FAMILY & TAX CROSSOVER 2015

by

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I. Dependency exemptions - who can claim child as dependent - GENERALLY

A. Taxpayer who is not claimed as a dependent on someone else's tax return.

B. U.S. Citizen, Resident Alien, U.S. National or resident of Canada or Mexico & not joint return filer.

C. Qualifying Child? (Meet all 4 tests)
1. Taxpayer's child, stepchild, foster child brother, sister, step brother, step sister or descendant
2. Younger than Taxpayer (and under 19 (24 if FT student)) OR Permanently and Totally disabled
3. Provided > 50% of support for the year, AND
4. Lived with taxpayer for >50% of the year.

D. Qualifying Relative? (Meet all 4 tests)
1. Taxpayer provided > 50% of support.
2. Dependent is taxpayer's child, stepchild, foster child (or their descendant), taxpayer's brother, sister, niece or nephew; taxpayer's parent, parent sibling, grandparent; taxpayer's step brother, step sister, step parent, son in-law, daughter in-law, brother in-law, sister in-law, father in-law, or mother in-law OR someone who lived with the taxpayer 100% of the year.
3. Relative Potential Dependent must NOT BE A QUALIFYING RELATIVE OF SOMEONE ELSE
4. Relative Potential Dependent must NOT HAVE HAD GROSS INCOME OVER $3,950

II. Special Divorce considerations

A. Custodial Parent (parent awarded custody) can claim, IF:
1. Child Receives >50% of the support from parents during the year
2. In the custody of one or both parents for >50% of the year

B. Non Custodial Parent (parent NOT awarded custody) can claim, IF:
1. Parents are divorced legally separated or lived apart during the last six months of the calendar yr.
2. Child Receives >50% of the support from parents during the year
3. In the custody of one or both parents for >50% of the year
4. The Custodial parent releases the exemption to the noncustodial parent using Form 8332 for current or for all future years. (IRC § 152(e).

C. Deduction may be denied by IRS / Tax Court if:
1. Different wording is used other than is on Form 8332
2. Form 8332 was required since 2008, and other agreements prior to 2008 may be used.

III. Property Divisions & Settlement

A. "BETWEEN SPOUSES" No Gain/Loss under IRC §1041(a) if:
1. Division Occurs within 1 year of divorce.
2 Related to marriage termination: (2-prongs)
   (a) Property division is made under agreement, AND
   (b) Division occurs within 6-years the date the marriage ends

B. "TRANSFER TO THIRD PARTIES" tax free if"on behalf of spouse/former spouse:
   1. Transfer to 3rd party is required by divorce order / agreement.
   2. Transfer to 3rd party is at the request of spouse / former spouse
   3. Transfer to 3rd party is with the consent of spouse / former spouse

C. Tax Result for transferred property
   1. Transferred Assets have carryover basis
   2. Transferred Assets have tacked-on holding period. §1.041-1T

D. Retirement
   1. Qualified Domestic Relations Order (QDRO) is a state court allocation of a plan having aspects described generally at section IRC § 400
   2. Changes / Conversions not subject to a QDRO are taxed to the recipient receiving the transfer.

IV. Division of income producing assets e.g. royalties, residuals, profit participation and how to handle them.

A. Operating Business
   1. Independent Valuation Appraisers
      (a) Value to outsiders on sale
         (1) Tax Impact on Sale
         (2) Security Issues on Secured Purchase Option
            (i) Ability of the purchaser to harm the business before full payment.
            (ii) Giving and Perfecting of Security interests
            (iii) Involvement of the Ex-spouse in the business
   2. Audit of past operating History do assure no depletion or diversion of assets.

V. Costs of Divorce

A. Legal fees & Court Cost are generally not deductible.
   1. Expenses relating to child custody & support
   2. Expenses for settlement of property

B. A directive to pay the attorney fees of the spouse is not deductible unless alimony related.

C. Deductible Costs:
   1. Tax Advice related to divorce, property division, and the like.
   2. Fees & Costs paid to determine or collect alimony.
   3. Tax Advice related to Estate Tax Consequences of property
   4. Funds paid to Valuation Experts relating to Alimony acquisition and tax evaluation.

VI. Tax filing status after separation and after dissolution

A. Single Status
   1. Unmarried
   2. Separated from a spouse by
      (a) Divorce Decree by December 31 of the tax year
      (b) Separate Maintenance Decree by December 31 of the tax year

B. Married Filing Jointly
   1. Married and living together on December 31 of the tax year

2. Married and living apart but not legally separated or divorced on December 31 of the tax year
3. Separated under an interlocutory decree
4. Living in a Common law marriage recognized by the state.
5. Note: Registered Domestic Partnership is NOT Marriage.

C. Head of Household
1. Not Married at year's end
2. Paid >50% of the cost of keeping a home.
3. Household was Principal residence of:
(a) Qualifying Child (claimable as dependent)
(b) Qualifying Relative that is a dependant
(1) Household member status alone is insufficient
(2) Theoretical qualifier only due to multiple support agreement is insufficient.
4. Taxpayer is U.S. Citizen or Resident during the entire year.

VII. Spousal support and tax consequences of spousal support - when will IRS recognize a valid order?

A. Alimony determined without regard to other language in the decree

B Qualifying for Alimony IRC §71(b)
1. Cash payments
2. Required by a decree or written separation instrument / order.
3. Not specifically designated as being NOT ALIMONY in the decree.
4. Spouses MUST NOT be members of the same household.
5. Payment must not be considered as child support
6. Alimony must be a payment that is set to expire upon recipient's death.
7. No Joint Return Filing

C. Categories that will not be considered to be Alimony
1. Child Support
2. In-Kind, non-cash transfers
3. A spouse's own share of their community property.
4. Payments made in trust for upkeep of payor's assets and property.

D. Alimony recapture rule of IRC §71(f). 3 year formula. Recapture causes:
1. Loss of deduction from the previous payor
2. Loss of income inclusion for the previous recipient

VIII. Child Care Credit

A. Separated Spouse can claim if:
1. Maintains separate household
2. Furnishes over half of the household cost
3. Both the child tax credit and the child and dependent care credit on the same return=OK
4. Qualifying person has several categories
5. Payments for care cannot be paid to your spouse
6. Qualifying expenses must be reduced by the amount of any benefits provided by your employer
7. Beware: if you pay someone to come to your home & provide care you may become a

household employer & may have to withhold and pay social security and Medicare tax and pay federal unemployment tax.

VIII. Innocent Spouse

A. Types of Relief (Publication 971 & Form 8857)
1. Relief of responsibility for paying tax, interest, and penalties if your spouse did something wrong on your tax return.
2. Relief by Separation of Liability, including understatement of tax (plus interest and penalties) on your joint return between you and your spouse (or former spouse).
3. Equitable Relief, if a spouse does qualify for innocent spouse relief otherwise.

B. Spouse opposing a filer for innocent spouse relief will be notified and can oppose the innocent spouse filer

IX. Sale of Home.

A. Exclusion of $250,000 of gain per spouse

B. Later sale for non-home-use resident requires:
1. Non-occupant / Non-User owns a portion of the home, AND
2. Occupant / User former spouse uses under divorce instrument & as main home.

X. Tax Relief (Bankruptcy and Offer in Compromise) before and after bankruptcy

A. Individual or Joint Debt? It can determine tax liability in some cases.
1. Spousal liability is found in family code §§ 900-1000
2. A debt arises when the time the obligation arises.
3. Liability for personal debts can occur through (a) divorce court assignment to the separate person, (b) "necessaries doctrine", and (c) the case of a deceased spouse that leaves debt behind.
4. Probate code §§ 1352-4 deal with claims against a deceased's estate.
5. Community Property estate is liable for the debt of either spouse regardless of whether incurred before or during marriage. Family Code §910
6. Earnings of a spouse before marriage before marriage are not subject to liability of a debt after marriage. Family Code §910

B. Cancellation of Debt (COD) Income under IRC §108, using community property rules can cause COD liability to a spouse under any number of facts and theories.

C. Bankruptcy by one spouse, protects the filing spouse and the filing spouse's community property.
(a) Bankruptcy Filing brings community property into the bankrupt's estate
(b) Quasi-community property, that which was acquired prior to 1969? while domiciled elsewhere which would have been community if the spouse that acquired it had been domiciled in California at the time of its acquisition.
(c) Community presumption of Family Code § 760 (presumption of community property) is trumped by the title presumption of California Evidence code § 662.
(d) Transmutation can change the ownership from community to separate, but it must not be done in a way that constitutes bankruptcy abuse: In re William J. Beverly (9th Cir BAD 2007)

XI. Cases

A. *Perez v. Commissioner* (2015) 144. T.C. No. 4, 2015 FA 1674. Human egg donor payments for *pain and suffering associated with donation is included in income.*

B. *Farahani v. Commissioner* (2014) T.C. Memo. 2014-111, 2014 FA 1645 Father may not deduct as alimony the amount that trial court allocated for child support payment from father's award of back pay in wrongful termination case. Father won $305,000. wrongful termination case, then was garnished for $43,893 for back child support, and then deducted the garnishments as if they were child support.

C. *Sergienko and Corona v. Commissioner* (2014) T.C. Memo. 2014-5 6. No dependency exemption when you fail to show that the child live with you for more than 50% of the year.

D. *Weaver-Adams v. Commissioner* (2014) T.C. Memo. 2014-73,2014 FA 1638 Wife must include in income a QDRO distribution from husband's 401(k). Wife treated distribution as "tax free" pension. She was assessed $23,655 deficiency and an accuracy related penalty of $4,731. This taxpayer lost because of (1) express language in the QDRO that she would be taxable, and (2) Her failure to roll over.

E. *Carrino v. Commissioner* (2014) T.C. Memo. 2014-34, 2014 FA 1629. As spouses marriage end, husband invests in new hedge fund. After Discovery, husband settled admitting that 72.5% of husband's interest in CRLLC was community property and the remaining 27.5% was his separate property.

F. *DeLong v. Commissioner* (2013) T.C. Memo. 2013-70, 2013 FA 1581. Brandon and Tamsin DeLong, California residents filed for divorce. Parties stipulated that husband would pay $3,000 to for family support. The court continued it and called it mixed spouse support and child support. Husband files return and characterizes all of the $24,491 under the stipulation as alimony. Court uses *Berry v. Commissioner* (2005) T.C. Memo. 2005-91, 2005 CFLR 9953, 2005 FA 1192, where it had interpreted California law as providing that a family support obligation ceases on the recipient's death. Since no part of the support was "fixed" as child support, taxpayer wins and the Tax Court rules it to be 100% alimony and deductible.

G. *Armstrong v. Commissioner* (2012) 139 T.C. No. 18. Arbitration award enabled one spouse to claim one of two children for support provided that husband was current on child support. Later the Judge reinforces the order for later years. In year 5, ex-wife fails to provide Form 8332, and Husband files agreed decree with his taxes. Held, for IRS. IRS is not required to track court order and stipulations, (and IMO, especially ones that conditionally depend upon other facts). Further, form 8332 release must be unconditional.

H. *O'Neil v. Commissioner* (2012) T.C. Memo. 2012-339. $268,000 of income is obtained via Husband's work. Tax return showing a $70,000 amount due is filed but with no payment. Later, their house is refinanced to generate $70,000 but it is spent elsewhere. H&W get a "status-only" dissolution. Wife asks for "innocent spouse" while husband files for bankruptcy. In other words, the court at length seemed to believe that all of this family's decisions and moves were part of a common plan. Wife's charges of abuse and threats to force her signing were not believed.

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Linda S. Gross is an experienced family law litigator, known for her expertise in handling premarital agreements, property issues, particularly financial valuations and tracing property, child custody, and child and spousal support. A certified family law specialist with a Master's at Law in Taxation, she balances advocacy with economy. She is knowledgeable where drug, alcohol or mental health issues are present. She also does Collaborative Divorce, where she helps clients achieve a cost-effective, flexible and fair restructure of their finances and parenting and divorce with respect and dignity. In all cases, she strives to serve her clients with expertise and common sense.

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