

Impact of Affordable Care Act On Tax Benefits For Qualifying Children

By: Mary Kate Kelley-Scheidler

Introduction

The Affordable Care Act is here. One of the main questions for family lawyers about the provisions of the Affordable Care Act (hereinafter, “ACA”) is how the ACA will impact tax benefits for qualifying children of divorced or separated parents. Specifically, the question is, how will the ACA impact award of the dependency exemption in divorce and paternity cases? The ACA requires individual taxpayers and their dependent children to obtain “minimum essential coverage” for healthcare.

A Premium Assistance Tax Credit is available, but this credit is tied to claiming the dependency exemption for a qualifying child. The parent who claims the dependency exemption for a qualifying child, or who is entitled to claim the dependency exemption for a qualifying child, is subject to a penalty if the parent fails to provide “minimum essential coverage” for healthcare to their qualifying dependent child(ren). The penalty, euphemistically referred to as the “individual shared responsibility payment,” is included on the taxpayer’s Form 1040.

The penalty is not subject to criminal prosecution or assessment. The IRS may not file a lien or levy on the property of the taxpayer for failure to pay. If the taxpayer fails to pay the penalty, the only remedy the Internal Revenue Service (hereinafter, “IRS”) has is to offset any refund, now or in the future.

It is the interplay between claiming the dependency exemption for a qualifying child on the taxpayer’s Form 1040, combined with the availability of the Premium Assistance Tax Credit to assist with purchasing healthcare coverage or the penalty for failing to provide minimum essential coverage, that will cause challenges with awarding the dependency exemption.

This article is not intended to provide specifics for the provisions of the ACA as it pertains Premium Assistance or penalties. The reader will need to avail herself/himself of other literature or seminars that delve into greater detail about the provisions of the ACA and how the Premium Assistance Tax Credit or the penalty is actually calculated. Rather, this article is intended to provide strategies to family law practitioners for how to approach awarding of the dependency exemption in light of the ACA provisions.

This article will cover the following:

- I. An Overview of Tax Benefits/Penalty for Qualifying Children;
- II. Importance of Referencing Form 8332 in Divorce Decrees or Paternity Orders;
- III. Situations That Warrant Further Analysis Regarding the Benefit/Liability Associated with the Dependency Exemption for a Qualifying Child; and

IV. Including Reservation of Jurisdiction for Award of Tax Exemptions Language in Divorce Decrees or Paternity Orders.

I. **An Overview of Tax Benefits/Penalty for Qualifying Children**

For purposes of this article, the custodial parent for tax purposes is the parent with whom the qualifying child has lived the greater part of the tax year. See Code § 152(e)(4)(A). The IRS will count the number of nights a qualifying child lives at the domicile of each parent to make this determination. See Treasury Decision 9408 (T.D. 9408) for further information. You may also read the instructions attached to Form 8332 Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent.

When parents are awarded 50/50 parenting time, the parents should alternate years that they are treated as the custodial parent for tax purposes. This means that the parents will need to cooperate so that a qualifying child lives with the parent who will claim the tax benefits associated with being the custodial parent for tax purposes at least one more day in the tax year than the other parent. Several well-done breakout sessions at the Family Law Institute in previous years have discussed the language that should be included in a divorce decree to address the 50/50 parenting time situation.

Currently, there are seven tax benefits tied to qualifying children that are available to divorced and separated parents, and one penalty. The tax benefits are assigned in such a way so that divorced or separated parents of a qualifying child may share the tax benefits tied to the same child. The breakdown of the available tax benefits are as follows:

The Custodial parent for tax benefits is entitled to claim:

- A. Head of Household filing status (if he/she otherwise qualifies);
- B. Child and Dependent Care Credit (if he/she otherwise qualifies), but Only for expenses said parent actually paid during the tax year;
- C. Earned Income Credit (if he/she otherwise qualifies).

The Parent entitled to the dependency exemption may claim to:

- A. The Dependency exemption. Non-custodial parent **must receive a signed Form 8332** from the custodial parent for tax purposes to claim the dependency exemption. Without a signed Form 8332 the IRS will disallow the claiming of the dependency exemption. **It does not matter what a court order states.** The non-custodial parent must have a signed Form 8332 to claim the dependency exemption. This has been upheld by a recent Tax Court case, *Armstrong v. Comm.*, 139 TC No. 18, 2012. The Tax Court held that a noncustodial parent who attached a marital dissolution arbitration award, rather than a Form 8332, to his Form 1040 was not entitled to claim the dependency exemption, because the document did not conform with the substance of Form 8332;

- B. The Child Tax Credit (if he/she otherwise qualifies);
- C. The Premium Assistance Tax Credit (if he/she otherwise qualifies);
- D. The Additional Child Tax Credit (if he/she otherwise qualifies); and
- E. The penalty for failure to provide minimum essential coverage for healthcare.

II. Importance of Referencing Form 8332 in Divorce Decrees or Paternity Orders

As a Family Law practitioner, it is essential to understand that you must reference the signing of Form 8332 in divorce decrees and paternity orders. The reason for this is simple. The Tax Court has consistently held that a Court Order does not conform with the substance of Form 8332. Without a signed Form 8332, the claiming of the dependency exemption by the noncustodial parent will be disallowed by the IRS if the noncustodial parent is audited. Again, there have been breakout sessions at the Family Law Institute that has discussed the language that should be included.

III. Situations that Warrant Further Analysis Regarding the Benefit/Liability Associated with the Dependency Exemption for a Qualifying Child

While the ACA is changing the landscape for practicing Family Law, as it relates to healthcare coverage for children of divorcing or separated parents, it does not impact every divorce or paternity action to the same degree. For the most part, divorced or separated parents can continue to alternate years for the dependency exemption, as has been the practice in the past. However, there are situations where the ACA will significantly impact divorced or separated parents claiming the dependency exemption as it relates to tax benefits for qualifying children. The impact will most often be felt in situations where the parent who will be providing healthcare for the qualifying child (a) qualifies for the Premium Assistance Tax Credit; and, (b) obtains healthcare coverage through one of the government exchanges. In this situation, the parent will (most likely) be receiving assistance during the tax year in the form of a subsidy intended to offset the cost of healthcare premiums. In order to validate the subsidy provided for healthcare premiums, the parent receiving the subsidy will need to claim the dependency exemption for the qualifying child on his/her Federal income taxes. If the parent receiving the Premium Assistance Tax Credit in the form of a subsidy during the tax year does not claim the dependency exemption for the qualifying child, that parent will need to repay the subsidy paid out during the tax year to offset the cost of healthcare premiums.

The alternative to this scenario is a parent that obtains healthcare coverage through a government exchange and pays the premiums during the tax year without utilizing a subsidy, but is entitled to a refund of a portion of those premiums at the end of the year because they qualify for Premium Assistance Tax Credit. In order to receive the refund of premiums from the Premium Assistance Tax Credit, the parent making seeking Premium Assistance would need to claim the qualifying child as a dependent on his/her Federal income tax return. Without claiming the qualifying child as a dependent, he/she loses the refundable Premium Assistance Tax Credit.

This changes the face of how the dependency exemption can be awarded. In those situations where a parent is providing healthcare coverage for a qualifying child through a government exchange AND that parent qualifies for the Premium Assistance Tax Credit, it only makes sense to award the parent the dependency exemption for every year they qualify for the Premium Assistance Tax Credit. (A reminder: if the parent providing the healthcare coverage for a qualifying child is the noncustodial parent for tax purposes, a signed Form 8332 is absolutely necessary for he/she to claim the dependency exemption.)

Family Law practitioners may need to change the language utilized in divorce decrees and paternity orders so that no conditions apply on the signing of Form 8332, i.e., being current in child support. I do not know if there is a “magic bullet” to resolve the competing interests of divorcing or separated parents, but it is something that needs to be considered in light of the requirements placed on parents to qualify for ACA Premium Assistance.

V. Include Reservation of Jurisdiction for Award of Tax Exemptions Language in Divorce Decrees or Paternity Orders.

As time wears on, circumstances can, and often do, change from the original entry/filing of a divorce decree or paternity order. Thus, flexibility, as it relates to the awarding of the dependency exemption post-decree or post-order, should be part of divorce decrees and paternity orders. In light of ACA provisions requiring parents to provide minimum essential coverage for qualifying children, there needs to be flexibility as to which parent is entitled to claim the dependency exemption for a qualifying child so that the healthcare can be made more affordable. It is not as simple as the parent who provides healthcare coverage for a qualifying child should automatically be entitled to the dependency exemption. Clearly, there are times when alternating years between parents is still appropriate, even though one parent consistently provides the healthcare coverage for a qualifying child.

Rather, flexibility should be given to those situations in which a parent qualifies for the Premium Assistance Tax Credit AND obtains health insurance from one of the government exchanges. Under these circumstances that parent should be allowed to claim the dependency exemption for every year that he/she qualifies for the Premium Assistance Tax Credit. Without claiming the dependency exemption, the parent purchasing the insurance will lose the right to claim the Premium Assistance Tax Credit. Sample reservation language might look something like this:

“The Court reserves jurisdiction over the issue of the award of the dependency exemption(s) for qualifying child(ren). The parties may move the Court for a change in the award of the dependency exemption due the provisions of the Affordable Care Act (ACA) and the Premium Assistance Tax Credit, if circumstances are such that a party provides healthcare coverage for a qualifying child and qualifies for the Premium Assistance Tax Credit. In the alternative, the parties may move the Court for a change in the award of the dependency exemption due the provisions of the ACA if a party providing healthcare coverage no longer provides healthcare coverage for a qualifying child, or no longer qualifies for the Premium Assistance Tax Credit.”

Conclusion

This article attempts to provide some guidance and principles for handling the issue of tax benefits for qualifying children of divorcing or separated parents in light of the ACA. At this point it is virtually impossible to discuss the issue in little more than generalities. No one is even sure what the tax forms will look like that determine eligibility for the Premium Assistance Tax Credit. And, we won't know until tax season 2015.

The long-standing practice when awarding the dependency exemption for qualifying children has been to alternate years. For the most part, this practice can continue.

The only major exception would be in those particular circumstances where the parent providing healthcare for the qualifying child(ren) obtains healthcare coverage from a government exchange AND qualifies for the Premium Assistance Tax Credit. This situation would warrant the parent who is providing healthcare to be entitled to claim the qualifying child for every tax year that he/she would also qualify for the Premium Assistance Tax Credit.

About the Author

Mary Kate Kelley-Scheidler is a licensed attorney and an Enrolled Agent practicing as a solo practitioner with the law firm Carpe Diem Legal Services. Her practice focuses on drafting qualified domestic relations orders, domestic relations orders, court orders acceptable for processing and military pension division orders. Ms. Kelley-Scheidler also provides tax planning and preparation services with over ten years of professional tax preparation experience. Ms. Kelley-Scheidler has two grown children and lives with her husband Ray and their cat, "pretty boy" in New Brighton, Minnesota. Ms. Kelley-Scheidler enjoys gardening, watching Masterpiece Theatre on PBS and wearing cowboy boots.