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## Working Families Tax Relief Act of 2004

In October, President Bush signed the Working Families Tax Relief Act of 2004. WFTRA changes the definition of dependent by providing a uniform definition of "child" for several tax purposes, including pre-tax contributions to health plans and flexible spending accounts. The law becomes effective January 1, 2005.

### Definition of a Dependent.

The important change in WFTRA relates to "children" of the employee who are under the age of 19 (24 if full time student). Previously a child was a dependent of the employee or parent who provided half of the child's support generally without regard to where the child resided. Under WFTRA, the child is a dependent of the person with whom the child principally resides for more than half the year. It does not matter if that person provides support for the child. In other words, the support

requirement has been replaced with a residence requirement.

### Section 129 Dependent Care Flexible Spending Accounts

The definition of "qualifying individual" which affects Section 129 dependent care flexible spending accounts, appears to be more significant. First, the "head of household" has been eliminated which opens up tax advantages for a working parent who does not maintain a home. For example, the employee who lives with her parents may qualify to receive tax-free reimbursements for childcare.

Secondly, expenses for care of a disabled dependent with income over the exemption amount under Section 151 (currently \$3,100) will no longer qualify for tax-free reimbursements.

### Section 125 Cafeteria Plans

A final concern relates to election changes under Section 125 cafeteria plans. Under the new definition, certain individuals may receive excludable coverage under Section 105 special rules. It is understood, the IRS regulations will be modified to reflect for excludable coverage under Section 105 and not continue to be tied to the Section 152 definition.

In order to understand the outcome of the new rules, it is important to understand who qualifies as a section 152 dependent. The individual is considered a dependent if he or she is a qualifying relative or a qualifying child of the taxpayer.

Four criteria must be met to be a qualifying relative. (1) The individual has a specific family type relationship to the taxpayer. (2) The individual's annual gross

income is less than the Section 151 limit of \$3,100. (3) The individual is not a qualifying child of any other taxpayer. (4) The individual receives more than half of his or her support from the taxpayer.

Four criteria must be met to be a qualifying child. (1) The individual has a specific family type relationship to the taxpayer. (2) The individual does not provide more than half of his or her own support. (3) The individual has the same place of residence as the taxpayer for more than half the year. (4) The individual does not turn age 19 (24 if a full time student) by the end of the tax year.

There is a special rule for children who are permanently and totally disabled. The age requirement is considered satisfied if the child is permanently and totally disabled at any time during the calendar year in which the child turns the limiting age without regard to whether the child is a student or not.

## H.R. 1308 Ordering Rules

The new law establishes ordering rules for when an individual might be a qualifying child of two or more taxpayers. If one of two taxpayers who is claiming a child as a "qualifying child" is the parent of that child, they may claim the child as a dependent. If neither of the two taxpayers claiming the "qualifying child" are parents, the taxpayer with the highest adjusted gross income

would claim the child as a dependent. If both taxpayers are parents and they file separate tax returns, the parent with whom the child resided the longest during the tax year would claim the child. If the child lived with both parents an equal amount, the parent with the highest adjusted gross income would treat the child as a qualifying child.

The new law provides that a Section 152 dependent of a taxpayer cannot claim dependents and a married individual who files a joint tax return with their spouse cannot be a dependent of any taxpayer.

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