Tax Issues of Divorce
About NATP

NATP is the largest association dedicated to equipping tax professionals with the resources, connections, and education they need to provide the highest level of service to their clients. NATP is comprised of more than 23,000 leading tax professionals who believe in a superior standard of ethics and exemplify professional excellence. Members rely on NATP to deliver professional connections, content expertise, and advocacy that provides them with the support they need to best serve their clients. The organization welcomes all tax professionals in their quest to continually meet the needs of the public, no matter where they are in their careers. The NATP headquarters is located in Appleton, Wisconsin. To learn more, visit www.natptax.com.

Our Commitment

NATP exists to be the most reliable resource for gaining and developing professional tax expertise. The design of this publication is to provide accurate and authoritative information on the subject matter covered, presented with the understanding that the National Association of Tax Professionals is not engaged in rendering legal or accounting services.

This text has been prepared with due diligence but may not address every possible situation. In the event that there is a change or update needed due to legislation or the discovery of an error, NATP will create and post an addendum at www.natptax.com/taxstore.

NATP updated this material to 2016. At the time of updating, the most recent authorized forms are for 2015. Therefore, we used 2015 forms throughout the text for examples and illustrations.
Acknowledgment

We would like to thank Bloomberg BNA Interactive Forms for the contribution made in providing the 2015 Interactive Forms for completing examples included in this text.
Course Description

Divorce can be an emotional rollercoaster for the parties involved. Understanding the complications and economic effect at the tax level reassures the taxpayers their returns have been properly prepared. As a tax professional, it’s your responsibility to explain the tax implications of divorce, and report income and expense correctly on the individuals’ returns. When children are involved, it can be tricky to determine which taxpayer can claim an exemption for a child. Knowing how to distinguish between child support and other payments is important. Being prepared when clients come to you in the midst of divorce can alleviate some tax filing problems.

Objectives

Upon completion of this course, you will be able to:

- Identify the most appropriate filing status for separated or divorced taxpayers.
- Summarize the exceptions to both spouses being jointly and severally liable when filing a joint return.
- Distinguish which parent is eligible to claim a child as a dependent.
- Recognize the difference between custodial and noncustodial parent for tax purposes.
- Differentiate between alimony, child support, and property settlements.
- Summarize the tax treatment of a qualified domestic relations order (QDRO).
- Determine if a divorced taxpayer has a carryover of an NOL, capital loss, or passive loss.
- Assess community property state complications.
## Table of Contents

### Filing Status
- Marital Status ......................................................... 2
  - Married ............................................................... 2
  - Not Married ........................................................ 2
  - Considered Unmarried ............................................. 3
- Married Filing Jointly ................................................ 4
- Married Filing Separately .......................................... 4
  - Special Rules for MFS ............................................. 4
  - Itemized Deductions .............................................. 6
- Head of Household ................................................... 8
- Single ........................................................................ 9
- Filing Status Review Question .................................... 11
- Filing Status Review Answer ....................................... 13

### Joint and Several Liability
- Relief of Liability ..................................................... 15
  - Innocent Spouse Relief ........................................... 15
  - Separation of Liability Relief ................................... 16
  - Equitable Relief ...................................................... 16
- Injured Spouse ........................................................ 16
- Joint and Several Liability Review Question .................. 19
- Joint and Several Liability Review Answer ...................... 21

### Tax Issues Involving Children
- Dependency Exemption ............................................. 23
  - General Rules ....................................................... 23
  - Qualifying Child .................................................... 24
  - Qualifying Relative ................................................. 24
  - Determining Support .............................................. 25
  - Divorced or Separated Parents’ Rules ......................... 29
- Tax Issues Involving Children Review Questions ............. 39
- Tax Issues Involving Children Review Answers ................. 41

### Alimony
- Alimony Requirements ............................................. 43
  - Alimony Quick Chart ............................................... 45
- Reporting Alimony .................................................... 45
  - Deducting Alimony Paid .......................................... 45
  - Reporting Alimony Received ...................................... 46
Alimony Recapture .................................................. 46
  Reporting Recapture ........................................... 47
Alimony Trusts ..................................................... 48
Third-party Payments ............................................ 49
  Life Insurance Premiums ...................................... 49
  Expenses of a Jointly Owned Home ......................... 49
  Payments for a Nonowner ................................... 50
Lump-sum Alimony Payments ................................. 51
Alimony Review Questions ................................... 53
Alimony Review Answers ..................................... 55
Child Support ....................................................... 57
  Fixed Child Support ........................................... 57
  Deemed Child Support ....................................... 58
Child Support Review Question ............................. 61
Child Support Review Answer ............................... 63
Property Settlements ............................................. 65
  Personal Residence ........................................... 65
    Effect on Homebuyer Credit ............................... 66
Qualified Domestic Relations Order ....................... 69
  Requirements ................................................ 69
  Payments ..................................................... 70
  Penalty ....................................................... 70
  Basis ......................................................... 71
  Rollover ..................................................... 71
Miscellaneous Provisions .................................... 71
  Assignment of Income ..................................... 71
  Savings Bond Interest ...................................... 71
  Restricted Property ........................................ 72
  Property Transferred Pursuant to Divorce ............... 72
  Property Received ......................................... 73
Property Settlements Review Questions .................. 75
Property Settlements Review Answers ..................... 77
Impact of Divorce on Carryforwards ....................... 79
  Business Credits .......................................... 79
  Minimum Tax Credit ........................................ 79
  Charitable Contribution ................................... 79
  Capital Loss ............................................... 80
  Net Operating Loss ........................................ 80
S Corporation Losses ................................................. 80
Impact of Divorce on Carryforwards Review Question .................. 81
Impact of Divorce on Carryforwards Review Answer ..................... 83
Community Property Issues ........................................... 85
  Spouses Living Apart All Year ........................................ 85
  Reporting Provisions ................................................. 86
  Ending the Community .............................................. 86
  Special Rules for Innocent Spouse ................................... 87
    Relief from Liability Attributable to Community Income .............. 87
    Equitable Relief .................................................... 88
  Community Property Issues Review Question ......................... 89
  Community Property Issues Review Answer ........................... 91
Practitioner Responsibilities ............................................. 93
  Conflict of Interests .................................................. 93
  Consent ............................................................... 94
  Practitioner Responsibilities Review Question ........................ 95
  Practitioner Responsibilities Review Answer .......................... 97
Appendix ................................................................. 99
  Appendix A: Worksheet for Determining Support ..................... 99
  Appendix B: Determining Filing Status in a Divorce Situation Table 100
  Appendix C: Alimony Determination Chart ............................ 101
Filing Status

When working with couples who are in the process of a divorce, determining their filing status is not as straightforward as it may seem. First, a taxpayer must determine, at the end of the tax year, whether he or she is:

- Married.
- Not married.
- Considered unmarried.

After determining whether a divorced or divorcing individual is married, unmarried, or considered unmarried for federal tax purposes, the preparer must decide which status fits best.

- Married filing jointly.
- Married filing separately.
- Head of household.
- Single.
- Qualified widow(er) with dependent child.

While each filing status has its own requirements, advantages, and disadvantages, remember that filing status is determined as of December 31 of the tax year. Therefore, until the divorce is final, the taxpayers are still married for tax purposes. If the divorce is final by December 31, the taxpayer is not married for the entire tax year [§7703(a)(1)].

Note: If the taxpayers are married for the tax year in question, part of the decision-making process of what filing status to use is to review the interlocutory decree or separation agreement to determine if the issue of filing tax returns is addressed before selecting a filing status. The decree or agreement might require a joint return for a tax year ending before the divorce is final.
Marital Status

Married

An individual defined under §7703(a)(1) is considered married for the entire tax year if, on the last day of the tax year, the individual and his or her spouse meet any one of the following.

Common-law marriage — Two people living together in a common-law marriage that is recognized in the state where they now live or in the state where the common-law marriage began.

Interlocutory decree — When a couple is separated under an interlocutory (not final) decree of divorce, for tax purposes they are not considered officially divorced (Reg. §1.6013-4(a); Rev. Rul. 57-368).

Legally married — State law governs whether two people are legally married.

Married but living apart — A couple that is married and living apart, but not legally separated under a decree of divorce or separate maintenance and do not qualify as considered unmarried.

Divorce and remarriage — If a couple obtains a tax-motivated divorce in one year, for the sole purpose of filing tax returns as unmarried individuals, and at the time of divorce, intends to and does remarry each other in the next tax year, the IRS requires they file as married individuals (Rev. Rul. 76-255, Situation 2).

Note: The terms “spouse,” “husband and wife,” “husband,” and “wife” include an individual married to a person of the same sex if the individuals are lawfully married under state law, and the term “marriage” includes such marriage between individuals of the same sex. Laws applicable to opposite sex married couples apply equally to same sex married couples, including divorce laws.

Not Married

Under §7703(a)(2), an individual is not married for the entire year if either of the following apply.

- Divorce or separate maintenance decree — If the court issues a final decree of divorce or separation by the last day of the tax year (December 31), the person is unmarried for the entire tax year.
An annulment — If, after a couple files a joint return, their marriage is annulled by a competent state court which holds that under state law a valid marriage never existed, that couple must file amended returns as unmarried individuals for the years that they filed a joint return. Since under state law no valid marriage ever existed, the individuals are single for the period during which they had filed joint returns (Rev. Rul. 76-255, Situation 1).

As a result, the individuals must file amended returns (Form 1040X, Amended U.S. Individual Income Tax Return) claiming single or head of household status for all tax years affected by the annulment that are not closed by the statute of limitations for filing a tax return. The statute of limitations generally is three years after filing the original return.

Considered Unmarried

Under §7703(b), an individual is considered unmarried for the entire tax year if, on the last day of the tax year, he or she qualifies as an abandoned spouse.

An abandoned spouse is an individual who meets the following.

- Pays more than half the cost of maintaining his or her household for the taxable year.
- Files a separate return.
- Maintains a household that is the principal residence of a dependent child for more than six months of the year (even if the taxpayer does not actually claim the deduction).
- Lives apart from one’s spouse for the last six months of the tax year.

Dependent child is defined under §152(f) as a son, daughter, stepson, or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer. Adopted child is the same as a child by blood.

Living apart from one’s spouse for the last six months of the year is required. In Laurel Marie Hopkins, TC Memo 1992-326, the taxpayer could not claim head of household status because she could not evict her estranged husband from her house. Because they did not divorce, and did not live in separate residences during last six months of tax year, her proper filing status was married filing separately.

Note: Living apart requires a geographical separation and living in separate households. Allowing the spouse to spend one night on the couch violates this requirement.
Married Filing Jointly

Married filing jointly (MFJ) generally produces the most favorable combined tax results. However, when going through a divorce, the spouses do not always agree to file a joint return during the year of separation. The taxpayers cannot use the MFJ status if the divorce is final at the end of the tax year.

Filing a joint return makes each spouse jointly and severally liable for any unpaid taxes and income tax-related penalties, interest, or deficiency regardless of the separate taxable income of each spouse. If liability for tax on the income of the other spouse is a concern, he or she should consider filing married filing separately (MFS). Even though filing separately can produce a higher tax liability, it prevents the spouse from being liable for any tax on any unreported income of the other spouse or tax adjustments related to the other spouse.

Note: The Nebraska Supreme Court has determined that a trial court in a marital dissolution case cannot require the spouses to file joint federal income tax returns. The Court reasoned that compelled joint filing was inappropriate since the trial court could instead equitably adjust its division of the marital estate to account for the adverse tax consequences resulting from a spouse’s unreasonable refusal to file a joint return [Matthew John Bock, appellee, v. Jennifer Lynn Dalbey, appellant, (6/15/2012 Sup Ct NE) Docket No. 5-10-973].

Married Filing Separately

Each individual reports only his or her income, exemptions, deductions, and credits on MFS returns. However, if the individual lives in a community property state and files a separate return, the income could be separate income or community income for income tax purposes. (The topic of community property issues is covered later in this text). Taxpayers cannot use MFS status when the divorce is final.

Special Rules for MFS

Factors unique to MFS returns include the following.

- A taxpayer generally cannot claim the adoption expense exclusion or credit.
- Alternative minimum tax (AMT) exemption amount is one-half of that allowed on a joint return.
- Capital loss deduction is limited to $1,500 (instead of $3,000 on a joint return).
- In most cases, a taxpayer cannot claim the credit for child and dependent care expenses.
- Dependent care assistance program exclusion is limited to $2,500 (half of $5,000 if a joint return).
• A taxpayer cannot claim earned income credit.
• The taxpayer cannot claim the American opportunity credit or the lifetime learning credit.
• Interest from qualified savings bonds used for higher education expenses is not excludable.
• The taxpayer can claim a partial IRA deduction if either spouse participated in an employer retirement plan during the year and the taxpayer's modified AGI (MAGI) is less than $10,000. The taxpayer cannot claim an IRA deduction if the MAGI is $10,000 or more.
• If one spouse itemizes deductions, the other spouse must also itemize, as the standard deduction for the non-itemizing spouse becomes zero. When this happens, the taxpayers should claim as many itemized deductions as possible.
• If an individual actively participated in a passive rental real estate activity that produced a loss, generally the loss can offset nonpassive income, up to $25,000. However, married persons filing separate returns, who lived together at any time during the year, cannot claim this special allowance. Married persons can each offset up to $12,500 in passive losses from real estate activities if they lived apart at all times during the year.
• If both spouses claim the basic standard deduction, it is half the amount allowed on a joint return.
• A taxpayer cannot claim a student loan interest deduction.
• The marginal tax rate is generally higher as it increases more quickly at MFS income levels than at MFJ income levels.
• If the taxpayer lived with his or her spouse at any time during the tax year:
  • He or she cannot claim the credit for the elderly or the disabled.
  • There will be more social security or equivalent railroad retirement benefits included in income (up to 85%) because the base amount is zero.
• The following deductions and credits are reduced at income levels that are half those for a joint return.
  » Child tax credit.
  » Retirement savings contributions credit.
Itemized Deductions

Under the general rule, when a taxpayer files as MFS and the other spouse itemizes, the standard deduction is zero [§63(c)(6)(A)]. If one spouse itemizes, then the other spouse should itemize.

An exception to the general rule occurs when one spouse files as head of household.

- If a married individual files a separate return with head of household status, elects to itemize deductions, and the other spouse has to file as MFS, the spouse filing MFS is not eligible for the full standard deduction (CCA 200030023).

- If the spouse who files as MFS elects to itemize deductions, the spouse who files a separate return with head of household status can still use the full standard deduction available for head of household status.

In separate property states, not community property states, the following table identifies itemized deductions a taxpayer can claim on his or her separate return whether he or she paid the expenses separately with his or her own funds or jointly with the spouse.
## Deducting Itemized Deductions on Separate Returns—Separate Property States

<table>
<thead>
<tr>
<th>IF the taxpayer had the following deduction ...</th>
<th>AND the taxpayer ...</th>
<th>THEN the taxpayer can deduct on his or her separate federal tax return...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical expenses</td>
<td>Paid with funds from a joint checking account in which taxpayer and his or her spouse have an equal interest.</td>
<td>One-half the total medical expenses, subject to the limits, unless taxpayer can show that he or she alone paid the expenses.</td>
</tr>
<tr>
<td></td>
<td>Paid medical expenses of a spouse incurred when taxpayers were married or paid when married.</td>
<td>Taxpayer can deduct the medical expense.</td>
</tr>
<tr>
<td>State income tax</td>
<td>Files a separate state income tax return.</td>
<td>State income tax he or she alone paid during the year.</td>
</tr>
<tr>
<td></td>
<td>Files a joint state income tax return and taxpayer and spouse are jointly and individually liable for full amount of state income tax.</td>
<td>State income tax he or she alone paid during the year.</td>
</tr>
</tbody>
</table>
|                                               | Files a joint state income tax return and taxpayer is liable for only his or her own share of state income tax. | Smaller of:  
  • State income tax he or she alone paid during the year, or  
  • Total state income tax taxpayer and spouse paid during the year multiplied by the following fraction: numerator is taxpayer’s gross income and denominator is combined gross income. |
| Property tax                                  | Paid the tax on property held as tenants by the entirety from separate funds (otherwise, presumption is each paid half). | Property tax he or she alone paid. |
| Mortgage interest                             | Paid the interest on a qualified home held as tenants by the entirety from separate funds (otherwise, presumption is each paid half). | Mortgage interest he or she alone paid. |
| Casualty loss                                 | Has a casualty loss on a home taxpayer owns as tenants by the entirety | Half of the loss, subject to the deduction limits. Neither spouse can report the total casualty loss. |

**Note:** If the taxpayer lives in a community property state, these rules do not apply. Expenses paid out of separate funds, such as medical expenses, are deductible by the spouse who pays them. Equally, divide expenses paid out of community funds.
Head of Household

To file as head of household, the taxpayer must meet all the following requirements.

- Be unmarried or considered unmarried on the last day of the year.
- Pay more than half the cost of keeping up a home for the year.
  » Includes real estate taxes, mortgage interest, utilities, rent, maintenance, repairs, insurance, and food consumed on the premises.
  » Maintaining a home does not include the other costs taken into account when determining support, such as clothing, education, health, vacations, and similar support costs.
- Maintain a home for a qualifying person, such as a dependent child or a relative, who lives with the taxpayer in the home for more than half the year. If the qualifying person is a dependent parent, that parent does not have to live with the taxpayer.

Note: Even though the determination of who can claim head of household includes having a qualified person who could be a qualifying child or a qualifying relative, it is important to understand that, when married, in order to claim head of household, the definition of abandoned spouse under §7703(b)(1) requires a dependent child. Dependent child is defined under §152(f) as a son, daughter, stepson, or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer. Adopted child is the same as a child by blood.

EXAMPLE

Ted’s niece lives in his home for more than half the year. Ted claims her as a qualifying child. He is married and his wife did not live in the home the last six months of the year. He pays more than half the cost of keeping up the home.

His niece is his dependent child so he is eligible to file as head of household. If he is divorced before the end of the year, then he does not have to meet the narrower considered unmarried criteria and he can claim head of household.

Filing as head of household has the following advantages.

- The taxpayer is eligible for certain credits, such as dependent care credit and earned income credit, which a MFS return cannot claim.
- Income phase-out limits that reduce the child tax credit and retirement savings contributions credit are higher than the limits on a MFS return.
- The taxpayer can claim the standard deduction even if the other spouse files a separate return and itemizes deductions, because this is not a MFS return.
- The standard deduction for head of household is higher than that allowed on a single or MFS return.
- The tax rate is lower than on a single or MFS return.
**EXAMPLE**

Bob and Gail Neverhome are married and lived apart for the entire year. Their 14-year-old daughter, Dawn, lives with Gail for 9½ months of the year and with Bob during summer break, from mid-June through August. Bob and Gail each provide one-half of Dawn’s support and file separate income tax returns. Gail paid more than half the cost of maintaining her home. Per their agreement, Gail cannot claim the dependency exemption in odd years, which requires her to release the exemption with Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*. Therefore, Gail meets all requirements and is considered unmarried for tax purposes. She can file as head of household. Bob, on the other hand, can claim Dawn because of the release, but his filing status is MFS.

**Single**

Only couples who are legally separated (either under a decree of divorce or separate maintenance) as of December 31, can file single.

**Note:** Taxpayers moving due to divorce should file Form 8822, *Change of Address*, with the IRS so the IRS properly forwards their personal tax information. The IRS sends all correspondence by mail to the most recent address on file. Additionally, the individual should change payroll withholdings. Taxpayers should give their employer a new Form W-4, *Employee’s Withholding Allowance Certificate*, with their updated withholding status to single. Prior to divorce, lower married rates could apply for withholding. Not changing the withholding could result in an unexpected balance due for now unmarried taxpayers.

See Appendix B for a worksheet to help determine a taxpayer’s filing status when divorcing.
Notes
Filing Status Review Question

1. The divorce is not final, the individual does not have a qualifying child, and the other spouse does not want to file jointly. What filing status must the taxpayer use?
   A. Single.
   B. Married filing separately.
   C. Married filing jointly.
   D. Head of household.
Filing Status Review Answer

1.  
   A. Incorrect. A taxpayer in a divorce situation where the divorce is not final is still married.
   
   B. **Correct.** A taxpayer in a divorce situation, where the divorce is not final, is still married. If the other spouse does not agree to file jointly, MFS is the only option if the taxpayer does not have a qualifying child.
   
   C. Incorrect. To file MFJ, both spouses must agree to file jointly.
   
   D. Incorrect. Head of household requires the taxpayer to have a qualifying person to be eligible.

   [Married Filing Separately]
Notes
Joint and Several Liability

Generally, the IRS can collect from either spouse regardless of what the divorce decree states.

Relief of Liability

In some cases, a spouse (or former spouse) is relieved of the tax, interest, and penalties on a joint tax return. Three types of relief are available to married persons who filed joint returns.

- Innocent spouse relief.
- Separation of liability relief.
- Equitable relief.

A taxpayer requests relief by filing Form 8857, Request for Innocent Spouse Relief. The request for innocent spouse relief and separation of liability relief must be made no later than two years after the date the IRS first attempted to collect the tax. Requesting equitable relief does not have to be within the two-year timeframe (Notice 2012-8).

Innocent Spouse Relief

Innocent spouse relief provides relief from additional tax owed if the individual's spouse or former spouse failed to report income, reported income improperly, or claimed improper deductions or credits. In order to meet the innocent spouse relief, the taxpayer must meet all the following conditions.

- The taxpayer files a joint return, which has an understatement of tax directly related to the other spouse's erroneous items. Omitted income and incorrectly reported deductions, credits, and property basis are erroneous items on the joint return.
- The taxpayer can establish that he or she did not know, and had no reason to know, that the understated tax existed at the time he or she signed the return.
- Taking into account all the facts and circumstances, it would be unfair to hold this spouse liable for the understatement of tax.

Note: A taxpayer can qualify for partial relief if, at the time the return was filed, he or she knew or had reason to know of only a portion of an erroneous item (Pub. 971, Innocent Spouse Relief).
Separation of Liability Relief

This relief provides for the allocation of additional tax owed between spouses or former spouses because of an item improperly reported on a joint return. The tax allocated is the amount for which each individual is responsible.

The requesting spouse can obtain separation of liability relief if, at the time of the request, he or she meets one of the following requirements.

- He or she is divorced or legally separated from the spouse with whom he or she filed the joint return for which requesting relief.
- Is widowed.
- During the 12-month period prior to filing Form 8857, the taxpayer was not a member of the same household as the spouse on the joint return.

The individual does not qualify for this relief if he or she had actual knowledge of the item that gave rise to the understatement of tax when he or she signed the return.

Equitable Relief

If the taxpayer does not qualify for either the innocent spouse relief or the separation of liability relief and is liable for an underpayment or understatement of tax, the taxpayer can request equitable relief. To qualify for equitable relief, the individual must establish, under all the facts and circumstances, that it would be unfair to hold him or her liable for the understatement or underpayment of tax. Equitable relief is also available if the taxpayer reports the correct amount of tax on the joint return but it remains unpaid.

Injured Spouse

Injured spouse relief is different from innocent spouse relief, separation of liability relief, and equitable relief. An individual is an injured spouse when the IRS uses their portion of a refund from a joint return to pay the other spouse's past-due federal tax, state income tax, child support, spousal support, or federal nontax debt, such as a student loan.

The injured spouse files Form 8379, Injured Spouse Allocation, to claim a refund of his or her share of the joint overpayment that the IRS applies, or is expected to apply, as a refund offset to pay the other spouse's separate debt.
An individual is an injured spouse if he or she meets the following.

- Is not legally obligated to pay the past-due amount.
- Meets any of the following conditions.
  - Made and reported tax payments, such as federal income tax withholding or estimated tax payments.
  - Had earned income, such as wages, salaries, or self-employment income, and claimed (or expected to claim) the earned income credit or the additional child tax credit.
  - Claimed (or expected to claim) one or more of the following refundable credits.
    - American opportunity credit.
    - Federal tax paid on fuels credit.
    - Refundable prior-year minimum tax credit.
    - Premium tax credit.

**Note:** If the taxpayer’s residence was in a community property state at any time during the year, Form 8379 can be filed even if only the first item above (not legally obligated to pay the past-due amount) applies.

**Note:** To determine if a debt is owed (other than federal tax), and whether an offset will occur, Fiscal Service (FS) can be contacted at 800.304.3107 (for TTY/TDD help, call 866.297.0517).
Notes
Joint and Several Liability Review Question

1. All the following are exceptions to both spouses being jointly and severally liable when filing a joint return except:
   A. Innocent spouse relief.
   B. Separation of liability relief.
   C. Injured spouse relief.
   D. Equitable relief.
Notes
Joint and Several Liability Review Answer

1.

A. Incorrect. Innocent spouse relief is an exception to both spouses being jointly and severally liable when filing a joint return.

B. Incorrect. Separation of liability relief is an exception to both spouses being jointly and severally liable when filing a joint return.

C. Correct. Injured spouse is not an exception for joint and severally liability when filing a joint return. It has a different application.

D. Incorrect. Equitable relief is an exception to both spouses being jointly and severally liable when filing a joint return.

[Relief of Liability]
Notes
Tax Issues Involving Children

In a separation or divorce, the handling of tax issues involving children differ from those of an intact family. The most crucial of these is determining which parent is entitled to claim the children as dependents—the custodial or noncustodial parent. Additional issues include which parent (custodial or noncustodial) can claim the deduction for the child’s medical expenses or any of the credits associated with the child.

Note: Be sure to review the divorce decree or separation agreement to determine who is entitled to the dependency exemption. The tax law defines the custodial parent and noncustodial parent. The tax law also authorizes the custodial parent to claim the dependency exemption unless the custodial parent releases the exemption to the noncustodial parent.

Dependency Exemption

When applying the basic rules to determine if an individual is a qualifying child or a qualifying relative, a special rule exists for a child of divorced or separated parents. This rule is applicable only if meeting certain requirements; otherwise, the general rules of what constitutes a qualifying child or qualifying relative determine who claims the dependency exemption.

General Rules

A taxpayer can claim one exemption on a tax return for each dependent. A dependent means a qualifying child or a qualifying relative.

For either a qualifying child or a qualifying relative, they must meet the following tests.

- **Dependent taxpayer test** — The taxpayer or spouse, if filing jointly, cannot be claimed as a dependent by another taxpayer.

- **Joint return test** — A person who files a joint return cannot be claimed as a dependent unless that joint return is only a claim for refund and there would be no tax liability for either spouse on separate returns.

- **Citizen or resident test** — To be claimed as a dependent, the person must be a U.S. citizen, resident alien, national, or a resident of Canada or Mexico (there is an exception for certain adopted children).
Qualifying Child

- The child must be the taxpayer’s son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them.
- The child must be (a) under age 19 at the end of the year and younger than the taxpayer (or the taxpayer’s spouse, if filing jointly), (b) under age 24 at the end of the year, a full-time student, and younger than the taxpayer (or the taxpayer’s spouse, if filing jointly), or (c) any age if permanently and totally disabled.
- The child must have lived with the taxpayer for more than half the year. There are exceptions for temporary absences, children who were born or died during the year, and kidnapped children.
- The child must not have provided more than half of his or her own support for the year.
- The child is not filing a joint return for the year (unless filing a joint return only as a claim for refund).
- If the child meets the rules to be a qualifying child of more than one person, the taxpayer must be the person entitled to claim the child as a qualifying child.

EXAMPLE

Rebecca (age 12) lived with her mother, Olivia, all year. Rebecca is a U.S. citizen. Olivia is not a dependent of anyone else. Rebecca received 40% of her support from Olivia and 60% of her support from her grandmother.

Rebecca is a qualifying child of Olivia because:
- She is Olivia’s daughter (relationship test).
- She lived with her mother all year (residency test).
- She is under age 19 (age test).
- She did not provide more than half of her own support (support test).
- The other dependency tests have also been satisfied.
- She is a U.S. citizen (citizen or resident test).
- She did not file a joint return (joint return test).
- Olivia is not a dependent of anyone else (dependent taxpayer test).

Qualifying Relative

- The person cannot be the taxpayer’s qualifying child or the qualifying child of any other taxpayer.
- The person must meet the relationship test or the member of household test.
  - Relationship test — Be the taxpayer’s child, stepchild, foster child, or descendant of any of them (or other relative). For this test, a child, brother, sister, parent, grandparent, or in-law does not have to live with the taxpayer.
» **Member of household test** — Live with the taxpayer all year as a member of that household, except for temporary absences. The taxpayer’s relationship with the qualifying relative must not be in violation of local law. There are exceptions to the residency test for temporary absences, children who were born or died during the year, and kidnapped children.

- The person’s gross income for the year must be less than the current year exemption amount. There is an exception if the person is disabled and has income from a sheltered workshop.
- The taxpayer must provide more than half of the person’s total support for the year.

**Note:** If the taxpayer is entitled to claim an exemption for a dependent, the dependent cannot claim his or her own personal exemption on his or her own tax return. This is true even if the eligible taxpayer does not actually claim the dependency exemption deduction.

---

**Determining Support**

In most cases, the support test is easy to determine because the child has a limited amount of income. However, in cases where the child has his or her own source of income, such as social security benefits, compensation from working, a trust fund that pays for the child’s health and maintenance, or payments received from the state, it can be more difficult to determine who has provided the support for the child.

For example, state payments are support provided by the state. When determining if the child meets the qualified child support test, the payments are not included with amounts provided by the child. For the qualifying relative support test, neither the taxpayer nor the relative can use state payments when determining support provided.

**Items Included in Support**

To figure if an individual provided more than half of another person’s support, first determine the total support provided for that person. Total support includes amounts spent to provide the following.

- Food.
- Lodging.
- Clothing.
- Education.
- Medical and dental care premiums.
- Recreation and transportation.
- Similar necessities.
Generally, the amount of an item of support is the amount of the expense incurred in providing that item. Divide expenses not directly related to any one member of the household, such as the cost of food for the household, utilities, or homeowner’s insurance, equally among all members of the household.

If the taxpayer provides a person with free lodging, the taxpayer provides support for that person equal to the fair rental value (FRV) of the room, apartment, house, or other shelter in which the person lives.

- FRV includes a reasonable allowance for the use of furniture and appliances and for heat and other utilities the taxpayer provides.
- FRV is the amount a taxpayer could reasonably expect to receive from a stranger for the same kind of lodging. Use FRV instead of actual expenses. In some cases, the FRV can be equal to the rent paid.
- If the taxpayer provides the total lodging, the amount of support provided is the FRV of the room the person uses or a share of the FRV of the entire dwelling if the person has use of the entire home.
- If the taxpayer does not provide the total lodging, divide the total FRV depending on how much of the total lodging the taxpayer does provide.

Capital items purchased for a person during the year are included in total support under certain circumstances, such as furniture, appliances, and cars. Only items that exclusively benefit the child are support for the child.

The following examples show when a capital item is or is not included in the calculation of support.

**EXAMPLE**

Tom purchased an $800 power lawnmower for his 13-year-old son, Adam, to use in keeping the lawn of their family home trimmed. Because a lawnmower is ordinarily an item the taxpayer buys for personal and family reasons that benefits all members of the household, Tom cannot include the cost of the lawnmower in the support of the child.

However, if Tom purchased the mower for Adam to use exclusively for his summer job of cutting lawns, it is a contribution towards Adam’s support.

**EXAMPLE**

Frank purchased a $500 television set as a birthday present for his 12-year-old daughter, Tiffany. Tiffany has the television in her bedroom for her exclusive use. Frank can include the cost of the television set in determining his contribution toward the support of Tiffany.

**EXAMPLE**

Joseph paid $5,000 for a car and registered it in his name. Joseph and his 17-year-old daughter, Julia, used the car equally. Because Joseph owns the car and did not give it to his daughter, but merely let her use it, he cannot include the cost of the car in the Julia’s total support. However, he can include as part of her support the amount of his out-of-pocket expenses of operating the car for her benefit.
EXAMPLE

Sue's 17-year-old son, Josh, used personal funds to buy a used car for $4,500. Sue provides the rest of Josh's support totaling $4,000. Since Josh purchased and owns the car, the car's FMV ($4,500) is included in his total support. The $4,000 support Sue provided is less than half of her son's total support of $8,500. Sue did not meet the support test because Josh provided more than half of his own support. Therefore, Josh is not a qualifying child and Sue cannot claim him as a dependent.

Amounts a veteran receives under the GI Bill for tuition payments and allowances while attending school are included in total support as funds provided by the veteran.

EXAMPLE

During the year, Gerald's son, Mason (a veteran), age 22, and a full-time student, received $10,000 from the government under the GI Bill. Mason used this amount for his education. Gerald provided the rest of his support totaling $9,800. Because the GI benefits are included in total support as funds provided by Mason, Mason does not qualify as Gerald's dependent. Mason provided more than 50% of his own support.

If a taxpayer pays someone to provide child care or disabled dependent care, he or she can include these payments in the amount provided for the support of the child or disabled dependent, even if the taxpayer claims a credit for the payments.

Determining Source of Support

In determining support provided by the child, the child's own funds are not support unless the child actually spends the funds for support.

EXAMPLE

Brad Brainchild, age 12, won $6,000 in a spelling bee and put it into a savings account. This money is not support provided by Brad because he did not spend the money for his support.

However, if Brad's parents let him spend the money on a bike, computer, and games, Brad contributed the $6,000 toward his total support. If that was his only contribution toward his support, as long as Mr. and Mrs. Brainchild provided more than $6,000 toward his support, Brad did not provide more than half of his total support.

It is necessary to identify the total support for the child from all sources. Include all amounts the child received, such as tax-exempt income, social security benefits, government assistance, etc., in determining if the child provided more than half of his or her own support.

Social security benefits a child receives and uses for his or her own support are provided by the child (Rev. Rul. 57-344).

Benefits provided by the state to a needy person generally are support provided by the state.
**Foster child payments** received from a child placement agency for the support of a foster child are support provided by the agency.

**Student loans** the child is under obligation to repay are support provided by the child *(Philip J. McCauley, 56 TC 48)*.

**EXAMPLE**

Janice, age 20 and a full-time student, obtained a student loan she is obligated to repay. The amount of loan proceeds she used to support herself during the year is support provided by her.

**Items Not Included in Total Support**

The following items are not included in total support.

- Federal, state, and local income taxes paid by persons from their own income.
- Funeral expenses.
- Life insurance premiums.
- Medical insurance benefits.
- Scholarships received by a child if the child is a full-time student.
- Social security and Medicare taxes paid by persons from their own income.
- Survivors’ and Dependents’ Educational Assistance payments used for support of the child who receives them.

**Preparation Pointer:** The easiest way to prove that a child did not provide more than half of his or her own support is to show that someone else provided more than half the child’s support. Divide the child’s total support received from all sources by two. If the support provided by the child exceeds that figure, the child provided more than half of his or her own support.

**Support Worksheet**


This worksheet determines whether someone other than the child provided more than half of the child’s support. When dealing with divorced or separated parents, combine the amounts each person paid for the child’s support and treat it as one payment to determine if the child provided more than half of his or her own support.

**Preparation Pointer:** Keep the worksheet in the taxpayer’s file. Do not attach the worksheet to the return.
Divorced or Separated Parents’ Rules

A child is the qualifying child of his or her noncustodial parent if *all four* of the following statements are true [Reg. §1.152-4(b)].

- The parents are either:
  - Divorced or legally separated under a decree of divorce or separate maintenance.
  - Separated under a written separation agreement.
  - Lived apart at all times during the last six months of the year, whether or not they are or were married.
- The child received more than half of his or her support for the year from the parents.
- The child is in the custody of one or both parents for more than half the year.
- Either of the following applies.
  - The custodial parent signs a written declaration indicating that he or she agrees not to claim the child as a dependent for the year, and the noncustodial parent attaches this written declaration to his or her return.
  - A pre-1985 decree of divorce or separate maintenance or written separation agreement that applies to the current year provides for the following.
    - The noncustodial parent can claim the child as a dependent.
    - There was no change to the decree or agreement after 1984 to say the noncustodial parent cannot claim the child as a dependent.
    - The noncustodial parent provides at least $600 for the child's support during the current year.

The custodial parent is the parent with whom the child lived for the greater number of nights during the year [Reg. §1.152-4(d)(1)].

Count the Nights

It is important for each parent to track the number of nights the child spent with him or her.

If the parents divorced or separated during the year and the child lived with both parents before the separation, the custodial parent is the one with whom the child lived for the greater number of nights during the rest of the year.

A child lives with a parent for a night if the child sleeps:

- At that parent's home, whether or not the parent is present.
- In the company of the parent, when the child does not sleep at a parent's home (for example, the parent and child are on vacation together) [Reg. §1.152-4(d)(1)].
Parent Works at Night

If, due to a parent’s night-time work schedule, a child lives with the parent who works at night for a greater number of days but not nights, that parent is the custodial parent. On a school day, the child is treated as living at the primary residence registered with the school [Reg. §1.152-4(d)(5)].

Absences

If a child is not with either parent on a particular night because, for example, the child is staying at a friend’s house, treat the child as living with the parent with whom the child normally would have lived for that night, except for the absence. But if it cannot be determined with which parent the child normally would have lived, or if the child would not have lived with either parent that night, the child is treated as not living with either parent that night [Reg. §1.152-4(d)(3)].

New Year’s Eve

Allocate a night that straddles two tax years to the tax year in which the night begins [Reg. §1.152-4(d)(2)]. Therefore, the night of December 31, New Year’s Eve, is part of the tax year in which the month of December begins.

Summer Camp

If the child lives with each parent for alternate weeks during the summer and attends a summer camp, the amount of time spent at camp is split between the parents according to how many nights he or she would have resided at each of their houses normally [Reg. §1.152-4(g), Example 12].

EXAMPLE

During the summer, April’s daughter, Lizzie spends six weeks at summer camp. Ordinarily, Lizzie alternated weeks with each parent. During the time she is at camp, count Lizzie as living with April for three weeks and with her father for three weeks since this is how long she would have lived with each parent if she had not attended summer camp.

Emancipated Child

For a child emancipated under state law, treat the child as not living with either parent.

EXAMPLE

When Jim’s son, Tom, turned age 18 on May 15, he became emancipated under the law of the state where he lives. As a result, Tom is not in the custody of his parents for more than half of the year. The special rule for children of divorced or separated parents does not apply [Reg. §1.152-4(g), Example 6].
**EXAMPLE**

Freedom lives with her mother, Teresa, from January 1 until May 31, and she lives with her father, David, from June 1 through the end of the year. Freedom turned 18 and became emancipated under state law on July 4. Freedom is in the custody of her parents for more than half the year. However, she is not in the custody of either parent beginning on July 4. Thus, Freedom lives with her mother, Teresa, the greater number of nights, which makes Teresa the custodial parent [Reg. 1.152-4(g), Example 7].

**Equal Number of Nights**

If the child lived with each parent for an equal number of nights during the year, the custodial parent is the parent with the higher adjusted gross income (AGI).

*Note:* See Reg. §1.152-4(g) for 20 examples of divorced parent situations.

**EXAMPLE**

Jacob lived with his father, Earl, for 180 nights during the year and he lived the same number of nights with his mother, Cynthia (Earl's ex-wife). Five other nights during the year, Jacob stayed with friends and it cannot be determined with which parent he normally would have lived. Earl’s AGI is $60,000 and Cynthia’s AGI is $45,000. Since Jacob lived with each parent the same number of nights, and even though Cynthia's address is Jacob's address of record for school and, in the past, she qualified as the custodial parent, Earl is Jacob’s custodial parent because they are tied for equal nights but Earl has the higher AGI.

**EXAMPLE**

Richard and Dorothy Debater decided to part ways. Richard moved out of the Debater home on May 30. Dorothy and their three children, ages 16, 14, and 8, remained in the Debater home. They agreed that Richard would have the children overnight for visitation every weekend, most birthdays, and holidays. Little did they realize that they needed to keep track of the nights each child spent with them.

Each parent should keep track of the number of nights the children stay with him or her to know who is entitled to the dependency exemptions.

A Julian calendar shows May 30 is the 150th night in a nonleap year, with 215 nights remaining. Whichever parent has the children for at least 108 nights (215 ÷ 2 = 107.5, rounded to 108) can claim the children as dependents.

If any of the children stay overnight with friends on some of the weekends, those sleepover nights count as Richard’s, not Dorothy’s, nights.

Keeping track of each night for each child, perhaps on a calendar, makes claiming the dependency exemption easier to substantiate for the tax return.
Written Declaration

The noncustodial parent can claim his or her child if the custodial parent signs a written declaration unconditionally releasing the exemption [Reg. §1.152-4(e)(1)(i)]. The custodial parent must complete either Form 8332 or, if allowed, a similar statement (containing the same information required by the form) to make the written declaration.

Post-1984 and pre-2009 divorce decree or separation agreement — The noncustodial parent can attach certain pages from the decree or agreement instead of Form 8332. The decree or agreement must state all three of the following.

- The noncustodial parent can claim the child as a dependent without regard to any condition, such as payment of support.
- The custodial parent agrees not to claim the child as a dependent for the year.
- The years for which the noncustodial parent can claim the child as a dependent.

The noncustodial parent must attach all the following pages of the decree or agreement to his or her tax return.

- The cover page (write the other parent's social security number on this page).
- The pages that include all the information identified in the bullet points above.
- The signature page with the other parent's signature and the date of the agreement.

For post-2008 divorce decree or separation agreement — The noncustodial parent can no longer attach pages from the decree or agreement instead of Form 8332. The custodial parent must sign either Form 8332 or a similar statement, whose only purpose is to release the custodial parent's claim to an exemption for a child; the noncustodial parent must attach a copy to his or her return. The form or statement must release the custodial parent's claim to the child without any conditions. For example, the release must not depend on the noncustodial parent paying support.

The noncustodial parent must attach Form 8332, or a similar statement, to his or her tax return for each year the noncustodial parent claims that child as a dependent. If filing electronically, send Form 8332 with Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-file Return, to the IRS.
EXAMPLE

Lori and Mike, the parents of Claire, execute a written separation agreement. The agreement provides that Claire lives with Lori and that Mike agrees to make monthly child support payments to Lori. The agreement further provides that Lori will not claim Claire as a dependent in the current year and in subsequent alternate years. The agreement does not expressly condition Lori’s agreement not to claim Claire as a dependent on Mike’s payment of child support or any other condition. The agreement contains all the other information requested on Form 8332. Mike attaches the agreement to his current year tax return.

Mike cannot claim Claire as a qualifying child in the current year because Lori released the right to claim Claire as a dependent by executing the separation agreement. A separation agreement executed in tax years beginning after July 2, 2008, does not satisfy the requirements for the form of a written declaration.

In order for Mike to claim Claire he should have attached Form 8332, or similar statement signed by Lori.

The custodial parent can release the exemption for the following.

- One year.
- Specified years (for example, alternate years, odd years or even years).
- All future years, as specified in the declaration.

| Form 8332
Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Name of noncustodial parent</td>
<td>Noncustodial parent’s social security number (SSN)</td>
</tr>
</tbody>
</table>

**Part I**
Release of Claim to Exemption for Current Year

I agree not to claim an exemption for ________________________________ Name of child for the tax year 20 ___.

Signature of custodial parent releasing claim to exemption________________________ Custodial parent’s SSN____________________ Date____________________

Note. If you choose not to claim an exemption for this child for future tax years, also complete Part II.

**Part II**
Release of Claim to Exemption for Future Years (If completed, see Noncustodial Parent on page 2)

I agree not to claim an exemption for ________________________________ Name of child for the tax year(s) ________________________________ (Specify. See instructions.)

Signature of custodial parent releasing claim to exemption________________________ Custodial parent’s SSN____________________ Date____________________

**Part III**
Revocation of Release of Claim to Exemption for Future Year(s)

I revoke the release of claim to an exemption for ________________________________ Name of child for the tax year(s) ________________________________ (Specify. See instructions.)

Signature of custodial parent revoking the release of claim to exemption________________________ Custodial parent’s SSN____________________ Date____________________
The custodial parent completes Form 8332, as follows.

- Part I releases the claim to the child's exemption for the current year.
- Part II releases a claim to the child's exemption for one or more future years. The custodial parent enters either the specific future year(s) or writes: all future years in the space provided in Part II.
- Part III of Form 8332 revokes the written declaration. For tax years beginning after July 2, 2008 (generally, the 2009 calendar year), the custodial parent can revoke a release of claim to exemption that he or she previously released (via Form 8332 or a similar statement) to the noncustodial parent.
  - The revocation is effective no earlier than the tax year beginning with the calendar year following the calendar year in which the custodial parent provides, or makes reasonable efforts to provide, the noncustodial parent with written notice of the revocation. Therefore, if the custodial parent provides notice of revocation to the noncustodial parent in year 1, the earliest tax year the revocation can be effective is the tax year beginning in year 2.
  - Because of the revocation, the custodial parent must attach a copy of the revocation to his or her tax return each year he or she claims the child as a dependent.

Note: Keep as permanent tax records a copy of the revocation and evidence of delivery of the notice to the noncustodial parent, or of reasonable efforts to provide actual notice.

EXAMPLE

In 2017, Mike fails to provide child support, so Lori signs a Form 8332 revoking the release of her right to claim Claire as a dependent for 2018. Lori delivers a copy of the Form 8332 to Mike in December 2017, attaches the Form 8332 to her tax return for 2018, and keeps a copy of the revocation and evidence of delivery of written notice to Mike.

For 2018, only Lori can claim Claire as a dependent because in 2017, she revoked the release of her right to claim Claire and the revocation takes effect in 2018 (the first year after the year Lori provides written notice of the revocation to Mike.)

EXAMPLE

Tom and Ann were divorced in 2010. Their divorce decree states that their son, Jacob, is to live with Ann, but that Tom is entitled to claim Jacob as a dependent. In 2010, Ann provided Tom with Form 8332 indicating he could claim Jacob from 2010 through 2020. However, Tom lost his job in 2017 and stopped paying child support. Their divorce decree states that if Tom falls behind on child support, he is not entitled to claim Jacob.

In order for Ann to claim Jacob on her 2017 tax return, she must have provided Tom with notification, before December 31, 2016, that she was revoking her release to claim Jacob. After doing so, she can claim Jacob the year following her notification to Tom, which means if she revokes her release sometime in 2017, the earliest she could claim Jacob is on her 2018 tax return.
Deductions and Credits  The deductions and credits related to children can easily cause uncertainty when dealing with divorcing and divorced couples. Dividing them among parents depends on which parent is the custodial parent and whether or not the custodial parent has waived his or her right to claim the exemption.

The following benefits are available when having a qualified dependent when filing.

- Dependency exemption deduction.
- Child tax credit.
- Education tax credits.
- Student loan interest deduction.
- Head of household filing status.
- Child and dependent care tax credit.
- Earned income tax credit.
- Tax-free dependent care assistance benefits.
- Premium tax credit.

**Note:** If the custodial parent does not waive the right to claim the dependency exemption of the qualifying child, only the custodial parent is eligible to claim the deductions and credits related to the qualifying child.

If the child is the qualifying child or qualifying relative of the noncustodial parent, the noncustodial parent becomes eligible to claim the following deductions and credits. The custodial parent is ineligible to claim these benefits whether or not the noncustodial parent claims them.

- Dependency exemption deduction.
- Child tax credit.
- Education tax credits.
- Student loan interest deduction.
- Premium tax credit.

Regardless of whether the custodial parent actually claims the dependency exemption, the child remains the custodial parent’s qualifying child for the following benefits.

- Head of household filing status.
- Child and dependent care tax credit.
- Earned income tax credit.
- Tax-free dependent care assistance benefits.

**Note:** Under no circumstance can a noncustodial parent claim the four custodial parent benefits listed above.
EXAMPLE

Bob and Gail Neverhome have legally separated. Their 14-year-old daughter, Dawn, lives with Gail for a majority of the year and with Bob from mid-June through August. Bob and Gail each provide half of Dawn's support. The separation agreement specifies that Bob can claim the exemption for Dawn in odd-numbered years and Gail can claim the exemption for Dawn in the even-numbered years. In the odd-numbered years, Gail signs Form 8332, releasing Dawn’s exemption to Bob.

Gail can file as head of household, as she paid more than half the cost of maintaining her home, which is also Dawn's home for the majority of the year. Even though she released the exemption to Bob, it does not affect her ability to claim head of household status.

Following is the chart summarizing which parent, custodial or noncustodial, can claim certain deductions and credits for their child(ren).

<table>
<thead>
<tr>
<th>Taxpayer can claim…</th>
<th>If claiming dependency exemption</th>
<th>If dependency exemption waived on Form 8332</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Custodial</td>
<td>Noncustodial</td>
</tr>
<tr>
<td>Dependency exemption deduction</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Child tax credit</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Earned income tax credit</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Education credits</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Student loan interest deduction</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Head of household filing status</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Child and dependent care credit</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Tax-free dependent care assistance</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premium tax credit</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

In addition, the child is the dependent of both parents for purposes of the medical expense deduction rules, whether or not the custodial parent releases the claim to the exemption, if the taxpayers meet both of the following.

- Divorced, legally separated under a decree of divorce or separate maintenance, legally separated under a written separation agreement, or lived apart at all times for the last six months of the calendar year.
• The parents of a child who meets the following provisions:
  » Receives more than one-half of the child’s support during the calendar year from the child’s parents.
  » Is in the custody of one or both parents for more than one-half of the calendar year.
  » Qualifies as a qualifying child or qualifying relative of one of the child’s parents (Rev. Proc. 2008-48).

Medical expenses covered under this provision include:
• Medical expense reimbursements or deductions.
• Excludable fringe benefits.
• Distributions from an HSA or Archer MSA.

The implementation of the Affordable Care Act (ACA) presents new issues for divorced parents with dependent children. The parent who claims the child as his or her dependent is responsible for obtaining the child’s insurance. This is true whether the child lives with the parent claiming the dependency exemption or not. Even if the custodial parent is not responsible for making the premium payments, the custodial parent can still owe a penalty if the child is uninsured.
Notes
Tax Issues Involving Children Review Questions

1. ___ The custodial parent is generally the parent with whom the child lives for the greater number of nights during the tax year.
   A. True.
   B. False.

2. ___ If the custodial parent relinquishes the dependency exemption to the noncustodial parent via Form 8332 or other similar statement, and he or she meets all qualifications, what combination of tax benefits is the custodial parent entitled to claim?
   A. Head of household, child tax credit, earned income tax credit, and education credit.
   B. Child tax credit, education credit, and student loan interest deduction.
   C. Head of household, education credit, and earned income tax credit.
   D. Head of household, child and dependent care credit, and earned income tax credit.
Tax Issues Involving Children Review Answers

1.  
   A. **Correct.** Effective for tax years beginning after July 2, 2008, the custodial parent is generally the parent with whom the child lives for the greater number of nights during the tax year.

   B. Incorrect. The general rule for determining the custodial parent bases the determination on the number of nights the child spends with each parent.

   [Divorced or Separated Parents Rules]

2.  
   A. Incorrect. If the custodial parent relinquishes the exemption to the noncustodial parent, the custodial parent still claims head of household status and earned income credit, but the noncustodial parent is able to claim the child tax credit and the education credit.

   B. Incorrect. If the custodial parent relinquishes the exemption to the noncustodial parent, the noncustodial parent is able to claim the child tax credit, education credit, student loan interest deduction, and tuition deduction.

   C. Incorrect. If the custodial parent relinquishes the exemption to the noncustodial parent, the custodial parent still claims head of household status and earned income credit, but the noncustodial parent is able to claim education credit.

   D. **Correct.** If the custodial parent relinquishes the exemption to the noncustodial parent, the custodial parent still claims head of household status, child and dependent care credit, and earned income tax credit.

   [Deductions and Credits]
Notes
Alimony

In a divorce situation, it is important to be able to differentiate between alimony and child support, because alimony is taxable to the recipient and deductible by the payer. On the other hand, child support is nontaxable to the recipient and nondeductible by the payer. Review the divorce decree or separation agreement to determine if the payments are identified as alimony or child support.

Alimony Requirements

To be treated as alimony for federal tax purposes, all the following requirements of §71 must be met.

- The payment is under a written decree or separation agreement. A decree is a document issued by a judge or court. A separation agreement is a document negotiated by the divorcing couple. For tax purposes, a written divorce or separation instrument is one of the following.
  
  » Decree of divorce or separate maintenance — The difference between a decree of divorce and a separate maintenance decree relates to the dissolution of the marriage.
    
    • The court issues a divorce decree when the marriage legally dissolves.
    • The court issues a separate maintenance decree when the couple legally separates and lives apart.
    • A decree of support or temporary alimony alone, with no accompanying requirement of separation, is not considered a decree of divorce or separate maintenance when reviewing the requirements to be considered unmarried.
  
  » Separation agreement — A separation agreement is a written agreement between two spouses settling the terms of their marital rights. A divorce proceeding is not necessary for payments under this type of agreement to qualify as alimony.

  » Temporary support order — Temporary support orders require one spouse to make payment to the other spouse. Typically, these orders specify the types and amount of payments to make from the time of filing the petition to the granting of the final decree. Another name for a temporary support order is an interlocutory decree.

- Once the divorce is final, the couple is no longer married for tax purposes. To be alimony, spouses cannot be members of the same household at any time of making payments. After the divorce or legal separation is final, the payer has one month from the date of the first payment for one of the spouses to move out in order to satisfy this requirement.
The payments must be in cash or cash equivalents.

The taxpayer makes payments to or on behalf of a spouse or former spouse.

The divorce or separation instrument cannot specifically state that payments are not alimony.

The spouses cannot file a joint return with each other.

The obligation to make a nondelinquent payment cannot survive the death of the payee spouse and there must be no liability to make any payment in cash or property as a substitute for alimony upon, or after, the death of a payee spouse. Treat payments that continue after the death of the payee spouse as a property settlement and not alimony. If specified in the decree, the estate of the payer spouse can be obligated to make payments that qualify as alimony.

The designation of the payments, or deemed designation, cannot be child support.

Note: Voluntary payments that were not made under a divorce decree or separation agreement are not deductible as alimony under §71(b).

For example, the payments in Vincent J. Boido Jr., et ux. v. Comm. (T.C. Summary Opinion 2004-65) were voluntary payments determined to be child support and not alimony.

Because of the importance of the wording in the divorce decree or separation agreement regarding alimony payments, consideration should be given to the defining requirements outlined in §71.

Examine each type of payment designated in the divorce or separation agreement to determine if it qualifies as alimony. If a payment, or type of payment, fails one of the tests, that payment is not alimony for tax purposes. However, other payments meeting all the requirements as alimony continue to qualify as alimony.
Alimony Quick Chart

<table>
<thead>
<tr>
<th>Alimony</th>
<th>Not Alimony</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required by divorce decree or separation</td>
<td>Not required by divorce decree or separation</td>
</tr>
<tr>
<td>agreement</td>
<td>agreement</td>
</tr>
<tr>
<td>The payer does not file a joint return with</td>
<td>The payer and recipient file a joint return.</td>
</tr>
<tr>
<td>the recipient</td>
<td></td>
</tr>
<tr>
<td>Payment is:</td>
<td>Payment is:</td>
</tr>
<tr>
<td>• Cash</td>
<td>• Not cash</td>
</tr>
<tr>
<td>• Check</td>
<td>• A noncash property settlement</td>
</tr>
<tr>
<td>• Money order</td>
<td>• Spouse’s part of community income</td>
</tr>
<tr>
<td>Not designated as not alimony</td>
<td>Designated in agreement as not alimony</td>
</tr>
<tr>
<td>Spouses are not living in same household</td>
<td>Spouses are living in same household</td>
</tr>
<tr>
<td>Not required after death of recipient</td>
<td>Required after death of recipient</td>
</tr>
<tr>
<td>Not treated as child support.</td>
<td>Treated as child support</td>
</tr>
<tr>
<td>Result:</td>
<td>Result:</td>
</tr>
<tr>
<td>• Taxable to recipient</td>
<td>• Not income to recipient</td>
</tr>
<tr>
<td>• Deductible by payer</td>
<td>• Not deductible by payer</td>
</tr>
</tbody>
</table>

See Appendix C for a chart on determining if a payment is alimony or not.

Reporting Alimony

Deducting Alimony Paid

A payer spouse claims a deduction for alimony paid, as long as it meets the requirements as alimony. Take the deduction as an adjustment to income on Form 1040, U.S. Individual Income Tax Return, Line 31. Enter the amount of alimony paid on Form 1040, Line 31a. In the space provided on Line 31b, enter the former spouse/recipient’s social security number.

Observation: Use Form 1040 when reporting alimony deductions as Forms 1040A, 1040EZ, 1040NR, or 1040NR-EZ do not have a place to report deductions for alimony.
Multiple Recipients

If a taxpayer has to pay alimony to more than one person, enter the social security number of one of the recipients. Show the social security number and amount paid to each of the other recipients on an attached statement. Enter total payments on Line 31a.

**Caution:** The IRS warns in Pub. 504, *Divorced or Separated Individuals*, if the payer spouse does not list the payee spouse's social security number, he or she could be subject to a $50 penalty and the alimony deduction might be disallowed. The IRS also warns the payee spouse of a $50 penalty for not providing the social security number.

Reporting Alimony Received

The recipient of alimony reports the amount received as income on Form 1040, Line 11, or if a nonresident alien, on Form 1040NR, Schedule NEC, Line 12.

**Observation:** Use Form 1040 when reporting alimony income as there is no place on Forms 1040A, 1040EZ, or 1040NR-EZ to report alimony received.

Alimony Recapture

When alimony payments decrease or terminate during the first three calendar years, the payer spouse could be subject to the recapture rule. If this rule applies, the payer must include the recapture amount in income in the third year and the payee spouse deducts the recapture amount.

The three-year period starts with the first calendar year the payer spouse makes qualifying alimony payments. The second and third years are the subsequent two calendar years whether or not the payer spouse makes payments.

The recapture rule occurs when alimony paid in the second or third year decreases by more than $15,000 from the prior year.

Decreases in alimony paid do not include:

- Payments made under a temporary support order.
- Fluctuating payments based on a fixed percentage of income from a business, property, or compensation from employment or self-employment.
- Payments that decrease because of the death of either spouse or the remarriage of the payee spouse before the end of the third year.
EXAMPLE

Under the terms of their divorce agreement, Alan Lincoln is required to pay his former spouse, Grace, the following amounts as alimony.

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>$40,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>$15,000</td>
</tr>
<tr>
<td>Year 3</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

The following worksheet is used to determine the amount of alimony subject to recapture.

Worksheet 1. Recapture of Alimony

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Alimony paid in 2nd year</td>
<td>15,000</td>
</tr>
<tr>
<td>2.</td>
<td>Alimony paid in 3rd year</td>
<td>10,000</td>
</tr>
<tr>
<td>3.</td>
<td>Floor</td>
<td>15,000</td>
</tr>
<tr>
<td>4.</td>
<td>Add lines 2 and 3</td>
<td>25,000</td>
</tr>
<tr>
<td>5.</td>
<td>Subtract line 4 from line 1. If zero or less, enter -0-</td>
<td>0</td>
</tr>
<tr>
<td>6.</td>
<td>Alimony paid in 1st year</td>
<td>40,000</td>
</tr>
<tr>
<td>7.</td>
<td>Adjusted alimony paid in 2nd year (line 1 minus line 5)</td>
<td>15,000</td>
</tr>
<tr>
<td>8.</td>
<td>Alimony paid in 3rd year</td>
<td>10,000</td>
</tr>
<tr>
<td>9.</td>
<td>Add lines 7 and 8</td>
<td>25,000</td>
</tr>
<tr>
<td>10.</td>
<td>Divide line 9 by 2</td>
<td>12,500</td>
</tr>
<tr>
<td>11.</td>
<td>Floor</td>
<td>15,000</td>
</tr>
<tr>
<td>12.</td>
<td>Add lines 10 and 11</td>
<td>27,500</td>
</tr>
<tr>
<td>13.</td>
<td>Subtract line 12 from line 6</td>
<td>12,500</td>
</tr>
<tr>
<td>14.</td>
<td>Recaptured alimony. Add lines 5 and 13</td>
<td>12,500</td>
</tr>
</tbody>
</table>

* If you deducted alimony paid, report this amount as income on Form 1040, line 11. If you reported alimony received, deduct this amount on Form 1040, line 31a.

As a result, in Year 3 Alan must report $12,500 of recaptured alimony as income and Grace deducts $12,500.

Note: A blank copy of the Worksheet 1, Recapture of Alimony, is in Pub. 504.

Reporting Recapture

If a payer spouse must include a recapture amount in income, report it on Form 1040, Line 11 (Alimony received) as follows.

- Cross out the word received and write RECAPTURE.
- On the dotted line next to the amount, enter the former spouse's last name and social security number.
The recipient spouse can deduct the recapture amount as follows.

- Report the amount of recapture on Form 1040, Line 31a (Alimony paid).
- Cross out the word paid and write RECAPTURE.
- In the space provided, enter the former spouse’s social security number.

**EXAMPLE**

The following illustrates the reporting of the recapture by Alan and Grace, from the prior example, on their individual Forms 1040.

**Alan's Form 1040 — Reporting the recapture income**

<table>
<thead>
<tr>
<th>Income</th>
<th>7 Wages, salaries, tips, etc. Attach Form(s) W-2</th>
<th>7</th>
</tr>
</thead>
<tbody>
<tr>
<td>8a</td>
<td>Taxable interest. Attach Schedule B if required</td>
<td>8a</td>
</tr>
<tr>
<td>8b</td>
<td>Tax-exempt interest. Do not include on line 8a</td>
<td>8b</td>
</tr>
<tr>
<td>9a</td>
<td>Ordinary dividends. Attach Schedule B if required</td>
<td>9a</td>
</tr>
<tr>
<td>9b</td>
<td>Qualified dividends</td>
<td>9b</td>
</tr>
<tr>
<td>10</td>
<td>Taxable refunds, credits, or offsets of state and local income taxes</td>
<td>10</td>
</tr>
<tr>
<td>11</td>
<td>Alimony received</td>
<td>11</td>
</tr>
<tr>
<td>12</td>
<td>Business income or (loss). Attach Schedule C or C-EZ</td>
<td>12</td>
</tr>
<tr>
<td>13</td>
<td>Capital gain or (loss). Attach Schedule D if required. If not required, check here.</td>
<td>13</td>
</tr>
</tbody>
</table>

**Grace's Form 1040 — Reporting the recapture deduction**

<table>
<thead>
<tr>
<th>Adjusted Gross Income</th>
<th>23 Educator expenses</th>
<th>23</th>
</tr>
</thead>
<tbody>
<tr>
<td>24</td>
<td>Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ</td>
<td>24</td>
</tr>
<tr>
<td>25</td>
<td>Health savings account deduction. Attach Form 8889</td>
<td>25</td>
</tr>
<tr>
<td>26</td>
<td>Moving expenses. Attach Form 3903</td>
<td>26</td>
</tr>
<tr>
<td>27</td>
<td>Deductible part of self-employment tax. Attach Schedule SE</td>
<td>27</td>
</tr>
<tr>
<td>28</td>
<td>Self-employed SEP, SIMPLE, and qualified plans</td>
<td>28</td>
</tr>
<tr>
<td>29</td>
<td>Self-employed health insurance deduction</td>
<td>29</td>
</tr>
<tr>
<td>30</td>
<td>Penalty on early withdrawal of savings</td>
<td>30</td>
</tr>
<tr>
<td>31a</td>
<td>Alimony paid</td>
<td>31a</td>
</tr>
<tr>
<td>b Recipient's SSN</td>
<td>123-45-8789</td>
<td>31a</td>
</tr>
<tr>
<td>32</td>
<td>IRA deduction</td>
<td>32</td>
</tr>
</tbody>
</table>

**Alimony Trusts**

The payer can transfer property to a trust that provides for distribution of income to the payee spouse to satisfy the alimony requirements. When this occurs, the recipient spouse includes income from the trust, to the extent distributed and as reported on Schedule K-1 (Form 1041, *U.S. Income Tax Return for Estates and Trusts*). However, the individual is not eligible for an alimony deduction when the trust makes the distribution and not the payer. Instead, the trust takes an income distribution deduction on Form 1041 for the amount distributed to the recipient spouse.

If the trust distributes principal to the beneficiary, it is not deductible by the trust or taxable to the beneficiary. Therefore, the trust instrument should specify that the trust make payments only from income if the trust wants to take a deduction for the payments.
Third-party Payments

Often, as part of the divorce or separation agreement, the taxpayer is required to make payments on behalf of the spouse for medical expenses, tuition, housing costs such as mortgage, rent, utilities, or taxes, insurance, etc. Cash payments, including a check or money order, made payable to a third party on behalf of the taxpayer’s spouse, can be alimony if the payments otherwise qualify.

Cash payments made to a third party at the written request of the recipient spouse can qualify as alimony if they meet certain conditions. The payer spouse must receive the written request from the recipient spouse before filing his or her tax return for the year. The request must clearly state the following.

- The payments are in lieu of alimony paid directly to the spouse.
- Both spouses intend the payment to be alimony.

By meeting these requirements, treat the payments as received by the recipient spouse and then paid to the third party.

**EXAMPLE**

According to their divorce decree, James must pay the medical and dental expenses of his former spouse, Ann. If the payments otherwise qualify, James can deduct them as alimony on his tax return. Ann must report them as alimony received. As such, she can include them in figuring her deductible medical expenses.

**EXAMPLE**

Under their separation agreement, Karrie must pay the real estate taxes, mortgage payments, and insurance premiums on a home owned by her spouse, Tom. If the payments otherwise qualify, Karrie can deduct the payments as alimony on her return and Tom must report them as alimony received. If Tom is itemizing his deductions, he can deduct the real estate taxes. If the home is a qualified home, he can also deduct the mortgage interest.

Life Insurance Premiums

Alimony includes premiums a taxpayer must pay under his or her divorce decree or separation agreement for insurance on his or her life to the extent the taxpayer’s spouse owns the policy.

Expenses of a Jointly Owned Home

If a divorce or separation agreement states that a taxpayer must pay expenses for a home owned by him or her and his or her spouse or former spouse, some of the payments can be alimony.
Use the following table to determine the portion of a payment that is alimony and the portion claimed as an itemized deduction by the recipient spouse.

<table>
<thead>
<tr>
<th>Expenses of a jointly owned home</th>
<th>IF a taxpayer must pay all of the ...</th>
<th>AND the home is ...</th>
<th>THEN the taxpayer can deduct and the taxpayer’s spouse (or former spouse) must include as alimony ...</th>
<th>AND the payer spouse can claim as an itemized deduction ...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage payments (principal and interest)</td>
<td>Jointly owned</td>
<td>Half of the total payments</td>
<td>Half of the interest as interest expense (if the home is a qualified home).&lt;sup&gt;1&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Real estate taxes and home insurance</td>
<td>Held as tenants in common</td>
<td>Half of the total payments</td>
<td>Half of the real estate taxes.&lt;sup&gt;2&lt;/sup&gt; The home insurance is not deductible.</td>
<td></td>
</tr>
<tr>
<td>Held as tenants by the entirety or as joint tenants</td>
<td>None of the payments</td>
<td>All of the real estate taxes. The home insurance is not deductible.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1 The payee spouse (or former spouse) can deduct the other half of the interest if the home is a qualified home.

2 The payee spouse (or former spouse) can deduct the other half of the real estate taxes.

**Payments for a Nonowner**

If the occupant spouse has no ownership interest in the home and the nonoccupant spouse is making the payments, the payments are not alimony. To qualify as alimony, the payment must be in cash or paid to a third party on behalf of the spouse living in the home. The owner of the residence is liable for the housing payments, not the nonowner occupant. Therefore, the payer spouse is not making the payment on behalf of the occupant spouse.

Mortgage interest and property taxes may be deductible. Treat the interest payments as follows.

- If the couple does not have a child, the interest does not qualify as mortgage interest because the couple is no longer married and the spouse making the payment does not use the home as a personal residence.
- If the nonoccupant spouse making the payments has a child who lives in the home with the occupant spouse, the home can qualify as a second home of the nonoccupant spouse. Use of the home by the child constitutes personal use by the nonoccupant parent under §280A(d).
Lump-sum Alimony Payments

The terms of the divorce or separation agreement can allow for a payment of alimony in a lump-sum. This can relieve the payer spouse of his or her responsibility for the payment of support to the other spouse.

The payer spouse is allowed a deduction for the payment under §215 if the payment meets the requirements of §71. The recipient of the lump-sum payment is required to claim it as income (PLR 200329003). However, the taxpayers can be subject to the rules of alimony recapture.

EXAMPLE

Under Tim and Katie’s divorce decree, Katie is to pay $1,250 monthly spousal support to Tim until his death. The decree defines these payments as alimony that is deductible by Katie and includable in Tim’s income. Under the decree, Katie has the option, at her sole discretion, to make a one-time $250,000 lump-sum payment in complete satisfaction of her obligation to pay future alimony.

The lump-sum payment qualifies as alimony, as it is in satisfaction of Katie’s obligation and, as such, stands in the place of the alimony required by the divorce decree. The $250,000 payment is deductible by Katie and includable in Tim’s income.

Because this lump-sum takes place in the first year, Tim has a deduction in the third year and Katie has income in that year because recapture applies. The way to avoid this is to have the lump-sum provision apply any year other than the first or second year.
Notes
Alimony Review Questions

1. ___ A payment to a spouse under a divorce decree qualifies as alimony if the spouses do not file a joint return with each other and all the following requirements are met except:
   A. The payment is in cash.
   B. The divorce decree does not designate the payment as not alimony.
   C. The payments are to continue after the death of the recipient spouse until a minimum amount is paid.
   D. The payment is not child support in disguise.

2. ___ Cash payments (including checks and money orders), made to a third party on behalf of the taxpayer’s spouse under the terms of a divorce or separation instrument, are treated as alimony if the payments otherwise qualify. Cash payments made to a third party at the written request of a spouse also qualify as alimony if all the following conditions are met except:
   A. The payments are in lieu of alimony paid directly to the spouse.
   B. The written request states that both spouses intend the payment as alimony.
   C. The payee spouse treats the payments as received and then paid to the third party.
   D. The payer spouse receives the written request from the payee spouse before the end of the tax year in which making payments.
Alimony Review Answers

1.  
   A. Incorrect. The payment must be a cash payment.
   B. Incorrect. The divorce decree must not designate the payment as not alimony.
   C. Correct. There is no liability to make any payment (in cash or property) after the death of the recipient spouse.
   D. Incorrect. The payment cannot be for child support.

   [Alimony Requirements]

2.  
   A. Incorrect. The payments are in lieu of alimony paid directly to the spouse.
   B. Incorrect. The written request states that both spouses intend the payment as alimony.
   C. Incorrect. The payee spouse treats the payments as received and then paid to the third party.
   D. Correct. The payer spouse must receive the written request before the payer spouse files his or her tax return for the year.

   [Third Party Payments]
Notes
Child Support

A payment specifically designated as child support, or treated as specifically designated as child support under the divorce or separation agreement, is not alimony. The amount of child support can vary over time. Child support payments are not deductible by the payer and are not taxable to the recipient.

Note: Child support payments received by the recipient spouse become that spouse’s money and any expense that the spouse uses the money for is paid by him or her. For instance, the recipient spouse pays daycare expenses with child support money. That spouse can claim the dependent care credit for the amount paid.

Fixed Child Support

A fixed child support payment is a specifically designated payment identified as child support under the divorce or separation agreement, even if the agreement meets all the other requirements for the payment to be alimony. However, the spouses cannot treat a payment designated as alimony as child support.

Example

Kevin and Jane were divorced in July. The divorce decree states that Kevin is to pay Jane $1,000 per month, with the payments terminating at the earlier of Jane’s death or in ten years. The decree also states that $600 of the $1,000 monthly payment is for the support of their two children. Under this agreement, $600 per month is child support, nondeductible by Kevin and not taxable to Jane. The remaining $400 per month qualifies as alimony.
Deemed Child Support

Deemed child support can result from a payment not specifically designated as child support for tax purposes. This occurs when the agreement reduces the payment under one of the following situations.

**Contingency relating to the child** — A contingency relates to the child if it depends on any event relating to that child. It does not matter whether the event is certain or likely to occur. Events relating to the child include the child:

- Gaining employment.
- Leaving the household.
- Leaving school.
- Getting married.
- Reaching a specified age or income level.
- Dying.

**Clearly associated with a contingency** — Payments that would otherwise qualify as alimony are presumed to be reduced at a time clearly associated with the happening of a contingency relating to the child only in specific situations.

Reg. §1.71-1T(c), Q-18, defines two tests for determining whether there is a contingency relating to the child. By meeting either of the following tests, the payments are child support for tax purposes.

- Payments are to be reduced within six months before or after a child has attained the age of 18, 21, or the local age of majority.
- Payments reduced on two or more occasions, that occur not more than one year before or after a different child of the payer spouse attains a certain age between the ages of 18 and 24, inclusive, are payments associated with a contingency. The certain age referred to must be the same for each child but does not need to be a whole number of years.

In all other situations, reductions in payments are not clearly associated with the happening of a contingency relating to the child.

Either the taxpayer or the IRS can overcome the presumption in the two situations above. Do this by showing that the time to reduce payments is determined independently of any contingencies relating to the children.

**EXAMPLE**

When Tom and Sue divorced, it was customary in their local jurisdiction to have alimony payments for a period equal to half the time the marriage lasted. They were married 16 years, so Sue received alimony for 8 years. The court also awarded her child support. After 8 years had passed, the payments went down 25% and, within 6 months of that, went to $0 when their child turned 18. Tom and Sue can overcome the presumption of a contingency relating to a child with 25% of payments based on the fact that alimony is customary in their local jurisdiction for a period equal to half the time of marriage and the payments are alimony.
Note: Interest received on past-due child support payments is taxable as interest income (CCA 200444026).

EXAMPLE

Matt and Lilly have two children: (1) Ann, born on June 19, 1992, and (2) Jeff, born on March 5, 1995. Matt and Lilly’s divorce became final on January 20, 2004. The age of majority in their state of residence is 18.

The court ordered Matt to pay Lilly $2,000 per month until January 20, 2011, when the payments decrease to $1,000 per month; on January 20, 2015, payments reduce to $500 per month until January 20, 2024, when the payments end. In addition, the decree indicates that all payments terminate upon the death of Lilly. Ann reached age 18 on June 19, 2010, and age 21 on June 19, 2013. Jeff reached age 18 on March 5, 2013, and age 21 on March 5, 2016.

The reductions in the payments do not fall within six months of age 18 or 21 for either child. Based solely on that test, they would treat none of the payments as child support. Instead, the payments would qualify as alimony. However, they must meet both tests to be alimony, so further examination is necessary.

On the date of the first reduction, January 20, 2011, Ann is 18 years, 7 months and 1 day. The one-year window for Ann is from 17 years, 7 months, and 1 day to 19 years, 7 months, and 1 day of age.

On the date of the second reduction, January 20, 2015, Jeff is 19 years, 10 months and 15 days old. The one-year window for Jeff is from 18 years, 10 months and 15 days to 20 years, 10 months and 15 days of age.

Ann’s age on 1/20/11

|------------------------|------------------------|

Jeff’s age on 1/20/15

|------------------------|------------------------|

When both reductions take place, Ann and Jeff are between the ages of 18 and 24. Since Jeff’s lower age limit falls within Ann’s upper age limit, the reduction in payments are clearly associated with a child contingency. This means that $1,500 of the $2,000 is child support. The $500 that remains after both reductions is alimony from the beginning of the payments.
Notes
Child Support Review Question

1. ___ The divorce decree says that the taxpayer is to pay the former spouse $1,000 maintenance. Upon the youngest child reaching age 19, the maintenance payments are to end. What are these maintenance payments?

A. Child support.
B. Property settlement.
C. Alimony.
D. None of the above.
Child Support Review Answer

1.  

A. **Correct.** Since the maintenance payments are clearly contingent on a child reaching a certain age, this is child support even if not called so in the decree.

B. Incorrect. These payments are not a property settlement; they are clearly contingent on a child reaching a certain age. This is child support even if not called so in the decree.

C. Incorrect. These payments are not alimony; they are clearly contingent on a child reaching a certain age. This is child support even if not called so in the decree.

D. Incorrect. A is the correct answer.

[Deemed Child Support]
Notes
Property Settlements

Generally, there is no gain or loss in connection with the transfer of property between spouses when it is incident to divorce. Section 1041 treats such transfers as nonportable gifts. Review the divorce decree or separation agreement to determine if it addresses property transfers.

Note: The no-gain-or-loss rule does not apply if the spouse (or former spouse) of the individual making the transfer is a nonresident alien. A transfer to a nonresident alien spouse is a taxable transaction, reportable by the transferring spouse.

A transfer is incident to divorce in the following situations.
- The transfer relates to the marital termination or occurs within one year after the divorce or legal separation is final.
- It relates to the end of the marriage.
  - The transfer relates to marital termination if a divorce or separation instrument (original or modified) requires it and the transfer occurs within six years after the divorce or legal separation is final.
  - Transfers taking place more than six years after the cessation of the marriage can still relate to the end of the marriage. Taxpayers need to show there were factors that hampered an earlier transfer, such as legal or business impediments to a transfer or disputes concerning the value of the property at the time of the cessation of the marriage and the transfer is effected promptly after the impediment is removed.

Personal Residence

There are several possible outcomes with a divorcing couple's personal residence. The home can be transferred to one spouse, sold, or remain titled in joint names until the occurrence of a specified event.

For sales of a personal residence after May 6, 1997, a taxpayer can exclude gain from income by meeting certain qualifications. A loss is nondeductible.

Under §121, taxpayers who own and use a home as their principal residence in two out of the five years preceding the date of sale can exclude up to $250,000 of gain. Taxpayers who file a joint return can exclude up to $500,000 of gain if either spouse owns the home and both spouses use the home for two of the preceding five years.
A spouse who vacates the principal residence prior to its sale but maintains ownership can still meet the two-of-the-preceding-five-years test. Solely for purposes of §121, an individual shall be treated as using property as a principal residence during any period of ownership while an individual’s spouse or former spouse is granted use of the property as a principal residence under a divorce or separation instrument [Reg. §1.121-4(b)].

A spouse who receives a principal residence as part of a property settlement incident to divorce includes the former spouse's holding period (ownership test). However, the recipient spouse must meet the use test in order to exclude gain.

The basis of the transferred property in the hands of the recipient spouse is the adjusted basis in the hands of the transferor spouse immediately before the transfer.

**Note:** The transferor is required to provide the transferee, at the time of the §1041 transfer, records sufficient to determine the adjusted basis and holding period of the property as of the transfer date [Reg. §1.1041-1T(e)].

**EXAMPLE**

Hugo and Jane were married in August 1995 and bought a home later that year. They owned and occupied the home until June 3, 2012, when they divorced and Hugo moved to a different residence. The court granted Jane use of the home until their child reached age 18, after which they were to sell the home and split the proceeds. She lived there until August 14, 2016, two months after their daughter reached age 18, when they sold the house for a gain of $100,000.

Hugo and Jane can each exclude $50,000 of the gain on the sale of the residence even though Hugo did not live in the home for the entire five-year period prior to the sale. Hugo counts Jane’s use as use by him.

**Effect on Homebuyer Credit**

The transfer of a personal residence between spouses does not trigger a taxable event [§1041(a)]. The transfer of a residence incident to divorce does not trigger repayment of the first-time homebuyer credit (FTHBC). Repayment of the credit occurs if the divorcing taxpayers dispose of the home during the divorce or, upon the transfer of the house to the receiving spouse, the receiving spouse disposes of the home after the transfer.

If they took the first-time homebuyer credit, the tax effect on the recipient spouse depends on when they purchased the residence, as the rules vary.

The 36-month recapture period is over for purchases eligible for the credit in 2009 or 2010. For divorcing taxpayers who dispose of a principal residence they purchased in 2008, recapture still applies. Any of the following is a disposition.

- Sale.
- Conversion of the entire home to business or rental property.
- Abandonment.
- Destruction, condemnation, or disposition under a threat of condemnation (unless an exception applies).
- Foreclosure.
- Death.
- Ceases to be principal residence.

There are two exceptions to the recapture rules for condemnations and government service employees.

- An exception applies for the destruction, condemnation, or disposition under a threat of condemnation of the home. For the exception to apply, the taxpayer must replace the home within two years of the event. The repayment of the credit is with the tax return for the year in which the two-year period ends.
- Certain government service employees do not have to repay the credit if the taxpayer (or spouse) meets the both of the following conditions.

  » Is a member of the uniformed services or foreign service or an employee of the intelligence community.

  » Sold the principal residence, or it ceased to be the principal residence after 2008, because government orders were received to serve on qualified official extended duty (for a period of more than 90 days or indefinitely).

    • Serving at a duty station that is at least 50 miles from the taxpayer’s main home.

    • Living in government quarters under government orders.

In general, if a taxpayer purchased a principal residence in 2008, for which he or she claimed the FTHBC, and used it as his or her taxpayer’s principal residence during all of 2009 and 2010, then report the repayment of the credit over a 15-year period, beginning with the 2010 tax return. This credit was actually an interest-free loan.

**EXAMPLE**

Tom and Ann qualified as first-time homebuyers. They purchased a principal residence on May 12, 2008, for $200,000 and claimed a $7,500 credit on Form 5405, *First-Time Homebuyer Credit*. Beginning in 2010, they are required to recapture $500 ($7,500 ÷ 15) of the credit each year for the next 15 years.

In 2016, Tom and Ann divorce and Ann receives the residence as part of the property settlement. She is liable for the $500 annual recapture tax on the residence. Tom is not responsible for any of the repayment, as ownership has transferred to Ann.

The transfer of ownership of a principal residence to one spouse incident to divorce does not trigger recapture of the FTHBC. A later disposition of that residence by the recipient spouse does trigger recapture of the FTHBC. Only the recipient spouse is responsible for the 2008 credit recapture and any accelerated repayments that are required in the future [§36(f)(4)(C)(i)]. However, the amount due under the accelerated recapture rule cannot exceed the gain from sale of the home to an unrelated third party or foreclosure. For this purpose, the basis of the home is reduced by the unpaid credit balance [§36(f)(3)].
For any disposition of the residence, complete Form 5405.

**EXAMPLE**

Bob and Gail Neverhome, bought a home on June 14, 2008, and claimed the $7,500 first-time homebuyer on their 2008 tax return. The Neverhomes separated on October 1, 2015, and sold their home on February 14, 2016, for a $2,000 gain. Form 5405 is completed. Since their gain is less than the remaining amount of credit to repay, the amount they report on Line 60b of their Form 1040 is $2,000.

---

**For Paperwork Reduction Act Notice, see your tax return instructions.**

**Form 5405 (Rev. 12-2016)**

**Repayment of the First-Time Homebuyer Credit**

<table>
<thead>
<tr>
<th>Part I Disposition or Change in Use of Main Home for Which the Credit Was Claimed</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Enter the date you disposed of, or ceased using as your main home, the home for which you claimed the credit (MM/DD/YYYY) (see instructions).</td>
<td>▶ 02/14/2016</td>
</tr>
<tr>
<td>2. If you meet the following conditions, check here □ I (or my spouse if married) am, or was, a member of the uniformed services or Foreign Service, or an employee of the intelligence community. I sold the home, or it ceased to be my main home, in connection with Government orders for qualified official extended duty service. No repayment of the credit is required (see instructions). Stop here.</td>
<td></td>
</tr>
</tbody>
</table>
| 3. Check the box below that applies to you. See the instructions for the definition of "related person."
| a. □ I sold (including through foreclosure) the home to a person who isn’t related to me and had a gain on the sale (as figured in Part III below). Go to Part II below.
| b. □ I sold (including through foreclosure) the home to a person who isn’t related to me and didn’t have a gain on the sale (as figured in Part III below). No repayment of the credit is required. Stop here.
| c. □ I sold the home to a related person OR I gave the home to someone other than my spouse (or ex-spouse as part of my divorce settlement). Go to Part II below.
| d. □ I converted the entire home to a rental or business use OR I still own the home but no longer use it as my main home. Go to Part II below.
| e. □ I transferred the home to my spouse (or ex-spouse as part of my divorce settlement). The full name of my ex-spouse is ▶ |

The responsibility for repayment of the credit is transferred to your spouse or ex-spouse. Stop here.

| Part II Repayment of the Credit |  |
| 4. Enter the amount of the credit you claimed on Form 5405 for a prior year. See instructions if you filed a joint return for the year you claimed the credit or you checked the box on line 3f or 3g. | 4 | 7,500 |
| 5. If you purchased the home in 2015 or later, enter the amount of the credit you repaid with your tax returns for the years 2010 through 2015. Otherwise, enter -0-. | 5 | 3,000 |
| 6. Subtract line 5 from line 4. If you checked the box on line 3f or 3g, see instructions. If you checked the box on line 3a, go to line 7. Otherwise, skip line 7 and go to line 8. | 6 | 4,500 |
| 7. Enter the gain on the disposition of your main home (from line 15 below). | 7 | 1,000 |
| 8. Amount of the credit to be repaid. See instructions | 8 | 1,000 |

**Part III Form 5405 Gain or (Loss) Worksheet**

Note: Complete this part only if your home was destroyed or you sold your home to someone who isn’t related to you (including a sale through condemnation or under threat of condemnation). See Pub. 523, Selling Your Home, for information on what to enter on lines 9, 10, and 12. But if you sold your home through condemnation, see chapter 1 in Pub. 544, Sales and Other Dispositions of Assets, for information on what to enter on lines 9 and 10.

| 9. Selling price of home, insurance proceeds, or gross condemnation award. | 9 | 167,000 |
| 10. Selling expenses (including commissions, advertising and legal fees, and seller-paid loan charges) or expenses in getting the condemnation award. | 10 | 11,000 |
| 11. Subtract line 10 from line 9. This is the amount realized on the sale of the home. | 11 | 156,000 |
| 12. Adjusted basis of home sold (see instructions). | 12 | 158,500 |
| 13. Enter the first-time homebuyer credit claimed on Form 5405 minus the amount of the credit you repaid with your tax returns for the years 2010 through 2015. | 13 | 4,500 |
| 14. Subtract line 13 from line 12. This is the adjusted basis for purposes of repaying the credit. | 14 | 155,000 |
| 15. Subtract line 14 from line 11. | 15 | 1,000 |

- If line 15 is more than -0-, you have a gain. Check the box on line 3a and complete Part II. However, check the box on line 3f (instead of the box on line 3a) if your home was destroyed or you sold the home through condemnation or under threat of condemnation. Then complete Part II if you purchased the home in 2008 or you purchased the home in 2011 and the event occurred in 2014.
- If line 15 is -0- or less, check the box on line 3b. However, if your home was destroyed or you sold the home through condemnation or under threat of condemnation, check the box on line 3g instead. You don’t have to repay the credit.
Qualified Domestic Relations Order

A qualified domestic relations order (QDRO) is a judgment, decree, or court order.

- A QDRO creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant under a qualified retirement plan.
- A QDRO must meet the requirements of specifying certain facts and cannot alter the amount, form, etc., of benefits.
- It relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of the participant.
- A state domestic relations law governs the provisions of a QDRO.

Requirements

A QDRO must clearly identify the following.

- The name and last known mailing address of the participant and the name and mailing address of each alternate payee covered by the order.
- The amount or percentage of the participant's benefits payable by the plan to each alternate payee, or the manner in which the amount or percentage is to be determined.
- The number of payments or the period to which the order applies.
- Each plan to which it applies [§414(p)(2)].

A QDRO does not alter the amount, form, etc., of benefits if the order does not require the following.

- A plan to provide any type or form of benefit, or any option, not otherwise provided under the plan.
- The plan to provide increased benefits.
- The payment of benefits to an alternate payee, which a previous QDRO requires paying to another alternate payee.
Payments

The QDRO can require payments to the alternate payee after the participant's earliest retirement age even if the plan participant is not eligible for a distribution from the plan. The earliest retirement age means the earlier of the following:

- The date on which the participant is entitled to a distribution under the plan.
- The later of:
  - The date the participant reaches age 50.
  - The earliest date on which the participant could begin receiving benefits under the plan if the participant separated from service. If the plan would not pay benefits to a participant until the participant separates from service, a QDRO cannot require payment to the alternate payee before the participant separates from service or reaches age 50.

The QDRO can require a payment to the alternate payee as if the participant had retired on the date on which such payment is to begin under the order.

The alternate payee steps into the shoes of the plan participant and receives all the rights the participant has under the plan. The individual receiving payments from a qualified plan pursuant to a QDRO treats the payments in the same manner as the participant would have treated them.

If the alternate payee is a spouse or former spouse of the plan participant, the alternate payee pays tax as if he or she were the distributee of the plan. If the alternate payee is a child or other dependent of the participant, report the distribution as a distribution to the plan participant and taxable to the plan participant (Notice 89-25, Q-3).

Penalty

The 10% early distribution penalty does not apply to any distribution from a qualified retirement plan to an alternate payee pursuant to a QDRO regardless of the alternate payee's age at the time of the distribution [§72(t)(2)(C)]. However, this exception does not apply to a distribution from an IRA even if the distribution is pursuant to a domestic relations order from the court.

If the alternate payee is under age 59½ at the time of the distribution and the distribution is rolled over to an IRA, any subsequent distributions from the IRA before the alternate payee reaches age 59½ are subject to the 10% premature distribution penalty unless another exception applies. If possible, a better option is to leave the funds in a segregated account with the plan trustee. Future distributions from the segregated account pursuant to the QDRO are not subject to the penalty even if made before the alternate payee reaches age 59½.
Basis

If the alternate payee is a spouse or former spouse of the plan participant, the participant's basis is allocated on a pro rata basis between the present value of the alternate payee's interest and the total present value of all the benefits payable with respect to the plan participant [§72(m)(10)].

Rollover

The alternate payee is eligible to rollover, or timely transfer to an IRA, all or a portion of a distribution under a QDRO. A trustee-to-trustee transfer is necessary to avoid 20% withholding on the transfer [§402(e)(1)(B)].

Note: Although a QDRO does not apply to an IRA or nonqualified plan, spouses can transfer an IRA tax-free in divorce situations. Transfer of an interest in an IRA to a spouse or former spouse under a divorce instrument is not considered a taxable transaction [§408(d)(6)]. The transferee is the account owner when done.

EXAMPLE

Dan and Marie divorced. Under the terms of the divorce decree, the administrator of Dan’s §401(k) plan is to distribute a one-time payment of $75,000 to Marie under a QDRO.

If Marie wants the money, the administrator withholds 20% as income tax withholding, which is credited to Marie on Form 1099-R, Box 4. The distribution is not subject to any early withdrawal penalties when paid under a QDRO.

If Marie gets the money and rolls it to an IRA, she needs to make up for the 20% withheld. If she rolls only the remaining cash, the 20% amount is taxable as a distribution to Marie.

Alternative: An option available to Marie is to have the administrator make the payment directly to her IRA trustee—in which case, there is no 20% withholding.

Miscellaneous Provisions

Assignment of Income

The common-law assignment of income doctrine can override the §1041 treatment on the transfer of certain assets.

Savings Bond Interest

Deferred or accrued interest on Series E and EE bonds must be included in the transferor spouse's gross income in the year of the transfer incident to divorce (Rev. Rul. 87-112, as clarified by Rev. Rul. 2002-22).
Restricted Property

When the employee spouse or former spouse transfers restricted property received in exchange for services to a nonemployee spouse or former spouse, the employee recognizes income when the property becomes vested, or the nonemployee spouse disposes of the property (§83).

Property Transferred Pursuant to Divorce

The following chart summarizes the tax treatment of property transferred from a taxpayer and his or her spouse or former spouse pursuant to a divorce.

<table>
<thead>
<tr>
<th>IF the taxpayer transfers...</th>
<th>THEN the taxpayer...</th>
<th>AND his or her spouse or former spouse...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income-producing property (such as an interest in a business, rental property, stocks or bonds)</td>
<td>Includes on his or her tax return any profit or loss, rental income or loss, dividends or interest generated or derived from the property during the year until the date the property is transferred</td>
<td>Reports any income or loss generated or derived after the transfer of the property</td>
</tr>
<tr>
<td>An interest in a passive activity with unused passive activity losses</td>
<td>Cannot deduct his or her accumulated unused passive activity losses allocable to the interest</td>
<td>Increases the adjusted basis of the transferred interest by the amount of the unused passive activity losses</td>
</tr>
<tr>
<td>Investment credit property with recapture potential</td>
<td>Does not have to recapture any part of the credit</td>
<td>Has to recapture part of the credit if he or she disposes of the property or changes its use before the end of the recapture period</td>
</tr>
<tr>
<td>Nonstatutory stock options and nonqualified deferred compensation</td>
<td>Does not include any income, gain, or loss upon the transfer</td>
<td>Includes an amount in gross income when he or she exercises the stock options or on the payment or availability of the deferred compensation</td>
</tr>
</tbody>
</table>
Property Received

The tax law treats property a taxpayer receives from his or her spouse (or former spouse, if the transfer is incident to a divorce) as acquired by gift for income tax purposes. Its value is not taxable to the recipient spouse.

The basis in property received from a taxpayer's spouse (or former spouse, if incident to a divorce) is the same as his or her spouse's adjusted basis. This applies for determining either gain or loss when the recipient spouse later disposes of the property. It applies whether the property's adjusted basis is less than, equal to, or greater than its value at the time of the transfer or any consideration the recipient spouse paid. It also applies even if the property's liabilities are more than its adjusted basis.
Notes
Property Settlements Review Questions

1. ___ A QDRO must identify each of the following **except**:
   A. The number of payments.
   B. The alternate payee’s age.
   C. The name and last known mailing address of the participant and the name and mailing address of each alternate payee covered by the order.
   D. Each plan the QRDO covers.

2. ___ Upon a divorce, if one spouse transfers an interest in a passive activity that has suspended losses, what happens to the suspended passive losses?
   A. The receiving spouse adds the suspended losses to the adjusted basis of property.
   B. The transferring spouse receives a current year deduction for his or her share of the suspended passive loss.
   C. Neither spouse receives a suspended passive loss. The carryover is lost for both.
   D. The receiving spouse receives only his or her share of the suspended passive loss.
Notes
Property Settlements Review Answers

1.  
A. Incorrect. The QDRO is required to address the number of payments.  
B. **Correct.** The alternate payee’s age is not required.  
C. Incorrect. The QDRO is required to have the name and last known mailing address of the participant and the name and mailing address of each alternate payee.  
D. Incorrect. The QDRO must identify each plan it covers.  

[Qualified Domestic Relations Order]

2.  
A. **Correct.** The receiving spouse adds the amount of suspended losses to the adjusted basis of the property received.  
B. Incorrect. The transferring spouse does not receive a current year deduction.  
C. Incorrect. The suspended passive loss is not lost. The receiving spouse adds the suspended passive loss to the adjusted basis of the property received.  
D. Incorrect. The receiving spouse adds the entire suspended passive loss to the adjusted basis of the property received.  

[Property Transferred Pursuant to Divorce]
Impact of Divorce on Carryforwards

Upon the completion of the divorce, the final joint tax return could contain various types of tax carryforwards. The IRS has issued guidance for some items but not for others. State law may dictate which spouse receives the credit carryforward.

Business Credits

Divorcing couples can have suspended business credits or business credit carryforwards on their final joint return. The IRS ruled that the credit carryforward and recapture potential followed the property to the receiving spouse (PLR 8828032). Without any other guidance, it seems logical to allocate a suspended credit or a general business credit carryforward to the spouse receiving the property or business giving rise to the credit.

Minimum Tax Credit

The regulations do not specifically address minimum tax credit (MTC) carryforwards. A taxpayer can claim a minimum tax credit against regular tax for the portion of the prior year’s alternative minimum tax attributable to timing differences. Since there is no published authority regarding how to allocate MTC carryforwards, it would be reasonable to allocate the share of the credit based on the property or business received in the divorce settlement.

Charitable Contribution

Charitable contribution carryforwards are apportioned between spouses based on the ratio of what the separate carryforwards would have been if the spouses had filed separate returns for the year(s) the excess contribution arose [Reg. §1.170A-10(d)(4); Rev. Rul. 76-267].
Capital Loss

Capital loss carryforwards are allocated based on the separate capital gains and losses of each spouse [Reg. §1.1212-1(c)(1)(iv)]. Divide equally between the spouses any gains and losses on jointly owned or community property.

Net Operating Loss

Net operating loss carryforwards are required to be allocated between the spouses in the ratio of what separate net operating loss carryforwards would have been with each spouse separately computing income and deductions [Reg. §1.172-7(d)].

EXAMPLE

Jim and Tammy filed joint returns for 2016 and 2017. They sustained a joint NOL of $1,000 for 2016 and a joint NOL of $2,000 in 2017.

For 2016, Jim’s deductions exceeded his gross income by $700 and Tammy’s deductions exceeded her gross income by $300. Therefore, allocate $700 of the 2016 $1,000 joint NOL carryover to Jim, and $300 to Tammy.

For 2017, Jim’s income exceeded his deductions by $1,500 and Tammy’s deductions exceeded her income by $3,500. They had a $2,000 NOL on a joint return, all of which is the separate NOL of Tammy.

S Corporation Losses

After 2004, upon transfer of the S corporation stock, the transferee spouse receives the basis in the stock of the transferor spouse and any disallowed losses or deductions [§1366(d)(2)(B)]. Any transfer prior to 2005, the transferee spouse received only the basis in the stock of the transferor spouse.
Impact of Divorce on Carryforwards Review Question

1. Marie and Chad filed their final joint return in 2016. In 2017, they were divorced. In 2016, they had an NOL in which they elected to forgo the NOL carryback. Which of the follow items is a factor in determining what portion of the NOL each of them get (if any) as a carryforward to 2017?

   A. What the divorce decree says.
   B. The ratio of each spouse’s separately computed income and deductions in 2016.
   C. Whose fault it is they are getting divorced.
   D. If child support is timely paid.
Notes
Impact of Divorce on Carryforwards Review Answer

1. 

A. Incorrect. For NOLs, the rules are set. The divorce decree does not override the tax law.

B. Correct. Net operating loss carryforwards are required to be allocated between the spouses in the ratio of what separate net operating loss carryforwards would have been with each spouse separately computing income and deductions [Reg. §1.172-7(d)].

C. Incorrect. The grounds for divorce does not enter into tax law.

D. Incorrect. Whether child support is current has no bearing on an NOL carry-forward.

[Net Operating Loss]
Community Property Issues

Married taxpayers who reside in a community property state are subject to special rules for determining taxable income. Community (or marital, as in the case of Wisconsin) property states include:

- Arizona.
- California.
- Idaho.
- Louisiana.
- Nevada.
- New Mexico.
- Texas.
- Washington.
- Wisconsin.

Taxpayers residing in a community property state during any part of the tax year can have community income. Married spouses filing separate returns must report one-half of any income described as community income under state law ($66). Each spouse can claim a credit for one-half of the income tax withheld from community income.

In some states, a husband and wife can enter into an agreement that affects the status of property or income as community or separate property. Check the state law to determine how it affects the individuals.

Spouses Living Apart All Year

Special rules apply if all the following conditions exist.

- A taxpayer and his or her spouse live apart all year.
- A taxpayer and his or her spouse do not file a joint return for a tax year beginning or ending in the calendar year.
- A taxpayer or his or her spouse has earned income for the calendar year that is community income.
- A taxpayer and his or her spouse have not transferred, directly or indirectly, any of the earned income between themselves before the end of the year. Do not take into account transfers satisfying child support obligations or transfers of very small amounts or value.
Reporting Provisions

If all these conditions exist, the taxpayers report community income as follows.

**Earned Income:** Earned income that is not trade, business, or partnership income is income of the spouse who performed the services to earn the income. Earned income is wages, salaries, professional fees, and other pay for personal services. Yet, earned income does not include amounts paid by a corporation that are a distribution of earnings and profits rather than a reasonable allowance for personal services rendered.

**Trade or Business Income:** Income and related deductions from a trade or business that is not a partnership belong to the spouse carrying on the trade or business. If capital investment and personal services both produce business income, treat all the income as trade or business income.

**Partnership Income or Loss:** Income or loss from a trade or business carried on by a partnership is income or loss of the spouse who is the partner.

**Separate Property Income:** Income from separate property is income only to the owner of that property.

**Social Security Benefits:** Social security and equivalent railroad retirement benefits are the income of the spouse who receives the benefits.

**Other Income:** Treat all other community income, such as dividends, interest, rents, royalties, or gains, as provided under the state's community property law.

Ending the Community

When the marital community ends, the spouses divide the community assets (money and property) between them. Report income received before the community ended according to the community property rules. Income received after the community ended is separate income, taxable only to the spouse to whom it belongs.

An absolute decree of divorce or annulment ends the community in all community property states. A decree of annulment, even though it holds that no valid marriage ever existed, usually does not nullify community property rights arising during the marriage. However, state law may provide exceptions.

A decree of legal separation or of separate maintenance may or may not end the community. The court issuing the decree can terminate the community and divide the property between the spouses.

A separation agreement can divide the community property between the taxpayer and his or her spouse. It can provide that this property, along with future earnings and property acquired, is separate property. This agreement can end the community.
Special Rules for Innocent Spouse

Generally, taxpayers must follow community property laws when filing a tax return if married and living in a community property state.

Community property laws generally provide that the taxpayer and spouse are both entitled to one-half of the total community income and expenses. If they filed a joint return in a community property state, both spouses are jointly and severally liable for the total liability on the return. If requesting relief from joint and several liability, do not consider state community property laws in determining whether an item belongs to the taxpayer or the taxpayer’s spouse or former spouse.

If the couple files separate returns, each spouse reports one-half the total community income and expenses on each separate return.

If the taxpayers were married and filed a separate return in a community property state and are now liable for an underpayment or understatement of tax, the innocent spouse has two ways to get relief.

Relief from Liability Attributable to Community Income

Under the innocent spouse provisions, relief is available if the taxpayer is not responsible for the tax related to an item of community income when all the following conditions exist:

- Taxpayer did not file a joint return for the tax year.
- Taxpayer did not include the item in gross income on his or her separate return.
- The item of community income the taxpayer did not include in gross income is one of the following:
  - Wages, salaries, and other compensation the taxpayer’s spouse (or former spouse) received for service he or she performed as an employee.
  - Income the taxpayer’s spouse (or former spouse) derived from a trade or business he or she operated as a sole proprietor.
  - The taxpayer’s spouse’s (or former spouse’s) distributive share of partnership income.
  - Income from the taxpayer’s spouse’s (or former spouse’s) separate property, other than described above. Use the appropriate community property law to determine what is separate property.
  - Any other income that belongs to the taxpayer’s spouse (or former spouse) under community property law.
- Taxpayer establishes that he or she did not know of, and had no reason to know of, that item.
- Under all facts and circumstances, it would not be fair to include the item in gross income.
If meeting all the above conditions, write Innocent Spouse Relief Under IRC 66(c) across the top of Form 8857. Complete Parts I, II, and IV. Attach a statement to the form explaining why the taxpayer qualifies for relief.

**Equitable Relief**

A taxpayer is allowed equitable relief if *both* of the following apply.

- The taxpayer has an understated tax or an underpaid tax.
- Taking into account all the facts and circumstances, the IRS determines it would be unfair to hold the taxpayer liable for the understated or underpaid tax.
Community Property Issues Review Question

1. ___ When the marital community ends, the spouses divide the community assets (money and property) between them. Which of the following is true?

   A. Income received before the community ended is reportable according to the community property rules.
   
   B. Income received after the community ends is separate income, taxable only to the spouse to whom it belongs.
   
   C. Both A and B.
   
   D. None of the above.
Community Property Issues Review Answer

1.  
   A. Incorrect. It is true that income received before the community ended is taxable according to the community property rules. However, Answer B is also correct—income received after the community ended is separate income, taxable only to the spouse to whom it belongs.

   B. Incorrect. It is true that income received after the community ended is separate income, taxable only to the spouse to whom it belongs. However, Answer A is also correct—income received before the community ended is taxable according to the community property rules.

   C. Correct. Income received before the community ended is taxable according to the community property rules and income received after the community ended is separate income, taxable only to the spouse to whom it belongs.

   D. Incorrect. Both A and B are correct.

   [Ending the Community]
Notes
Practitioner Responsibilities

A practitioner may have been doing the tax returns for a married couple for years. However, the relationship of the couple ends with divorce and any information they once shared during marriage now becomes confidential.

Practitioners who knowingly or recklessly disclose or use information of one of the spouses with the other spouse can be subject to a misdemeanor with fines up to $1,000 and one year in jail. [§7216]

Additionally, §6713 imposes a civil penalty of $250 up to $10,000 per disclosure or use of tax return information unless there is an exception under §7216(b).

Conflict of Interests

Under Circular 230, §10.29, a practitioner may not represent a client in his or her practice before the IRS if representation involves a conflict of interest.

A conflict of interest exists if either of the following applies.

- The representation of one client is directly adverse to another client.
- There is a significant risk that the representation of one or more clients is materially limited by the practitioner’s responsibilities to another client, a former client, or a third person, or by a personal interest of the practitioner.

Conflicts of interest usually are unintentional and often arise unexpectedly. A practitioner may even find he or she cannot represent either party due to the former relationship with both parties before the conflict of interest arose.

The majority of conflicts arise from the following situations.

- Both spouses believe the practitioner represents them.
- The practitioner has an interest in the outcome of the case.
- The practitioner has confidential information.
- The practitioner has conflicts with the attorneys.
- The practitioner advises both spouses during the initial phase of the divorce proceedings.
- The practitioner completes both spouses’ tax returns after the divorce.
Consent

Although a conflict of interest may exist, the practitioner can represent both parties if all the following apply.

- The practitioner reasonably believes that he or she is able to provide competent and diligent representation to each affected client.
- Law does not prohibit representation.
- Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the practitioner knows of the existence of a conflict of interest. Each affected client may make the confirmation within a reasonable period of time after the informed consent, but no later than 30 days.

The practitioner must retain copies of the written consents for at least 36 months from the date of the conclusion of the representation of the affected clients, and provide the written consents to any officer or employee of the IRS upon request.
Practitioner Responsibilities Review Question

1. ___ Regarding practitioner representation, all the following are true except:
   
   A. Practitioners may represent both taxpayers, providing law does not prohibit it.
   
   B. Practitioners may represent both taxpayers, providing he or she can provide competent and diligent representation to each affected client.
   
   C. Practitioners may represent both taxpayers, providing each affected client waives the conflict of interest and gives written consent.
   
   D. Practitioners must retain written consents for up to 12 months from the date of the conclusion of the representation of the affected clients.
Notes
Practitioner Responsibilities Review Answer

1.  

A. Incorrect. Practitioners may represent both taxpayers, providing law does not prohibit it.

B. Incorrect. Practitioners may represent both taxpayers, providing he or she can provide competent and diligent representation to each affected client.

C. Incorrect. Practitioners may represent both taxpayers, providing each affected client waives the conflict of interest and gives written consent.

D. Correct. Practitioners must retain written consents for at least 36 months from the date of the conclusion of the representation of the affected clients, not 12 months.

[Conflict]
Appendix A: Worksheet for Determining Support

Worksheet for Determining Support

Funds Belonging to the Person You Supported
1. Enter the total funds belonging to the person you supported, including income received (taxable and nontaxable) and amounts borrowed during the year, plus the amount in savings and other accounts at the beginning of the year. ____________________________ 1.
2. Enter the amount on line 1 that was used for the person’s support. ____________________________ 2.
3. Enter the amount on line 1 that was used for other purposes. ____________________________ 3.
4. Enter the total amount in the person’s savings and other accounts at the end of the year. ____________________________ 4.
5. Add lines 2 through 4. (This amount should equal line 1). ____________________________ 5.

Expenses for Entire Household (where the person you supported lived)
6. Lodging (complete line 6a or 6b):
   6a. Enter the total rent paid ____________________________ 6a.
   6b. Enter the fair rental value of the home. If the person you supported owned the home, also include this amount in line 21. ____________________________ 6b.
7. Enter the total food expenses ____________________________ 7.
8. Enter the total amount of utilities (heat, light, water, etc. not included in line 6a or 6b). ____________________________ 8.
9. Enter the total amount of repairs (not included in line 6a or 6b). ____________________________ 9.
10. Enter the total of other expenses. Don’t include expenses of maintaining the home, such as mortgage interest, real estate taxes, and insurance. ____________________________ 10.
11. Add lines 6 through 10. These are the total household expenses ____________________________ 11.
12. Enter total number of persons who lived in the household ____________________________ 12.

Expenses for the Person You Supported
13. Divide line 11 by line 12. This is the person’s share of the household expenses ____________________________ 13.
14. Enter the person’s total clothing expenses ____________________________ 14.
15. Enter the person’s total education expenses ____________________________ 15.
16. Enter the person’s total medical and dental expenses not paid for or reimbursed by insurance ____________________________ 16.
17. Enter the person’s total travel and recreation expenses ____________________________ 17.
18. Enter the total of the person’s other expenses ____________________________ 18.
19. Add lines 13 through 18. This is the total cost of the person’s support for the year ____________________________ 19.

Did the Person Provide More Than Half of His or Her Own Support?
20. Multiply line 19 by 50% (.50) ____________________________ 20.
21. Enter the amount from line 2, plus the amount from line 6b if the person you supported owned the home. This is the amount the person provided for his or her own support. ____________________________ 21.
22. Is line 21 more than line 20?
   ☐ No. You meet the support test for this person to be your qualifying child. If this person also meets the other tests to be a qualifying child, stop here; don’t complete lines 23–26. Otherwise, go to line 23 and fill out the rest of the worksheet to determine if this person is your qualifying relative.
   ☐ Yes. You don’t meet the support test for this person to be either your qualifying child or your qualifying relative. Stop here.

Did You Provide More Than Half?
23. Enter the amount others provided for the person’s support. Include amounts provided by state, local, and other welfare societies or agencies. Don’t include any amounts included on line 1. ____________________________ 23.
25. Subtract line 24 from line 19. This is the amount you provided for the person’s support ____________________________ 25.
26. Is line 25 more than line 20?
   ☐ Yes. You meet the support test for this person to be your qualifying relative.
   ☐ No. You don’t meet the support test for this person to be your qualifying relative. You can’t claim an exemption for this person unless you can do so under a multiple support agreement, the support test for children of divorced or separated parents, or the special rule for kidnapped children. See Multiple Support Agreement, Support Test for Children of Divorced or Separated Parents or Parents Who Live Apart, or Kidnapped Child under Qualifying Relative.

Note: Taxpayers should keep a completed copy of this worksheet for their records.
Appendix B: Determining Filing Status in a Divorce Situation Table

Determining Filing Status in a Divorce Situation

Was the taxpayer not married (§7703(a)(2)) or considered unmarried (§7703(b)) on 12/31 as defined earlier?

Yes

Was there a final decree of divorce or separation?

Yes

Single

No

Head of Household (if qualifications are met)

No

Do they want to file jointly?

Yes

Married Filing Jointly

No

Married Filing Separately
Appendix C: Alimony Determination Chart

**Alimony Determination**

1. **Were the spouses members of the same household any time during the year?**
   - Yes → **Was the couple legally separated under a decree of divorce or separate maintenance?**
   - No → **Did the spouses file a joint return?**
     - Yes → **Are the payments made under a written decree of divorce or separation instrument?**
       - Yes → **Does the agreement specifically state the payments are not alimony?**
         - Yes → **Not Alimony**
         - No → **Were the payments in cash?**
           - Yes → **Were the cash payments made to or on behalf of the spouse or former spouse?**
             - Yes → **Do the payments terminate upon the death of the recipient spouse?**
               - Yes → **Are the payments or portion of the payments designated as child support?**
                 - Yes → **Is the payment reduced as a result of a contingency related to a child?**
                 - No → **Alimony**
               - No → **No**
             - No → **No**
           - No → **No**
         - No → **Not Alimony**
       - No → **Not Alimony**
     - No → **No**

2. **Yes →**

3. **No →**

This chart outlines the criteria for determining if payments are considered alimony for tax purposes. It involves a series of yes/no questions that lead to a final determination of whether the payments are alimony or not.
Index

A
Alimony
   Lump-sum ........................ 51
   Recapture ....................... 46
   Third party payment ............. 49
Alimony trust ...................... 48

B
Basis of property .................. 73

C
Capital loss carryforward .......... 80
Charitable contribution carryforward .... 79
Child care ........................... 27
Child support ........................ 57
   Deemed ........................... 58
   Fixed ............................. 57
Community property ................ 85, 87
Conflict of interest ................ 93

D
Dependency
   Divorced or separated parents rules ... 29
   General rules ..................... 23
   Support test ..................... 25

E
Equitable relief ..................... 16

F
Filing status
   Head of household ...................... 8
   Married filing jointly ................. 4
   Married filing separately ............ 4
   Single ................................ 9

Form 8332
   Revocation .......................... 34
   Unconditional declaration ............ 32

I
Incident to divorce ................. 65
Injured spouse ..................... 16
Innocent spouse .................... 15
Itemized deductions ................. 6

M
Minimum tax credits .................. 79

N
Net operating loss carryforward .... 80

P
Personal residence ................... 65
Property settlement .................. 65

Q
Qualified domestic relations order ... 69
Qualifying child .................... 24
Qualifying relative .................. 24

S
Sale of residence .................... 65
Separation of liability relief ........ 16

T
Temporary support orders ............ 43