News Release

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For Immediate Release

SIBLINGS CAN CLAIM OTHER SIBLINGS AS DEPENDENTS

Excellent Tax Strategy for Young Students or Professionals Meeting Certain Criteria May Not Be Around for Long—So Take Advantage Now

NEW YORK, January, 2007 – "I'm my own grandpa," sang the country duo Lonzo and Oscar 60 years ago. Today, the tax law has gone them one better by treating a sibling (brother or sister) as a "child" for some tax purposes. "This anomaly has created an unintended, but lucrative, opportunity for siblings who may be students or in the working world who meet certain criteria to claim tax benefits they may not have thought possible," according to Harris Abrams, RIA Tax Analyst from Thomson Tax & Accounting.

Under an overhaul of the law that took effect in 2005, a dependent can be either a "qualifying child" or a "qualifying relative." For someone to be a taxpayer's "qualifying child" (and hence a dependent), that person must:

- have the same principal place of abode as the taxpayer for more than one-half of that tax year;
- be the taxpayer's lineal descendent (child, grandchild, etc.) or sibling (including a step-sibling or half-sibling);
- be under age 19 at the close of the year, under age 24 and a full-time student, or be permanently and totally disabled; and
- not have provided more than half of his or her own support during the year.

Under this broad definition, more than one person may be entitled to claim a given individual as a dependent. Although tie-breaking rules are provided for these cases, those rules don't kick in unless there's a dispute over who can claim a dependent. "If the parties want to cooperate to produce the best tax result, they're free to do so," explains Abrams.

Here's a typical situation for taking advantage of the flexibility that these rules provide. Say that Mom and Dad have had a financially successful year. Their adjusted gross income (AGI) is so high that they can't take advantage of the dependency deduction or the child tax credit (which is available for children under age 17 at year's end) for their 16-year-old daughter.

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For joint filers in 2006, the dependency deduction starts to phase out when adjusted gross income hits $225,750 and is completely lost at AGI of $348,250. The rules for the child tax credit are even stricter—the credit starts to phase out when joint filers have AGI in excess of $110,000.

Now suppose that the daughter has an older brother who also lives at home. The daughter may qualify as her brother's dependent, too. After all, the two siblings have had the same principal place of abode during the year. They have the right relationship, because a sibling can be a "qualifying child." The daughter is young enough to be a dependent, and she doesn't provide more than half of her own support. (Note that it makes no difference whether the brother provided any of his sister's support.) And while the tie-breaking rules give the parents first crack at the dependency deduction, the parents will gladly step aside if it's for the family's greater good.

Abrams points out that the child who's claiming a sibling as a dependent cannot himself qualify as someone's dependent. If he can, he's not entitled to have his own dependents. Therefore, the brother in this case must be age 19 or more and not a full-time student, age 24 or more even if a full-time student, or must provide more than half of his own support.

This tax maneuver will qualify the brother for three tax breaks: the dependency deduction, the child tax credit, and the earned income credit. For 2006, the dependency deduction is $3,300. For a child in a low tax bracket, say 10%, that's worth only $330.

The child tax credit is more valuable--$1,000 for each qualifying child who is under age 17 at year's end. Since this is a credit rather than a deduction, it reduces tax dollar for dollar. If the credit exceeds the tax, a refund is available for up to 15% of the taxpayer's earned income above $11,300.

The biggest payoff comes with the earned income credit. This credit, which is refundable, can be as much as $2,747 for a taxpayer with one qualifying child. It increases with the taxpayer's earned income up to a point, but then starts to phase out. For taxpayers with one qualifying child, the credit is fully eliminated when the taxpayer has earned income over $34,000 for joint filers or $32,000 for non-joint filers.

"Here's where the strategy can really pay off," says Abrams. The parents in this case can't claim the earned income credit, because they have too much earned income. But the brother, whose career is just getting off the ground, may have earned income that's low enough to claim the credit. Note, however, that if the brother has more than $2,800 of investment income, he is disqualified from claiming the earned income credit.

"Strange as it may seem to treat a sibling as a 'qualifying child,' this strategy is perfectly legal if all of the requirements are met," says Abrams. However, he cautions, "The opportunity may not be around for long. Proposals have been introduced for closing the loophole, and they may be enacted for 2007. Still, the opportunity is available for 2006 and, by way of an amended return, for 2005."

Warning. When one sibling claims another as a dependent, there may be implications with respect to health insurance and college financial aid, so you should consult your tax and financial advisors before implementing the strategy.

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