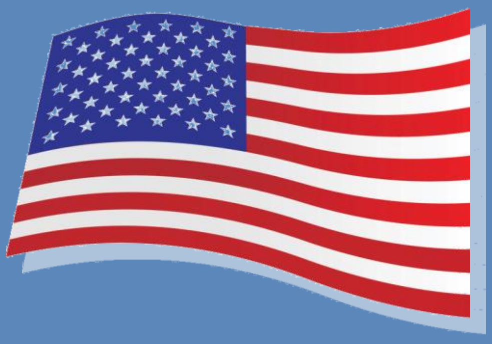
Federal Tax Guide for Resource Families

Tax Year 2010

Presented by the American Resource Families Institute



“Nearly every conceivable accession to wealth, except gifts and inheritances, starts with the premise it is taxable, unless it is specifically excluded by the Internal Revenue Code (§61).”

Generally, the tax benefits described in this guide are available to families that have taxable income in the form of wages or self-employment income. If your family has no wage earner, and receives only non-taxable benefits such as Supplemental Security Income (SSI) or Social Security benefits, then you may not be eligible for the tax benefits listed here.

Federal Tax Guide for Resource Families

2010 Tax Year

Table of Contents

Introduction

We are pleased to present the 2010 Federal Tax Guide for Resource Families. This resource guide is dedicated to the families that open their hearts and homes to children in need and provide the love and support to make a difference in the life of a child.

The tax guide provides valuable information worth several thousand dollars or more in tax benefits. The guide explains basic rules and offers tips on ways that foster and adoptive parents and kinship* caregivers can claim deductions and credits available to them. Neither the Internal Revenue Service (IRS) nor commercial tax manuals offer information on unique tax rules that affect these families. As a result, obscure and complicated tax rules cause some families, and even some commercial tax preparers, to overlook or miss deductions and tax credits.

This information should not be considered legal advice or tax advice – it is general information that should not be acted upon except in consultation with a professional tax advisor. Give a copy of this guide to your tax preparer, and discuss the qualifications for any of the benefits discussed here.

Congress enacted several changes in the tax laws that are of special interest to foster and adoptive parents and kinship caregivers. You should also be aware that changes in the law, regulations, and IRS policies might occur after this guide is published. Consult a professional tax advisor for changes to the current tax year. See (page 23) for information on free tax preparation through a Volunteer Income Tax Assistance (VITA) site and locating a tax professional in your area.

Throughout the United States, thousands of foster, adoptive, and kinship families are working hard to make life better for themselves and their families. With the jobs they hold and inadequate foster care reimbursements, many simply cannot earn enough to achieve their goals. However, this year, eligible families can get as much as $5,666 from the Earned Income Credit (see page 12) and even more if they also qualify for the Child Tax Credit (see page 18).

Finally, this guide focuses primarily on low-to-moderate income families. Some issues of interest to upper-bracket families, such as the phase out of certain tax benefits and the alternative minimum tax, are not addressed here (visit www.IRS.gov for information).

Thank you for sharing your family and your home, giving love, encouragement, and hope to children and families in need.

American Resource Families Institute

* Kinship caregivers are individuals who have related children, e.g., a grandchild or a nephew placed in their home by a child welfare agency. These caregivers may be licensed and receive the regular board payment, or they may be unlicensed and receive a payment that is less than the regular cost of care reimbursement. In some cases, kinship caregivers have no involvement with a child welfare agency, and receive child only cash assistance (usually "TANF")

2010 Tax Law Changes

Congress enacted several important changes in the tax laws that are in effect for the 2010 tax year. **Filing deadline is April 18, 2011**.

Highlights of the changes are:

- **Adoption Credit** is refundable for 2010, meaning that you may claim it even if you owe no tax. The maximum adoption credit has increased to $13,170. Also, the maximum exclusion from income for benefits under your employer's adoption assistance program has increased to $13,170. These amounts are phased out if your modified AGI is between $182,520 and $222,520. You cannot claim the credit or exclusion if your modified AGI is $222,520 or more. See page 17 for more information.
- **Earned Income Credit** maximum increased to $5,666.00. The maximum amount of earned income increased to $45,373.00 (MFJ/2 children). The maximum amount of investment income increased to $3,100.00. (See page 12)
- **Education Credit** For tax year 2010, the following changes have been made to the Hope and American opportunity credits. The Hope credit is not available for 2010. The American opportunity credit is available for 2010 and is unchanged from 2009. (See page 19)
- **Child Tax Credit** minimum earned income amount decreased to $3,000.00. (See page 18)
- **Standard Mileage Rate** is 50 cents per mile for 2010. **Medical related mileage** is 16.5 cents per mile for 2010. See Transportation under "What Medical Expenses Are Includable" in Publication 502

Even if you do not otherwise have to file a return, you should file one to get a refund of any federal income tax withheld. You should also file if you are eligible for any of the following credits:

- Making work pay credit
- Earned income credit
- Additional child tax credit
- American opportunity credit
- First-time homebuyer credit
- Credit for federal tax on fuels
- Adoption credit
- Refundable credit for prior years minimum tax
- Health coverage tax credit

General Rules

Taxable Income

Taxable income is generally reported on the following form types: **Form 1099** or **Form W-2.**

1. **Form 1099-MISC:** Payments for services performed for a trade or business by people not treated as its employees. This form is issued to the *service provider* when $600.00 or more is paid during the calendar year (tax year). **Form 1099-MISC is reported to the Internal Revenue Service (IRS).**

2. **W-2 income** is the earnings of an employee (*service provider*) who works for an employer (*recipient of service/agency*). If income was received and social security, or Medicare tax was withheld, or would have been withheld a W-2 should be issued. In addition, every employer (recipient of service or agency) that pays remuneration for services performed by an employee (service provider), must file a Form W-2 for each employee (service provider). **W-2 income is reported to the IRS.**

A service provider may work for more than one recipient of service or agency. Since W-2's and 1099's are issued to the service provider (employee or independent contractor) of **each** employer (recipient of service/agency), a service provider may receive more than one W-2 or 1099 statement.

If a foster parent receives taxable payments, the agency issues a Form W-2 or 1099-MISC to both the foster parent and IRS. The income must be reported on the tax return. Consult a tax professional for proper reporting on your tax return.

A foster parent or caregiver may receive a Form W-2 if they are considered a household worker. A household worker performs work in or around your home. Some examples of household workers are:

- Babysitters (Respite)
- Domestic workers
- Health aides
- Housekeepers
- Nannies
- Private nurses

Household workers are not employees if the household worker can control how the work is done. The worker is not an employee but is self-employed (**1099-MISC**). A self-employed worker usually offers services to the public in an independent business. A worker who performs childcare services in his or her home generally is not an employee. If an agency provides the worker and controls what work is done and how it is done, the worker is not an employee to the service recipient, but is the employee of the agency.

If a service provider receives a Form 1099 or W-2 in error, contact the issuing agency and ask for a corrected form. The responsibility to pursue a corrected form falls on the taxpayer. Consult a tax professional for assistance.

Non-Taxable Income

As foster and adoptive parents and kinship caregivers, most payments received are excluded from taxable income and are not reported on a tax return. These include:

- cost of care reimbursements;
- specialized or difficulty of care payments;
- most other reimbursements from government or private child welfare agencies;
- child-only cash assistance (referred to in many states as “TANF” or Temporary Assistance to Needy Families); and
- Food Stamp Program.

Foster-care Payments: Payments received from a state, political subdivision, or a qualified foster care placement agency for providing care to qualified foster individuals in your home generally are not included in your income. However, you must include in your income payments received for the care of more than 5 individuals age 19 or older and certain difficulty-of-care payments.

§***IRC 131*— Difficulty-of-care payments***: Additional payments that are designated by the state as compensation for providing the additional care that is required for physically, mentally, or emotionally handicapped qualified foster individuals. A state must determine that the additional compensation is needed and the care for which the payments are made must be provided in your home.

Some payments are treated as taxable income, when a foster parent:

- cares for more than ten children or operates a group home;
- is paid to keep a bed available even if it is not used;
- is paid for his or her time;
- cares for more than five persons over the age of 19.

Adoption assistance payments and related subsidies for child care or other special needs, that are paid by government child welfare agencies for adopted children, are also excluded from taxable income. These payments are considered public assistance and should not be reported on your tax return.

Deductions and Credits

There are two basic kinds of tax benefits, deductions, and credits.

1. A **deduction** is subtracted from **taxable income**, and is generally less valuable to a taxpayer. The value of a deduction is based on the marginal tax rate of the taxpayer.

   *Example: A tax **deduction** of $1,000*

   Taxpayer A, in the 15% tax bracket, will save $150
   (15% of $1,000)

   Taxpayer B, in the 27% tax bracket, will save $270
   (27% of $1,000)

2. A **tax credit** is a dollar for dollar reduction in **tax liability**.

   *Example: A **tax credit** of $1,000*

   All taxpayers will have his or her tax bill reduced by $1,000

However, because tax laws and procedures are very complicated, other factors can influence the ultimate value to the taxpayer.

Refundable and Non-Refundable Credit

Most tax credits are **non-refundable.** They simply reduce or eliminate the income tax you owe.

Suppose you owe $400 in income taxes and qualify for a non-refundable credit worth $1,000. The credit will eliminate the amount you owe — **but you cannot get the remaining $600.**

Some tax credits are **refundable.** This means the taxpayer receives a refund for the full credit, even if no tax is due.

Suppose you owe $400 in income taxes and qualify for a refundable credit worth $1,000. The credit will eliminate the amount you owe — ***and the IRS will send you a check for the remaining $600.***

Dependency Exemption

Dependents of a taxpayer who meet a four-part test may be claimed as exemptions and listed on the front page of the tax return (Form 1040 or 1040A). The dependency exemption is worth $3,650 for each dependent, and can trigger eligibility for other valuable tax benefits such as the Earned Income Credit, Child Tax Credit, Child and Dependent Care Credit, and Education Credits.

Overview of the Rules for Claiming an Exemption for a Dependent
(Excerpt from IRS Publication 17)

Caution: The following is only an overview of the general rules. For details, see Publication 17.

- You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer.
- You cannot claim a married person who files a joint return as a dependent unless that joint return is only a claim for refund and there would be no tax liability for either spouse on separate returns.
- You cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident, U.S. national, or a resident of Canada or Mexico, for some part of the year.
- You cannot claim a person as a dependent unless that person is your **qualifying child** or **qualifying person (relative).**
- You lose part of the benefit of your exemptions if your adjusted gross income is above a certain amount. Please refer to Publication 17 for phase-out ranges.

Tests to Be a Qualifying Child

Relationship

1. The child must be your son, daughter, stepchild, **eligible foster child**[*], brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them.

Age

2. The child must be (a) under age 19 at the end of 2010, (b) under age 24 at the end of 2010 and a full-time student, or (c) any age if permanently and totally disabled.

Residence

3. The child must have lived with you for more than half of the year (183 days).

[*] An **eligible foster child** is an individual who is placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Note that temporary absences for summer camp, school, or even institutional care do not disrupt the child's residence. In addition, a child born during the year and placed in a home for the balance of the year meets the living arrangement requirement.

Support

4. **The child** must not have provided more than half of **his or her own support for the year**.

If the child meets the rules to be a qualifying child of more than one person, you must be the person entitled to claim the child as a dependent (see IRS Pub. 501 or consult a tax professional)

Tests to Be a Qualifying Relative

Child or person

1. The person cannot be your qualifying child or the qualifying child of anyone else.

Relationship

2. The person either (a) must be related to you in one of the ways listed under *Relatives who do not have to live with you*,* or (b) must live with you **all year** as a member of your household.

Income

3. The person's gross income for the year must be less than $3,650.

Support

4. You must provide more than half (50%) of the person's total support for the year. The support test can be a challenge, because all payments for cost of care reimbursement, all adoption assistance payments and TANF, SSI or other cash assistance count as support, but not support provided by the taxpayer.

For more information, see IRS Publication 501, *Exemptions, Standard Deduction, and Filing Information.*[†]

**** Relatives who do not have to live with you:***

A person related to you in any of the following ways does not have to live with you all year as a member of your household to meet this test.

- Your child, stepchild, **eligible foster child**[‡], or a descendant of any of them (A legally adopted child is considered your child)
- Your brother, sister, half brother, half sister, stepbrother, or stepsister
- Your father, mother, grandparent, or other direct ancestor, but not foster parent

† Special note for resource caretakers who are single, or who are married but separated from your spouse: A child placed in your home who qualifies for a dependency exemption may help you qualify for Head of Household filing status, which will further reduce your tax liability. See IRS Publication 501 for more information.

‡ Eligible foster child: An eligible foster child is an individual who is placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

- Your stepfather or stepmother
- A son or daughter of your brother or sister
- A brother or sister of your father or mother
- Your son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law

Dependents are not allowed a personal exemption. If you can claim an exemption for your dependent, the dependent cannot claim his or her own exemption on his or her own tax return.

Social Security Numbers

The IRS is very strict in requiring that a dependent, or a qualifying child for one of the tax credits listed below, must have a valid Social Security Number (SSN). Foster parents should obtain a foster child's SSN and the name on file with Social Security from the caseworker; if the child does not have a SSN, or if it is lost, the caseworker should obtain a new one from the Social Security Administration.

Foster children who are not citizens may not be eligible for a SSN; in that case, the caseworker can apply for an Individual Taxpayer Identification Number (ITIN-Form W-7) that must be used if the child is claimed as a dependent. ITIN's cannot be used to claim EITC. An Adoption Taxpayer Identification Number (Form W-7A) is also available for pending adoptions.

Earned Income Tax Credit (EITC)

Workers Get the Most Out of Your Paychecks: EITC is the largest public benefit program providing support to working families.

If you have:	And your earned income is less than:	Maximum EITC for 2010 tax year is:
One qualifying child	$35,535 ($40,545 MFJ)	$3,050
Two qualifying children	$40,363 ($45,373 MFJ)	$5,036
Three or more qualifying children	$43,352 ($48,362 MFJ)	$5,666
No qualifying children	$13,460 ($18,470 MFJ)	$ 457

This is a refundable credit (see page 9).

Qualifying a child for EITC:

Relationship

To be your **qualifying child**, a child must be your:

- Son, daughter, stepchild, **eligible foster child**[§] or a descendant of any of them (for example, your grandchild)

- or Brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew)

Age

The child must be **under the age of 19** at the end of 2010
<u>Except:</u>

- A full-time student under age 24
    - or a person who is totally disabled of any age

Residence

The child must have **resided in the taxpayer's home** for <u>more than</u> six months.
Maximum investment income - $3,100

It is important to note that a "qualifying child" for EITC does not have to meet the IRS tests for a dependent.

Be aware…

- Taxpayers with certain **unearned income** that exceeds $3,100 from interest, dividends, rent, or capital gains cannot receive EITC.

- Taxpayers who file with the filing status "**married separate**" cannot receive EITC.

- When more than one person files a return claiming the same qualifying child (**Tie-Breaker Rules**), see IRS Publication 17 or consult a tax professional.

Congress has imposed **severe penalties** on taxpayers or tax preparers who fraudulently or intentionally disregard the rules and regulations for claiming EITC. Therefore, taxpayers should exercise caution and be informed about the rules for the Earned Income Tax Credit.

"The credits help workers keep working
and care for themselves and their children."

[§] Eligible foster child: An eligible foster child is an individual who is placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Charitable Contributions

Foster parents: You may be able to deduct as a charitable contribution some of the costs of being a foster parent. Foster parents are volunteers and therefore the expense for your volunteer service is deductible as Charitable Contributions.

- If you have no profit motive in providing foster care and are not, in fact, making a profit
- In addition, a qualified organization must designate the individuals you take into your home for foster care

You can deduct expenses that meet both of the following requirements:

- They are unreimbursed out-of-pocket expenses to feed, clothe, and care for the foster child
- They must be mainly to benefit the qualified organization

Unreimbursed expenses that you cannot deduct as charitable contributions may be considered support provided by you in determining whether you can claim the foster child as a dependent person (relative). For details, see Publication 501, Exemptions, Standard Deduction, and Filing Information or consult a tax professional.

A foster child placed in your home for purposes of adoption by you is considered by the IRS to be caring for your own child, even if the adoption is not finalized in the tax year.

Example: You cared for a foster child because you wanted to adopt her, not to benefit the agency that placed her in your home. Your unreimbursed expenses related to this child are not deductible as charitable contributions.

Transportation expenses that are not reimbursed by the agency and directly related to the care of the foster child may also be a charitable deduction. This may include trips to administrative case reviews or to court hearings, visits to the foster child's siblings or other relatives, and trips for medical care. When using a family car, *parking* and *tolls* may be included. Actual *gas* and *oil* expenses (but not depreciation of the car) may be used, **or** the taxpayer may deduct *14 cents per mil*e. To deduct mileage, you must maintain a reliable written log.

Tip: A foster parent should always seek **reimbursement** from the child welfare agency **to the extent possible**. Reimbursement of a $100 expense gets you $100. Claiming a $100 expense as a charitable deduction gets you no more than $15 if you are in the 15% tax bracket.

Reminder: Keep good records of expenditures and consult with a tax professional when considering large or unusual deductions.

Recordkeeping

The IRS does not expect, or want, additional documents attached to tax forms that prove various expenses were incurred or show when certain children were placed in your home. However, the IRS reserves the right to ask for documentation, and a taxpayer who fails to provide proof upon request is at risk of losing a deduction or credit. Therefore, foster parents, adoptive parents and kinship caregivers should maintain records concerning the children in their homes, and the expenses that they incur. Generally, records should be kept for **at least three years**.

Suggestions

Identify sources of income or reimbursement.

- You may receive money from a variety of sources. Your records identify the sources of your income and reimbursements. Separate business from non-business income and taxable from non-taxable income. Remember, you are a professional, treat your volunteer service as a business.

Keep track of expenses.

- You may forget an expense unless you record it when it occurs. Maintain records to identify expenses for which you can claim a deduction. Make notes on your receipts of the purpose for the expense. Creating this habit will ensure you have valid receipts for your deductions.

Keep documents that show residency

- As IRS increases compliance efforts concerning dependents and the Earned Income Tax Credit, there is a greater chance that foster parents may be asked to demonstrate that their foster child lived with them. Parents can be prepared by holding on to placement paperwork, school records, medical documents, and childcare records that indicate dates and the child's address.

Tip: Many caregivers have adopted the "envelope system." Envelopes marked with certain categories of expenses are stuffed with receipts upon returning from shopping trips. Recordkeeping should be prepared monthly. This makes a daunting task easier and eliminates the year-end receipt chaos.

Professional Foster Parents

The ever-changing world of foster care brings a higher level of care for foster children. The higher level of care has introduced the professional foster parent. Some foster parents may receive compensation beyond the foster care reimbursement and this income may be taxable. If you receive a 1099-MISC for this income, the IRS presumes you are a business.

Business Expenses

Business expenses are the cost of carrying on a trade or business. These expenses are usually deductible if the business is operated to make a profit.

What Can I Deduct?

To be deductible, a business expense must be both **ordinary and necessary**. An **ordinary expense** is one that is common and accepted in your trade or business. A **necessary expense** is one that is helpful and appropriate for your trade or business. An expense does not have to be indispensable to be considered necessary. Ask yourself, "is this expense ordinary or necessary for my business and why?" Keep notes and accurate records. Remember, the IRS may request to view these documents.

Personal Expenses

Generally, you cannot deduct personal, living, or family expenses. However, if you have an expense for something that is used partly for business and partly for personal purposes, divide the total cost between the business and personal parts. You can deduct as a business expense only the business part.

Business Use of Your Home

If you use part of your home for business, you may be able to deduct expenses for the business use of your home. These expenses may include mortgage interest, insurance, utilities, repairs, and depreciation. Know the square footage of your home and the areas used "exclusively" for business purposes. Refer to Publication 587, Business Use of Your Home.

Example: Your home is 1500 square feet. The bedroom used exclusively for foster children is 150 square feet. The percentage allowable for business use of your home is 10% of the expenses.

Business Use of Your Car

If you use your car in your business, you can deduct car expenses. Refer to Publication 463, Travel, Entertainment, Gift, and Car Expenses.

This list is not all inclusive of the types of business expenses that you can deduct. For additional information, refer to Publication 535, Business Expenses or consult a tax professional.

Adoption Tax Credit

In 2010 and 2011, you may be able to take a refundable tax credit for qualifying expenses paid to adopt an eligible child (including a child with special needs). This means that you could qualify for a tax refund even if you did not have federal income tax withheld. **The Adoption Credit for 2010 is up to $13,170**.

For tax years prior to 2010, the adoption credit is not refundable. **If you carried forward an adoption credit from 2005 or later (because the credit was more than the tax you owed), you can claim the carried-forward amount as a refundable credit in 2010.** You can find the amount of any unused carry forward amount on line 23 of the worksheet on page 5 of the 2009 Form 8839, Qualified Adoption Expenses.

The adoption of a "Special Needs" child **does not require the taxpayer to have qualifying expenses.** The IRS defines a special needs child as:

- A citizen or resident of the U.S.
- The state determines that the child cannot or should not be returned to parents
- Probably will not be adopted unless adoption assistance is provided to the adoptive parents
- The child otherwise meets the definition of eligible child

If the state determines the child to be special needs, keep that documentation. Under new Adoption Credit Rules for the 2010 tax year, you must attach one or more adoption-related documents (identified in the form instructions) with the completed Form 8839 (PDF), Qualified Adoption Expenses, and attach the form to your Form 1040 or Form 1040A return, to claim the adoption credit or income exclusion. The required documents are different if the adoption is foreign, or domestic, final or not final and if the adoption is for a special-needs child.

You cannot file a tax return with the adoption credit electronically. You must file a paper tax return because you need to attach the supporting documents.

Records you need to keep to claim the adoption credit or the income exclusion

Keep the following documents to make sure you get any credit that is allowable:

- receipts for qualified adoption expenses,
- entry visas for foreign adoptions,
- final decree, certificate or order of adoption,
- home study by an authorized placement agency,
- child placement agreements or court orders, and
- determination of special needs status by a State or the District of Columbia.

If not a special needs adoption, qualifying expenses are defined as **reasonable** and **necessary** expenses directly related to a legal adoption.

Examples include:

- court costs,
- attorney fees,
- traveling expenses (including amounts spent for meals and lodging while away from home), and
- other expenses directly related to the legal adoption of an eligible child.

Excluded or non-qualifying expenses include:

- for adopting your spouse's child,
- for a surrogate parenting arrangement,
- that violate state or federal law,
- paid using funds received from a federal, state, or local program,
- paid or reimbursed by your employer or any other organization, or
- allowed as a credit or deduction on a federal tax return.

An **eligible child** must be

- under age 18, or
- mentally or physically disabled

For 2010, you may not get the full amount of the exclusion if your modified adjusted gross income (MAGI) is $182,520 or more and the credit is completely phased out if your MAGI is $222,520 or more. IRS may make inflation adjustments to the maximum amount of the income exclusion and the MAGI amount for the phase-out for 2011.

For more information, see IRS Form 8839, *Qualified Adoption Expenses.*

Child Tax Credit

The Child Tax Credit (CTC) is $1000, for the 2010 tax year, for each qualifying child. A **qualifying child** for the Child Tax Credit must meet the following requirements:

- The child must be the taxpayer's biological child, grandchild, adopted child, sibling, stepchild, or relative, or **an eligible foster child**
- The child must be under the age of 17 at the end of the year
- The child must be a citizen or resident of the U.S.
- The child must qualify as the taxpayer's dependent

Generally, foster and adoptive parents and kinship caregivers who are eligible to claim a dependency exemption for a child under age 17 are also eligible to claim the Child Tax Credit. CTC is a non-refundable credit, however, taxpayers may qualify for the refundable Additional Child Tax Credit .See IRS Publication 972.

Child and Dependent Care Credit

This credit is available for work-related expenses incurred by the taxpayer for care of a qualifying individual, who must be a dependent (see page 10). Generally, expenses must be for the care of a **child under age 13**. However, this age limit is waived for a dependent who is **disabled** and **not capable of self-care (requires medical diagnosis)**.

***Physically or mentally not able to care for oneself**. Persons who cannot dress, clean, or feed themselves because of physical or mental problems are considered not able to care for themselves. Also, persons who must have constant attention to prevent them from injuring themselves or others are considered not able to care for themselves.*

Maximum expenses are $3,000 per year for one child, and $6,000 per year for two children. The credit is calculated as a **percentage of the allowable expenses**. The credit can be up to 35% of your expenses depending on your adjusted gross income. Employer dependent care assistance plans maximum is $5,000.

Qualifying expenses include:

- child care expenses
- after school programs
- summer camp (Not **overnight** camp expenses).

Childcare payments to a relative qualify, unless the relative is a dependent of the taxpayer. You will need to report the name, address, and Social Security number of anyone you paid to provide child care in order to claim this credit. (Phase-out ranges apply, see IRS Publication 503 and Form 2441 or consult a tax professional)

Education Credits

The **American Opportunity Credit** and the **Lifetime Learning Credit** are based on amounts paid for "qualified expenses" for college, vocational training and other post-secondary education. The American Opportunity Credit is $2500 of which up to **$1000 is refundable** and the Lifetime Learning credit is **non-refundable**, and can be claimed for expenses incurred by the taxpayer or the taxpayer's dependent.

The following rules apply to both the American Opportunity Credit and the Lifetime Learning Credit:

- The definition of qualified higher education expenses for tax-free distributions from a qualified tuition program is expanded to include amounts paid in 2009 or 2010 for the purchase of computer software, any computer or related peripheral equipment, fiber optic cable related to computer use, and Internet access.
- The school must be eligible to participate in a student aid or student loan program administered by the U.S. Department of Education.
- The credit cannot be claimed for educational expenses paid through a scholarship, employer, education IRA, or other third party source.
- Educational expenses paid with borrowed funds qualify.
- Educational expenses paid by a taxpayer for a dependent who is claimed as a dependent qualify for the credit.
- Educational expenses do not include personal expenses such as room and board.
- A student may claim **either** the American Opportunity Credit or the Lifetime Learning Credit but **not both in the same year.**
- Taxpayers who file married filing separately are not eligible for these credits.

American Opportunity Credit

The American Opportunity Credit can now be claimed for the first four years of post-secondary education

- Generally, 40% of the American Opportunity Credit is now a refundable credit, which means that you can receive up to $1,000 even if you owe no taxes.

- However, none of the credit is refundable if the taxpayer claiming the credit is a child:

  (a) who is under age 18 (or a student who is at least age 18 and under age 24 ***and*** whose earned income does not exceed one-half of his or her own support),
  (b) who has at least one living parent, and
  (c) who does not file a joint return.

Vocational training that leads to a certificate upon completion will qualify. Examples of vocational courses include certified nurse's aide, certified child care worker, and certified auto mechanic courses offered at community colleges or other qualifying institutions. The course load for a vocational training program must be at least a half time course load for one semester.

The American Opportunity Credit is up to $2,500 per student per year. The credit is phased out (gradually reduced) if your modified adjusted gross income (AGI) is $90,000 ($180,000 if you file a joint return).

Lifetime Learning Credit

Qualifying expenses for this credit include **tuition and fees** for **any post-secondary instruction** at a qualifying educational institution. There is **no minimum course requirement**, so individual classes at community colleges or other approved institutions will qualify. Also, the cost of continuing education classes, including foster parent conferences, may qualify if offered by a qualified educational institution.

The Lifetime Learning Credit is 20% (40% if a Midwestern disaster area student) of tuition and fees, up to $2,000 per tax return. Therefore, this is a maximum amount for all family members combined.

To claim education credits, the taxpayer must complete Form 8863 and attach it to Form 1040. Phase-out ranges apply. For more information, see IRS Publication 970, *Tax Benefits for Education.*

Tip: *Education expenses can also be taken as an adjustment to income under the tuition and fees deduction instead of a credit. The tax return should be computed both ways to determine which is more beneficial. A taxpayer cannot claim an education credit and a tuition and fees deduction for the same student in the same tax year. (See Publication 970 for more information or consult a tax professional)*

Special Rules for Legal Guardians

A number of states sponsor "Assisted Guardianship" or "Subsidized Guardian" programs as a permanency option. Under these programs, a foster parent, often a relative of the child, assumes legal guardianship of the child. In many cases, the child welfare agency continues to provide cost of care reimbursement payments and other supports to the caregiver. The following special rules apply to guardians:

- Cost of care reimbursement and difficulty of care payments are not taxable income, and should not be reported on the caretaker's tax return.
- Expenses related to legal guardianship of a child are not eligible as charitable contributions. The IRS has determined that legal guardianship as considered caring for your own child.
- A guardian child not related to you may be claimed as a dependent if the guardian provides more than half of the child's support and the child lives in the caretaker's home for the full year. A guardian child related to you does not need to live with you all year.
- A child claimed as a dependent may also be a qualifying child for the Child and Dependent Care Credit, the Child Credit, and the Education Credits.
- A child placed by a public or private child welfare agency with a guardian can be a qualifying child for the Earned Income Tax Credit, if the child resides with the guardian for more than 6 months.

Claims for Prior Years

If you learn about your eligibility for a tax benefit for the first time in this guide, you may be concerned about previous year's tax returns. Any taxpayer may file an amended return, Form 1040X, to correct errors in a prior year return. The IRS will issue refunds for amended returns up to three years prior. The deadline for filing an amended return that claims a refund for the 2007 tax year is April 18, 2010. The IRS will not honor claims for refunds for the 2006 tax year.

If you have misplaced a prior year return, you can obtain a free transcript or copy of the actual return for a fee of $57.00, from the IRS. Form 4506-T, *Request for Transcript of Tax Return* and Form 4506, *Request a copy of a tax Return* are available online at www.irs.gov or can be ordered from the IRS by calling (800) 829-1040.

Resources

Where to Find More Information

There are many sources of more information, and much of it is free. The IRS prints dozens of publications, including several cited in this booklet. The following is a list of the most relevant publications:

Publication 17	*Your Federal Income Tax* – a 270+ page book that provides information on a wide variety of income tax topics
Publication 505	*Tax Withholding and Estimated Tax*
Publication 596	*Earned Income Credit*
Publication 972	*Child Tax Credit*
Publication 503	*Child and Dependent Tax Credit*
Publication 501	*Exemptions, Standard Deduction, and Filing Information*
Publication 556	*Examination of Returns, Appeal Rights, and Claims for Refund*
Publication 970	*Tax Benefits for Higher Education*
Form 8839	*Qualified Adoption Expenses*
Publication 587	*Business Use of Your Home*

These and many other IRS publications are free. To obtain these publications and any of the forms mentioned in this booklet, you can:

- call (800) 829-1040;
- pick them up at most IRS offices; or
- download them from the IRS web site: http://www.irs.gov/formspubs/index.html

The Center on Budget and Policy Priorities publishes an annually updated Earned Income Tax Credit Outreach Kit with reproducible posters, flyers, and much other useful information. The 2010 edition is available at: http://eitcoutreach.org

The American Bar Association Section of Taxation maintains a web site with a page that lists over 100 links to tax related web sites, including federal and state agencies, and private organizations. This is available at: http://www.abanet.org/tax/sites.html

Professional Tax Preparation

When it is time to file a tax return, many taxpayers seek help from a professional tax preparer.

- Average fees range from $75 - more than $150 for tax preparation and E-filing based on the forms required to be completed.

We are collaborating with the **National Association of Enrolled Agents** and **WA State Society of Enrolled Agents** to provide training to enrolled agents on foster care tax issues. To locate a trained enrolled agent near you, call 202-822-NAEA or visit www.NAEA.org. For WA residents, **call WA Society of Enrolled Agents** at (800) 613-2801 to find a trained enrolled agent near you.

What is a Refund Anticipation Loan?

- Very high-interest loans
  - Interest rate can be over 180 percent
- Processing fee can be $80 or more
  - Some preparers charge a percentage of the EIC refund, driving fees even higher
- No guarantee refund will equal the loan amount

Volunteer Income Tax Assistance (VITA)

- Provides free tax filing help for low-income taxpayers at community sites
- Sponsored by the IRS
- In many communities across the country
- Volunteers are trained under IRS guidance
- Taxpayers can receive refund in 7-12 days through e-filing

Enrolled Agents Support Resource Families

The WSSEA and the NAEA are working with ARFI to provide tax assistance to Resource Families Nationwide. Visit www.ARFInstitute.org for more information and a list of enrolled agents trained on foster care tax issues.

Call ***211*** nationwide for information on the VITA sites in your community or the IRS at (800) 829-1040. Be aware that most VITA sites are only open during the tax-filing season (late January through April 15th), and many VITA sites cannot handle relatively complicated or multi-year returns. It is best to call before hand for an appointment.

What to bring to your tax appointment:

- Proof of identification
- Social Security Card for you and each member of your family or a Social Security verification letter
- Birth dates for you, your spouse and dependents
- Current year's tax package (if you've received one)
- W-2 form
- Interest and dividend statement
- A copy of last year's federal and state tax returns if available
- Bank routing numbers and account numbers for direct deposit
- Total paid for day care and day care provider's Tax ID Number

The tax rules summarized in this guide are complex, and applying the rules to a particular family can be very challenging. Generally, foster and adoptive parents and kinship caregivers should consult with a tax advisor before using the information in this guide.

Enrolled Agents are licensed to practice by the federal government and authorized to appear in the place of the taxpayer at the IRS. Only Enrolled Agents, attorneys, and CPAs may represent taxpayers before the IRS. The differences between Enrolled Agents and other tax professionals are only Enrolled Agents are required to demonstrate to the IRS their competence in matters of taxation before they may represent a taxpayer before the IRS. Unlike attorneys and CPAs, who may or may not choose to specialize in taxes, all Enrolled Agents specialize in taxation. Enrolled Agents are the only taxpayer representatives who receive their right to practice from the U.S. government (CPAs and attorneys are licensed by the states). To locate an EA in your area visit www.naea.org or call (800) 424-4339.

Other sources for referrals of tax professionals are the state CPA Society. Phone numbers can be located in the yellow pages of the phone directory or online.

Tax attorneys, accountants, and enrolled agents are professional sources of assistance, but this representation can be expensive. Referrals can be obtained through the local bar association, the state CPA Society, or the National Association of Enrolled Agents.

Except in California and Oregon, there are no licensing standards for commercial tax return preparers. A small minority of tax preparers lack sufficient training and experience, and some may even promote fraudulent claims in order to generate higher fees. Generally, it is best to ask for several references from a prospective tax preparer, and to ask about the individual's experience with foster and adoptive parents and kinship caregivers. Avoid tax return preparers who "guarantee" large refunds.

IRS Inquiries and Disputes

Slightly more than 1% of all taxpayers receive audit letters and as many as 10% of EITC filers receive letters raising questions about their returns. Often, IRS letters request relatively simple information, such as the Social Security Number of someone in the household. In some cases, the letter requests more detailed information concerning the tax return. If you paid someone to prepare your return, that individual or company should provide some assistance in responding, if you need help. Depending on the circumstances, an additional fee may be charged.

The Taxpayer Advocate Service is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should. Contact your local IRS office or call (800) 829-1040.

Conclusion

This guide offers general information about tax benefits that may be available to foster, adoptive parents, and kinship caregivers. The application of the tax laws to your specific circumstances will require reference to numerous rules and policies that could not be included in this guide. We urge you to consult with a tax professional before making decisions about claiming particular tax benefits. Give a copy of this guide to your tax advisor, and discuss how these tax laws apply to your family and your earnings.

For information on tax workshops for caregivers or comments and suggestions about this information, please contact the ARFI at info@ARFInstitute.org or (253) 988-2275.

For information regarding enrolled agent training, please contact Kathy A Suits, EA, Summit Capital Advisors, 253-589-1401 or ksuits@summitcapitaladvisors.net.

The American Resource Families Institute (ARFI) is a nonprofit organization dedicated to support and provide education and advocacy for resource families across America.

ARFI has provided services to resource families, nonprofit organizations, state and private agencies, support groups and tax professionals nationwide.

American Resource
Families Institute

2200 N 30th St # 202
Tacoma, WA 98403-3364
(253) 988-2275
www.ARFInstitute.org