

VALUATION OBSERVATIONS

*Some practical observations from a practicing
business appraiser.*

VLC

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DEPENDENCY EXEMPTIONS

Who's Entitled?

Everybody wants it, but who is entitled to it? The dependency exemption is \$3,650 for 2009 and is scheduled to be the same for 2010. If one spouse is in the 33% tax bracket, the benefit will be \$1,205 less federal taxes due for each dependent claimed; whereas if the other spouse is in the 25% tax bracket, the tax benefit will be \$913 for each dependent claimed. The logical deduction would be that the spouse in the higher tax bracket should take the exemptions for the children. But not everyone is entitled. There are rules. Yes, the IRS has rules for everything. Let's take a look.

Relationship Test

First, the child must "qualify", which includes not only your biological children, but also includes adopted, foster, stepchildren, siblings, stepsiblings, half siblings, or any descendant of any of them.

Age Test

The child must be under age 19 at the end of the year. However, this changes to under age 24 at the end of the year if a full-time student. A full-time student must be enrolled at a school that has a regular teaching staff, course of study, and a regularly enrolled student body at a school and the child must be enrolled for the number of hours or courses the school considers to be full time during at least 5 months of the year. Vocational schools do apply. However, an on-the-job training course, correspondence school, or school offering courses only through the internet does not count as a school.

Residency Test

The child must have lived with you for more than half of the year. There are exceptions for temporary absences such as illness, education, business, vacation, or military service. This test can get a little dicey when the parents are separated or divorced.

Typically, the custodial parent gets the exemption. However, if 4 tests are met, the noncustodial parent will qualify.

1. The parents are divorced or separated under a written agreement, or lived apart at all times during the last 6 months of the year (whether or not they are or were married).
2. The child received over half of his/her support for the year from the parent.
3. The child is in the custody of one of the parents for more than half of the year.
4. The custodial parent signs a written declaration that he or she will not claim the child as a dependent for the year, and the noncustodial parent must attach this document to his or her return.

The custodial parent is the one with whom the child lived for the greater number of nights during the year, beginning on the date of separation.

- ❖ If the number of nights is equal, then the custodial parent is the one with the higher adjusted gross income.
- ❖ December 31 is treated as part of the year in which the day begins.
- ❖ If the child emancipates prior to June 30, then the child is not in the custody of either parent for the year.
- ❖ If the child is with neither parent on a particular night (ex: stayed at a friend's house), the child is treated as having been with the parent that the child would normally have been scheduled with.
- ❖ If, due to a parent's nighttime work schedule, a child lives for a greater number of days but not nights with the parent who works at night, that parent is treated as the custodial parent. On a school day, the child is treated as living at the primary residence registered with the school.

The written declaration is very important. And **BEWARE**, this rule has changed. Beginning with divorces in 2009, you can no longer attach to the tax return the page of the separation agreement releasing the exemption. Form 8332 must be completed and attached for IRS acceptance.

Support Test

The parent must provide more than half of the child's total support during the calendar year. To figure this, include in the denominator the entire amount of support the child received from all sources.

- ❖ You cannot include in your contribution to your child's support any support that is paid for by the child with the child's own wages, even if you paid the wages.
- ❖ The year you provide the support is the year you actually pay for it, not when it is due. If the support is paid with borrowed funds, it is the year the support expenses are paid, not the year the loan is repaid.
- ❖ Armed Forces dependency allotments are considered support provided by you.
- ❖ A scholarship or tuition from a GI bill received by a child who is a full-time student is not taken into account in determining whether the child provided more than half of his/her own support.
- ❖ Social security benefits received by the child are considered support provided by the child.
- ❖ Support provided by the state, such as welfare, food stamps, housing, etc. are considered support provided by the state, not the parent.
- ❖ Foster care payments are considered support provided by the state or agency, not the parent.
- ❖ Medical insurance premiums you pay are included in the support you provide.

Changes abound

As mentioned above, new divorces require Form 8332 to release the exemption to those otherwise not qualifying. Another change is the phase-out. If you recall from a few years ago, I discussed the Dependency Exemption Phase-out in Vol. 7, No. 1. Dependency Exemptions *Don't lose the benefit*. This phase-out has been eliminated for the 2010 tax year. But then, this repeal sunsets after 2010 and it is anybody's guess as to what the IRS will do then. The Obama Administration has promised a complete tax overhaul this year. So, all we can do is wait and see.

If you would like additional information, or have a question, please do not hesitate to call.

Very truly yours,

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Terri Lastovka is the founder of Valuation & Litigation Consulting, LLC. Her practice focuses on business valuations and litigation consulting in the areas of domestic relations, gift and estate tax, probate, shareholder disputes, economic damages, and forensic accounting. She draws from a wide range of experiences, including public accounting, law, banking, and CFO. She has received extensive training from the American Society of Appraisers in the area of business valuation and works closely with members of the bar to effectuate practical settlements. Terri also serves as the Director of Legal & Finance for Journey of Hope, a grass roots non-profit organization providing financial support to cancer survivors and sits on the Board of Trustees of the Center for Principled Family Advocacy.