National Taxpayer Advocate 2008 Annual Report to Congress 363 (Legislative Recommendation: *Simplify the Family Status Provisions*); see also National Taxpayer Advocate 2006 Annual Report to Congress 463 (Legislative Recommendation: *Uniform Definition of Qualifying Child*); Pres. Advisory Panel on Fed. Tax Reform, *Simple, Fair & Pro-Growth: Proposals to Fix America's Tax System* 60 ff. (2005).

Assuming this simplification through bifurcation of the family tax provisions, resolution of the national requirements for children should follow suit. In sum, current law that allows children with TINs to reside in the U.S. or contiguous countries would persist under the Family Credit, reflecting ability to pay. The current EITC requirement of an SSN valid for employment would persist, but only for the Worker Credit, to which it logically applies. The current rule applicable to the CTC (and ACTC), which generally requires that a qualifying child be a citizen, national, or resident of the United States, would become obsolete, since the CTC and ACTC would be subsumed by the Family and Worker Credits. Obsolescence of this rule would resolve the confusion surrounding the national status of children who qualify for a refundable credit.