Chapter 4: Divorce
Learning Objectives

Upon completion of this seminar, participants should be able to—

- Describe how to apply the special rule for divorced or separated parents.
- Determine if payments to a spouse (or former spouse) constitute alimony.
- Summarize income allocation rules for taxpayers in community property states.
- Divide tax attributes between divorcing taxpayers.
Key Developments

• TC Memo 2014-147, Davis, father granted exemptions without regard to dissolution agreement with ex-spouse. Page 36

• TC Memo 2017-101, Mudrich, pre-divorce payment in a divorce year paid partially to ex-spouse was not alimony. Page 41

• TC Memo 2015-126, payment to former spouse was not alimony, it was property not cash. Page 41
I. Filing Status Considerations

When is the person considered unmarried:

For most tax issues the marital status will be based on their status at the stroke of midnight on 12/31. State law will have the final say.

NOTE: An *interlocutory decree*, generally, is a *judicial decision that is not final*. An interlocutory decree of divorce in the United States, for example, is a judicial decree pronouncing the divorce of the parties provisionally but not terminating the marriage until the *expiration of a certain period*. The purpose of requiring such a period of time is to discourage quick and easy divorce, to encourage reconciliation, and to enable the court to supervise the arrangements to be made for the children of the marriage.
II. Children of Divorced (or Separated) Parents

By default, the exemption belongs to the parent where the child spent the majority of their nights. The non-custodial parent must to claim an exemption:

- Be acting under court direction, i.e. divorce or separate maintenance and not living together.
- Parents together provided over ½ of support
- One or both of the parents had custody for greater than ½ of the year.
- The “custodial” parent relinquishes their right to claim child in a written declaration.
II. Children of Divorced (or Separated) Parents

The parent who paid will be able to claim or receive the:

- Employer paid medical expense reimbursements
- Health coverage
- Excludible employer fringes
- Medical Expenses
- MSA Accounts
- HSA Accounts
II. Children of Divorced (or Separated) Parents

Counting the nights rule:

Many custody agreements are “joint custody agreements” – so who is custodial parent.

Whichever parent the child spent the majority of their nights (slept in their home) with.

See Davis v. Comm., TC Memo 2014-147

CASE: In Davis, the Tax Court granted dependency exemption to the father (even though a dissolution judgment awarded custody to mother), ruling he was the custodial parent because his child resided with him at his mother’s home for more than half the year. (Davis v. Comm., TC Memo, 2014-147)
II. Children of Divorced (or Separated) Parents

Some of the problems:

1. Maintain a log recording the nights the child stayed in the home.
2. If it is exactly 50/50 the highest AGI wins.
3. An emancipated child, the child is living with neither parent.
4. Absences, counts as the parent where the child would have normally stayed.
II. Children of Divorced (or Separated) Parents

How to award the exemption to the non-custodial parent – EXECUTE FORM 8332.

An exception for pre-2009 agreements if:

1. There are NO conditional statements in agreement. – NOT LIKELY – AND

2. The custodial parent does not claim the child. – DO YOU TRUST THE CUSTODIAL PARENT WILL COMPLY - AND

3. An indication of what years the agreement applies to.
To revoke the release of claim, a statement must be furnish to the non-custodial parent, either Form 8332 or a conforming statement Reg. 1.152-4(e).

To meet the requirements the notice must:

Be delivered in a prior year to the period released.

Must specify the years that are being revoked. – No indication means no revocation.

Custodial parent should attach revocation to their return.

Use Form 8332 Part III
II. Children of Divorced (or Separated) Parents

How does the custodial parent deliver this to the ex – By certified mail or legal representation. This can prove the attempt was in prior year.
II. Children of Divorced (or Separated) Parents

The exemption release does not:

- Change the taxpayer’s ability to claim HOH
- The eligibility for EITC
- Dependent care expenses
- Dependent care benefit exclusion

But the exemption release prevents the custodial parent from:

- Taking the CTC
- Education Credits
- Education Exclusions and Deductions
II. Children of Divorced (or Separated) Parents

G Seeliger, TC Memo 2017-175

In what most observers deemed a harsh result a divorced father was denied the exemption as awarded by the divorce decree.

- The taxpayer was in total compliance with the divorce decree that awarded the exemption to him.
- As a post 2009 decree failed to obtain the Form 8332 from the custodial spouse.
- Court said to bad so sad the IRC 152(e)(2) requirements controlled the exemption not the decree.
III. Alimony and Child Support

C. To be alimony the payment must:

1. Be in cash, not property.
2. The payment is not designated as something else that is excludible.
3. The spouses are not members of the same household.
4. No payments or requirement to make payments stipulated after death.
5. The payment is not treated as child support.
III. Alimony and Child Support


If it is not in writing it did not happen:

Bonus earned in pre-separation period was received in a divorce year.

- The bonus was split 50/50 with ex-spouse.
- Agreement did not provide for support.
- There was no evidence that the parties were in fact separated at the time of the payment.

Court determination – The payment was not alimony.
III. Alimony and Child Support


Transfer of property (real estate) to the ex-spouse in satisfaction of alimony requirements was not deductible as alimony.

For a payment to be “alimony” it must be paid in cash: IRC 71(b)(1).
III. Alimony and Child Support

E. It is allowed to make payments to a third party if the payments are:

1. Made in lieu of alimony payments
2. It is the intention of the parties.
3. The process is agreed to in writing prior to the year the payments are made.
III. Alimony and Child Support

The home where the non-resident spouse pays the mortgage.

EXERPT—TABLE 4 (IRS Publication 504): Expenses for a Jointly-Owned Home

If a taxpayer must pay all the mortgage payments (principal and interest) AND both spouses own the home jointly, then the taxpayer can deduct and the taxpayer’s spouse (or former spouse) must include as alimony half of the total payments. Each spouse qualifies for the Schedule A deduction of half of the interest expense (assuming a qualified home).

If the taxpayer must pay all the real estate taxes and homeowners insurance AND the home is held as tenants in common, then the taxpayer can deduct and the spouse (or former spouse) must include as alimony half of the total payments. Each spouse qualifies for a Schedule A deduction of half of the real estate taxes paid (no deduction is generally available for the homeowners insurance).

If the taxpayer must pay all the real estate taxes and homeowners insurance AND the home is held as tenants by the entirety or in joint tenancy, then the taxpayer cannot deduct any alimony and the spouse has no reportable income. The taxpayer qualifies to deduct all the real estate taxes on Schedule A (no deduction is generally available for the homeowners insurance).
III. Alimony and Child Support

It was all alimony, why because it was not a “fixed” amount.

CASE: In *DeLong*, the Tax Court concluded that family support payments made by an individual to his legally separated spouse were *alimony, not child support.*

At issue was the Superior Court’s second support order that noted the family support payments were for both spousal support and child support. *The Court did not allocate any specific portion of the family support payments as spousal support or child support in either the support order or its predecessor.*

The Tax Court rejected the IRS’s argument that the family support payments were designated as *non-alimony,* and concluded that no amount of the family support payments qualified as *child support* under IRC Sec. 71(c).

The Court noted that the statutory directive that child support payments be “fixed” was generally taken literally. Mr. DeLong’s support orders made an unallocated award of spousal and child support. Consequently, they did not “fix” any portion of the family support payments as a sum that was payable for the support of his children for purposes of IRC Sec. 71(c)(1). In addition, there was no amount specified in the support orders that was to be reduced upon the occurrence of a contingency specified in the support orders relating to Mr. DeLong’s children or at a time that could clearly be associated with that kind of contingency under IRC Sec. 71(c)(2). *(DeLong v. Comm., TC Memo 2013-70)*
III. Alimony and Child Support

It is child support if:

H. There are events contingent on a child event, Page 44, Item H and

I. Payments are clearly associated with a child event.

J. The assumption can be overcome by showing an the reduction was not a child event.
III. Alimony and Child Support

If there is both alimony and child support

- If all payments are not made.
- Alimony is considered not paid first.

**EXAMPLE:** Wolfgang’s divorce decree calls for him to pay his former spouse $200 a month ($200 × 12 months = $2,400 a year) as child support and $150 a month ($150 × 12 months = $1,800 a year) as alimony. If Wolfgang pays the full amount of $4,200 ($2,400 + $1,800) during the year, he can deduct $1,800 as alimony and his former spouse must report $1,800 as alimony received. If he pays only $3,600 during the year, $2,400 is child support. He can deduct only $1,200 ($3,600 − $2,400) as alimony and his former spouse must report $1,200 as alimony received.
IV. Alimony Recapture

The basic rule:

Second year payment is > $15,000 of year three, then recapture is triggered of the excess amount.

The first year excess payment is determine based on the adjusted second year payment (reduced for any excess).

Year one is excessive to the extent it exceeds:

$15,000 +

50% of year two after adjustment +

100% of year three payment – Example following
IV. Alimony Recapture

Year One Payment = $36,000

Year Two Payment = $48,000

Year Three Payment = $24,000

Year Two Excess - $24,000 + $15,000 = $39,000

Year Two Payment $48,000 - $39,000 = $9,000

Year One Excess - $36,000 – ($15,000 + ($39,000 x 50%) = $34,500) = $1,500

Recaptured Amount = $10,500 - In year 3 as alimony received or paid.
IV. Alimony Recapture

There are some other events that can trigger recapture such as:

Payments made under temporary orders.

Payments that end in three year period due to death or remarriage.

Payments based on a contingency such as earnings, retirement or other economic event.
V. Property Settlements

E. IRC Sec. 1041(c)(1) – A property transfer that occurs within one year after marriage will be considered a transfer incident to the divorce.

Recent Case – Belot, TC Memo 2016-113 Continued to run joint business after divorce but almost two years after the initial divorce settlement transferred shares of the jointly held business to spouse.

Court Decision – Even though the ultimate transfer of the business occurred after 1 year and not a part of the divorce settlement it still qualified under IRC 1041
VI. Income Allocation

Will be based on the following, but will vary based on individual state rules:

Community Property - Division based on community property rules to date of divorce, then individual interests.

Equitable Distribution – If you earned it, then you pay the taxes, joint property earnings will be divided based on state law.
Understanding the QDRO – Qualified Domestic Relations Order

An order that will divide retirement rights or funds between the parties of divorce, transferring the ownership/right to the beneficiary of the QDRO.

The details:

✓ Payments to spouse will be their taxable income but can be rolled over
✓ Payments to dependents will be taxable to the owner of the account.
VII. Retirement Benefits

Pertinent Issues:

- There MUST be a court order written in the appropriate format to be a QDRO.
- Distributed amounts are not subject to a premature distribution penalty.
- But the spouse can rollover amounts transferred pursuant to a QDRO, deferring taxation.
- Once the spouse transfer amounts to their account any withdrawals from the spouses account may be subject to a premature distribution penalty.
VIII. Estimated Tax Payments

The allocation will:

1. Equitable Distribution Jurisdiction – Based on “agreement” by spouses.
2. Community Property – Depends on where money came from.
3. Require a statement attached to the return and IRS will struggle with the process.
VIII. Estimated Tax Payments

To determine the appropriate “safe harbor” payment for:

Prior year unmarried taxpayers – Calculate tax liability for prior year as if they had been married.

Prior year married taxpayers – Calculate separate tax and allocate the resulting percentage to each taxpayer.

Each spouse’s separate liability

Total of both spouses separate liabilities
IX. Allocating Tax Carryforwards in Divorce

How it works:

✓ Each spouse will be credited with their share of any carryforward.
✓ Property issues will follow ownership.
✓ NOLs will follow respective shares of activities that generate losses.
✓ PALs will follow who ends up with activity that created PAL carryovers.
✓ Transfer of S-Corps suspended losses will be released if there is sufficient basis.