Tax Issues in Divorce and Separation for Family Law Attorneys

by

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Family Law Section of Colorado Bar Association
October 21, 2016

ALIMONY PAYMENTS

I. Definition of alimony.

1. Alimony is an amount paid to a spouse or former spouse under a divorce or separation agreement. Voluntary payments made to a spouse aren't treated as alimony. I.R.C. §§ 71(a) and 215(a).
2. The payee spouse must include alimony payments in gross income. The payor spouse can deduct the alimony payments from gross income in finding adjusted gross income. I.R.C. § 215.
3. Alimony is an "above the line deduction." The payor doesn't have to itemize deductions to be allowed the alimony deduction. I.R.C. §§ 62(a)(10) and 67(a).
4. As a general rule, there is no requirement for the payor spouse to withhold income taxes on alimony payments. Alimony payments to a nonresident alien, however, are subject to withholding requirements, where such payments are deemed United States source income. I.R.C. § 1441(a); see also, Rev. Rul. 69-108. It is possible that a tax treaty with the home country of the payee may negate the withholding requirement.
5. Alimony is not considered income from self-employment; therefore, social security and Medicare taxes are not applied to alimony.
6. Since compensation for purposes of an IRA includes alimony, the payee spouse may contribute alimony to the IRA (subject to the IRA contribution limitations). I.R.C. § 219(b)(4).
7. The payee spouse must provide his or her social security number to the payor spouse, and the payor spouse is required to indicate the name and social security number of the payee spouse on the first tax return on which the payor spouse claims an income tax deduction for alimony payments made. I.R.C. § 215(c); Reg.1.215-1T, Q&A 1. There is a $50 penalty imposed on any party who fails to comply with these rules. I.R.C. §§ 6723 and 6724(d)(3)(C).

II. Requirement for a payment to be alimony.

To qualify as alimony and separate maintenance payments, a payment must meet seven criteria set in I.R.C. § 71 and Treas Reg. § 1.71-1T.

1. The payment must be received by or on behalf of a spouse pursuant to a "divorce or separation instrument."
    a. Divorce or separation instrument includes:
        i. A decree of divorce or separate maintenance or written instrument incident to divorce,

ii. a written separation agreement, or
iii. a support decree requiring a spouse to make payments for the support or maintenance of the other spouse (such as a temporary and pendente lite order of support). I.R.C. § 71(b)(2).

b. The agreement must be in writing. An oral understanding between the parties isn't sufficient. Nor is a letter from payor spouse to payee spouse stating the intention to pay alimony.

c. The payments must be required by the agreement and must be made after execution of a divorce or separate maintenance decree or a written separation agreement. Prince v. Commissioner, 66 T.C. 1058 (1976) (stating "[s]ection 71(a)(1) requires a writing which memorializes the agreement between the former spouses concerning support obligations.")

d. Voluntary payments aren't treated as alimony. For example, if a husband's obligation to pay alimony terminates on wife's remarriage, payments after that event aren't alimony. Hoffman v. Commissioner, 54 TC 1607 (1970), aff'd 455 F2d 161 (7th Cir. 1972).

e. The payments do not have to be fixed, nor a specific amount, nor must they be periodic in nature. The payment doesn't have to constitute support of a spouse.

2. Only cash payments (including checks and money orders payable on demand) qualify as alimony or separate maintenance payments. I.R.C. §§ 71(b)(1) and 215(b).

a. The payment must be received by or on behalf of the payee spouse.

b. Transfers of services or property (including a debt instrument of a third party or an annuity contract), execution of a debt instrument by the payor, or the use of property of the payor do not qualify as alimony or separate maintenance payments. Treas. Reg. § 1.71-1T(b) Q&A 5.

c. Assuming all other requirements are satisfied, a payment of cash by the payor spouse to a third party under the terms of the divorce or separation instrument will qualify as a payment of cash which is received "on behalf of a spouse." For example, cash payments of rent, mortgage, tax, or tuition liabilities of the payee spouse made under the terms of the divorce or separation instrument will qualify as alimony or separate maintenance payments. Treas. Reg. § 1.71-1T(b) Q&A 6.

d. Payments of cash to a third party on behalf of a spouse qualify as alimony or separate maintenance payments if the payments are made to the third party at the written request of the payee spouse. For example, instead of making an alimony or separate maintenance payment directly to the payee, the payor spouse may make a cash payment to a charitable organization if such payment is pursuant to the written request, consent or ratification of the payee spouse. Such request,

consent or ratification must state that the parties intend for the payment to be treated as an alimony or separate maintenance payment to the payee spouse, subject to the rules of section 71, and must be received by the payor spouse prior to the date of filing of the payor's first return of tax for the taxable year in which the payment was made. Treas. Reg. § 1.71-1T(b), Q&A 7.

e. Where the payor spouse owns the property and the payee spouse uses the property, any payments to maintain property (including mortgage payments, real estate taxes and insurance premiums) are not payments on behalf of a spouse, even if those payments are made pursuant to the terms of the divorce or separation instrument. Treas. Reg. 1.71-1T(b), Q&A 6.

f. Where the payee spouse owns the residence, and the payor spouse pays the mortgage, property taxes, repairs and insurance, such payments will qualify as alimony if all of the I.R.C. § 71 requirements are satisfied. The payee spouse may deduct the mortgage interest and real estate taxes paid on a spouse's behalf, provided the payee spouse itemizes deductions, and further provided that the interest constitutes qualified residential interest. Rev. Rul 62-39. If itemizing deductions, the payee spouse can deduct the real estate taxes and, if the home is a qualified home, also include the interest on the mortgage in figuring deductible interest.

g. Where the property is owned jointly, one-half of the total amount of mortgage payments, including both principal and interest, may be treated as alimony, and one-half of the interest may be deducted as mortgage interest, if it is qualified residential interest. With respect to real estate taxes and home owner insurance, if the residence is held as tenants in common, half of the total payments are deductible as alimony, and half the real estate taxes can be deducted as itemized deductions. If the residence is held in joint tenancy, however, none of the payments are deductible as alimony, but the payor spouse can deduct all of the real estate taxes as itemized deductions. None of the home insurance is deductible for spouses that hold the property as joint tenants and tenants in common. Rev. Rul. 67-420.

h. Where one spouse is in sole and exclusive possession of property, the entire amount of utility charges paid by the non-occupying spouse may be treated as alimony or separate maintenance payments, if otherwise qualified under the above rules. Rev. Rul. 62- 39.

i. Premiums paid by the payor spouse for term or whole life insurance on the payor's life made under the terms of the divorce or separation instrument will qualify as payments on behalf of the payee spouse to the extent that the payee spouse is the owner of the policy. Reg. 1.71-1T(b), Q&A 6.

3. The divorce or separation agreement doesn't designate the payment as nondeductible by the payor or excludable from the payee's income. I.R.C. § 71(b)(1)(B), Treas. Reg. § 1.71-1T, Q&A 8.

    a. The parties can affirmatively agree that an otherwise qualifying payment is not alimony or separate maintenance, and accordingly is not deductible by the payor or includible by the payee. A court may order that the payments are nondeductible/nontaxable.

    b. A copy of the designation must be attached to the payee's first filed tax return each year that the designation applies. Treas. Reg. § 1.71-1T, Q&A 8.

4. The divorced or legally separated spouses must reside in separate households when the payment is made. I.R.C. § 71(b)(1)(C).

    a. A formerly shared home is considered one household, even if the parties are physically separated within the home.

    b. The spouses will not be treated as members of the same household if one spouse is preparing to depart from the household of the other spouse, and does depart not more than one month after the date the payment is made. Treas. Reg. 1.71-1T(b), Q&A 9.

    c. Exception to separate household rule: When the parties aren't divorced or legally separated, payments made under a written separation agreement or a court order requiring one spouse to make payments for the support of the other can qualify as alimony even if the parties share the same household at the time the payments are made. Treas. Reg §1.71-1T, Q & A 9.

5. The payor is not liable to make any payment for any period after the death of the payee spouse, and there is no liability to make any payment (whether in cash or in property) as a substitute for such payments after the death of the payee spouse. I.R.C. § 71(b)(1)(D).

    a. Alimony payments must end at the death of the payee spouse. A provision requiring payments to continue after the death of the payee will taint all payments, including those made both before and after death. A required payment to the payee's estate will taint any other payments designated as alimony, since a payment to the payee's estate is considered a payment after death. Treas. Reg. 1.71-1T(b) Q&A 13.

    b. A divorce or separation instrument doesn't need to include a statement that the payor has no liability for payments after the payee's death if the liability for continued payments would then end under state law. I.R.C. § 71(b)(1)(D). It is strongly recommended, however, that the applicable divorce instrument should contain a provision stating that all alimony payments terminate upon the death of the payee spouse.

c. Payments that are to continue beyond the payee's death, in the form of substitute payments, lose their alimony status during life. Substitute payments are generally payments that increase in amount, become accelerated, or begin as a result of the payee's death. A facts-and-circumstances test is used to determine if payments are substitute payments. Reg §1.71-1T, Q & A 13-14.

i. Example. Under a divorce decree, H will pay W annual alimony payments of $20,000 terminating on the earlier of 15 years or W's death. If W dies before the end of the 15-year period, H will pay W's estate the difference between the total amount that H would pay if W survived the entire period and the amount actually paid. Result: None of the payments qualify as alimony.

6. Payments can't be treated as child support. I.R.C. § 71(c), Treas. Reg §1.71-1T, Q & A 15-18.

a. A payment which under the terms of the divorce or separation instrument is fixed (or treated as fixed) as payable for the support of a child of the payor spouse does not qualify as an alimony or separate maintenance payment. Treas. Reg. § 1.71-1T(b), Q&A 15.

b. When a payor who is required to pay both alimony and child support hasn't made all required payments during the year, the rule is that regardless of how the payments are designated, they are first considered to be child support until the entire child support obligation for the year is met. Only then any payments made in excess of required child support are treated as alimony. Thus, no alimony deduction is available until all the child support for the year is paid. I.R.C. § 71(c)(3). The only way for the payor spouse to reduce his child support payments and still get the full alimony deduction is by modifying the divorce instrument to reduce the child support obligation.

7. The parties must file separate income tax returns. I.R.C. § 71(e).

a. The payor must include the payee's social security number on his or her first tax return for the taxable year in which the payment is made. The payee is required to furnish this number to the payor. I.R.C. § 215(c); Treas. Reg. 1.215-1T, Q&A 1.

III. Recapture of alimony and separate maintenance payments.

Payments can't violate excess front-loading rules set in I.R.C. § 71(f).

1. "Excessive alimony" determined under rules of section 71(f) will be recharaterized as a property settlement. The excess alimony payment will be included in the taxable income

of the payor spouse and will be deducted in computing the adjusted gross income of the payee spouse, all in the third post-separation year.

2. The alimony recapture rule exists to prevent taxpayers from "disguising" otherwise nondeductible property settlement payments as alimony payments by attempting to "front-load" and deduct property settlement payments that are purportedly characterized as alimony.

3. The recapture rule applies with respect to excess amounts of alimony payments made in the first and the second post-separation years whether or not alimony payments are actually made in the second or third post-separation years. I.R.C. § 71(f)(6).

4. The payor spouse is subject to the recapture rule in the third post-separation year if
    a. the alimony the payor spouse paid in the third post-separation year decreases by more than $15,000 from the second post-separation year or
    b. the alimony the payor spouse paid in the first post-separation year exceeds the average annual payments made in second and third post-separation years by more than $15,000.

5. The reasons for a reduction or termination of alimony payments that can require a recapture include:
    a. A change in divorce or separation instrument,
    b. A failure to make timely payments,
    c. A reduction in payor's ability to provide support, or
    d. A reduction in payee's support needs.

6. The recapture amount is the sum of:

    a. The excess of the amount of alimony during the first post-separation year over the sum of $15,000 plus the average of:
        i. alimony payments paid by the payor during the second post-separation year reduced by excess payments for the second post-separation year and
        ii. alimony payments paid by the payor during the third post-separation year, and

    b. excess payments for the second post-separation year.

7. The first post-separation year is the first calendar year in which the payor spouse paid alimony to the payee spouse. The second and third post-separation years are the succeeding calendar years. I.R.C. § 71(f)(6).

8. The payor spouse is, in effect, allowed to pay up to $15,000 of excess alimony in each of the first two post-separation years without recapturing the excess.

9. A Two-Step Process to Determine Excess Alimony Payments:

    a. Step One: Compare the aggregate amount of alimony payments in the third post-separation year to the aggregate alimony payments made in the second post-separation year. If the payments in the second post-separation year exceed the aggregate payments in the third post-separation year by more than $15,000, the excess over $15,000 is subject to recapture in the third post-separation year. I.R.C. § 71(f)(4).

    b. Step Two: Compare the aggregate amount of alimony payments made in the first post-separation year to the average of the aggregate amount of the non-excessive alimony payments made in the second post-separation year and the alimony payments made in the third post-separation year. If the payments in the first post-separation year exceed the average of the non-excessive payments in the second post-separation year plus the payments made in the third post-separation year by more than $15,000, the excess over $15,000 is subject to recapture in the third post-separation year. I.R.C. § 71(f)(3).

10. Example: If the payments are $50,000 in the first year, $20,000 in the second year, and nothing in the third year, the recapture amount will consist of $5,000 from the second year (the excess of $20,000 over $15,000) plus $27,500 for the first year (The excess of $50,000 over the sum of $15,000 plus $7,500. The $7,500 is the average payments for years two and three after reducing the payments by the $5,000 recaptured from year two.)

11. Exceptions to the alimony recapture rules.

    a. Payments in the three post-separation years are under $15,000 per year.
    b. Payments terminate because either spouse dies before the end of the third post-separation year. I.R.C. § 71(f)(5)(A)(i), (ii).
    c. Payments terminate because the payee spouse remarries before the end of the third post-separation year. I.R.C. § 71(f)(5)(A)(i),(ii).
    d. Payments are made under a support decree or order and are, thus, not considered alimony for purposes of the recapture rules.
    e. Payments aren't alimony for recapture purposes because made under a liability to pay a fixed portion of income from a business or property, or from compensation for employment or self-employment. I.R.C. § 71(f); Temp Reg. §1.71-1T, Q&A, 19-25. For this exception to apply, the fixed liability must extend at least three years.

12. Strategies to avoid the alimony recapture rules:

    a. Structure the payments to avoid triggering recapture rules.
    b. Structure the payments with equal payments of alimony made over at least three years.
    c. Structure the payments with an increase in payments over the three-year period.

d. The agreement can provide that the obligation of the payor spouse to make payments of alimony terminates upon the death of the payee spouse, and the payee spouse in fact dies during the three year "testing" period.

CHILD SUPPORT

1. A payment which under the terms of the divorce or separation instrument is fixed (or treated as fixed) as payable for the support of a child of the payor spouse doesn't qualify as an alimony or separate maintenance payment. I.R.C. § 71(c)(1); Treas. Reg §1.71-1T, Q & A 15.
2. Payments made for child support aren't deductible by the payor spouse and aren't taxable income to either the payee spouse or to the child. I.R.C. § 71(c)(1); Treas. Reg §1.71-1T, Q & A 15.
3. A payment is fixed as payable for the support of a child of the payor spouse if the divorce or separation instrument specifically designates some sum or portion as payable for the support of a child of the payor spouse. Treas. Reg §1.71-1T, Q & A 16.
    a. The concept of a "fixed" payment refers to a determinable payment for child support, rather than a specific amount. The actual amount of a payment can fluctuate.
4. Contingency rule
    a. A payment will be treated as a payment for child support and won't qualify as alimony if the payment is reduced
        i. on the happening of a contingency relating to a child of the payor, or
        ii. at a time which can clearly be associated with such a contingency.
    b. Contingency rule will apply even if other separate payments are specifically designated as child support payments.
    c. A contingency relates to a child of the payor if it depends on any event relating to that child, regardless of whether such event is certain or likely to occur.
        i. Events that relate to a child of the payor include the following:
            1. the child's attaining a specified age or income level,
            2. dying,
            3. marrying,
            4. leaving school,
            5. leaving the spouse's household, or
            6. gaining employment.
        ii. Example: A payment designated as "alimony" terminated upon the 18th birthday of a child. Despite the designation, the payment was treated as a child support payment. Hammond v. Commissioner, TC Memo 1998-53.

d. There are two situations in which payments that would otherwise qualify as alimony will be presumed to be reduced at a time "clearly associated" with a contingency relating to the payor's child.

    i. There's a rebuttable presumption that payments are for child support if they are to be reduced within six (6) months of the payor's child attaining age 18, 21, or the local age of majority.

    ii. A rebuttable child support presumption also applies if the payments are to be reduced at least twice within one year before or after a different child of the payor attains a certain same age between the ages of 18 and 24 (the age involved must be the same for each child).

e. In all other situations, reductions in payments won't be treated as clearly associated with the happening of a contingency relating to the payor's child.

f. The presumption in the two situations that payments are to be reduced at a time clearly associated with the happening of a contingency relating to a child of the payor may be rebutted (either by the Service or by taxpayers) by showing that the time at which the payments are to be reduced was determined independently of any contingencies relating to the children of the payor. The presumption in the first situation will be rebutted conclusively if the reduction is a complete cessation of alimony or separate maintenance payments during the sixth post-separation year or upon the expiration of a 72-month period. The presumption may also be rebutted in other circumstances, for example, by showing that alimony payments are to be made for a period customarily provided in the local jurisdiction, such as a period equal to one-half the duration of the marriage. Treas. Reg. §1.71-1T, Q & A 18.

    i. Example. A and B are divorced on July 1 of year 1. At that time they have two children. The divorce decree provides for alimony payments from A to B of $3,000 per month, but the payments are to be reduced to $2,000 per month on Jan. 1 of year 6, and to $1,000 per month on Jan. 1 of year 10. On the first reduction date (Jan. 1 of year 6) one of the children will be 20 years, 5 months and 17 days old. On Jan. 1, year 10, the second reduction date, the other child will be 22 years, 3 months and 9 days old. Since the reductions each occur not more than one year after a different child reaches the age of 21 years and 4 months, they are presumed to be clearly associated with a contingency relating to the children.

5. If a payment is recharacterized as child support, defeating an attempted characterization of it as alimony, an amount equal to the reduction in alimony is treated as child support from the outset, causing both the payor and payee spouse to possibly be required to amend a number of their income tax returns.

6. The IRS may seize an income tax refund to pay a parent's delinquent child support obligation. I.R.C. § 6305 and 6402(c); Reg. 301.6305- 1(b)(4)(iii).

PROPERTY SETTLEMENT ISSUES IN DIVORCE AND SEPARATION

1. Property transfers between spouses during marriage, or between former spouses incident to a divorce, are nontaxable. I.R.C. § 1041.
2. "Property" includes all property, whether real or personal, tangible or intangible, or separate or community.
3. The rule applies to property acquired before, during or after the end of a marriage and transferred to a former spouse. It applies regardless of whether the transfer is of property separately owned by the transferor, or is a division (whether equal or unequal) of marital property or community property. Treas. Reg. § 1.1041-1T(a), Q&A 5.
4. I.R.C. § 1041 does' t apply to services. If the transferor spouse performs valuable services for or on behalf of the payee spouse, gain would be recognized by the payee spouse. Treas. Reg. § 1.1041-1T(a), Q&A 4.
5. Transfer incident to a divorce requirement.
    a. A transfer is incident to a divorce if
        i. it occurs within one year after the date on which the marriage ceases (whether or not made pursuant to a divorce or separation instrument, and regardless of whether the marriage ends by divorce, annulment, or as the result of the violation of state law), or
        ii. it's related to cessation of the marriage. Transfers are related to cessation of the marriage if they are
            1. pursuant to a divorce or separation instrument, defined in I.R.C. 71(b)(2), and
            2. occur within 6 years of the cessation of the marriage. Treas. Reg. § 1.1041-1T(b), Q&A 7.
    b. Transfers are presumed not to be related to cessation of marriage if they don't meet six year or divorce or separation instrument requirements.
        i. The presumption may be rebutted by showing that the transfer was made to effect a division of property owned at cessation of the marriage. For example, a rebuttal could show legal or business impediments prevented the transfer during the 6 year period, or disputes concerning the value of the property delayed the transfer, and that prompt transfer occurred after the impediment was removed. Treas. Reg. § 1.1041-1T(b) .

6. Tax consequences.

    a. The transferor spouse will recognize neither gain nor loss on the transfer. I.R.C. § 1041(a)(1) and (2); Treas. Reg. § 1.1041-1T, Q&A 10.

        i. This nonrecognition rule applies even if the parties are acting at arms' length and if the transferee pays full consideration for the property, whether in cash, in exchange for the release of marital rights, or by the assumption of liabilities. Reg. § 1.1041-1T(a), Q&A 2; Reg. § 1.1041-1T(d), Q&A 11.

    b. The transferee spouse does not pay income tax on the value of the property received.

    c. The transferee has a carryover basis equal to the adjusted basis of the property in the hands of transferor immediately before transfer, and pays the tax on any appreciation when the property is sold.

        i. This applies whether the carryover basis is less than, equal to, or greater than the fair market value (FMV) at transfer.

        ii. Nontaxable treatment extends to transfers for cash or other property, the assumption of liabilities in excess of basis, or any other consideration. Even if liabilities on the property exceed the adjusted basis, they have no effect on the carryover basis. Treas. Reg §1.1041-1T(d).

        iii. Note: These rules differ from those used for determining the basis of property acquired by gift under I.R.C. § 1015.

            1. Under the basis rules for gifts, if the transferor's basis in the property is greater than its FMV at the time of the gift, then for the purpose of determining transferee's loss from the property the basis is FMV at transfer. But, the property's basis in a transfer between spouses is the same for all purposes (figuring gain or loss): the transferee spouse gets the same basis transferor had, even though transferee spouse treats the property as a gift.

7. Transfers to third parties on behalf of spouse.

    a. Transfers to a third party on behalf of a spouse (or former spouse) qualify for I.R.C. § 1041 nonrecognition treatment if:

        i. the transfer is required by a divorce or separation instrument;

        ii. the transfer is made at the written request of the other spouse; or

        iii. the transferor gets a written consent or ratification from the other spouse. Temp Reg §1.1041-1T(c), Q&A 9.

1. The consent or ratification must state that the parties intend the transfer to be treated as a transfer to the transferee spouse subject to the rules of Section 1041. The writing must be received by the transferor spouse prior to the date of filing the transferor's first income tax return for the taxable year in which the transfer was made. Reg. 1.1041-1T(c), Q&A 9.

b. The above rules don't apply to redemptions of stock owned by a spouse or former spouse. Reg §1.1041-1T(c), Q&A 9.

c. In a circumstance of the third party transfer, the transfer of property is treated as made directly to the transferee spouse, and such spouse is further treated as immediately transferring the property to the third party.

d. Note, however, that if there is a sale of marital property to a third party resulting in a division of the sale proceeds between the spouses, this is not viewed as a "transfer of marital property incident to a divorce", and is treated as any similar transaction not governed by Section 1041 would be.

i. Example: The divorce decree ordered the sale of the asset and the division of the proceeds. This would not be covered by section 1041; therefore, the parties would report gain or loss on the sale as would be the case in any non-divorce context.

8. <u>Transfers of property into trusts.</u>

a. Transfers in trust are frequently utilized in the context of divorce and separation. A trust provides the recipient spouse with a regular source of funds, rather than the payor spouse's unfunded promise to make alimony payments. Most transfers in trust fall under the rules of I.R.C. § 1041(e) and doesn't result in the recognition of any gain or loss to the transferor.

b. For income tax purposes, I.R.C. § 682 applies to trusts involved in a divorce or separation, not I.R.C. § 71. Note that the use of a trust avoids most of the alimony restrictions contained in I.R.C. § 71:

i. a trust may be designed to continue payments to the estate of the payee spouse, or to his or her beneficiaries.

ii. a trust may make decreasing payments to a spouse without any concern for recapture.

iii. A trust may provide lifetime support for a divorced spouse, or it may provide for payments for a fixed period of time, followed by a reversion to the transferor spouse (or such person's estate) or a payment to the transferor's children.

9. Life Insurance Policies.

    a. Transfer of a life insurance policy pursuant to divorce, even though made for consideration, does not trigger the transfer for value rule of I.R.C. § 101(a)(2), since I.R.C. § 1041 gives the transferee spouse a carryover basis in the property and negates the operation of the transfer for value rule.

10. Interests in IRAs.

    a. Transfers of interests in an IRA to a spouse or former spouse are treated as nontaxable transfers provided that the transfer is pursuant to a decree of divorce or separate maintenance or a written instrument incident to such a decree. I.R.C. § 71(b)(2)(A).

    b. Note that a transfer in accordance with a written separation agreement is not sufficient to achieve a nontaxable transfer of an IRA. An IRA transfer should be done via direct transfer (trustee-to-trustee). If the account owner takes a distribution from the IRA in the form of a check to the ex-spouse, that account owner will be taxed on that distribution.

    c. Once transferred under a divorce or separation agreement, the participant's interest in the IRA is treated as owned by and taxable to the transferee spouse. I.R.C. § 408(d)(6); Treas. Reg. 1.408-4(g)(1).

11. Interests in Qualified Retirement Plans.

    a. As a general rule, the ERISA rules prohibit the transfer ("alienation") of qualified retirement plans. However, in order to facilitate matrimonial settlements where qualified plans are involved, transfers of interests in qualified retirement plans may be made when they are in the form of a Qualified Domestic Relations Order (QDRO) that satisfies the requirements of ERISA. I.R.C. §§ 401(a)(13)(A) and 414(p).

    b. The transferee spouse is referred to as an "alternate payee" of the qualified plan.

    c. If the plan terms permit, a QDRO may provide for the payment of plan benefits that would be payable to the plan participant to an alternate payee at any time.

    d. A QDRO may be written to direct payments to an alternate payee prior to the time that the plan could make payments to a participant, Reg. 1.401(a)-13(g)(3), or at the earliest retirement age permitted under the plan. I.R.C. § 414(p)(4).

12. S Corporation Shares.

    a. Where S corporation stock is transferred pursuant to a divorce, any suspended losses incurred by the transferor are transferred to the transferee. I.R.C. § 1366(d)(2)(B).

13. Recapture of Depreciation, Investment Tax Credits.

    a. The transfer of property incident to divorce will not result in the recognition of depreciation or investment tax credit recapture, (even if the property is Section 1245 or Section 1250 property), since no gain or loss, including depreciation recapture, is triggered by I.R.C. § 1041, since the transfer is treated in the same manner as a disposition by gift.

14. Nonresident aliens.

    a. I.R.C. § 1041(a)(1) doesn't apply where the transferor's spouse is a nonresident alien. This rule has been extended to transfers to a former spouse incident to divorce. Gain or loss is recognized (if no other nonrecognition provision applies) at transfer if the property is transferred to a spouse who is a nonresident alien. Reg §1.1041-1T(a) .

15. Recordkeeping requirement.

    a. A transferor under I.R.C. § 1041 must, at transfer, supply the transferee with records to determine the adjusted basis and holding period as of the transfer date. If there is a potential for recapture of investment tax credit, records must be supplied to determine the amount and period of liability. Reg §1.1041-1T(e) .

FILING STATUS ISSUES FOR DIVORCED AND SEPARATED TAXPAYERS.

I. Marital status.

1. In general, the filing status depends on spouses' marital status. Marital status is determined under state or foreign law.
2. Taxpayers living together in a common law marriage that is recognized by the state law of their domicile or the state where the marriage began, are treated as married. Rev. Rul. 58-66.
3. Same-sex couples, legally married in jurisdictions that recognize their marriages, are treated as married for federal tax purposes. Rev. Rul. 2013-17. The ruling applies regardless of whether the couple lives in a jurisdiction that recognizes same-sex marriage or a jurisdiction that does not recognize same-sex marriage.
4. Spouses who are legally separated under a final decree of divorce or separate maintenance are not considered married for tax purposes. I.R.C. § 7703(a)(2).
5. Marital status for the entire tax year is determined on the last day of the taxable year (which is December 31 for calendar year taxpayers, and a person's date of death if he or she dies during the year). I.R.C. § 7703(a)(1).

6. If, as of the end of the tax year, there has been no "final" decree of divorce, annulment or separate maintenance, then the spouses are still considered as married even if they are separated from your spouse under a separation agreement or a non-final court decree.

II. Married Filing Jointly.

1. A joint return may only be filed by those taxpayers who are married at the close of a tax year. I.R.C. § 6013(a).
2. Joint return filing subjects both filers to joint and several liability for all taxes, interest and penalties due in connection with the return. Joint and several liability means that each taxpayer is legally responsible for the entire liability. Thus, both spouses on a married filing jointly return are generally held responsible for all the tax due even if one spouse earned all the income or claimed improper deductions or credits. This is also true even if a divorce decree states that a former spouse will be responsible for any amounts due on previously filed joint returns.
3. In some cases a spouse can get relief from joint and several liability. I.R.C. § 6015.
4. The IRS may attempt to collect all of any balance due from either spouse, notwithstanding any agreement between the spouses as to which will be responsible for federal tax obligations. I.R.C. § 6013(d)(3).
5. Joint return filing precludes deducting a payment to the recipient as alimony, and permits the recipient to not include the payment as income. I.R.C. § 71(e).
6. The parties should evaluate their relative marginal tax brackets, risks of audit and non-payment to determine the advantages and disadvantages of filing jointly or separately.

III. Married Filing Separately.

1. If persons are legally married and do not file a joint return, and if neither of them qualifies as “unmarried”, each of the spouses must file a separate return under filing status “married filing separately.”
2. Spouses who file their returns as married filing separately are not responsible for the tax liabilities of the other spouse. I.R.C. § 6013(d)(3).
3. A spouse who makes an alimony payment prior to divorce must file a separate return to deduct the alimony payments made during the year. I.R.C. §§ 71(e), 215.
4. If one spouse filing as married filing separately itemizes deductions, the other must do so as well - unless the non-itemizer qualifies for head of household status, in which case the standard deduction may be claimed.

IV. Abandoned Spouse Rule

1. Individuals treated as unmarried under this "abandoned spouse" rule can use the single or head of household rates.
2. A married person is considered single for tax purposes if the person meets all of the following tests (I.R.C. § 7703(b); Treas. Reg. § 1.7703-1(b)):
    a. Files a separate return.
    b. Maintains as his home a household that for more than half the tax year is the principal place of abode of a child for whom the person is entitled to a dependency deduction for the year, or would be so entitled if the person hadn't released the exemption to the noncustodial parent. I.R.C. § 7703(b)(1).
    c. Furnishes over half the cost of maintaining the household. I.R.C. § 7703(b)(2).
    d. During the last six months of the tax year, the person's spouse isn't a member of his household. I.R.C. § 7703(b)(3).
3. Either or both spouses can qualify as "unmarried" by meeting the test. If only one spouse qualifies, the other spouse must use married-filing-separately rates.
4. A person who doesn't meet the abandoned spouse rule is considered married even though living apart from his spouse, unless legally separated under a decree of divorce or separate maintenance. Treas. Reg. § 1.7703-1(a).

V. Head of Household.

1. A taxpayer who is unmarried must file either as an unmarried (single) individual or as a head of household.
2. The persons eligible to file as head of household are generally divorced or single parents, or persons who are still married but who are separated awaiting a final divorce determination and who have minor children.
3. In addition to the advantage of lower marginal rates than single filers, the head of household filer is allowed to claim a larger standard deduction than single filers or married persons filing separately. The head of household filer is permitted to either itemize or claim the standard deduction, regardless of what his or her spouse elects to do. I.R.C. §§ 63(c)(2)(B), 63(c)(6) and 63(g).
4. A person filing as head of the household may be able to claim earned income credits and child care credits unavailable on the return of a married person filing separately.
5. To qualify as a head of household for a tax year, a taxpayer must:
    a. be unmarried (or treated as unmarried under abandoned spouse rule) at the end of the year;

b. not be a surviving spouse;
c. not be a nonresident alien at any time that year; and
d. maintain a household:
    i. that's taxpayer's home, and for more than half of the tax year, the principal place of abode of
        1. the taxpayer's qualifying child or
        2. an individual for whom the taxpayer may claim a dependency deduction. I.R.C. § 2(b)(1)(A)), or
    ii. (not necessarily his own) that for the tax year is the principal place of abode for either the taxpayer's father or mother, if the person is entitled to a dependency deduction for that parent. I.R.C. § 2(b)(1)(B).

6. If the taxpayer receives alimony payments from his or her spouse and uses such payments to maintain the household, the taxpayer spouse will be considered as having furnished this amount, not the payor spouse.

7. The taxpayer claiming head of household status is not required to have custody of a child to be eligible to claim this filing status. Nevertheless, the time spent by a child at the parent's home is relevant to determine whether such home constitutes the principal residence of the child for more than one-half of the taxable year. Temporary absences may be relevant in making this determination, but should not be an issue where they are routine and not an indication of another place of residence of the child. Treas. Reg. § 1.2-2(c)(1).

RELIEF FROM JOINT AND SEVERAL LIABILITY

The IRS Restructuring and Reform Act of 1998, P.L. 105-206, expanded relief from joint and several liability into three categories:

a. innocent spouse relief - I.R.C. § 6015(b);
b. separation of liability - I.R.C. § 6015(c); and
c. equitable relief - I.R.C. § 6015(f).

I. Innocent Spouse Relief under I.R.C. § 6015(b).

1. In order for a taxpayer to qualify for a relief under Code section 6015(b)(1), the taxpayer must meet all of the following requirements:
    a. File a joint return for a taxable year in issue;
    b. There is an understatement of tax attributable to erroneous items of nonrequesting spouse;
    c. In signing the return the requesting spouse did not know and had no reason to know that understated tax existed; and

d. Taking into account all the facts and circumstances, it would be unfair to hold the requesting spouse liable for the deficiency in tax attributable to understatement.

2. Relief under Code section 6015(b) is available if the requesting spouse makes an election within two (2) years after IRS begins collection activities with regard to the requesting spouse.

3. If the requesting spouse meets I.R.C. § 6015(b) requirements, the spouse is relieved of liability of tax attributable to an understatement, plus any related interest, penalties, and interest. If the requirements aren't met with respect to the entire liability, relief regarding a portion of the liability may be granted. I.R.C. § 6015(b)(2).

4. For purposes of sections 6015(b) and 6015(c), an "understatement" is that portion of the amount required to be shown on the return for the taxable year which exceeds the amount of tax imposed that already shown on the return.

5. <u>Knowledge element.</u>

    a. A requesting spouse has knowledge or reason to know of an understatement in two circumstances:

        i. the requesting spouse actually knew of the understatement, or

        ii. a reasonable person in similar circumstances would have known of the understatement at the time the return was signed. Treas. Reg. § 1.6015-2(c).

    b. All facts and circumstances are relevant in determining whether a spouse has actual knowledge or reason to know of an understatement at the time the return was signed. Treas. Treas. Reg. § 1.6015-2(c) and Treas. Reg. § 1.6015-3(c)(2).

    c. Treas. Reg. § 1.6015-3(c)(2) identifies the following factors for determination whether the requesting spouse had actual knowledge of an understatement:
        i. the requesting spouse made a deliberate effort to avoid learning about an item in order to avoid joint liability; and
        ii. the requesting spouse and the nonrequesting spouses jointly owned the property that resulted in the erroneous item.

    d. Treas. Reg. § 1.6015-2(c) identifies several facts and circumstances on which IRS may rely in determining whether a requesting spouse had reason to know of an understatement at the time the return was signed:
        i. The nature of the erroneous item and the amount of the erroneous item relative to other items;
        ii. The couple's financial situation;
        iii. The requesting spouse's educational background and business experience;
        iv. The extent of the requesting spouse's participation in the activity that resulted in the erroneous item;

v. Whether the requesting spouse failed to inquire, at or before the time the return was signed, about items on the return or omitted from the return that a reasonable person would question; and
vi. Whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns.

6. All facts and circumstances are relevant in determining whether it is inequitable to hold a requesting spouse jointly and severally liable for an understatement. Treas. Reg. § 1.6015-2(c). The relevant facts include:
    a. The requesting spouse significantly benefitted, directly or indirectly, from the understatement;
    b. The requesting spouse has been deserted by the nonrequesting spouse; and
    c. The requesting spouse received benefit on the return from the understatement.

II. Separation of Liability Relief under I.R.C. § 6015(c).

1. The request to have a separate determination of the requesting spouse's deficiency under I.R.C. § 6015(c) is available only to a spouse who:
    a. Is no longer married to the nonrequesting spouse (divorced or widowed), or is legally separated; or
    b. Has not been a member of the same household as the nonrequesting spouse at any time during the twelve-month period ending on the date of the filing of the election for relief.
2. Relief by separation of liability under I.R.C. § 6015(c) is not available if:
    a. the requesting and nonrequesting spouses transferred assets to one another as part of a fraudulent scheme;
    b. at the time of signing a tax return, the requesting spouse had actual knowledge of any erroneous items giving rise to the deficiency that were allocable to the nonrequesting spouse; or
    c. the nonrequesting spouse transferred property to the requesting spouse to avoid tax or the payment of tax.
3. Knowledge element.
    a. In the case of omitted income, knowledge of the item includes knowledge of the receipt of the income. Treas. Reg. § 1.6015-3(c)(2).
    b. In the case of an erroneous deduction or credit, knowledge of the item means knowledge of the facts that made the item not allowable as a deduction or credit. Treas. Reg. § 1.6015-3(c)(2).

c. If a deduction is fictitious or inflated, IRS must establish that the requesting spouse actually knew that the expenditure wasn't incurred, or not incurred to that extent. Treas. Reg. § 1.6015-3(c)(2).

4. An election to allocate a deficiency limits the requesting spouse's liability to that portion of the deficiency allocated to the requesting spouse. Treas. Reg. § 1.6015-3(d)(1).
    a. Erroneous items of income are allocated to the spouse who was the source of the income.
    b. Wage income is allocated to the spouse who performed the services producing such wages.
    c. Items of business or investment income are allocated to the spouse who owned the business or investment.
    d. Erroneous deductions related to a business or investment are allocated to the spouse who owned the business or investment.
5. Relief under Code section 6015(c) is available if the requesting spouse makes an election within two (2) years after IRS begins collection activities with regard to the requesting spouse.

III. Equitable Relief under I.R.C. § 6015(f).

1. If the requesting spouse does not qualify for innocent spouse relief (I.R.C. § 6015(b)) or separation of liability relief (I.R.C. § 6015(c)), the spouse may still be relieved of responsibility for tax, interest, and penalties through equitable relief under I.R.C. § 6015(f).
2. Unlike innocent spouse relief or separation of liability relief, the requesting spouse can get relief from an unpaid tax. An unpaid tax is an amount of tax the spouses properly reported on their return but have not paid.
3. In order to be considered for equitable relief from joint and several liability, the requesting spouse should meet all of the following threshold conditions:
    a. The requesting spouse filed a joint return for the taxable year for which the relief is sought;
    b. Relief is not available to the requesting spouse under section 6015(b) or 6015(c) of the Code;
    c. No assets were transferred between the spouses as part of a fraudulent scheme by the spouses;
    d. The nonrequesting spouse did not transfer disqualified assets to the requesting spouse;
    e. The requesting spouse did not file or fail to file the return with fraudulent intent; and

f. The income tax liability from which the requesting spouse seeks relief is attributable to an item of the nonrequesting spouse.

4. After the six threshold requirements are satisfied, the requesting spouse may be relieved of all or part of the liability if the IRS determines, taking into account all the facts and circumstances, that it would be inequitable to hold the requesting spouse liable.

5. IRS will make streamlined determinations granting equitable relief under I.R.C. § 6015(f), in cases in which the requesting spouse establishes that the requesting spouse:

    a. is no longer married to the nonrequesting spouse;

    b. would suffer economic hardship if relief were not granted; and

    c. did not know or have reason to know that there was an understatement or deficiency on the joint income tax return. Rev Proc 2013-34.

6. If a requesting spouse is not entitled to a streamlined determination because the requesting spouse does not satisfy all the elements, the revenue procedure provides a nonexclusive list of factors that will be taken into account in determining whether to grant full or partial equitable relief. No one factor is determinative and all factors will be considered and weighed appropriately.

7. Equitable factors include:

    a. Marital status. Whether the requesting spouse is no longer married to the nonrequesting spouse as of the date the IRS makes its determination.

    b. Economic hardship. Whether the requesting spouse will suffer economic hardship if relief is not granted.

    c. Knowledge or reason to know.

        i. Understatement cases. Whether the requesting spouse knew or had reason to know of the item giving rise to the understatement or deficiency as of the date the joint return (including a joint amended return) was filed, or the date the requesting spouse reasonably believed the joint return was filed.

        ii. Underpayment cases. In the case of an income tax liability that was properly reported but not paid, whether, as of the date the return was filed or the date the requesting spouse reasonably believed the return was filed, the requesting spouse knew or had reason to know that the nonrequesting spouse would not or could not pay the tax liability at that time or within a reasonable period of time after the filing of the return.

    d. Legal obligation. Whether the requesting spouse or the nonrequesting spouse has a legal obligation to pay the outstanding federal income tax liability.

e. Significant benefit. Whether the requesting spouse significantly benefited from the unpaid income tax liability or understatement.

f. Compliance with income tax laws. Whether the requesting spouse has made a good faith effort to comply with the income tax laws in the taxable years following the taxable year or years to which the request for relief relates.

g. Mental or physical health. Whether the requesting spouse was in poor physical or mental health.

8. IRS Notice 2011-70 expanded a two-year limitation for filing the request for equitable relief. Under the new rules the equitable relief must be filed within ten (10) years from the date the tax liability was assessed or, if there is a claim for credit or refund, either within three (3) years after the date of original return was filed or two (2) years after the date the tax was paid, whichever is later.

IV. Procedure.

1. To seek innocent spouse relief, separation of liability relief, or equitable relief, a requesting spouse should submit to the IRS a completed Form 8857, Request for Innocent Spouse Relief, or a written statement containing the same information required on Form 8857, which you sign under penalties of perjury.
2. Refer to Publication 971, Innocent Spouse Relief, for more information.
3. IRS is required to notify the spouse with whom a requesting spouse filed the joint return of the request and allow him or her to provide information for consideration regarding the relief claim.

V. Drafting example.

1. Divorce instrument can be drafted to support pending or potential request for relief from joint and several tax liability by spouses.
2. The following example of separation agreement's language was drafted to support Wife's innocent spouse relief request, where Husband is self-employed and claims his business income and expenses on Schedule C of the couple's joint tax returns; Wife had no involvement in the Husband's business.

> "Husband acknowledges that Wife did not have personal knowledge with respect to the business expense deductions of Husband's businesses as reported on the joint income tax returns; that she did not review his business records regarding said deductions; and that when she signed the returns Wife did not know, and had no reason to know, of the existence of the understated tax."

DEPENDENCY EXEMPTION

1. In general, a parent is entitled to a dependency exemption for a child who was under age 19 at the close of the year, or under age 24 and a full-time student, if the child had the same principal place of abode as the parent for more than half of the year and the child didn't provide more than half of his or her own support.
2. Only one parent may claim an exemption for each child.
3. If more than one parent can claim a child as a dependent under these rules, in most cases the exemption goes to the custodial parent.
    a. The custodial parent is the parent with whom the child resides for the greater number of nights during the calendar year. I.R.C. § 152(e)(4)(A); Reg. § 1.152-4(d). The test is based on the number of days of custody - not on the amount of support provided. Reg. § 1.152-4(b).
    b. For purposes of I.R.C. § 152(e), a child resides for a night with a parent if the child sleeps:
        i. At the residence of the parent, whether or not the parent is present, Treas. Reg §1.152-4(d)(1)(i); or
        ii. In the parent's company when the child does not sleep at the parent's residence. Treas. Reg §1.152-4(d)(1)(ii).
    c. Some special rules are provided for temporary absences, such as when a child is away at camp or while a parent is hospitalized. Under these rules, a child who doesn't reside with a parent for a night is treated as residing with the parent with whom the child would have resided for the night but for the absence. However, a child who doesn't reside with a parent for a night is treated as not residing with either parent for that night if it can't be determined with which parent the child would have resided or if the child would not have resided with either parent for the night. Treas. Reg §1.152-4(d)(3).
4. If a child is in the custody of one or both parents for more than one-half of the calendar year and the child resides with each parent for an equal number of nights during the calendar year, the parent with the higher adjusted gross income for the calendar year is treated as the custodial parent. Treas. Reg §1.152-4(d)(4).
5. <u>Release of claim to dependency exemption</u>
    a. Notwithstanding the rule providing that the parent with the greater amount of physical custody (the "over-night" rule) is entitled to the dependency exemption, such parent may agree to release that exemption to the other parent. In order to be eligible for this release, the following criteria must apply:

i. The parents are divorced or legally separated under a decree of divorce or separate maintenance, or are separated under a written separation agreement; or the parents lived apart at all times during the last six months of the calendar year. I.R.C. §§ 152(e)(1)(A)(i) through (iii).

ii. One or both parents provide more than half of the child's total support for the calendar year. I.R.C. § 152(e)(1)(A).

1. Support is determined by calculating the entire amount of support the child received from all sources, including child's income.

2. A payment of alimony is not treated as a payment for the support of a dependent. I.R.C. § 152(b)(4).

3. One or both parents have custody of the child for more than half of the calendar year. I.R.C. § 152(e)(1)(B).

4. The custodial parent signs a written declaration (IRS Form 8332) constituting an unconditional release that the custodial parent waives the right to claim the child as a dependent for any taxable year commencing with the year in which the declaration is executed. A custodial parent may also grant a release by executing a document that conforms to Form 8332.

a. A court order or decree or a separation agreement may not substitute for this declaration.

5. The noncustodial parent must attach the written declaration to his or her tax return for each year the noncustodial parent is claiming the exemption. I.R.C. § 152(e)(2); Reg. § 1.152-4T(a), Q&A 3.

b. The exemption may be released for one year, for a number of specified years, or for all future years, depending on the language of the written declaration. A specific year or series of years must be specified for this release to be effective. Reg. § 1.152-4T(a), Q&A 4; Treas. Reg. § 1.152-4(f) Ex. 7.

c. Since a release of the dependency exemption by a custodial parent applies for purposes of determining whether a child meets the definition of a qualifying child, it will also apply for the child tax credit. However, the release won't apply for purposes of the earned income credit, the child and dependent care credit, and head-of-household filing status, since the definition of "qualifying child" for those purposes is made without regard to the release provision. Conf Rept No. 108-696 (PL 108-311), p. 61.

d. Planning consideration. Where the custodial parent is receiving child support or alimony payments from the other parent, the custodial parent might prefer

granting the release only on an annual basis so he or she can refuse to do so if the other parent is delinquent.

e. Revoking a release.

i. A custodial parent may revoke a release that he or she previously made on Form 8332 or a similar statement. Part III of Form 8332 is used for this purpose. The custodial parent must attach a copy of the revocation to his or her return for each year he or she claims the child as a dependent as a result of the revocation.

ii. A revocation will be effective the year after the custodial parent gives notice of his or her intention to revoke a release to the noncustodial parent. Thus, if the custodial parent provided (or made reasonable efforts to provide) written notification of the revocation to the noncustodial parent in 2016, the revocation will be effective no earlier than 2017.

iii. The rules relating to release don't apply where, under the I.R.C. § 152(d)(3) rules for multiple support agreements, more than half of the child's support is treated as having been received from a taxpayer. (Code Sec. 152(e)(5))

6. Multiple support agreements

a. The parties may enter into a multiple support agreement. I.R.C. § 152(c). This is an exception to the general support test.

b. Multiple support agreement may arise where two or more people together pay over one-half the support of a child, but no one person alone pays more than one-half.

i. For example, a child lives with her grandparents. Her divorced parents each provide 35% of her support, and her grandparents provide 30%. Neither parent has custody, and neither provides more than half the child's support. A multiple support agreement could allow either parent or the grandparents to claim the dependency exemption.

c. In such circumstances, one of the payors may be treated as paying over one-half of the support of a child and may claim the child as a dependent if:

i. The taxpayer paid over 10% of the total support;

ii. If not for the support test, the taxpayer could satisfy the requirements for the dependency exemption with respect to the child;

iii. The claimant attached to his or her return a Form 2120, Multiple Support Declaration, signed by every other person meeting the requirements of (i) and (ii), above. The persons signing Form 2120 agree by signing the Form

that they will not claim the dependency exemption for that year. I.R.C. § 152(c)(1) through (4).

7. If the requirements of I.R.C. § 152(e) and the regulations relating to the custodial parent's release of the child's exemption apply, the child is treated as the dependent of both parents who are divorced, separated, or living apart for purposes of:

    a. the rules for excluding dependents' medical reimbursements;
    b. the exclusion for employer-provided accident or health plan coverage;
    c. the rules treating employee's relatives as employees for purposes of certain fringe benefits;
    d. the rules for deducting dependents' medical expenses;
    e. the exclusion of Archer medical savings account (MSA) distributions used to pay qualified medical expenses; and
    f. the exclusion of health savings account (HSA) distributions used to pay qualified medical expenses. Reg §1.152-4(f); Rev. Proc. 2008-48.

DEDUCTIBLE LEGAL FEES IN DIVORCE

1. Tax advice. The payment of legal fees for tax advice is deductible to the extent the lawyer's fee represents work done relating to these tax aspects.

2. Collection of taxable alimony. Legal fees incurred for the collection of taxable income are deductible. Under this tax principle, taxpayers can deduct that portion of legal fees in divorce relating to getting alimony. This covers the legal work involved in setting up the alimony payments (via the separation agreement or divorce decree). It also covers the legal fees incurred to enforce collection, if payments are missed. Conversely, however, the legal fees incurred by the paying party to resist alimony claims are nondeductible personal expenses.

3. Capitalization of legal fees. To the extent legal work is involved in acquiring marital assets in a divorce or separation, the allocable part of the fee can be added to the basis of the assets acquired. While this is not as favorable as a deduction, it should save taxes when the assets are eventually disposed of.

4. One of the most difficult elements in obtaining tax benefits from legal fees in connection with divorce is establishing what part of the fee to allocate to the deductible (or capitalizable) work. The burden is on the taxpayer to come up with an allocation. If all the taxpayer has is an unitemized legal bill ("For legal services rendered, $6,000"), the taxpayer may not be allowed any deduction. Therefore, it is important that an attorney itemizes the legal fees for tax advice.