

Guidance on Qualifying Relative and the Exemption Amount

Notice 2018-70

SECTION 1. PURPOSE

The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue proposed regulations clarifying the definition of “qualifying relative” in § 152(d) for purposes of various provisions of the Internal Revenue Code (Code), including the new \$500 credit for other dependents under § 24(h)(4) and head of household filing status under § 2(b), for taxable years in which the § 151(d) exemption amount is zero.

SECTION 2. BACKGROUND

In general, § 151(a) of the Code allows a taxpayer to claim deductions for exemptions for the taxpayer and his or her spouse (§ 151(b)), and for any dependents (§ 151(c)). Before amendment by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” Pub. L. No. 115-97 (Act), § 151(d) provided for an exemption amount of a base dollar amount that was adjusted for inflation. Before the Act, the exemption amount for 2018 was calculated to be \$4,150. See Rev. Proc. 2017-58, 2017-45 I.R.B. 489, modified and superseded by Rev. Proc. 2018-18, 2018-10 I.R.B. 392.

Section 152(a) of the Code generally defines a “dependent” to mean a “qualifying child” or a “qualifying relative.” Section 152(d)(1) defines a qualifying relative to mean an individual (A) who bears a specific relationship to the taxpayer, (B) whose gross income for the calendar year in which the taxpayer’s taxable year begins is less than the exemption amount (as defined in § 151(d)), (C) who receives over one-half of his or her support from the taxpayer for the calendar year in which the taxpayer’s taxable year begins, and (D) who is not a qualifying child of the taxpayer or any other taxpayer for any taxable year beginning in the calendar year in which the taxpayer’s taxable year begins.

Section 11041(a)(2) of the Act added § 151(d)(5) to provide special rules for taxable years 2018 through 2025 for the exemption amount in § 151(d). Specifically, § 151(d)(5)(A) provides that, for a taxable year beginning after December 31, 2017, and before January 1, 2026, the term “exemption amount” means zero, thereby suspending the deduction for personal exemptions. See H.R. Rep. No. 115-466 at 204 (2017) (Conf. Rep.). However, § 151(d)(5)(B) provides that, for purposes of any other provision of the Code, the reduction of the exemption amount to zero will not be taken into account in determining whether a deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction, under § 151. The Conference Report states that this provision clarifies that the reduction of the personal exemption to zero “should not alter the operation of those provisions of the Code which refer to a taxpayer allowed a deduction . . . under section 151,” including the child tax credit in § 24(a). Id. at 203 n.16.

Section 11022(a) of the Act amended § 24 of the Code to create a \$500 credit for certain dependents of a taxpayer other than a qualifying child described in § 24(c), for whom the child tax credit is allowed. The \$500 credit applies to two categories of dependents: (1) qualifying children for whom a child tax credit is not allowed and (2) qualifying relatives as defined in § 152(d). See § 24(h)(4)(A). Like the amendment to § 151(d) reducing the exemption amount to zero, this new credit applies for taxable years 2018 through 2025. The Conference Report explains the intended scope of this credit: “The credit is further modified to temporarily provide for a \$500 nonrefundable credit for qualifying dependents other than qualifying children. The provision generally *retains the present-law definition of dependent.*” See H.R. Rep. No. 115-466 at 227 (emphasis added).

Separately, Code § 2(b)(1)(A) defines a head of household to include an individual who is not married at the close of the taxable year, who is not a surviving spouse (as defined in § 2(a)), and who maintains as his or her home a household for a qualifying individual for the required period of time. A qualifying individual under § 2(b)(1)(A)(ii) includes a qualifying relative if the taxpayer is entitled to a deduction under § 151 for the person for the taxable year. Under § 151(c), a deduction is allowed for individuals who are dependents as defined in § 152, including qualifying relatives described in § 152(d).

SECTION 3. GUIDANCE UNDER CONSIDERATION

The Treasury Department and the IRS intend to issue proposed regulations providing that the reduction of the exemption amount to zero under § 151(d)(5)(A) for taxable years 2018-2025 will not be taken into account in determining whether a person

is a qualifying relative under § 152(d)(1)(B). Accordingly, in defining a qualifying relative for purposes of various provisions of the Code that refer to the definition of dependent in § 152, including, without limitation, for purposes of the new credit under § 24(h)(4) and head of household filing status under § 2(b), the § 151(d) exemption amount referenced in § 152(d)(1)(B) will be treated as \$4,150 (adjusted for inflation), for taxable years in which the § 151(d)(5)(A) exemption amount is zero.

Section 151(d) provides for two different exemption amounts for taxable years 2018 through 2025. For purposes of determining whether a deduction is allowed for personal exemptions, § 151(d)(5)(A) requires that the exemption amount be zero—thereby suspending this deduction. But for other provisions of the Code that reference the deduction for other purposes, Congress indicated in § 151(d)(5)(B) that the reduction of the exemption amount to zero is not to be taken into account. Instead, the exemption amount should remain \$4,150 for 2018 (adjusted for inflation in future years).

Construing § 152 in light of the structure of the statute, the Treasury Department and the IRS believe that the exemption amount referenced in that section must be \$4,150 (adjusted for inflation), rather than zero, for purposes of determining who is a qualifying relative. This interpretation accords with § 151(d)(5), which aims to suspend the deduction for personal exemptions without substantively changing other Code provisions that directly or indirectly reference the § 151(d) exemption amount.

This interpretation is also confirmed by the structure of several Code provisions that necessitate a non-zero exemption amount in § 152(d)(1)(B). For example, to be a qualifying relative under § 152(d)(1)(B), an individual must have gross income that is “less than the exemption amount.” But if the exemption amount were zero, an

individual's gross income would have to be less than zero—a near impossibility. And because it would be highly unusual for an individual to have gross income less than zero,¹ virtually no individuals would be eligible as qualifying relatives. A zero exemption amount would thus effectively render § 152(d)(1)(B) inoperable and eliminate an entire category of dependents. The Treasury Department and IRS do not believe Congress intended to make such a significant change in such an indirect manner.

In addition, the new \$500 credit that Congress enacted at the same time, and in the same Act, as it reduced the § 151(d) exemption amount likewise depends on a non-zero exemption amount in § 152(d)(1)(B). Section 24(h)(4)(A), as amended, creates a \$500 credit available for each dependent of the taxpayer other than a qualifying child for whom the child tax credit is allowed. This provision references the definition of dependent in section 152, which includes both qualifying relatives and qualifying children, and it was understood at the time of enactment that this provision “generally retain[ed] the present-law definition of dependent.” H.R. Rep. No. 115-466 at 227. But if the exemption amount referenced in § 152(d)(1)(B) were zero, the entire category of qualifying relatives would be effectively excised from the definition of dependent. As a consequence, the \$500 credit generally would not be available for qualifying relatives, and the availability of this credit would shrink to only a limited category of qualifying children for whom the child tax credit is not allowed. This does not appear to be what Congress intended when it enacted the new \$500 credit.

Further, head of household filing status also depends on a non-zero exemption amount in § 152(d)(1)(B). Under § 2(b)(1)(A), an individual is considered a head of

¹ This could occur if an individual engaged in a business involving the sale of goods incurs inventory costs that exceed gross sales revenue. See § 1.61-3(a).

household if, inter alia, he or she maintains as his or her home a household for either (i) a qualifying child or (ii) “any other person who is a dependent of the taxpayer.” Because the only dependents other than qualifying children are qualifying relatives, a zero exemption amount in § 152(d)(1)(B), and the resulting near elimination of qualifying relatives, would render the express provision for other dependents in § 2(b)(1)(A)(ii) superfluous. It also would deny head of household filing status to many individuals who previously qualified for that filing status and otherwise would continue to qualify. There is no reason to believe that Congress intended its alteration of the § 151(d) exemption amount to have this effect.

Accordingly, the Treasury Department and IRS intend to propose regulations to clarify that the reduction of the exemption amount to zero in § 151(d)(5)(A) for taxable years 2018-2025 does not apply to the gross income limitation in the definition of qualifying relative in § 152(d)(1)(B).

SECTION 4. RELIANCE

Before the issuance of the proposed regulations described in this notice, taxpayers may rely on the rules described in section 3 of this notice.

SECTION 5. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on all aspects of the proposed guidance under consideration as described in this notice.

Written comments may be submitted by November 16, 2018, to Internal Revenue Service, CC:PA:LPD:PR (Notice 2018-70), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044, or electronically to Notice.Comments@irs counsel.treas.gov (please include “Notice 2018-70” in the subject

line). Alternatively, comments may be hand-delivered between the hours of 8:00 a.m. and 4:00 p.m. Monday to Friday to CC:PA:LPD:PR (Notice 2018-70), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, D.C. 20224. Comments will be available for public inspection and copying.

SECTION 6. DRAFTING INFORMATION

The principal author of this notice is Victoria J. Driscoll of the Office of Associate Chief Counsel (Income tax & Accounting). For further information regarding this notice contact Victoria J. Driscoll at (202) 317-4718 (not a toll-free call).