ClientLine®

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WHO QUALIFIES AS A DEPENDENT FOR TAXES?

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Dependents can help reduce your tax bill by claiming valuable credits like the child tax credit, dependent care credit, or adoption credit. But who qualifies as a dependent?

SUPPORT

Generally, a dependent relies on another person for financial support, such as housing, food, clothing, and necessities. Typically, this includes your children or other relatives, but it can also include people not directly related to you, such as a domestic partner or stepchildren.

THREE TESTS

There are three general tests that all dependents must meet to qualify.

1. If someone can be claimed as a dependent, that person can't claim any dependents, even if they have a qualifying child or relative. For example, if you have a qualifying 21-year-old child who also has a one-year-old, your 21-year-old will not be able to claim their one-year-old as a dependent.
2. You can't claim a married person as a dependent if they file a joint tax return.
3. Dependents must be U.S. citizens, U.S. green card holders, or residents of Canada or Mexico.

CHILDREN

A child qualifies as a dependent if they are younger than 19 or are a full-time student younger than 24 at the end of the calendar year. And the child must be younger than you. But there is no age limit if the child is permanently and totally disabled.

Also, the child must be your son, daughter, stepchild, foster child, or grandchild. Generally, a child must have lived with you for at least half of the year, and you must have provided at least half of their financial support.

OTHER RELATIVES

Your sibling, stepsibling, half-sibling, niece or nephew can also be dependents. Non-related qualifying dependents can be of any age. They will need to live with you for the entire year and must not have a gross income exceeding $4,400 for the tax year, and you must provide more than half of their support.

WHO CAN CONTRIBUTE TO A 529 PLAN?

You can help any child save for college expenses by contributing to a 529 college savings plan. All 529 plans accept third-party contributions, regardless of who owns the account. That means anyone, including grandparents, aunts, uncles, or even friends, can help a child save for college.

The money you invest in a child's 529 plan grows on a tax-deferred basis, and distributions are completely tax-free when used to pay for the child's qualified education expenses. Because of this tax-free compounding, even a small gift can potentially grow substantially over time. Every dollar a student has in college savings is one dollar less that they will have to borrow in student loans.

Beginning in 2024, beneficiaries can rollover unused 529 funds to a Roth IRA. Several rules apply, so consult your tax professional.

CLIENT PROFILE

Elizabeth is considering whether she should buy long-term care insurance. She's 35 years old and healthy, so she's not sure it's the best use of money now. What should she consider when making a final decision?

Long-term care insurance generally covers a portion of the expenses incurred due to a chronic medical condition. Most policies will pay a percentage of the cost of care in your home, an assisted living facility, or a nursing home.

Most people think of it as coverage for old age needs. But, long-term care insurance provides aid should you develop an illness or incur an accident at any age.

Elizabeth's annual premiums will likely be lower since she is currently healthy. However, actuaries look at your family history, including DNA ancestry sites to see if you are likely to develop a long-term disease like Alzheimer's and Parkinson's.

Qualified long-term care insurance premiums can be deducted if you itemize on Schedule A. However, there are deductible limits based on age.

Client Profile is based on a hypothetical situation. The solutions discussed may or may not be appropriate for you.

TAX DEDUCTION VS. TAX CREDIT

Tax credits and tax deductions may be the most satisfying part of preparing your tax return. Both reduce your tax bill, but in very different ways.

DEDUCTIONS

Deductions reduce how much of your income is subject to taxes. Deductions lower your taxable income by the percentage of your highest federal income tax bracket. So, if you fall into the 22% tax bracket, a $1,000 deduction saves you $220.

CREDITS

Tax credits directly reduce the amount of tax you owe, giving you a dollar-for-dollar reduction of your tax liability. For instance, a tax credit valued at $1,000 lowers your tax bill by $1,000.

Generally, tax credits are more valuable than tax deductions. However, there are times when a deduction can be more useful if it reduces your adjusted gross income (AGI) to allow you to take advantage of tax breaks you wouldn't receive if your AGI were higher.

WHICH WOULD YOU RATHER HAVE?

	$5,000 TAX DEDUCTION	$5,000 TAX CREDIT
AGI	$100,000	$100,000
Less: Tax Deduction	($5,000)	
Taxable Income	$95,000	$100,000
Tax Rate	22%	22%
Tax	$20,900	$22,000
Less: Tax Credit		($5,000)
Tax Due	**$20,900**	**$17,000**

REFUNDS

Some tax credits are refundable or partially refundable, like the child tax credit or the American opportunity tax credit. That means if your calculated tax is $600 and you have a refundable tax credit of $1,000, you'll receive a $400 refund. But most tax credits are non-refundable. That means you won't receive a refund if using a tax credit reduces your tax bill below $0.

ON AVERAGE, 70% OF AMERICANS OVER 65 WILL NEED SOME FORM OF LONG-TERM CARE SERVICE IN THEIR LIFETIME.

Source: Longtermcare.gov

HOW TO DEAL WITH UNPAID INVOICES

Proactive processes can help protect your company and its cash flow.

PREPARATION

Complete some due diligence before you decide to work with a client. Basic internet research for reviews can show how well the company is managed.

And when you start a contract with a customer, ensure that invoicing and payment details are provided. Spell out how you invoice and payment due dates so there's no confusion. Be clear on what payment methods you accept and what your late payment policy is.

FOLLOW UP

If your client has missed a payment due date, follow up immediately with a polite email reminder. And if you have contact information for the accounts payable department, reach out to them, as they will generally know why your invoice is unpaid. It could be that they're waiting on approvals or missing information.

FOLLOW UP

If the client continues to be delinquent despite your follow up efforts, perhaps you should stop providing products or services until you're paid in full.

Q **What's the difference between fixed and variable costs?**

A It's important for small business owners to track and understand how expenses vary with changes in production and sales volume because it impacts many aspects of the business.

Most businesses have both fixed and variable costs. Fixed costs, or overhead expenses, are incurred regardless of a change in production and sales volume. Examples of fixed costs include rent, insurance, utilities, and some taxes (like property tax).

Examples of variable costs include raw materials, delivery expenses, sales commissions, and credit card processing fees.

RAISING FINANCIALLY SAAVY KIDS

Whether your kids are toddlers or teenagers, it is critical that you teach them how to become financially independent.

KEEP THE END IN SIGHT

If you have adult children living at home with you, work with them to set a date to move out. Having a solid end date in mind can help keep them moving forward and on track.

CREATE A BUDGET

Use your experience to help your child create a realistic budget to help ensure spending doesn't exceed income after taxes and savings. The budget should list after-tax salary, living expenses, debt payments, retirement contributions, savings goals and spending money.

Savings goals should include building an emergency fund of three to six months of living expenses in case they lose their job or need to pay an unexpected bill.

TEACH THEM

Educate your child on the benefits of the time value of money, paying off debt, and how to build good credit. This can help keep them from running aground financially in the future.

Building good money habits when they are young and living within their means will help them and you when they move away.

REVIEW YOUR CREDIT REPORT OFTEN

Your credit report is your financial biography. It's key to determining the interest rates you'll pay on loans and can impact a job application if you work in certain fields. You'll want to review all three of your credit reports at least once a year to ensure they are correct.

THREE REPORTS

According to a Consumer Reports study in 2021, one in three people reported finding errors on one of their credit reports. There are three credit reporting companies: TransUnion, Experian, and Equifax. You'll want to review your report from all three. Just because your Experian report is correct doesn't guarantee your Equifax report contains the same information.

IT'S PERSONAL

Start by reviewing the personal information (name, address(es), and dates of birth) to ensure that the data is correct. If you see an address you don't recognize, it could signify that someone has misused your Social Security Number. This could be an early warning sign of identity theft.

ACCOUNT STATUS

Next, review all the accounts reported to the credit bureau. Ensure you know what each one is for and that you opened the account. Also, look at the payment status of each account for accuracy. Even one incorrect notation of a late payment can significantly impact your credit score.

You can receive each of your credit reports free once per year at *Annualcreditreport.com*.