

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:EBEO:Branch 4
EM:Madden: WTA-M-102335-98

date: APR 28 1998

to: Chief Advocacy Team

from: Chief, Branch 4
(Employee Benefits and Exempt Organizations), CC:EBEO:Br.4

subject: Earned Income Credit - Sections 32(c)(1)(C) and 32(c)(3)(B)(iii)

This responds to your January 22, 1998, memorandum requesting guidance about the availability of the earned income credit in situations where a child lives with a parent who shares household expenses with another adult. Your memorandum raises issues involving (1) the application of the tie-breaker rule in section 32(c)(1)(C) of the Internal Revenue Code to individuals who share household expenses, (2) the definition of eligible foster child in section 32(c)(3)(B) of the Code, and (3) the effect of the recent U.S. Tax Court case, Lestrangle v. Commissioner, T.C. Memo. 1997-428.

General Background

Section 32(a) allows an earned income credit (EIC) in the case of an eligible individual. An eligible individual is defined by section 32(c)(1)(A) to include any individual who has a qualifying child for the taxable year. Section 32(c)(3)(A) defines a qualifying child with respect to any taxpayer for any taxable year, as an individual who meets certain relationship, abode, and age tests and with respect to whom the taxpayer meets certain identification requirements.

An individual satisfies the relationship test under section 32(c)(3)(B) if the individual is the son, daughter, or adopted child of the taxpayer; a grandchild of the taxpayer; a stepson or stepdaughter of the taxpayer; or an eligible foster child.

Under section 32(c)(3)(C) an individual satisfies the age requirements if he or she is under age 19 as of the close of the taxable year, or under age 24 as of the close of the taxable year if a full-time student, or is permanently and totally disabled. Under section 32(c)(3)(D), the identification requirement is satisfied if the taxpayer includes the name, age, and taxpayer identification number of the otherwise qualifying child on the return.

The tie-breaker rule of section 32(c)(1)(C) applies if there would otherwise be two or more eligible individuals with respect

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to the same qualifying child. Under the tie-breaker rule only the taxpayer with the highest modified adjusted gross income (MAGI) is treated as the eligible individual with respect to that qualifying child.

The Service's longtime position has been that an individual is a qualifying child if the individual meets the relationship, abode, and age tests, and that while a taxpayer must meet the identification requirement in order to claim the credit, that requirement is not part of the definition of a qualifying child. Under this approach, the tie-breaker rule applies even if the taxpayer with the highest MAGI does not identify the child on that taxpayer's income tax return. In Lestrance v. Commissioner, T.C. Memo. 1997-428, the United States Tax Court held otherwise. Under the Court's view, the identification requirement is an essential element of the definition of a qualifying child, so that the tie-breaker rule does not apply unless the taxpayer with the higher MAGI identifies the child. A pending technical correction, retroactive to the original effective date of the tie-breaker rule, is consistent with the Service position described above and inconsistent with the result in Lestrance.

The matter of how the Service should apply the tie-breaker rule in light of the Lestrance decision is currently under active consideration at the highest levels in the Service. The issue is being coordinated among many offices with a view to providing a consistent response available to all parts of the Service. We anticipate a resolution in as little as the next few days, and will notify you accordingly. Meanwhile, the discussion of the tie-breaker rule below is based on the Service's pre-Lestrance approach.

Application of the Tie-Breaker and Eligible Foster Child Rules

Assume a mother, M, has one child, C, who is 10 years old. M and C live with M's boyfriend, B, for the entire taxable year. M and B share the household expenses. B has a higher MAGI than M. No one else lives with M, C, and B.

In this situation there is only one eligible individual with respect to C, but there are two possibilities. C is a qualifying child of M, so M is the eligible individual unless the tie-breaker rule applies. The tie-breaker rule applies if C is also a qualifying child of B. In that event, B is the eligible individual rather than M, because B has the higher MAGI.

Whether C is a qualifying child of B depends on whether C satisfies the relationship test with respect to B. Assuming that C is not B's son, daughter, adopted child, grandchild, or stepchild, satisfying the relationship test turns on whether C is B's "eligible foster child." An eligible foster child is defined

in section 32(c)(3)(B)(iii) as an individual who is not otherwise described in section 32(c)(3)(B) whom the taxpayer cares for as his or her own child and who has the same principal place of abode as the taxpayer for the entire taxable year. C lives with B for the entire taxable year, so the only remaining question is whether B cares for C as his own child.

The phrase "cares for as his or her own child" is not defined in section 32(c)(3)(B), its legislative history, the regulations, or the case law arising under section 32. Whether a taxpayer cares for another individual as his or her own child is a question of fact, the answer to which will depend on the particular facts and circumstances of each case.

The fact that B shares living expenses with C's mother does not necessarily mean that B cares for C as his own child, although he might. Other facts more directly related to B's relationship with C will be relevant, and could either support or negate a conclusion that B cares for C as his own child.

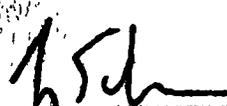
Similarly, the fact that B is the mother's boyfriend is not controlling. For example, if B were some other friend of M sharing living expenses, or M's sister, the factual question would be the same: Does B care for C as B's own child? Depending on all the facts and circumstances surrounding B's relationship with C, the answer could be either yes or no, and the eligible individual would be determined accordingly.

Your memorandum refers to Publication 596, Earned Income Credit, and in particular to Example 3 and the section on unmarried couples living together, both on page 12. Example 3 involves children living with their mother and the mother's sister. That the sister cares for the children as her own is an assumed fact. Similarly, in the section on unmarried couples living together, that a child is a qualifying child of both members of the couple is an assumed fact. (The child might be the actual child of both, or the eligible foster child of one, or even the eligible foster child of both.) These portions of Publication 596 do not attempt to illustrate the determination of whether a child is in fact an eligible foster child. They are designed merely to illustrate the application of the tie breaker rule in situations that involve or may involve eligible foster children.

Where a child lives with a parent who shares household expenses with another adult, a determination that the other adult is the eligible individual rather than the parent may be advantageous to the household. Using the 1997 EIC amounts and the example above, assume further that M has earned income and MAGI of \$6,000 and B has earned income and MAGI of \$7,500. If M is the eligible individual with respect to C, M could receive an

EIC of \$2,049.—On the other hand, if B is the eligible individual, then B could receive an EIC of \$2,210, a better overall result for the household. If the income amounts are altered in this scenario, there can be an opposite effect. For example, assume instead that the earned income (and MAGI) amounts are \$12,000 for M and \$15,000 for B. If M is the eligible individual, the EIC amount is \$2,195, but if B is the eligible individual, the amount is only \$1,715.

I hope this information is useful to you in formulating your recommendations. If you have any questions regarding this memorandum, please contact Erin Madden at (202) 622-6060.



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