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## NEWS RELEASE

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### **From Child Care to College; Don't Miss Tax Savings Available for Parents**

*Thomson Reuters Tax Analyst Examines Significant Opportunities*

**New York, NY, March 12, 2009** – Much has been written on the high cost of raising children. From diapers to designer jeans, and child care to college costs, the expenses add up almost as fast as Junior can text a message asking for cash. As college students wind down from spring break, parents face a different rite of spring: the April 15 tax return due date. On that return, your children may actually be the source of tax savings—not for diapers or jeans, but perhaps for child care and college tuition, says Bob D. Scharin, Senior Tax Analyst from the Tax & Accounting business of Thomson Reuters.

If you welcomed the birth of a new baby in 2008, you are now entitled to a \$3,500 exemption deduction. This deduction is available for each of your dependents. (For 2009 the deduction amount grows to an inflation-adjusted \$3,650.) An income-related exception, however, can reduce the exemption. If your adjusted gross income exceeds a specified amount—e.g., \$239,950 for joint return filers in 2008 (\$250,200 for 2009)—the \$3,500 exemption deduction is reduced by as much as one-third.

A high income is not the only thing that can curb this tax savings. The exemption deduction is not allowed for purposes of the alternative minimum tax (AMT). Thus, if you are hit by this parallel tax scheme that takes back what some regular income tax breaks appear to provide, having more children will only put you into a deeper AMT hole.

Another tax treat for parents is the \$1,000 child tax credit. Unlike a deduction, which reduces your income subject to tax, a credit is a dollar-for-dollar reduction in your tax bill. “That is a great deal, if you qualify,” says Scharin.

The \$1,000 child tax credit may be claimed for each under-age-17 child. An income phaseout applies, however, at a level much lower than the one for exemption deductions—e.g., \$110,000 for joint filers.



## Tax Savings for Parents

Page 2 of 3

March, 2009

Working parents may also be entitled to a tax credit for the expenditures incurred for the care of their children while the parents are at work. This credit is highest for those with low incomes, but bottoms out at 20% of eligible child care costs for those with incomes above \$43,000.

Eligible costs are limited to \$3,000 for the expenses of one child or \$6,000 if incurred for two or more qualifying children. That works out to a maximum tax credit (using the 20% rate) of \$600 for those with one qualifying child or \$1,200 for those with two or more children.

Furthermore, eligible expenses cannot exceed the earned income of a single parent, or in the case of a married couple, the lower-earning parent. "One more thing," advises Scharin, "The child must be under age thirteen."

Many parents take advantage of their employer-sponsored dependent care flexible spending account (FSA) plans to pay the same kind of child care costs with pre-tax earnings. Those plans may cover up to \$5,000 of costs. The dependent care credit is coordinated with these FSA plan benefits to prevent double dipping.

The coordination takes the form of reducing your credit-eligible cost ceiling by the amount received from an FSA. For instance, suppose you maxed out your FSA eligibility to the tune of \$5,000, but spent far more for child daycare.

If you have one eligible child, you cannot claim a dependent care credit because the \$5,000 exceeds the \$3,000 credit-eligible expense ceiling. If instead you have two eligible children, you subtract the \$5,000 FSA benefit from the \$6,000 credit-eligible expense ceiling and can claim a credit for \$1,000 of additional child care expense. At a 20% credit rate, you save an additional \$200.

Single parents get a special type of tax savings: "head of household" filing status. It provides a tax rate schedule that is more favorable than the one for other unmarried individuals. That is because more income is needed before they get pushed into higher tax brackets. Also, this filing status provides a larger standard deduction than is available for other single taxpayers, and higher income thresholds before which some tax breaks phase out.

Saving for Junior's college costs? Consider contributing to a qualified tuition program (QTP). This is one family-friendly tax break that has no income restrictions. You can make nondeductible cash contributions to a QTP (also referred to in tax parlance as a 529 plan), and the earnings on the contributions build up tax-free. Distributions from a QTP are not taxed to the extent used to pay for eligible college expenses.

If your child has already begun college, you may be eligible for either of two tax credits or a tax deduction. You cannot claim more than one of these tax breaks with respect to the same student.

The Hope Scholarship credit is a per-student credit. For 2008, it is available for qualified tuition and related expenses of an eligible student's first two years of postsecondary education; thanks to a recent law change, in 2009, this credit can be claimed for the first four years of postsecondary



### **Tax Savings for Parents**

Page 3 of 3

March, 2009

education. In 2008, the maximum credit is \$1,800 for 2008, calculated as the sum of 100% of up to \$1,200 of eligible expenses, plus 50% of eligible expenses in excess of \$1,200, but not in excess of \$2,400. For 2009, the maximum credit is boosted to \$2,500, calculated as the sum of 100% of up to \$2,000 of eligible expenses, plus 25% of the eligible expenses in excess of \$2,000, but not in excess of \$4,000.

The Lifetime Learning credit is a per-taxpayer credit. The maximum credit is \$2,000, calculated as 20% of up to \$10,000 of qualified tuition and related expenses.

Both credits are subject to the same modified adjusted gross income limitations. For 2008, the credits phase out ratably in the \$96,000 to \$116,000 range for joint return filers. For 2009, the beefed-up Hope Scholarship credit phases out in the \$160,000 to \$180,000 income range for joint return filers; and the Lifetime Learning credit phases out in the \$100,000 to \$120,000 range for joint return filers. (The income levels are half these amounts for unmarried taxpayers.)

The maximum tuition deduction is \$4,000. This figure applies for joint return filers whose income does not exceed \$130,000. The maximum deduction is \$2,000 if their income is more than \$130,000 but not more than \$160,000 (Here too the income levels are half these amounts for unmarried taxpayers.)

Unlike the credits, the deduction drops in cliffs (i.e., \$2,000 increments), rather than ratably. Thus, an extra \$1 in income above a threshold can result in a \$2,000 smaller deduction.

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