

Rocky Mountain Financial Professionals

Little-Known Tactic Increases Child Care Credit

Article Highlights:

- Social Security Benefits
- Child Care Credit
- Partnership
- Joint Venture
- Material Participation
- Retirement Benefits

When both spouses in a married couple are jointly involved in the operation of an unincorporated business (generally a Schedule C), it is fairly common – but incorrect – for all of that business’s income to be reported as just one spouse’s income, even when they both work in the business.

In such cases, the spouse not taking credit for his or her portion of the earned income loses out on the chance to accumulate his or her own eligibility for Social Security benefits. In addition, to claim a child care credit, both spouses on a joint return must have earned income (or imputed income if one of the spouses is a full-time student or is disabled), so unless the spouse not including a portion of the income from the joint business has another source of earned income, the couple will not be allowed a child care credit.

There are ways to remedy this situation, however. One option is to file a partnership return for the activity, in which case each spouse will receive a K-1 that reports his or her share of the net profit. An approach that avoids the necessity of filing a partnership return, and that is probably less complicated, is a qualified joint-venture election, in which each spouse elects to file a separate Schedule C for his or her respective share of the business. This gives them both self-employed income for the purposes of the self-employment tax and for claiming the child care credit.

A qualified joint venture refers to any joint venture involving the conduct of a trade or business if:

- (1) The only members of the joint venture are husband and wife,
- (2) Both spouses materially participate in the trade or business, and
- (3) Both spouses elect to apply this rule.

Generally, to meet the material participation requirement, each spouse will have to participate in the activity for 500 hours or more during the tax year.

If the net income from the business exceeds the annual cap on income subject to the Social Security tax, the combined self-employment tax for the spouses with split Schedule Cs will exceed what a single spouse would have paid if he or she had filed a single Schedule C.

An additional benefit when filing split Schedule Cs is the opportunity for both spouses to participate in IRAs and self-employed retirement plans.

If you have questions about how splitting the business income between spouses might apply to your specific situation, please contact this office.