RIGHTING TAX WRONGS FOR IMMIGRANTS

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INTRODUCTION

Internal Revenue Code § 151 allows taxpayers personal exemptions for themselves, their spouses, and their dependents, which, prior to the Tax Cuts and Jobs Act (TCJA), allowed taxpayers to receive a reduction of taxable income of several thousand dollars for each dependent in the taxpayer’s family, including the taxpayer, their spouse, and/or their dependent children and relatives. Section 152(b)(3) defines dependents to include only those individuals who reside in the “United States or a country contiguous to the United States.” Thus, Congress permitted taxpayers and their spouses to reduce their taxable income by the exemption amount by claiming qualifying individuals on their tax return who resided in the United States, Mexico, and Canada.

Prior to the TCJA, the personal exemption amount under § 151 was $4,050 for the taxpayer and each of his or her dependents, adjusted for inflation every year. When the TCJA passed in 2017, Congress reduced the exemption amount to $0 for the tax years spanning 2018 through 2025, which seemingly provided no federal tax benefit for taxpayers claiming dependents in Canada and Mexico. In lieu of the personal exemption, Congress approximately doubled the standard deduction, doubled the child tax credit, and created a nonrefundable $500 credit for taxpayers supporting “qualifying

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1 I.R.C. § 151.
2 Id. § 152(b)(3).
relatives” as defined by § 152(d) (the “Other Dependent Credit” or ODC).\(^5\) The language of the statute explicitly excludes from the credit those dependents residing in Canada and Mexico.\(^6\)

The effect of the TCJA on families supporting qualifying dependents in Canada and Mexico has been dramatic. Not only have these families’ taxable incomes increased significantly due to the elimination of the dependent exemption amount, but they have also lost the ability to count their entire family (as defined by the tax code) on Form 1040, which has resulted in reduced benefits across multiple federal and state agencies.\(^7\)

For example, take the case of a taxpayer and his or her spouse earning $50,000 in the United States and supporting two dependents residing in Mexico who satisfy all the elements of § 152(d) for qualifying relatives. In 2017, prior to the TCJA, and assuming the family claims the standard deduction and has no above-the-line deductions, the family could claim four exemptions and have taxable income calculated as follows:

\[
\text{Taxable Income} = \text{Income} - \text{Standard Deduction} - \left(\text{4 x Exemptions}\right)
\]

\[
\text{Taxable Income} = 50,000 - 12,700 - (4 \times 4,050) = 21,100
\]

With a tax rate of 10%, the family’s federal income tax would be $2,110.

The same family in 2018, just one tax year later, earning the same amount of money and supporting the same family members who still qualify as dependents under § 152(d) will have a whopping 48% increase in their taxes due to the elimination of the personal exemption for the two dependents. The amount of tax is calculated as follows:

\[
\text{Taxable Income} = \text{Income} - \text{Standard Deduction} - \left(\text{4 x 0}\right)
\]

\[
\text{Taxable Income} = 50,000 - 24,000 - (4 \times 0) = 26,000
\]

With a tax rate of 12%, the family’s federal income tax would be $3,120.

What’s more, is that the family may not be able to receive the dependent exemption amounts for state tax purposes if the Internal Revenue Service

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\(^5\) Id. §§ 11021–11022, 131 Stat. at 2072–73 (codified at I.R.C. §§ 24, 63).

\(^6\) I.R.C. § 24(b)(4)(B) (“[Partial credit allowed for certain other dependents] shall not apply with respect to any individual who would not be a dependent if subparagraph (A) of section 152(b)(3) were applied without regard to all that follows ‘resident of the United States.’”).

(IRS) does not issue individual taxpayer identification numbers (ITINs) to the dependents residing in Mexico. They would also have trouble showing their correct family size for Free Application for Federal Student Aid (FAFSA) and Medicaid purposes as well as for purposes of other state benefits that use the federal tax return to determine family size. And should they need to file an offer in compromise (OIC) with the IRS, their “reasonable collection potential” would be overstated due to incorrect family size.

Although the TCJA is set to sunset in 2025, many analysts believe that Congress will make the provisions related to the dependent exemption amount permanent. In its consideration of extending the TCJA, Congress has the opportunity to restore the historical tax treatment of our neighboring countries. This Essay argues that if Congress makes the basic structure of the TCJA permanent as it relates to the standard deduction, personal exemptions, and the ODC, then it should repeal the disqualification of dependents in Canada and Mexico from eligibility for the ODC in order to help restore the historic tax benefits the United States has granted its bordering countries that were lost when the TCJA eliminated the dependent exemption amount.

This change would not only ease the tax burden for the family from the hypothetical above with dependents in countries that border the United States, but it would also allow the family to declare the correct family size (as defined in the tax code) for the variety of purposes required by other federal and state agencies. The tax burden would be reduced by $1,000 for the two $500 ODCs, leaving the family to pay $2,120. This would increase their tax burden by $10 as compared to 2017, which is a negligible amount.

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8 See supra note 7.
9 I.R.S. Form 656, Offer in Compromise (2023).
I. CONGRESS HAS PROVIDED FAVORABLE TAX TREATMENT TO “COUNTRIES CONTIGUOUS” FOR OVER ONE HUNDRED YEARS BECAUSE IT IS GOOD FOR THE UNITED STATES

The term “contiguous country” was introduced in the first federal income tax act, the Revenue Act of 1913, in the context of tariffs on goods from foreign nations, offering a more favorable tax rate to products originating in a contiguous country. The Revenue Act of 1940 extended a favorable withholding tax rate to non-U.S. residents from a “contiguous country.” The term gained a foothold in connection with exemptions for dependents in the subsequent Revenue Act of 1942, specifying that nonresident alien individuals could only claim the credit for dependents if they were residents of a contiguous country. This terminology now extends to various laws concerning immigration, interstate transportation, and excise taxes.

Fostering positive relations with neighboring states is essential for seamlessly integrating economies by granting the United States access to expansive markets and strategic energy reserves. Currently, Mexico and Canada stand as the United States’ foremost trading partners, accounting for more than half a trillion dollars in trade. This robust economic partnership not only bolsters the U.S. economy but it also fortifies diplomatic ties.

The significance of these relationships extends beyond economic considerations. The agricultural sector—a cornerstone of the U.S. economy—significantly relies upon the contributions of Mexican

farmworkers. Recognized as essential frontline workers by the U.S. federal government, these individuals play a pivotal role in ensuring food security for the nation. During the COVID-19 pandemic, their essential status was underscored by their prioritized access to vaccines, highlighting the interconnectedness of economic and public health considerations.

Expanding U.S. collaboration with neighboring nations could yield even more substantial benefits. Enhanced economic integration can lead to the development of joint initiatives, collaborative research endeavors, and streamlined regulatory frameworks. This deeper level of cooperation not only strengthens economic ties, it also promotes shared goals in areas such as environmental sustainability, technology innovation, and regional security. Acknowledging the interdependence between the United States and its neighbors underscores the importance of ongoing diplomatic efforts. Regular dialogues and diplomatic engagements can pave the way for mutually beneficial agreements, fostering an environment conducive to sustained economic growth, innovation, and overall prosperity for all countries involved.

Continuing to ignore the historic tax benefits the United States has provided to neighboring countries may have the added negative impact of decreasing remittances to home countries from taxpayers supporting family members in those countries because of the increased tax burden due to the TCJA. This, in turn, negatively impacts the U.S. economy. Studies have shown that there is a correlation between the amount of money taxpayers send back to their home country and U.S. exports to that country. Because

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remittances have the effect of promoting U.S. exports of technological, recreational, or luxury goods by increasing the human capital and earning potential in those countries receiving remittances, a decrease or slowdown of remittances could have the effect of curbing the U.S. economy.  

Providing preferential treatment to the countries contiguous to the United States has played an important role in shaping U.S. economic and diplomatic relations. From its origins in trade agreements to its presence in tax legislation, this practice has played a crucial role in fostering positive relationships with neighboring countries. Embracing this interdependence and recognizing the potential consequences of neglecting historic tax benefits emphasizes the need to restore the application of the country contiguous language of § 152. In doing so, the United States can promote sustained economic growth, innovation, and prosperity while acknowledging the broader global implications of these ties.

II. TCJA PREVENTS TAXPAYERS FROM REPORTING THEIR CORRECT FAMILY SIZE AS ALLOWED BY THE TAX CODE

Up until the enactment of the TCJA, the ITIN unit issued ITINs to applicants who were spouses and dependents from Canada and Mexico as allowed by law. Suddenly, the ITINs stopped for most of these individuals after passage of the TCJA in 2017. The guidance from the ITIN unit indicates that the IRS interpreted § 151(d)(5)(A) as reducing the exemption amount to $0, meaning there is no reason to claim a dependent from Canada or Mexico on a return because there is no monetary tax benefit in doing so. Therefore, the IRS would not issue ITINs to these individuals. This policy decision makes the “contiguous country” language superfluous, seemingly without regard to its history or purpose.

21 Id. at 10.
There are several important federal tax benefits that the IRS eventually included in the Internal Revenue Manual (IRM) as well as a myriad of federal and state benefits that are only accessible through the issuance of ITINs. The list of “allowable tax benefits” that qualify an individual for an ITIN post-TCJA includes the American opportunity tax credit, head of household filing status, spouse filing a joint return, premium tax credit, the Other Dependent Credit, and the child and dependent care credit.

The instructions and the ITIN unit’s actions unfairly deprive dependents in Canada and Mexico of access to other important nontax and state benefits. A taxpayer’s family size—as shown by the number of exemptions on their tax return—can be important for federal tax reasons, but many nontax federal and state programs also calculate benefits based on the number of exemptions on a tax return. These include, but are not limited to, immigration-related applications, student financial aid applications, emergency Medicaid applications, and state tax returns, particularly when the state exemption amount remains above $0 for dependents satisfying § 152. The failure to issue ITINs to these dependents can result in inaccurate family size counts and reduced benefits under these programs. Although these are not “tax benefits,” Treasury Regulation § 301.6109-1(d)(3)(ii) does not state that there need be any immediate monetary tax benefit attached to the ITIN; rather, it states that an ITIN may be issued if an individual “is required to furnish a taxpayer identification number.” Section 151(e) requires a taxpayer identification number to claim an exemption—that is to say, to count all your family members on your tax return.

Moreover, an accurate count of a taxpayer’s family size affects the family’s ability to access the correct collection alternative should they find themselves in the position of owing federal tax debt. In determining the

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25 Lora, supra note 23.
26 International Returns and Documents Analysis: IRS Individual Taxpayer Identification Number (ITIN) Real Time System (RTS), IRM 3.21.263.9.3.2.2.2(1)–(6) (Nov. 1, 2023).
27 Lora, supra note 23.
28 Id.
30 I.R.C. § 151(e).
amount of an offer in compromise, the IRS determines the amount of future income available to pay the tax debt, which in turn depends on the number of persons permitted as dependents on the taxpayer’s current year income tax return. While the IRM considers “reasonable exceptions,” the examples provided do not appear to contemplate dependents with disallowed ITINs. Furthermore, requiring an explanation to justify an exception is time-consuming and costly for all parties involved.

In the long run, the ITIN unit’s actions impose unnecessary administrative burdens on the IRS. The IRS has issued ITINs to dependents who are residents of Canada or Mexico since 1996. Continuing to do so will impose no additional costs and will result in efficiencies for the IRS in the future. If the IRS does not renew these ITINs now, they will expire and require renewal after 2025 if the TCJA sunsets. This may cause a backlog, creating delay and expense for the IRS and taxpayers when dependents renew their ITINs after the Act sunsets. Renewal of ITINs to prevent deactivation for dependents who satisfy the elements of § 152(d) helps the IRS and the taxpayer by decreasing administrative burdens and costs and protecting vulnerable taxpayer communities.

The cessation of ITIN issuance to dependents in Canada and Mexico following the TCJA represents a significant departure from longstanding practice and has broader implications for those individuals seeking access to various federal and state benefits beyond tax-related incentives. The exclusion of dependents from important nontax programs and the potential disruption in family size calculations for the purposes of federal tax debt resolution underscore the far-reaching consequences of this shift in policy. The shift presents a number of unnecessary administrative burdens on the IRS which could be resolved by restoring the longstanding practice of issuing ITINs to dependents and spouses from countries contiguous to the United States.

31 See Offer in Compromise: Financial Analysis, IRM 5.8.5.20(3) (Apr. 8, 2024).
32 See id.; IRM 5.8.5.22.1(4).
33 Lora, supra note 23.
34 Id.
III. THE TCJA SUNSET WILL PROVIDE AN OPPORTUNITY TO RIGHT THE WRONG

If the TCJA sunsets, the personal exemption and the relevance of the “country contiguous” language of § 152 will be restored, and taxpayers will be able to accurately account for the correct number of individuals on their tax return. Despite budgetary analyses projecting a potential increase in the budget deficit exceeding $3 trillion over a span of ten years if the TCJA is extended, several sources indicate that the TCJA provisions related to the increased standard deduction and child tax credit are favored by a number of groups and politicians who will likely push to make those provisions permanent. Those in support of making TCJA individual provisions permanent include the Tax Foundation, Heritage Foundation, and the American Legislative Exchange Council.

The potential extension of the TCJA or a bill to make the provisions permanent would open up a valuable opportunity to address the provision in the law that has prevented taxpayers from accurately determining their family size. One straightforward approach to fix the issue would be to repeal § 24(h)(4)(B). This proposed modification would restore the historical favorable tax treatment of our neighboring countries, Canada and Mexico. Under this adjustment, those who qualify for a dependent exemption under § 152(d) would be eligible to claim the $500 nonrefundable ODC. This strategic amendment not only streamlines the tax process for affected individuals but also aligns with the broader goal of creating a more inclusive...


38 Currently, the nonrefundable Other Dependent Credit “shall not apply with respect to any individual who would not be a dependent if subparagraph (A) of section 152(b)(3) were applied without regard to all that follows ‘resident of the United States.”’ I.R.C. § 24(h)(4)(B).

39 See id.
and equitable tax framework for taxpayers with dependents in Canada or Mexico.

The impact of § 24(h)(4)(B) results in the exclusion of otherwise eligible qualifying relatives from eligibility to claim the ODC. Repealing the provision will not only provide a small but meaningful tax benefit for these families, but it will also allow them to count all their family members who qualify under § 152 as dependents on the return. The ripple effect allows these families to access state tax and other federal benefits, where the definition of dependents under the federal tax code plays a pivotal role in determining the amount of the benefit. Furthermore, the restoration of dependents under § 152 for individuals residing in Canada and Mexico goes beyond immediate tax considerations. It reflects a broader commitment to reinstating the historical tax treatment that our nation has traditionally afforded to them.

The restoration of the relevance of the “countries contiguous” language, coupled with the authorization for families to include their entire household on their tax returns through the ODC, does not pose a substantial risk of escalating fraudulent claims because the ODC is a nonrefundable tax credit, which significantly diminishes the likelihood of overpayment and fraudulent activities. The inherent safeguard lies in the fact that nonrefundable tax credits, like the ODC, are of limited impact. While they can reduce a taxpayer’s liability to zero, they cannot generate a refund on their own. This fundamental distinction sets them apart from refundable credits, which have the potential to result in cash refunds.

The potential sunset of the TCJA provides a critical opportunity for Congress to right the wrong and allow taxpayers to accurately determine family size. Repealing § 24(h)(4)(B) provides a straightforward solution to restore the relevance of the “country contiguous” language of § 152 if the personal exemption is not restored, allowing affected families to claim the ODC and providing the justification for issuance of the ITIN for all family members. This adjustment reinstates the historical tax treatment for our neighboring countries and fosters a commitment to fairness and equity in the broader tax framework. Importantly, the inherent safeguards of nonrefundable tax credits, such as the ODC, mitigate the risk of fraudulent claims, which safeguards the integrity of the ITIN program and tax code.
IV. CONCLUSION

The TCJA had adverse implications for immigrant taxpayers, as well as their spouses and dependents—particularly those who provide support to family members residing in Mexico or Canada. This legislation resulted in not only a tax hike but also erected a significant obstacle that prevented certain immigrant families from accurately including all family members on their tax returns. Consequently, this limitation prevented them from availing themselves of crucial state and federal tax and nontax benefits.

To address this issue, Congress must take corrective action by repealing the nonapplicability of the “country contiguous” provision dictated by § 24(h)(4)(B). By reinstating the relevance of this provision, lawmakers can rectify the unintended consequences that have disproportionately affected immigrant families, ensuring their rightful inclusion in the tax system. Such a repeal aligns with the principles of fairness and inclusivity, as it seeks to mitigate the barriers faced by immigrant taxpayers and facilitates their access to important nontax benefits at both the state and federal levels. This targeted legislative amendment reflects a commitment to a more equitable and comprehensive approach to tax policy and fosters a system that accommodates the diverse circumstances of immigrant families supporting loved ones across contiguous borders.