

**DIVORCE**

**I. TAX CONSIDERATIONS IN A DIVORCE ENGAGEMENT**

A. Filing Status

1. Some separated or divorced spouses may qualify for Head of Household Status.
2. Divorcing spouses who continue to file jointly need to be aware that each signatory to a jointly filed return is severally liable for any tax due.

B. Income Allocation

1. During the year that a marriage terminates, the allocation of income and deductions can be a complicated.
2. For community property states and equitable distribution states the applicable rules may be significantly different.

C. Alimony and Other Payments

1. Payments between spouses can take the form of property settlements [Code Section 1041] which have no tax consequences, or alimony payments that represent taxable income to the payee [Code Section 71] and a reduction of taxable income to the payer [Code Section 215], or child support [Code Section 71) which represents neither taxable income nor expense to those involved.
2. Divorce tax planning involves knowing how to structure the payments for the best tax advantage.

D. Child Care Concerns

1. The structure of a divorce settlement when children are involved include not just issues of child support.
2. Other important considerations include:
  - a) Child Care Credits (Code Section 21).
  - b) Child Tax Credits (Code Section 24).
  - c) Education Credits/Expenses (Code Sections 25A, 221,222).
  - d) Medical Expense deductions for dependent children (Code Section 213).

E. Use of Trusts in a Divorce: Is that a viable protective remedy?

F. Retirement Plans: When should a qualified domestics relations order **[QDRO]** be in place and what are the rules?

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### G. Other Issues:

1. Tax Carry-forwards.
2. Stock Options, both incentive and non-qualified.

## II. FILING STATUS ISSUES

A. A divorced or divorcing couple's filing status is determined as of the last day of a tax year [Code Section 7703(a)]. Even if they no longer live in the same household, for tax purposes the couple could still be deemed to be married.

B. A couple is no longer married for tax purposes when:

1. A final divorce decree is issued by a domestic relations court; or,
2. A domestic relations court issues a final decree that constitutes a legal separation under local law and requires the couple to live apart.
3. In addition to (1) or (2) above, a married individual who qualifies as an abandoned spouse is treated as unmarried for certain tax purposes, including the determination of filing status. Under Code Section 7703(b), a spouse is considered abandoned when all of the following conditions have been met:
  - a) The abandoned individual pays more than half the cost of maintaining his/her household for the taxable year;
  - b) The individual files a separate tax return;
  - c) The individual's household is the principal home of a dependent child for more than six months of the tax year and the individual is entitled to claim the dependency exemption (even if no claim is made); and,
  - d) The individual lives in a separate residence from his/her spouse for the last six months of the tax year.[Hopkins, Laurel Marie, TC Memo 1992-326, 63 TCM 3113 (1992)].
4. Failure to satisfy the conditions or circumstances above, the taxpayer who is legally married is married for tax purposes as well.

C. Head of Household Status (HOH)

1. Following a divorce an individual with custody of a child often qualifies for head of household filing status. In addition, a married individual who qualifies as an abandoned spouse is generally eligible for HOH filing status as well.
2. To qualify for HOH under Code Section 2(b), a taxpayer must:
  - a) Be unmarried for tax purposes;
  - b) Maintain a home that is the principal place of abode for more than half the year for an unmarried child or a relative who can be claimed as a dependent.

- c) Pay more than half the cost of maintaining that home.
- 3. The requirement to pay the costs of home maintenance is not the same as providing more than half the child's support for purposes of the dependency exemption.
  - a) Home maintenance costs include property taxes, insurance, mortgage payments, repairs, and providing food on the premises.
  - b) Home maintenance costs do not include clothing, education, medical expenses, or the like.
- 4. To qualify for HOH status, the custodial parent does not have to be entitled to claim a dependency exemption.

Frank has custody of his son, Robert, and pays the full cost of maintaining Robert's primary abode. Frank provides 20% of Robert's support, Frank's ex-wife, Marie, provides 20% of Robert's support, and Robert's grandmother is responsible for the remaining 60% of Robert's annual support needs. Since Frank provides less than 50% of Robert's support, Frank cannot claim Robert as a dependent. However, Frank does qualify for HOH status.

- 5. When an abandoned spouse qualifies for and files HOH status, the other spouse is usually forced to file married, filing separately (MFS).
  - a) However, the other spouse may also qualify as an abandoned spouse and for HOH status.
  - b) That circumstance is possible when each spouse has a child and with respect to that child meets both the abandoned spouse and HOH rules.
- 6. Filing as HOH rather than MFS status provides an abandoned spouse with the following additional benefits:
  - a) Credits for child care expenses, earned income credits, and qualifying education expenses.
  - b) The ability to claim the standard deduction even if the other spouse itemizes deductions.
  - c) The ability to exclude interest income from Series EE bonds used for higher education.
  - d) The ability to deduct interest expense on qualified education loans.
  - e) An above the line deduction of qualified tuition expenses.
  - f) The ability to convert a traditional IRA to a ROTH; and,
  - g) Having higher adjusted gross income phase-out thresholds for various tax deductions and credits.