Taxpayers may be eligible for certain tax benefits if they support or live with their children. Distinguishing among taxpayers based on their family responsibilities adjusts for differences in ability to pay. In addition, tax benefits are used to meet social policy goals, such as encouraging work. However, they also add complexity to the tax code, particularly as new tax benefits are created and family life seemingly becomes more complicated. The resulting complexity imposes compliance burdens on all taxpayers (including those without children), contributes to taxpayer errors and noncompliance, and increases the costs of administering the tax code.

In providing certain tax benefits only to taxpayers with family responsibilities, the tax code sacrifices simplicity for other tax and social policy goals. In some cases, the gains in equity or achievement of other important goals may outweigh the additional costs in compliance and administrative burdens. In other cases, however, the benefits are small relative to the additional burdens imposed on taxpayers and the IRS.

In this paper, we consider one aspect of the complexity associated with child–related tax benefits. There are five major tax benefits that provide assistance to families with children: the dependent exemption, head of household filing status, the child tax credit, the child and dependent care tax credit, and the earned income tax credit (EITC). Each of these provisions has a unique definition of eligible child. Yet many taxpayers are eligible for more than one of these benefits, and must therefore understand more than one definition of “child” and keep records that will support each claimed benefit.
A consensus appears to be growing that the definition of child can be simplified without sacrificing many of the underlying policy goals that are achieved through the five benefits. In 2002, the Treasury Department proposed a uniform definition of child that would include the five provisions listed above. More recently, the Senate passed a reconciliation bill containing a provision similar to the Treasury uniform definition of child proposal. While the final conference agreement on the Jobs and Growth Tax Relief Reconciliation Act of 2003 did not include the uniform definition of child proposal, Senate interest in the proposal remains high, as evidenced by the inclusion of the proposal in the next tax bill to pass the Senate (the “Relief for Working Families Act of 2003” or H.R. 1308). While the Senate and Treasury proposals are similar, they differ in certain ways that reflect some of the trade-offs that must be made between simplification and other policy objectives.

ELEMENTS OF COMPLEXITY

Skimming through the instructions to the 1040A, a taxpayer might quickly discern that having a child complicates the filing of a tax return. There are multiple benefits to read about, each benefit defines a child differently, and some of the rules associated with specific benefits require a taxpayer to maintain extensive records to prove that his or her child is, indeed, his or her child.

Multiplicity of Benefits

Taxpayers with children may receive a number of tax benefits to help offset the costs of raising a family. In tax year 2004, there will be nearly 53 million filers who claim at least one child–related tax benefit. Of these, 50 million filers will claim child dependents, and millions will claim one or more other child–related tax benefits (see Table 1).

<table>
<thead>
<tr>
<th>TABLE 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>NUMBER OF RETURNS CLAIMING CHILD–RELATED TAX BENEFITS</td>
</tr>
<tr>
<td>Tax Year 2004</td>
</tr>
<tr>
<td>Child–Related Tax Benefit</td>
</tr>
<tr>
<td>Dependent Exemption with Child</td>
</tr>
<tr>
<td>Head of Household Filing Status with Child</td>
</tr>
<tr>
<td>Child Tax Credit</td>
</tr>
<tr>
<td>Child and Dependent Care Tax Credit</td>
</tr>
<tr>
<td>Earned Income Tax Credit with Child</td>
</tr>
</tbody>
</table>

Source: U.S. Department of the Treasury, Individual Tax Model.

In many cases, taxpayers will claim more than one of these benefits. For example, 30.3 million taxpayers will claim both child dependent exemptions and the child tax credit, 16.2 million taxpayers will claim both child dependent exemptions and the EITC, and 10.4 million taxpayers will claim all three. Over a million taxpayers will claim all five of the child–related tax benefits.

With each additional child–related benefit, the taxpayer may have to read additional instructions and provide more information on the tax return. At a minimum, a taxpayer must write each dependent’s name and social security number on the face of the return. If the taxpayer is also entitled to the refundable portion of the child tax credit, the EITC, and the child and dependent care tax credit, he or she must attach three separate schedules to the return—adding to the time (and possibly the monetary cost, if a taxpayer goes to a paid preparer) it takes to prepare the return. Even taxpayers without children may be affected as the sheer volume of the tax return and instructions increases with each additional benefit.

Differing Definitions

The complexity associated with multiple benefits is compounded when each
of those benefits has subtly different rules for similar-sounding concepts (see Table 2). For example, each provision requires some evidence of attachment between the taxpayer and the child. A taxpayer must demonstrate that he or she provides most of the support of a son or daughter to claim the dependent exemption, child tax credit, or child and dependent care tax credit. To claim head of household filing status or the EITC, the taxpayer must demonstrate that he or she resides with the child for over half the year. In addition, the taxpayer must demonstrate that he or she provides over half the costs of maintaining the household in which the taxpayer and child reside in order to claim head of household filing status or the child and dependent care tax credit.

Taxpayers can easily be confused by the subtle distinctions between the household maintenance tests used to qualify for head of household filing status (or the child and dependent care tax credit) and the similar, but not identical, support test used to determine whether someone is a dependent. For example, mortgage interest expenses and property taxes are counted toward the costs of maintaining a household, but the taxpayer is instructed to factor in the "fair rental value of a home" toward support. To compute household maintenance, taxpayers must measure the costs of food consumed on the premises. But for the support test, the taxpayer must include the costs of all food, regardless of where it is eaten.

Household maintenance tests, themselves, vary from provision to provision. Only single parents must prove that they maintain the households in which they and their dependents live in order to justify their filing status, but both married couples and unmarried taxpayers must meet household maintenance tests in order to qualify for the child and dependent care tax credit. The period of time over which the household maintenance test applies also differs in the two provisions.

Another indicator of attachment is the taxpayer’s relationship to a child, but the five provisions do not agree on which relationships matter most. A foster child will qualify the taxpayer for the EITC if the child lives in the taxpayer’s home for over half the year. But the taxpayer cannot claim the same child for the dependent exemption or the child tax credit unless the child lives in his or her home for the entire year. A taxpayer can claim a niece or nephew as a dependent (as long as the support and gross income tests are met) but can only claim the same child for the child tax credit or EITC if he or she cares for the child as his or her own.

Perhaps the most elemental sign of attachment between a taxpayer and child is if the taxpayer cares for a child as if the child is his or her own. The tax code considers a child who is not the taxpayer’s natural or adopted son or daughter to be his or her own for purposes of the dependent exemption if two conditions are met: first, the taxpayer cares for the child as his or her own; and second, the child lives with the taxpayer for the entire tax year. A similar “care” test applies to the EITC if the child is the taxpayer’s sibling, niece or nephew, or has been placed in the taxpayer’s home by a state agency. The tax code, however, offers little guidance to the taxpayer or the IRS as to what constitutes caring for a child as one’s own (or, more importantly, how to prove to the IRS that one does).

The definitions of child differ in another fundamental way. To qualify for the child and dependent care tax credit, the taxpayer’s child must be under the age of 13. For the child tax credit, the child must be under age 17. For the child dependent exemption and the EITC, the child must generally be under the age of 19 (or under the age of 24 if a full-time student). However, the EITC qualifying child may be any age if permanently and totally disabled. Similarly, there is no age cut-off for the dependent exemption if the child is
### TABLE 2
**COMPARISON OF KEY PROVISIONS RELATING TO QUALIFYING CHILDREN**

<table>
<thead>
<tr>
<th>Dependency Exemption</th>
<th>Head of Household Filing Status</th>
<th>Child Tax Credit</th>
<th>Child and Dependent Care Tax Credit</th>
<th>Earned Income Tax Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Relationship test</strong>&lt;br&gt;Sons, daughters, grandchildren</td>
<td>Yes</td>
<td>Yes, if qualifies as a dependent</td>
<td>Yes, if qualifies as a dependent and taxpayer cares for child as his or her own</td>
<td>Same as dependency exemption</td>
</tr>
<tr>
<td>Brothers, sisters, nieces, nephews</td>
<td>Yes</td>
<td>Yes, if qualifies as a dependent</td>
<td>Same as dependency exemption</td>
<td>Same as dependency exemption</td>
</tr>
<tr>
<td>Foster children (which may include relatives and unrelated children)</td>
<td>Any child may be treated as own child if lives with taxpayer for entire year and the taxpayer cares for the child as his own</td>
<td>Yes, if qualifies as a dependent</td>
<td>Yes, if lives with taxpayer for entire year, is placed by an authorized placement agency and taxpayer cares for the child as his or her own</td>
<td>Same as dependency exemption</td>
</tr>
<tr>
<td><strong>2. Age limit</strong>&lt;br&gt;Under 19 or under 24 if full-time student</td>
<td>Under 17</td>
<td>Under 13 (no age limit for disabled dependent)</td>
<td>Same as dependency exemption</td>
<td>No limit</td>
</tr>
<tr>
<td><strong>3. Gross income limit</strong>&lt;br&gt;Individual cannot be claimed as a dependent if earns more than the exemption amount, except if son, daughter, stepson, stepdaughter, or foster child under age limit</td>
<td>No age limit for unmarried sons, daughters, grandchildren, and stepchildren. Otherwise, same as dependency exemption</td>
<td>Same as dependency exemption</td>
<td>Same as dependency exemption</td>
<td>No limit</td>
</tr>
<tr>
<td><strong>4. Residency requirements</strong>&lt;br&gt;Certain related children do not have to live with the taxpayer, otherwise entire year</td>
<td>Child must live with the taxpayer for over one-half of the year</td>
<td>Same as dependency exemption</td>
<td>Child must live with the taxpayer for the period during which the expenses were incurred</td>
<td>Child must live with the taxpayer for over one-half of the year</td>
</tr>
<tr>
<td><strong>5. Support test</strong>&lt;br&gt;Taxpayer must provide over one-half of the child’s support.</td>
<td>No support test for unmarried sons, daughters, grandchildren, and stepchildren; otherwise, same as dependency exemption</td>
<td>Same as dependency exemption</td>
<td>Same as dependency exemption</td>
<td>None</td>
</tr>
<tr>
<td><strong>6. Household maintenance test</strong>&lt;br&gt;None</td>
<td>Taxpayer must provide over one-half of the costs of maintaining the household</td>
<td>None</td>
<td>Taxpayer must provide over one-half of the costs of maintaining the household for the period during which child lived with taxpayer</td>
<td>None</td>
</tr>
</tbody>
</table>
supported by the taxpayer and has gross income below the exemption amount. Finally, an unmarried taxpayer can file as a head of household if he or she resides with an adult self-supporting son or daughter—as long as the taxpayer is the one who pays over half the costs of maintaining the household.

One implication of multiple child benefits and differing definitions is that it is possible for several different family members, who live together for a full year, to claim the same child for at least four different tax benefits:

- The grandmother who provides more than half the costs of maintaining the home in which the child resides could claim head of household filing status;
- The child’s aunt who provides over half the child’s support and cares for the child as her own may claim the dependent exemption and the child tax credit; and
- The child’s mother (or aunt or grandmother) may claim the EITC.

Yet none of these women may claim the child and dependent care tax credit, even if they work and pay for the care of the child. To claim that credit, one taxpayer must both support the child and maintain the household in which she and the child reside.

**Record-keeping and Computations**

As noted above, taxpayers must provide over half the support of the dependent to claim the dependent exemption or child tax credit. The taxpayer must compute the potential dependent’s share of the household’s total expenses (including expenditures on food, housing, education, medical and dental care, entertainment, and transportation) and determine to what extent the taxpayer financed these purchases. Taxpayers must also keep receipts of expenditures—from rent payments to grocery bills—in order to prove support in the event of an audit. In addition, they must keep track of all forms of income coming into the household—whether taxable or not. When computing support, the taxpayer must subtract amounts provided by the potential dependent and others toward his or her support—including assistance from the government (such as Temporary Assistance for Needy Families or food stamps), the child’s other parent, or other members of an extended household.

A residency test is used with or in lieu of a support test for several of the child-related tax benefits, including head of household filing status, the child and dependent care tax credit, and the EITC. A residency test does not require taxpayers to retain extensive records documenting how they use their income (nontaxable as well as taxable) to pay for the care of their children or the maintenance of their household. Instead, taxpayers might be required to provide only one piece of paper—such as a note from a school, child care provider, or doctor—to prove that they reside with their child in the event of an audit. It also might be easier for taxpayers to obtain documentation showing that they meet the residency test. To document support, a taxpayer might need to keep contemporaneous records of expenditures on food, clothing, and incidental items. To document residency, a taxpayer could obtain school records or other evidence after the fact.

Even a residency test creates confusion and imposes record-keeping burdens. Drawing from interviews with IRS examiners and advocates for low-income taxpayers, the General Accounting Office (GAO, 2002) finds that many taxpayers do not appear to understand the documentation requested in the event of an audit. For example, the initial IRS contact letter (Form 886) suggests that filers provide school records containing the child’s
name, address, and dates of attendance for the entire tax year, and the name and address of the child’s parents or guardian. Responding to these letters, filers may obtain school records that show that their child resided with them during a school year. If a taxpayer provides records for a school year (e.g., September 2001 through June 2002) that does not coincide with over half of the tax year (e.g., 2001), then the IRS might not accept that documentation as complete.

**SOURCES OF COMPLEXITY**

There is no single reason for the complexity found in the child-related tax benefits. To some extent, complexity is the inevitable result of achieving tax and social policy goals. But other factors also give rise to complexity, including past simplification efforts that did not go quite far enough and anomalies that arise in drafting new tax legislation. Complexity is also caused or exacerbated by factors exogenous to the tax system, including changes in family structure and deficiencies in education and language skills.

**Different Policy Objectives**

While all the child-related tax benefits share the common goal of providing tax relief to taxpayers with children, each serves other goals as well. Some of the complexity associated with the child-related tax benefits derives from the different goals they meet.

Several child-related tax benefits are limited to working families, although the reasons for this limitation differ. The child and dependent care tax credit recognizes that taxpayers may incur expenses—in this case, care for a child or disabled spouse or dependent—in order to work, and these expenses affect a taxpayer's ability to pay in the same manner as other business expenses. Eligibility for the EITC and the additional child tax credit is also limited to working families, because one of the purposes of these credits is to offset social security taxes. EITC claimants are not required to provide more than half a child’s support because another goal of the credit is to help individuals move from welfare to work, and policymakers recognize that individuals in transition might receive substantial support from TANF or food stamps.

Differences in age tests also reflect various policy objectives. The child and dependent care tax credit, for example, subsidizes child care costs; presumably, the tax system does not need to offset the costs of day care for children who are old enough to be babysitters themselves. Thus, qualifying children must be under the age of 13 to qualify taxpayers for the child and dependent care tax credit, while other child-related tax provisions have higher age cut-offs.

**Partial Simplification Efforts**

Sometimes, efforts to simplify the tax code may have unintended and unfortunate results. Simplification gains from a provision in a tax bill may be offset because other related or similar provisions are not simplified at the same time.

The EITC, for example, has been the focus of several simplification efforts over the past 25 years. Prior to 1978, eligibility for the credit was based on maintaining a household in which a child under the age of 19 resided. When the EITC was made a permanent part of the tax code in 1978, Congress wanted the IRS to calculate the credit for all taxpayers who appeared eligible based on information reported on the return. But married filers did not report household maintenance on their tax returns. To enable the IRS to automatically compute the credit for taxpayers who ap-

---

1 The credit also contains a subsidy element, with a higher credit rate for lower-income taxpayers.
peared eligible, the 1978 legislation con-
formed the EITC eligibility criteria to other
information reported on the tax return.
For married couples, the credit was based
on having a dependent child (defined by
reference to Internal Revenue Code sec-
tion 151(c)(3) as a son, daughter, stepchild,
or foster child, under the age of 19 or un-
der the age of 24 and a full–time student)
in residence. For single parents, the child
(defined by reference to Internal Revenue
Code section 2(b)(1)(A)(i) as a son, daugh-
ter, stepchild, or grandchild of any age)
who qualified a parent for head or house-
hold filing status also entitled him or her
to the EITC.

While the 1978 simplification provi-
sions allowed the IRS to more easily de-
terminate potential eligibility for the credit
from information available on the tax re-
turn, it also meant that there were differ-
ences in eligibility for the credit among
married filers and heads of households.
For example, single parents had to dem-
onstrate that they provided over half the
costs of maintaining a household in which
a qualifying child resided, while married
couples had to show that they provided
over half the cost of supporting a qualify-
ing child. The definition of qualifying
child also differed by filing status. For
example, a divorced or separated parent
could qualify for head of household sta-
tus and the EITC if his or her adult self–
supporting son or daughter resided with
the taxpayer, even though the parent
could not claim the “child” as a depen-
dent and hence would not have been
qualified for the EITC if married. On the
other hand, a foster child could qualify a
married couple, but not a single person,
for the EITC.

Concern about EITC compliance prob-
lems led to a second simplification effort
in 1990. The support test for married fil-
ers, household maintenance requirements
for unmarried taxpayers, and the subtly
different relationship tests defining a child
were replaced by age, relationship, and
residency tests applicable regardless of
filing status. In addition to simplifying the
EITC’s eligibility criteria, these changes
were expected to better attain other goals.
For example, replacing the support and
household maintenance requirements
with a residency test extended eligibility
to more low–income individuals making
the transition from welfare to work (but
who still had a significant amount of wel-
fare income during the tax year). In most
other cases, sharing a residence with a
child could be viewed as a reasonable
proxy for expenditures on support or
household maintenance. Eliminating tests
that were difficult for low–income taxpay-
ers to comply with or even understand
and making the definition of EITC quali-
fying child the same regardless of filing
status simplified the EITC provisions. But
the changes also meant that the definition
of EITC qualifying child diverged from
the definitions of child for other tax ben-
efits. The child who qualified the taxpayer
for the EITC might no longer qualify the
taxpayer for either the dependent
exemption or head of household filing
status.

Cross–referencing Existing Definitions

Multiple definitions spawn even more
definitions. When writing new tax code
provisions, drafters often borrow from
language found elsewhere in the tax code.
While cross–referencing other definitions
should, in theory, lead to greater uniform-
ity and simplicity, the reality is that it
might not.

Consider, for example, the 1978 EITC
simplification effort described in the pre-
vious section. The drafters referenced one
definition of child for married couples
found in Internal Revenue Code section
151(c)(3) and a second definition of child
for unmarried parents found in Internal
Revenue Code section 2(b)(1)(A)(i). The
result was confusing and inconsistent in-
structions. For example, an unmarried
taxpayer could claim his or her grandchild for the EITC. If the taxpayer married, he or she could continue to claim the grandchild for the EITC only if the child lived with the taxpayer for the full year and was cared for by the taxpayer as his or her own.

The child tax credit also borrows from two existing provisions to create a new definition of child. To qualify for the child tax credit, the taxpayer’s child must be a dependent. However, the child must also meet the same relationship test as applies to EITC qualifying children. The result is a new (more restrictive) definition of foster child, which is not found elsewhere in the code. As with the EITC (but unlike the dependent exemption), the foster child for purposes of the child tax credit must be placed in the taxpayer’s home by an authorized placement agency. And as with the dependent exemption (but not the EITC), the foster child must reside with the taxpayer for a full year.

Family Life

Over the past 30 years, family life in the United States has changed dramatically. But with the exception of the child tax credit, the other child–related tax benefits have been in effect since the 1970s or earlier.

Over this period, the number of children under the age of 18 has remained fairly stable, but the number of potential tax filing units to whom children are somehow attached appears to be increasing. As Figure 1 shows, the number of children living with two parents has fallen by 16 percent between 1970 and 2000 while the number living with one parent has more than doubled. With the growth in single–parent families, there has also been an increase in extended families. Between 1970 and 2000, the number of single parents living with their children in households headed by other relatives more than tripled—growing from 500 thousand to 1.8 million. Hence, one child may be cared for—in some manner—by his or her custodial parent, noncustodial parent, and other relatives as well.

In other ways, the legal paper trail connecting the dots between caregivers is less visible. It has become increasingly likely that a single parent has never been married. Parents who have never been married are less likely to be awarded child support payments than those who were divorced. Between 1970 and 2000, the number of unmarried couples living with children under the age of 15 grew from about 200 thousand to 1.7 million.

The good news is that the tax code has anticipated these changes in family structure. Through tests for support, household maintenance, and residency, there are rules that allocate the various child–related tax benefits among family members. But as discussed in the preceding sections, these rules are complicated, and policymakers may not have anticipated the extent to which families would have

---


4 In 1999, 31 percent of custodial parents who are divorced were not awarded child support. In contrast, 52 percent of custodial parents who have never been married were not awarded child support. Authors’ computation based on data from U.S. Bureau of Census, Current Population Survey, April 2000. Available at http://www.census.gov/hhes/www/childs/support/childsu99.pdf.

to rely on these rules or that the IRS would have to enforce them.

**Literacy and Language**

Roughly a third of taxpayers with children qualify for the EITC and the additional child tax credit due to their relatively low incomes. Subtle distinctions in law and multiple computations may be particularly confusing for low-incomefilers who, relative to other filers, tend to have less education. Among families eligible for the EITC, over 26 percent did not
graduate from high school (see Table 3). Concern about the limited literacy of EITC applicants has led the IRS to overhaul and simplify the forms, instructions, and publications applicable to the EITC and child tax credit (though not necessarily of all other child–related provisions for which this population may be eligible).

Although some publications (including Publication 596 describing the EITC) are available in other languages (typically Spanish) and the IRS has Spanish–speaking operators on its telephone help lines, most forms, publications, and notices are written in English. Yet over 19 percent of those eligible for the EITC were born in countries where English was not the official or primary language.

**CONSEQUENCES OF COMPLEXITY**

Complexity in the tax code can have a number of adverse effects. Taxpayers may incur greater costs trying to comply with difficult tax provisions. Complexity may also lead to both intentional and unintentional noncompliance. Some taxpayers may be so confused by complicated provisions that they fail to claim the benefits to which they are entitled. Educating taxpayers about the child–related benefits for which they are eligible and enforcing the various eligibility criteria associated with child–related tax benefits can increase IRS administrative costs. In this section, we focus on the effects of the multiple definitions of child on compliance burdens and noncompliance.

**Burden**

One consequence of tax law complexity is increased taxpayer burden. One measure of burden is the value of time spent to comply with the law plus any monetary costs (e.g., the costs of tax prepar-

---

**TABLE 3**

EDUCATIONAL AND LANGUAGE BACKGROUND OF FILERS¹

<table>
<thead>
<tr>
<th></th>
<th>All Filers</th>
<th>Filers Eligible for EITC</th>
<th>All Other Filers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>108.2</td>
<td>15.2</td>
<td>93.0</td>
</tr>
<tr>
<td><strong>Percent of Filers</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education²</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Did not graduate high school</td>
<td>11.6</td>
<td>26.4</td>
<td>9.2</td>
</tr>
<tr>
<td>High school graduate</td>
<td>31.8</td>
<td>38.8</td>
<td>30.6</td>
</tr>
<tr>
<td>Some college</td>
<td>28.7</td>
<td>26.4</td>
<td>29.0</td>
</tr>
<tr>
<td>College graduate</td>
<td>18.9</td>
<td>6.7</td>
<td>20.9</td>
</tr>
<tr>
<td>Graduate degree</td>
<td>9.0</td>
<td>1.8</td>
<td>10.2</td>
</tr>
<tr>
<td>Language²</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Born in English–speaking country</td>
<td>88.3</td>
<td>79.5</td>
<td>89.6</td>
</tr>
<tr>
<td>Not born in English–speaking country</td>
<td>10.2</td>
<td>19.5</td>
<td>9.6</td>
</tr>
<tr>
<td>Unknown</td>
<td>1.6</td>
<td>1.0</td>
<td>0.8</td>
</tr>
</tbody>
</table>


Notes:

¹Because the CPS does not ask respondents if they filed tax returns, authors imputed filing status. Filers include individuals and, if married, couples whose income exceed filing thresholds or who appear eligible to claim the earned income tax credit. The estimates do not include individuals who file tax returns for other reasons, such as to obtain a refund of overwithheld taxes. The authors did not correct for income misreporting errors in the CPS. ²Education and language background shown for CPS reference person in filing unit.

⁶ Little is known about the effect of complexity on participation. We know of no studies that associate changes in tax law complexity with changes in tax return filing or the claiming of child–related tax benefits. However, to the extent that complexity increases compliance burdens—i.e., the costs of filing a return or claiming tax benefits—it likely reduces participation. In addition, confusing tax laws may cause taxpayers to unintentionally fail to claim tax benefits to which they are entitled.
ration software or payments to a tax preparer). The Paperwork Reduction Act of 1980 requires the IRS to estimate the average amount of time spent on four types of compliance activities: maintaining tax records, learning about tax laws, preparing the return, and sending the return to the tax authorities. These estimates, included in the instructions for every federal tax form, are based on a 1983 survey of taxpayers conducted by Arthur D. Little Inc. (1988). The IRS is currently completing work on a new tax burden model based on more recent survey data (Guyton et al., 2003).

In the absence of data on taxpayer compliance costs, we often rely on observable characteristics that are thought to be correlated with the burden of a tax provision, such as the length of forms, worksheets, and schedules associated with the provision. Table 4 lists one such attribute of burden: the number of words of instructions required to describe each child–related tax benefit. The dependent exemption requires the most words in Form 1040A to explain who is a qualifying child. Since it does not require explanation of the support test or how to allocate a child between divorced parents, the definition of an EITC qualifying child requires 40 percent fewer words. The definitions of child applicable to the other provisions piggyback off either the child dependent or EITC qualifying child definitions, and therefore are much shorter. The child tax credit’s relative brevity is due to the fact that its instructions are embedded in the instructions to the dependent exemption (and thus the instructions to allocating children between divorced parents are not repeated).

Both the instructions to the dependent exemption and the EITC refer to other publications, each of which contains an additional seven to eight pages explaining who is a qualifying child. (Comparing the number of pages in the publications is deceptive, as the instructions for dependent child use a much smaller font than that used in the EITC publication, which also includes pictures.) The publications explaining the dependent exemption and head of household filing status also include multi-line worksheets allowing the taxpayer to compute their shares of support and household maintenance.

Word and page counts are clearly imperfect indicators of compliance burdens. As noted by Kaplow (1996), the primary sources of compliance and administrative costs—such as recordkeeping and verification of taxpayer characteristics—cannot be discerned simply by looking at the tax code or tax return instructions. In fact, more precise rules might reduce ambiguity and thereby reduce compliance costs. If clearer rules and longer instructions lead to more accurate reporting (and fewer post-filing corrections), then they are not necessarily more burdensome than more general rules and shorter instruc-

<table>
<thead>
<tr>
<th>Child–Related Tax Benefit</th>
<th>Number of Words</th>
</tr>
</thead>
<tbody>
<tr>
<td>Child Dependent Exemption</td>
<td>1,765</td>
</tr>
<tr>
<td>Earned Income Tax Credit</td>
<td>1,011</td>
</tr>
<tr>
<td>Child and Dependent Care Tax Credit</td>
<td>413</td>
</tr>
<tr>
<td>Head of Household Filing Status</td>
<td>412</td>
</tr>
<tr>
<td>Child Tax Credit</td>
<td>241</td>
</tr>
</tbody>
</table>

Source: Authors’ computations.

7 A more comprehensive measure of compliance costs would also include the costs associated with post-filing activities (e.g., correspondence with the IRS, examinations, and so forth).
8 Somewhat more recently, Blumenthal and Slemrod (1992) conducted a survey of the amount of time and money it took for 2,000 Minnesota households to prepare their federal and state 1989 income tax returns.
9 Kaplow (1996) suggests that when considering a tax law change, the analyst should compute social welfare under the different rules and compare them. But it seems virtually impossible to specify a social welfare function (or build a burden model) that can reflect the fact that sometimes more detailed rules increase complexity and sometimes they decrease complexity.
tions. For example, if the tax code simply stated that taxpayers could claim any child as long as no one else did, many lines would be eliminated from the instructions. But this would not provide either taxpayers or the IRS with any guidance as to how handle the inevitable onslaught of competing claims.

Noncompliance

Complexity may affect compliance in a number of ways. First, a tax provision (or the tax code in general) could be so complicated that taxpayers ignore tax form instructions and make errors. Confusing laws can also lead to unintentional taxpayer errors, even when taxpayers attempt to follow instructions.

Second, complexity may create opportunities for intentional tax evasion. For example, tax preferences based on characteristics that the IRS cannot observe may encourage or facilitate noncompliance. In addition, the IRS may be reluctant to enforce ambiguous tax laws, because examinations are more costly and the outcome is less certain. Third, a complex tax code with many special provisions and exceptions may create the perception that the system unfairly favors those who know how to take advantage of loopholes. This perception of unfairness may lead taxpayers whose tax situations are relatively simple to nonetheless become less compliant.

Information on taxpayer compliance with child–related tax provisions comes from several studies. For child–related tax benefits other than the EITC, the most recent data come from the 1988 Taxpayer Compliance Measurement Program (TCMP), a stratified random sample of 54,095 audited tax returns. In addition, the IRS conducted several studies of compliance among EITC claimants between 1993 and 1999. In combination, these studies provide some insight into how complexity in child tax benefits might contribute to noncompliance.

Using the TCMP data, a General Accounting Office study (General Accounting Office, 1993) found that in 1988, taxpayers erroneously claimed exemptions for an estimated nine million dependents. Nearly three-quarters of erroneous claims were attributable to taxpayers’ failure to meet the dependent support test. Among those who did not meet the support test, taxpayers did not provide financial support for 57 percent of the claimed dependents. In the remaining cases, taxpayers lacked adequate records to demonstrate that they had met the support test.

Data from a sample of EITC claimants in 1999 indicate that failure to meet the residency test is one of the largest sources of EITC errors (IRS, 2002). However, it is not clear from this study the extent to which EITC errors are attributable to a failure to actually meet the residency test rather than an inability to provide adequate records to demonstrate eligibility. In addition, some taxpayers who failed the EITC residency test would have also failed the support test. While residency errors are high, the residency test might still be superior to the support test. Based on his analysis of the 1988 Taxpayer Compliance Measurement Program (TCMP), Liebman (2001) speculates that the replacement of the support test with a residency requirement may have reduced the EITC error rate by as much as 40 percent.

Evaluating the overlap between dependent and EITC claims provides some additional insight about the effects of maintaining multiple definitions of child for tax

---

10 Some analysis suggests that uncertainty—which could include uncertainty created by complex laws—might make taxpayers less likely to undertake risky activities, including intentional noncompliance. (See for example Scotchmer and Slemrod, 1989 and Alm et al., 1992.) However, it seems likely that that on net, complexity increases noncompliance.
purposes. At least 97 percent of the qualifying children who were claimed in tax year 1999 were also claimed as dependents by the same taxpayers. Of the children who were claimed as dependents and EITC qualifying children, about 66 percent met both the dependent and qualifying child tests. Seventeen percent of children failed both the dependent and qualifying child tests. Nearly 6 percent met the dependent tests, but not the EITC tests; and about 11 percent met the EITC tests but not the dependent tests.

Thus, EITC claimants seemed to have found it somewhat easier to meet the EITC qualifying child tests than the dependent test. (In more than half the cases where only the EITC was disallowed, the adjusted gross income (AGI) tiebreaker was the cause of the error. The AGI tiebreaker provision was modified by Economic Growth and Tax Relief Reconciliation Act of 2001, and most of these errors would be eliminated by the law change.) More importantly, in most cases where a qualifying child is allowed, the dependent is also allowed; and in most cases where one claim is disallowed, the other is also disallowed. This finding suggests that there is little rationale for maintaining separate EITC qualifying child and dependent definitions.

In addition, about 700,000 EITC qualifying children (about 3 percent of all qualifying children) were claimed by more than one taxpayer for purposes of the EITC in tax year 1999. About 1.3 million dependents represented in the EITC study were claimed as dependents more than once. Some of these duplicate claims may occur because taxpayers are confused about the EITC and dependent definitions.12

SIMPLIFYING DEFINITION OF CHILD

There is a growing consensus that the definition of a child can be simplified without sacrificing the policy goals associated with each of the five child-related tax benefits. The Treasury Department has proposed a uniform definition of child that could simplify filing for up to 53 million taxpayers. Members of Congress and others have also proposed the creation of a uniform definition of child. While the proposals are similar, the differences among them highlight the trade-offs between simplicity and other policy goals.

Description of Treasury Proposal

In April 2002, the Treasury Department proposed a uniform definition of qualifying child for purposes of the dependent exemption, the child tax credit, the child and dependent care tax credit, head of household filing status, and the EITC. A qualifying child would have to meet the following three tests:

- Relationship—The child must be the taxpayer’s son, daughter, stepchild, sibling, stepsibling, or a descendant of such individuals. Foster children placed with the taxpayer by authorized placement agencies would satisfy the relationship test. If the child is the taxpayer’s sibling or stepsibling or a descendant of any such individual, the taxpayer must care for the child as if the child were his or her own child.
- Residence—The child must live with the taxpayer in the same principal place of abode in the United States.

11 The other 3 percent were not claimed as dependents or could not be matched to dependents because of missing social security numbers.
12 Neither the TCMP nor EITC compliance studies distinguish taxpayer confusion from intentional misreporting. Research by Liebman (1995) and McCubbin (2000) suggests that at least a third of erroneous EITC qualifying child claims are intentional. A substantial portion of the remaining errors could be unintentional, and perhaps due to complex child definitions.
for over half the year. Military personnel on extended active duty outside the United States would be considered to be residing in the United States. As under current law, the taxpayer and child are considered to live together even if one or both are temporarily absent due to special circumstances such as illness, education, business, vacation, or military service.

- **Age**—The child must be under the age of 19, a full-time student if over age 18 and under age 24, or totally and permanently disabled. However, as under current law, qualifying children (who are not disabled) must be under age 13 for purposes of the child and dependent care tax credit and under age 17 (whether or not disabled) to qualify for the child tax credit.

Neither the support nor gross income tests would apply to qualifying children who meet the relationship, residence, and age tests. In addition, taxpayers would no longer be required to meet a household maintenance test when claiming the child and dependent care tax credit.

The proposal provides special guidance for taxpayers with more complicated family situations. For example, children may live with more than one taxpayer who is potentially eligible to claim them as qualifying children. The Treasury proposal would allow the taxpayers to determine among themselves who could claim the five child-related tax benefits. However, if the taxpayers do not agree and more than one taxpayer claims the same qualifying child, then the following tiebreaker rules would apply:

- If only one of the claimants is the child’s parent, then he or she would receive the tax benefit.
- If the child’s parents do not file a joint return and both claim the child on separate returns, then the tax benefit would accrue to the parent with whom the child resides the longest. If both parents reside with the child for the same length of time, then the benefit would accrue to the parent with the highest AGI.
- If the child’s parents do not claim the child, then the tax benefit would accrue to the claimant with the highest AGI.

The treatment of divorced or separated parents who together care for a child is also addressed. The Treasury proposal repeals the current law provision that allows a custodial parent to release the claim to a dependent exemption to a noncustodial parent if the parents, in combination, provide over half the support of a child. However, if there is a pre-existing child support instrument between the parents that allocates the dependent exemption to the noncustodial parent, then current law would pertain.

A third challenge is presented by children who are supported by taxpayers who reside outside the house. Taxpayers could continue to claim individuals who do not meet the proposed relationship, residency, or age tests as dependents if the current law dependency requirements are met. Thus, taxpayers would be able to claim a distantly related or unrelated child as a dependent if the child resides in the taxpayer’s home for the full year and meets the current law dependency tests. However, if more than one taxpayer

---

13 Under the proposal, a child who provides over half of his or her own support would not be considered a dependent of another taxpayer. This is consistent with current law. The current law dependency tests would also continue to apply to children who are U.S. citizens living abroad or non-U.S. citizens living in Canada and Mexico.
claims a child as a dependent, then the proposed residency–based tests would supercede current law.

**Impact on Complexity**

Nearly 53 million taxpayers could potentially benefit from simplifying the definition of qualifying child for the five related child tax benefits. The proposal would reduce taxpayer confusion over differing definitions of qualifying children. It would also reduce record–keeping burdens as taxpayers would no longer have to demonstrate that they support their children. Taxpayers would still have to maintain records to demonstrate that they reside with their child for over half the year, but the record–keeping requirements should be less burdensome for most taxpayers. Further, the proposal could result in the elimination of the six–line Schedule EIC and the page of instructions that accompanies it. Many taxpayers would no longer have to bother reading the four pages of instructions in Publication 501 that explain the support tests or complete the 22–line worksheet to calculate their share of a child’s support.

By conforming the law to actual taxpayer practice, the proposal provides other benefits that may not be captured in these measures. As discussed above, GAO found that many taxpayers had difficulty demonstrating that they met the support test, because they did not have adequate records to prove that they supported their child. But in many cases, they would have met the proposed tests because they resided with their child. The Treasury proposal may help these families by conforming the law to what they actually do (which may not include actually reading the instructions in Publication 501), thereby improving compliance and reducing post–filing administrative and compliance burdens.

**Winners and Losers**

While the primary goal of simplification is to reduce complexity in the tax code, achieving this goal inevitably involves trade–offs with other policy goals, which may cause some individuals to receive a tax cut while others will lose eligibility for tax benefits. Creating a uniform definition of child is not unique in this regard.

Replacing the support test with a residency test will allow some children to be claimed as dependents who currently are not claimed by any taxpayer. Under current law, they cannot be claimed as dependents by any taxpayer because over half their support comes from the government (through TANF or foster care payments, for example). Under the proposal, they could be claimed by taxpayers who reside with them for over half the year and who meet the relationship test. The proposal extends eligibility for the child and dependent care tax credit to taxpayers who pay for child care but who do not pay over half the costs of maintaining the home in which they and their children reside—including parents making the transition from welfare to work as well as parents who live in homes maintained by their own parents or other extended family members. In some instances, the elimination of the support test for the dependent exemption and the household maintenance test for the child and dependent care tax credit will simply shift the tax benefit from one taxpayer to another.

The proposal also expands the categories of children who are exempt from the gross income test. Under current law, dependents cannot have gross income in excess of the exemption amount. Sons, daughters, grandchildren, and foster children are exempted from this requirement if they are under the age of 19 (24 if a full–time student). Under the proposal, the exemption from the gross income test would also apply to adult disabled chil-
dren and other related children who live with the taxpayer (assuming they don’t already qualify under the foster child definition).

Some taxpayers will lose benefits as a consequence of the proposal. Under current law, single parents can claim head of household filing status if they provide over half the costs of maintaining the home in which they and their children reside. The child does not have to be the taxpayer’s dependent, which means unmarried taxpayers can potentially claim head of household filing status if they reside with their adult self-supporting sons and daughters. Married couples are not granted similar tax benefits, although presumably the presence of another adult in their household imposes as much burden on married couples as it does on single individuals. Under the proposal, taxpayers would not be able to claim head of household filing status for adult children, unless they supported the children and the children’s gross income was below the exemption threshold.

**Alternative Proposals**

Support for creating a uniform definition of child is growing, as indicated by the number of other proposals that have been made. Most recently, the Senate passed a reconciliation bill (and subsequently a second tax bill—H.R. 1308—with further tax relief for families with children) containing a uniform definition of child proposal based on a bill (S. 755) sponsored by Senators Charles Grassley and Max Baucus. Previously, proposals were made by Senator Orrin Hatch, Congressman Rob Portman, the Joint Committee on Taxation, the IRS Taxpayer Advocate, the American Bar Association, the American Institute of Certified Public Accountants, and the Tax Executive Institute. The proposals are very similar; their differences highlight choices made between simplicity and other tax policy goals.

For example, neither the Treasury nor Senate proposals modify the age tests applicable to the child–related tax benefits. In contrast, the proposals by JCT (2001), the Taxpayer Advocate (2001), and others would increase the age of children qualifying for the child tax credit to be the same as that applicable to the dependent exemption, EITC, and head of household filing status. Without question, a common age test would add to simplicity. It would also cost billions of dollars per year. We do not believe that the simplification gains merit the additional cost. Taxpayers generally know the age of their children, and the IRS can verify age independently through access to social security records.

The Treasury and Senate proposals differ in the treatment of complicated family situations where the child is being supported by someone outside the home. The Treasury proposal allows taxpayers to claim children as dependents if they meet the current law tests (including the support test), as long as no one else actually claims the child under the proposed residency–based requirements. Under the Senate proposal, taxpayers could claim children as dependents only if no one else is eligible to claim them. The Senate approach is simpler, but could result in some loss of tax benefits. For example, under the Treasury proposal, a grandfather would be able to claim his grandson who lived with his mother in a separate residence as a dependent, if he provided over half the child’s support and the child’s mother did not claim him as a dependent. Under the Senate bill, the grandfather could not claim his grandson as a dependent.

Also under the Senate bill, taxpayers would have to reside with a child in order to claim the child tax credit. For example, suppose that a grandfather supports his orphaned granddaughter, who resides with family friends. The arrangement with the friends is informal, allowing the grandchild to finish high school in her home town. The grandfather could
still claim the child as a dependent but would no longer be eligible for the child tax credit because he does not reside with the child. The family friends could not claim the child tax credit either, because they do not meet the relationship test.

The Senate bill applies a residency requirement more strictly than the Treasury proposal with one critical exception: the treatment of divorced or separated parents. As noted earlier, if both parents, in combination, provide over half the support of a child, then current law allows the custodial parent to claim the child as a dependent. The custodial parent, however, can waive the dependent exemption to the noncustodial parent. The Treasury proposal repeals the waiver provision prospectively. (Existing child support agreements are grandfathered.) We believe that repealing the waiver will not result in losses in after-tax income because parents can negotiate future child support agreements that account for the revision in tax laws. Divorce lawyers do not necessarily agree with this perspective, often arguing that the waiver provision increases the bargaining power of custodial parents during child support negotiations. The Senate bill retains the waiver provision, with some modification.

CONCLUSIONS

Attempts to achieve certain tax and social policy goals can lead to complicated tax provisions. Partial efforts at tax code simplification, the addition of new provisions that interact with existing provisions in complicated ways, changes in family structure, and literacy and language limitations also contribute to or exacerbate tax law complexity. Complexity in the child-related tax provisions takes the form of multiple benefits, differing definitions, and record-keeping requirements and computations. These complications increase taxpayer compliance burdens and contribute to noncompliance.

Support is growing for adopting a uniform definition of child. While proposals to create a uniform definition of child are similar, their differences highlight trade-offs between policy objectives. Using the same age limit to define a child would further simplify the child-related tax benefits but would result in large revenue losses. There are also trade-offs between simplification and precisely targeting assistance to those taxpayers who incur sizable costs from supporting children.

Adopting a uniform definition of child is only the first of many possible steps toward simplifying child-related tax benefits. Consolidating the five child-related tax benefits into one or a few benefits would significantly reduce complexity but require greater trade-offs between simplicity and other policy goals. For example, child-related tax benefits increasingly serve to target assistance to families viewed as having the greatest needs. However, eligibility tests vary from provision to provision, as notions of need and revenue constraints change. Thus, the child tax credit phases-out as income exceeds $110,000 ($75,000 if not married), the EITC phases-out as income exceeds $14,730 ($13,730 if not married), and the child and dependent care tax credit rate is reduced as income exceeds $15,000. Taxpayers are required to work to obtain the EITC, must incur work-related child care expenses to receive the child and dependent care tax credit, and must maintain a household to qualify for head of household filing status. An investment income test applies to the EITC but to none of the other child-related tax benefits. Filing status, citizenship, and U.S. residency requirements also differ among the child-related tax benefits.

To consolidate the child-related benefits, policymakers will have to decide which of the eligibility criteria are most important and which can be discarded in the interest of simplicity. They will also
have to make hard choices about who will receive a tax cut and who might lose tax benefits.

Acknowledgments

Prepared for the National Tax Association, 2003 Spring Symposium, May 29–30, Washington, D.C. We thank Tom Barthold, Warren Hrung, and Ron Schultz for their thoughtful comments. We also thank Robert Black for research assistance. Views and opinions expressed in this paper are those of the authors and do not necessarily represent the policies or positions of the Treasury Department.

REFERENCES


