

TAX Issues for Domestic Court

A basic, very basic overview of tax issues for Judges in Family Law Cases

DEDUCTIONS for Dependent Children

- ▶ Child Tax Exemption
- ▶ Child Tax Credit
- ▶ Tax Credit for Dependent Care
- ▶ Exclusion from Income for Dependent Care
- ▶ Earned Income Credit

- ▶ filing status of Head of Household

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DEDUCTIONS for Dependent Children

- ▶ **Basic Rule:**
- ▶ The custodial parent claims the children

- ▶ **Exceptions to the Basic Rule:**
- ▶ The custodial parent can agree (or the court can order the custodial parent) to allow the noncustodial parent to claim the children as dependents for the Child Tax Exemption and the Child Tax Credit under the special rules for children of divorced or separated parents.

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DEDUCTIONS for Dependent Children

- ▶ The noncustodial parent can only claim the
 - ▶ Child Tax Exemption and the Child Tax Credit

- ▶ Noncustodial parent cannot qualify for
 - ▶ Head of Household filing status, Dependent Care Tax Credits, or the Earned Income Credit

DEDUCTIONS for Dependent Children

- ▶ Noncustodial Parent must include with tax return:
 - ▶ Form 8332 Written Declaration or a similar written declaration releasing the exemption to the noncustodial parent
 - ▶ OR for time period after 1984 and before 2009, can include pertinent language of legal documents allowing use of exemption by noncustodial parent

DEDUCTIONS for Dependent Children

- ▶ Noncustodial Parent must include with tax return:
 - NEW RULE: Only Form 8332 Written Declaration or a similar written declaration releasing the exemption to the noncustodial parent can be attached if post 2008.
 - Court orders: to grant exemption to noncustodial parent, order the custodial parent to execute the IRS form 8332 or a similar declaration (i.e. consent order?)

DEDUCTIONS for Dependent Children

▶ **IMPORTANT POINT:**

▶ The tax exemptions and credits go with the child, they cannot be divided.

▶ a custodial parent may still be able to qualify to file as Head of Household

Horizontal lines for notes.

DEDUCTIONS for Dependent Children

▶ IF PARENTS DO NOT AGREE AND MORE THAN ONE PERSON FILES A RETURN CLAIMING THE CHILD:

▶ **Tie Breaker Rule**

- ▶ If only one person is the child's parent
- ▶ **The parent gets the deduction**
- ▶ If both are parents and they do not file a joint return
- ▶ **The parent with whom the child lived for the longer period during the year gets the deduction**
- ▶ If both are parents and the child lived with each for the same amount of time
- ▶ **The parent with the higher AGI gets the deduction**
- ▶ If neither is a parent
- ▶ **The person with the higher AGI gets the deduction**

Horizontal lines for notes.

DEDUCTIONS for Dependent Children

▶ Child Support Guidelines:

▶ "The schedule assumes that the parent who receives child support claims the tax exemptions for the child. If the parent who receives child support has minimal or no income tax liability, the court may consider requiring the custodial parent to assign the exemption to the supporting parent and deviate from the guidelines."

Horizontal lines for notes.

DEDUCTIONS for Dependent Children

- ▶ Child Support Guidelines:
- ▶
- ▶ COMMENT TO STATUTE:
- ▶ TRIAL COURT ERRED IN RULING IT HAD NO AUTHORITY TO MODIFY THE INCOME TAX DEDUCTION PROVISION OF THE PARTIES' SEPARATION AGREEMENT as they requested a recalculation of child support, obliging the trial court to apply the entirety of the guidelines, including not only the worksheets, but also the commentary. **Ticconi v. Ticconi, 161 N.C.App. 730, 589 S.E.2d 371 (2003).**

Taxable Consequences of Alimony and Spousal Support

- ▶ Alimony: defined as payment to or for a spouse or former spouse under a written divorce decree or separation instrument.
- ▶ **Does not include voluntary payments**

Taxable Consequences of Alimony and Spousal Support

- ▶ Things that are **NOT** deductible alimony:
- ▶
- ▶ Child Support
- ▶ Noncash Property Settlements
- ▶ Payments that are part of the spouse's community income
- ▶ Payments to keep up the payer's property
- ▶ Use of the payer's property

Taxable Consequences of Alimony and Spousal Support

- ▶ Things that **ARE** alimony: (according to the IRS)
- ▶ (Spouses cannot file a joint return)

- ▶ The payments is in cash
- ▶ The payment is pursuant to a legal instrument and the instrument does not designate the payment as NOT alimony
- ▶ The spouses are not members of the same household (although there is an exception to this)
- ▶ There is no liability to make the payment after the death of the recipient spouse
- ▶ The payment is not treated as child support

Taxable Consequences of Alimony and Spousal Support

- ▶ **CASH** means checks, money orders or currency

- ▶ Transfers of services or property, execution of debt instruments or use of property do NOT constitute alimony.

Taxable Consequences of Alimony and Spousal Support

- ▶ Cash payments to a third party on behalf of a spouse can qualify if the circumstances surrounding the payments is in writing. i.e. Utility Payments, Insurance Premiums

Taxable Consequences of Alimony and Spousal Support

- ▶ 3 YEAR RECAPTURE RULE:
- ▶ if payments decrease or terminate in the first 3 calendar years of the instrument, the deduction may be recaptured if alimony paid in the 3d year decreases by more than 15,000 from the 2d year OR if there is a significant decrease from year one to years 2 and 3.
- ▶ The 3 year time period does not include time for payments made under a temporary support order.
- ▶ Excluded if payments are terminated due to death or remarriage of payee
- ▶ Excludes fixed percentage awards

Taxable Consequences of Alimony and Spousal Support

- ▶ **Alimony** as defined by North Carolina law can certainly include property transfers, payments of expenses and execution of debt instruments. These items are just not deductible.
- ▶ **Upchurch v. Upchurch, 34 N.C.App. 658 (1977)**
- ▶ No error awarding possession of home as part of Alimony

Taxable Consequences of Alimony and Spousal Support

- ▶ **Alimony** as defined by North Carolina law can certainly include property transfers, payments of expenses and execution of debt instruments. These items are just not deductible.
- ▶ **Whedon v. Whedon, 58 N.C.App. 524 (1982)**
- ▶ court erred in ordering the husband to pay the wife's income taxes resultant upon the alimony award.

Consideration of tax consequences in Division of Property Cases

- ▶ **Basic Rule:** Transfers of property between spouses or between former spouses incident to divorce do not have immediate taxable consequences.
- ▶ “Incident to divorce” means (1) within one year after the date of divorce or is (2) related to cessation of marriage.
- ▶ Time limitations: 6 years for transfer
- ▶ - rebuttable presumption



Consideration of tax consequences in Division of Property Cases

“tax considerations” as part of the factors in N.C.G.S. 50-20

Before amendment in 2005: 50-20(c)(11) required the court to consider “the tax consequences to each party”.



Consideration of tax consequences in Division of Property Cases

“tax considerations” as part of the factors in N.C.G.S. 50-20

- ▶ **amended 50-20 (c)(11) in 2005** to read:
- ▶ **Chp 50-20 (c) (11)** The tax consequences to each party, including those federal and State tax consequences that would have been incurred if the marital and divisible property had been sold or liquidated on the date of valuation. The trial court may, however, in its discretion, consider whether or when such tax consequences are reasonably likely to occur in determining the equitable value deemed appropriate for this factor.



**Consideration of tax consequences in
Division of Property Cases**

Areas where evidence of tax considerations often appear:
VALUE OF PROPERTY
DISTRIBUTION OF PROPERTY

The parties have the burden of presenting evidence about
tax consequences.



**Consideration of tax consequences in
Division of Property Cases**

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**Consideration of tax consequences in
Division of Property Cases**

Cases:

Dolan v. Dolan, 148 N.C.App. 256 (2002)

These factors include "the tax consequences to each party." N.C. Gen. Stat. § 50-20(c)(11). Our courts have construed this provision "as requiring the court to consider tax consequences that will result from the distribution of property that the court actually orders." Weaver v. Weaver, 72 N.C.App. 409, 416, 324 S.E.2d 915, 920 (1985). ^{HN2} It is error for a trial court to consider "hypothetical tax consequences as a distributive factor." Wilkins v. Wilkins, 111 N.C.App. 541, 553, 432 S.E.2d 891, 897 (1993)



**Consideration of tax consequences in
Division of Property Cases**

Cases:

Dolan v. Dolan, 148 N.C.App. 256 (2002)

JUDGE WYNN'S DISSENT:

Since the plain language of the statute provides no such limitation on the consideration of tax consequences in determining whether an equal division is not equitable, I *certify* to our Supreme Court the holdings of this Court to the contrary, N.C. Gen. Stat. § 7A-30



**Consideration of tax consequences in
Division of Property Cases**

Cases:

Dolan v. Dolan, 148 N.C.App. 256 (2002)

AFFIRMED 355 N.C. 484 (2002)



**Consideration of tax consequences in
Division of Property Cases**

Cases:

Shaw – unpublished opinion of pre-amendment order



Consideration of tax consequences in Division of Property Cases

Cases:

Pellom v. Pellom, 669 S.E.2d 323 (2008)

- ▶ Pursuant to statute, a trial judge shall consider in an equitable distribution matter:
- ▶ The tax consequences to each party, including those federal and State tax consequences that would have been incurred if the marital and divisible property had been sold or liquidated on the date of valuation. The trial court may, however, in its discretion, consider whether or when such tax consequences are reasonably likely to occur in determining the equitable value deemed appropriate for this factor.
- ▶ N.C. Gen. Stat. § 50-20(c)(11) (2007)

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Consideration of tax consequences in Division of Property Cases

Cases:

Pellom v. Pellom, 669 S.E.2d 323 (2008)

- ▶ In applying the above statute, this Court has held:
- ▶ The trial court is not required to consider possible taxes when determining the *value* of property in the absence of proof that a taxable event has occurred during the marriage or *will* occur with the division of the marital property. We construe Section 50-20(c)(11) of the General Statutes as requiring the court to consider tax consequences that will result from the distribution of property that the court actually orders.
- ▶ *Weaver v. Weaver*, 72 N.C.App. 409, 416, 324 S.E.2d 915, 920 (1985) (internal citations omitted), *disapproved on other grounds by Armstrong v. Armstrong*, 322 N.C. 396, 403-04, 368 S.E.2d 595, 599 (1988).

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TAX Issues for Domestic Court

Tax considerations: considering the application of the tax code to the decisions rendered by the court

Burden of Proof: Parties have sole burden to produce evidence for the court to consider.

Apparent Limitation remains: To consider in ED only the tax consequences that will arise from actions of the court in distribution.

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