Tax Benefits for Parents

Article Highlights:

- Exemptions
- Child Tax Credit
- Earned Income Tax Credit
- Head of Household Filing Status
- Child Care
- Education Savings Plans
- Education Tax Credit
- Education Loan Interest
- Child's Medical Expenses

If you are a parent, whether single, married or divorced, there are a significant number of tax benefits available to you, including deductions, credits, filing status and exemptions that can help put a dent in your tax liability.

Exemptions – Regardless of filing status, you receive a $4,050 income exemption for each of your qualifying children whom you claim as a dependent on your tax return. In the case of divorced or separated parents, the exemption is allowed to the custodial parent unless the custodial parent releases the exemption to the non-custodial parent. If you are the custodial parent, you can release the exemption on a year-by-year basis or for multiple years if you wish to do so. However, being unable to foresee the future means it is generally wiser to release the exemption annually. The exemption amount gradually decreases to zero once a certain income threshold is reached; this phase out generally applies to higher income taxpayers.

Child Tax Credit – If you have dependent children, you are also entitled to a nonrefundable tax credit of $1,000 for each child under the age of 17 at the close of the year. The term "nonrefundable" means the credit can only be used to offset any tax liability you may have, and the balance of the credit is lost. If you are not filing jointly with the child's other parent and have released the exemption to that parent, then you will not qualify for the child tax credit for that child. In addition, this credit also phases out for higher income taxpayers. For lower income parents, a portion of the child tax credit, which is normally nonrefundable, can become refundable.

Earned Income Tax Credit – The earned income credit benefits lower income parents based upon your earned income, filing status (either married filing jointly or unmarried) and the number of qualifying children you have up to three. The credit for 2017 can be as much as $6,318, and better yet, the amount not used to offset your tax liability is fully refundable. This credit is phased out for higher income filers, and those with investment income of more than $3,450 for 2017 aren't eligible.

Head of Household Filing Status – The tax code provides a special filing status – head of household – for unmarried and separated taxpayers. The benefit of head of household filing status is that it provides lower tax rates and a higher standard deduction than the single status ($9,350 as opposed to $6,350 for a single individual in 2017). If you are an unmarried parent and you pay more than one-half the cost of the household for yourself and your child, you qualify for this filing status. Even if you are married, if you lived apart from your spouse the last six months of the year and pay more than one-half the cost of the household for yourself and your child, you qualify for this filing status.

Childcare – Many parents who work or are looking for work must arrange for care of their children. If this is your situation, and your children requiring care are under 13 years of age, you may qualify for a nonrefundable tax credit that can reduce your federal income taxes.

The childcare credit is an income-based percentage of up to $3,000 of qualifying care expenses for one child and up to $6,000 of qualifying care expenses for two or more children. The allowable expenses are also limited to your earned income, and if you are married, both you and your spouse must work and the limit is based upon the earned income of the spouse with the lower earnings. The credit percentages range from a maximum of 35% if your adjusted gross income (AGI) is $15,000 or less to 20% for an AGI of over $43,000.

If your employer provides dependent care benefits under a qualified plan that pays your child care provider either directly or by reimbursing you for the expenses, or your employer provides a day care facility, you may be able to exclude these benefits from your income. Of course, the same expenses aren't eligible for both tax-free income and the child care credit.

Education Savings Plans – The tax code provides two plans to save for your children's future education. The first is the Coverdell Education Savings Account, which allows non-deductible contributions of up to $2,000 per year. The earnings on these accounts are tax-free provided the amounts withdrawn from the accounts are used to pay qualified expenses for kindergarten and above. Coverdell contributions will phase out for higher income taxpayers beginning at an AGI of $190,000 for married taxpayers filing jointly and half that amount for other taxpayers.

A second plan, called a Qualified Tuition Plan (sometimes referred to as a Sec 529 plan), allows individuals to gift large sums of money for a family member's college education while continuing to maintain control of the funds. The earnings from these accounts grow tax-deferred and are tax-free if used to pay for college tuition and related expenses.

Contributions to these plans are not limited to the child's parents and can be made by virtually anyone, although if not the parents, then typically it is the grandparents who fund the accounts.

Education Credits – If you are a parent with a child or children in college, don't overlook the American Opportunity Tax Credit (AOTC). It provides a tax credit equal to 100% of the first $2,000 of qualified tuition and related expenses and 25% of the next $2,000 for each child who was enrolled at least half time. Better yet, 40% of the credit is refundable. This credit is good for the first four years of post-secondary education.

There is a second education credit called the Lifetime Learning Credit (LLC) that provides a nonrefundable tax credit equal to 20% of up to $10,000 of qualified tuition and related expenses. Unlike the AOTC, which is allowed per student, the LLC is calculated on a per-family basis with a maximum credit of $2,000 but is not limited to the first four years of post-secondary education.

You don't even have to pay the expenses to get the credits. The credits are allowed to the person claiming the exemption for the child. So if the child's grandparent, uncle, aunt or even an ex-spouse or the child's other parent pays the tuition, you still get the credit as long you claim the child as your dependent.

Student Loan Interest - Generally, personal interest you pay, other than certain mortgage interest, isn't deductible on your tax return. However, there is a special deduction, up to $2,500 per year, allowed for interest paid on a student loan (also known as an education loan) used for higher education. You don't have to itemize deductions to take advantage of this deduction, but you must have paid the interest on a loan taken out for your own or your spouse’s education or that of a dependent. So if you were legally obligated to pay the loan for one of your children who was your dependent when the loan was taken out, you may be able to claim this deduction, even if the child is no longer your dependent.

The student must have been enrolled at least half-time, and the loan must have been taken out solely to pay qualified higher education expenses. The lender can’t be a related person. This deduction phases out if your AGI is more than $65,000 ($130,000 if filing a joint return) and isn’t allowed if you use the married filing separate status.

Child’s Medical Expenses – If you itemize deductions, the unreimbursed medical expenses you pay for your dependents are counted for figuring your total medical expenses. This is true for both parents even if they do not file together as long as one of them is able to claim the child as a dependent.

If you have questions related to any of these tax benefits, please give this office a call.