

Office of Chief Counsel
Internal Revenue Service
memorandum

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date: October 13,1998

to: District Counsel, South Texas District, CC:MSR:STX:AUS
Attention: Lewis J. Hubbard, Jr. and Jerry L. Hamilton

from: Assistant Chief Counsel
(Employee Benefits and Exempt Organizations), CC:EBEO

subject: Significant Service Center Advice Request

This responds to your request for Significant Advice dated September 26, 1997, concerning a question posed by the Austin Service Center regarding the proper application of section 32(c)(1)(C) of the Internal Revenue Code.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice May Be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in Paragraphs III.D.4. and IV.A.5. of Part (35) of the CCDM. (See Office of Chief Counsel Notice dated February 10, 1997, regarding Service Center Advice Procedures.) This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document may not be disclosed beyond the office of individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

Issues

Situation 1

If a mother, X, with modified adjusted gross income (MAGI) of \$10,001, her daughter, Y, with MAGI of \$10,000, and one granddaughter, Z, lived together for the entire 1995 taxable year:

(a) Who can claim the earned income tax credit (EIC) under section 32 of the Code? What if their MAGI's are reversed?

(b) Does a taxpayer have to claim the EIC with respect to an individual who satisfies sections 32(c)(3)(A)(i), (ii), and (iii) of the Code?

(c) How should the Service treat similar factual situations in light of Lestrangle v. Commissioner, T.C. Memo. 1997-428?

Situation 2

If two sisters, A and B, lived together in 1995 with their respective foster children, C and D:

- (a) Can each sister claim the EIC under section 32 of the Code?
- (b) If one sister has a higher MAGI, does section 32(c)(1)(C) of the Code operate to disallow the EIC to the other sister?

Conclusions

Situation 1

(a) On the facts presented, Z is a qualifying child of both X and Y.

(i) If Y meets the age requirement then she is also a qualifying child of X, the rule of section 32(c)(1)(B) of the Code applies, and the tie-breaker rule of section 32(c)(1)(C) is not triggered, with the following result: X can claim the EIC with respect to both Y and Z by identifying them on her tax return, and Y cannot claim the EIC.

(ii) If Y does not meet the age requirement then she is not a qualifying child of X, the tie-breaker rule of section 32(c)(1)(C) of Code applies, and X's having a higher MAGI than Y produces the following result: X can claim the EIC with respect to Z by identifying Z on her tax return, and Y cannot claim the EIC. If the MAGI's are reversed, then Y can identify Z on her return and claim the EIC, and X cannot.

(b) If an individual satisfies the relationship, abode, and age tests with respect to a taxpayer, the individual is a qualifying child of that taxpayer regardless of whether the taxpayer identifies the individual as a qualifying child on the return.

(c) In light of the retroactive technical corrections made by section 6021 of the Internal Revenue Service Restructuring Act of 1998, the reasoning of Lestrangle v. Commissioner, T.C. Memo. 1997-428, should not be applied in similar factual situations.

Situation 2

(a) On the facts presented, C is A's qualifying child, and A can claim the EIC by identifying C on her return. D is B's qualifying child, and B can claim the EIC by identifying D on her return.

(b) The fact that both sisters and their respective foster children live at the same address does not automatically trigger the tie-breaker rule. The tie-breaker rule only applies if there are two or more otherwise eligible individuals with respect to the same qualifying child. In this situation, the rule does not apply because neither sister is an eligible individual with respect to the other sister's foster child. The fact that one sister has a higher MAGI therefore does not operate to disallow the EIC to the other sister.

Facts of Situation 1

X, Y, and Z lived together throughout all of 1995. X rented a 3-bedroom apartment throughout all of 1995. X is the mother of Y, and Z is the daughter of Y. X, Y, and Z each have a social security number. X and Y have MAGI's of \$10,001 and \$10,000, respectively. Z is 10 years old. Y pays her mother half of the rent and utilities for the apartment and receives exclusive use of one bedroom and shared use of the common areas. Y pays for Y's and Z's food.

Discussion of Situation 1

Relevant Legal Authorities

Section 32(a) of the Code allows the EIC in the case of an eligible individual. An eligible individual is defined by section 32(c)(1)(A) of the Code to include any individual who has a qualifying child for the taxable year.

"Qualifying child" is defined in section 32(c)(3) of the Code. A technical correction enacted in section 6021 of the Internal Revenue Service Restructuring Act of 1998, Pub. L. 105-206, amended section 32(c)(3) to clarify this definition. The amendment is effective as if included in the 1990 amending legislation.¹ As amended, section 32(c)(3)(A) of the Code defines a qualifying child as an individual:

(i) who bears a relationship to the taxpayer described in subparagraph (B),

¹Section 32 of the Code was substantially amended by the Revenue Reconciliation Act of 1990, Title XI of the Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508, sec. 11111(a), 104 Stat. 1388, 1388-408 (1990). This revision introduced the concept of a qualifying child by adding section 32(c)(3).

(ii) except as provided in subparagraph (B)(iii), who has the same principal place of abode as the taxpayer for more than one-half of [the] taxable year, and

(iii) who meets the age requirements of subparagraph (C).

An individual satisfies the relationship requirement under section 32(c)(3)(B) of the Code if the individual is the son or daughter of the taxpayer, or the descendant of either; a stepson or stepdaughter of the taxpayer; or an eligible foster child. An eligible foster child is defined in section 32(c)(3)(B)(iii) of the Code as an individual, who is not the son or daughter of the taxpayer, or a descendant of either, or a stepson or stepdaughter of the taxpayer, 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. Under section 32(c)(3)(C) of the Code an individual satisfies the age requirement 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) of the Code, a qualifying child shall not be taken into account under subsection (b) unless the taxpayer includes the name, age, and taxpayer identification number of the qualifying child on the return.

The tie-breaker rule of section 32(c)(1)(C) of the Code applies if there would be two or more eligible individuals with respect to the same qualifying child. Under the tie-breaker rule only the taxpayer with the highest MAGI is treated as an eligible individual with respect to that qualifying child.

Under section 32(c)(1)(B) of the Code, if an individual is a qualifying child of another taxpayer, that individual is not treated as an eligible individual. This rule is applied before the tie-breaker rule.

Who is a qualifying child?

Y is X's qualifying child if she satisfies the relationship, abode, and age tests. She satisfies the relationship test because she is X's daughter. She satisfies the abode test because she lived with X for more than half of 1995. If Y was under age 19, or 24 if she was a full-time student, or she was totally and permanently disabled, she satisfies the age test. If Y satisfies the age test, she is X's qualifying child.

Z is X's qualifying child if she satisfies the relationship, abode, and age tests. She satisfies the relationship test because she is X's granddaughter. She satisfies the abode test because she lived with X for more than half of 1995. She

satisfies the age test because she is 10 years old. Thus, Z is X's qualifying child.

Z is Y's qualifying child if she satisfies the relationship, abode, and age tests. She satisfies the relationship test because she is Y's daughter. She satisfies the abode test because she lived with Y for more than half of 1995. She satisfies the age test because she is 10 years old. (The fact that Y has exclusive use of the bedroom in the apartment does not mean that Y and Z have separate places of abode.) Thus, Z is Y's qualifying child.

As the preceding discussion indicates, Y may be X's qualifying child. If so, section 32(c)(1)(B) of the Code would apply. If not, the tie-breaker rule would apply because Z is a qualifying child of both X and Y.

How does the rule under section 32(c)(1)(B) of the Code operate in this situation? How does the tie-breaker rule operate in this situation?

If Y is X's qualifying child, section 32(c)(1)(B) of the Code is triggered. Because Y is the qualifying child of another taxpayer, Y is not an eligible individual and thus cannot claim the EIC with respect to Z, even though Z is Y's qualifying child. The MAGI's of X and Y are irrelevant because section 32(c)(1)(B) of the Code applies before the tie-breaker rule and prevents Y from being an eligible individual. With X as the only eligible individual with respect to Z, the tie-breaker rule is not triggered.

If Y is not X's qualifying child, the tie-breaker rule is triggered because both X and Y are otherwise eligible individuals with respect to Z. Because X has the higher MAGI, she is treated as an eligible individual, and Y is not. Thus, X is entitled to claim the EIC with respect to Z.

In this same situation, if the MAGI's are reversed (\$10,001 for Y and \$10,000 for X), the tie-breaker rule treats Y rather than X as an eligible individual with respect to Z. In that situation, Y is entitled to claim the EIC.

Does a taxpayer have to claim the EIC with respect to an individual who satisfies sections 32(c)(3)(A)(i), (ii), and (iii) of the Code?

If an individual satisfies the relationship, abode, and age tests with respect to a taxpayer, the individual is a qualifying child of that taxpayer. Even if the taxpayer does not identify the child on his or her return, the tie-breaker rule and the rule

under section 32(c)(1)(B) of the Code operate to disallow the EIC to certain individuals.

How should fact patterns similar to *Lestrangle v. Commissioner* be treated?

In *Lestrangle v. Commissioner*, T.C. Memo. 1997-428, Ms. Lestrangle lived with her 2-year old son (Treytaine), her sister (Heather), and her mother (Ms. Groom) for the relevant periods in 1994. Treytaine satisfied the relationship, abode, and age tests of a qualifying child in section 32(c)(3)(A) of the Code with respect to both Ms. Lestrangle and Ms. Groom. Heather satisfied these tests with respect to Ms. Groom. Ms. Lestrangle identified Treytaine on her return as a qualifying child and claimed the EIC with respect to him. Ms. Groom identified Heather on her return as a qualifying child and claimed the EIC with respect to Heather, but did not identify or claim the EIC with respect to Treytaine. Ms. Groom had a higher adjusted gross income than Ms. Lestrangle.

The Service disallowed the EIC to Ms. Lestrangle. The Service argued that the identification requirement was merely a procedural requirement, and that only the relationship, abode, and age tests are elements of the definition of a qualifying child. Therefore, because Treytaine met those elements with respect to both Ms. Lestrangle and Ms. Groom, the tie-breaker rule of section 32(c)(1)(C) of the Code applied. Accordingly, because Ms. Groom had a higher adjusted gross income,² Ms. Lestrangle could not claim the EIC with respect to Treytaine.

In holding for Ms. Lestrangle, the Tax Court concluded that the identification requirement was an essential element of the definition of qualifying child in section 32(c)(3) of the Code, so that the tie-breaker rule did not apply.

The Tax Court reached its conclusion in *Lestrangle* under a prior version of section 32(c) of the Code. As indicated above, section 6021 of the Internal Revenue Service Restructuring Act of 1998 made technical corrections to section 32(c) of the Code. These technical corrections are effective as if included in the original legislation in 1990.

The technical corrections to section 32(c) of the Code clarify that a qualifying child is an individual who satisfies the relationship, abode, and age tests. As a result, the

² In 1994, the rule was based on adjusted gross income rather than modified adjusted gross income.

reasoning in Lestrangle should not be applied to situations similar to the one described in that case.

Facts of Situation 2

A and B are sisters who live in the same house. A has a foster daughter, C, and B has a foster son, D. A and B had MAGI's in 1995 of \$11,000 and \$10,000, respectively. A and B equally share the cost of maintaining the house. C and D are both 15 years old and have social security numbers. A and B each pay their own personal expenses and the expenses of their respective foster child. A does not care for B's foster son as her own, and B does not care for A's foster daughter as her own.

Discussion of Situation 2

Can each sister claim the EIC?

C is A's qualifying child if she satisfies the relationship, abode, and age tests. Because C is not A's daughter, granddaughter, or stepdaughter, she can satisfy the relationship test only if she is A's eligible foster child. Although the facts do not specifically state that A cares for C as her own child, we assume that A does so because the facts describe C as A's "foster daughter" and indicate that B does not care for C as B's own child. If C has the same principal place of abode as A for the entire taxable year, she is A's eligible foster child. Although the facts do not specifically state that C has the same principal place of abode as A for the entire year, assuming she resides in the same house as A for the entire taxable year, she satisfies the abode test. C satisfies the age test because she is 15 years old. Thus, C is a qualifying child of A.

The rule under section 32(c)(1)(B) of the Code does not apply because A is not in turn the qualifying child of anyone else, and the tie-breaker rule does not apply for the reasons discussed below. A is an eligible individual with respect to C and is entitled to claim the EIC with respect to C. To claim the EIC, A must identify C on her return by including C's name, age, and social security number on the return.

This result would change if C does not have the same principal place of abode as A for the entire taxable year. If not, then C satisfies neither the relationship test nor the abode test. If C fails either of these tests, then C is not a qualifying child with respect to A, and A is not an eligible individual and cannot claim the EIC with respect to C.

A similar analysis applies to determine if D is B's qualifying child.

What if A has a higher MAGI than B?

The tie-breaker rule is triggered if C is also an a qualifying child of B or D is also a qualifying child of A because there would then be two potentially eligible individuals with respect to the same qualifying child.

The facts suggest, and we assume, that D is not A's son, grandson, or stepson. To satisfy the relationship test, D would therefore have to be an eligible foster child of A. The facts state that A does not care for D as her own child. Thus, D is not an eligible foster child of A. Because D fails the relationship test, D is not a qualifying child of A, and A is not an eligible individual with respect to D. Similarly, C is not a qualifying child of B, and B is not an eligible individual with respect to C. Because there are not two otherwise eligible individuals with respect to the same qualifying child, the tie-breaker rule does not disallow the EIC to either A or B. Thus, the MAGI's of A and B are irrelevant, even though A and B live at the same address.

If you have any questions regarding this memorandum, please contact this office at (202) 622-6060.

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