Navigating Divorce – Tax and Litigation Issues

(NDTL4)

KAPLAN

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NAVIGATING DIVORCE – TAX AND LITIGATION ISSUES (NDTL4)
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Unit 1

Introduction

LEARNING OBJECTIVES

- Describe the services offered by CPAs in domestic relations engagements.
- Understand the professional standards applicable to domestic relations engagements.
- Identify and address conflicts of interest.
- Summarize the income tax issues for a practitioner to consider in divorce negotiations.

DOMESTIC RELATIONS LITIGATION

General

One of the most active litigation service areas involving accountants is domestic relations or divorce litigation. Attorneys turn to CPAs for a variety of services to help them successfully represent their client's interests. Among these services are:

1. calculation of the spouses' annual income, including salaries, bonuses, deferred compensation, fringe benefits, and other non-salary benefits;
2. preparation or verification of statements of assets and liabilities as of the date of separation of spousal interests specified in state law;
3. valuation of a business or professional practice and assistance to outside appraisers of assets; and
4. provision of guidance of tax strategies and planning, as they relate to alimony, child support, and equity distributions.

A variety of technical knowledge can come into play in any divorce situation, from auditing and accounting techniques, to in-depth tax and valuation alternatives. In addition, the CPA needs personal characteristics that facilitate working comfortably in situations where there is a great deal of animosity between the adversaries.

In domestic relations work, the CPA may serve as a consultant for the divorce attorney or expert witness. As a consultant, the CPA is engaged by the attorney to develop information that will be used by the attorney during settlement negotiations. Usually, the CPA is not expected to testify, and workpapers may be protected by attorney-client privilege. When engaged as an expert witness, the CPA is often deposed and required to testify, and all workpapers relating to the engagement are subject to discovery. Here is a list of suggestions for use in performing these services.

- **Get an engagement letter.** This letter should spell out what services are being offered, the retainer amount (there should usually be one), and the hourly rate. It should state that the fee is not dependent on the outcome of the engagement. It should also state that you are not responsible for the eventual outcome of tax strategies subject to IRS interpretation. Sample engagement letters appear at the end of this unit.

- **Give all advice in writing.** This will help to ensure against misunderstandings, which can be the source of professional liability claims.

- **You must be knowledgeable about state law relating to domestic relations.** You should make use of your contacts in the legal profession to acquire appropriate reference material on state statutes, state court decisions, and local court rules relating to domestic relations issues.

- **Know your tax law.** It is mandatory to be aware of the tax law relating to asset distributions, alimony, child support, and deferred compensation. Broad knowledge and background in general taxation are very desirable.

- **Communicate with the attorney.** Make sure the attorney is aware of what actions you are taking and why. Also, make sure you understand what the attorney expects from you.

- **Know who your client is.** Have an understanding with the attorney that is spelled out in your engagement letter. This may seem obvious, but there can be surprises. It is not uncommon for an accountant to provide tax advice to both parties. In such a situation, Treasury Circular 230, Section 10.29 requires Enrolled Agents and Certified Public Accountants to secure written conflict-of-interest waivers that must be retained for three years following the engagement.

- **Try to learn the attitudes of the couple.** This will help determine how adversarial or difficult your investigative work could be and what possible situations might arise during documentation requests, concerning time for research. If you are not provided with necessary documents, you cannot provide information to the attorney.

- **Gain as much information about the parties as circumstances permit.** Find out all you can about their lifestyles, hobbies, avocations, business backgrounds, and habits. This information can offer many possible clues about incomes and assets.

- **Try to determine what level of tax knowledge the parties and their divorce counsels have.** Do not assume they are aware of the tax consequences of the actions they are contemplating.

- **Prepare a record of separate and/or marital assets.** Include details such as cost basis, owner(s) of record, fair market value, and liquidity. Identify closely held business interests, deferred compensation, tax credits, and other tax attribute carryforwards. In some jurisdictions, domestic relations courts will also consider an asset's taxable status. For example, equity in a personal residence can usually be realized tax-free by either party, while proceeds from a retirement plan will be taxable.

Role of the Client's Accountant

- Assist an expert with tax advice on the financial consequences of any plan for the division of marital assets.
- Assist an expert in valuing a business by preparing historical financial data of the business and a description of the business.

Role of the Accountant Expert

- Assist in the identification and valuation of assets, review all financial data, assist legal counsel in the preparation of interrogatories, advise legal counsel at depositions of other experts, including at trial, and review the other accountant's expert report. Keep in mind that this gives the opposing side many opportunities to dispute tax opinions and methods or application to amounts of discounts. These two particular areas are highly contested in court cases; therefore, it is imperative that the expert be prepared to explain the methodologies and any opinion of value thoroughly.
- Provide tax and financial advice at the time of settlement.
- Evaluate opposing financial or tax expert witness opinions and methods.
- Review and analyze tax returns, financial statements, and other financial disclosures. Knowing "what" to look for requires knowledge and understanding of the tax returns you are reviewing. For example, there is no balance sheet shown with a Schedule C sole proprietorship, which makes this a perfect situation for possible hiding of assets.

Types of Engagements

- Valuations of Unique Assets
  - License, degree, or enhanced earning capacity
  - Professional practices
  - Closely held corporations
  - Pensions

- Tax Concerns
  - Deductibility of family support and/or maintenance
  - Recapture of front-loaded alimony
  - Spousal transfers
  - Retirement plans and deferred compensation
  - Stock options
  - Appreciation of property
  - Phantom income
  - Other
- Consultant
  - Assist in interpreting complex financial transactions
  - Prepare questions for cross-examination of other expert witnesses
  - Assist in preparing requests for production of documents
  - Assist in preparing interrogatories
  - Other

Items Lawyers Consider in Retaining Experts

- Prior association with the client is usually detrimental.
- Ability to speak clearly and articulate complex facts—often, it will be necessary to take complex issues and explain them in non-technical language. Juries, and sometimes judges, are not always knowledgeable about terms such as *discount rate*, *cap rate*, *QDRO*, etc. This presents an opportune time for you to educate and articulate these issues so the jury, and/or judge, will better understand the issue at hand.-Consequently, they will base their decisions on understandable facts and circumstances.
- Enthusiasm.
- Composure under fire of cross-examination—self-control is crucial. Quick temper, sarcasm, or disrespect will do nothing but possibly have a negative impact on your presentation to the court and their perception of your credibility. Remember, there are CLE courses teaching lawyers how to tear down an expert witness. Be prepared.

- Availability of time—if you are a competent and well-trained expert, you will be in demand. In order to keep up with the demand for your services, it may require hiring assistants to do the basics of analysis, especially when you have to work around the schedule of a court.
- Familiarity with the judicial process.
- Credentials—you must obtain a valuation credential if you intend to offer expert opinions on value. Attorneys who work in domestic relations litigation will tell you—judges respect those initials behind your name.

PROFESSIONAL GUIDELINES AND CONSIDERATIONS

Code of Professional Conduct of the American Institute of Certified Public Accountants

The principles provide the framework for rules that govern performance of professional services by members.

- **Responsibilities.** Members should exercise sensitive, professional, and moral judgment in all their activities in carrying out their responsibilities as professionals.
- **Public Interest.** Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.
- **Integrity.** Members should perform all professional responsibilities with the highest sense of integrity in order to maintain and broaden public confidence.
- **Objectivity and Independence.** Members should maintain objectivity and be free from conflicts of interest in discharging professional responsibilities. Members in public practice should be independent in fact and appearance when providing auditing and other attestation services.
- **Due Care.** Members should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibilities to the best of the member's abilities.
- **Scope and Nature of Services.** Members in public practice should observe the Code of Professional Conduct's principles in determining the scope and nature of the services that will be provided.

General Standards Rule [1.300.001]

A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council.

- **Professional Competence.** A member shall undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

- **Due Professional Care.** A member shall exercise due professional care in the performance of professional services.
- **Planning and Supervision.** A member shall adequately plan and supervise an engagement.
- **Sufficient Relevant Data.** A member shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

Statement on Standards for Consulting Services No. 1

Additional standards for Consulting Services address the distinctive nature of consulting services in which the client's understanding may establish valid limitations on the practitioner's performance of services.

- **Client Interest.** Serve the client's interest by seeking to accomplish the objectives established, by the understanding with the client, while maintaining integrity and objectivity.
- **Understanding with Client.** Establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of services to be performed. Modify the understanding if circumstances require a significant change during the engagement.
- **Communication with Client.** Inform the client:
  - Conflicts of interest that may occur pursuant to the "Integrity and Objectivity Rule" of the code (ET sec. 1.100.001 and 2.100.001)
  - Significant reservations concerning the scope or benefits of the engagement
  - Significant engagement findings or event

ADVICE FOR CPAS AND CLIENTS

Personal Issues

As a CPA advisor, the personal issues faced by those negotiating a divorce settlement are often the toughest issues to address.

- Keep your objectivity.
- Direct your client to beneficial resources.

Common Mistakes

You may want to share this list of mistakes others commonly make with your clients, so they can avoid the same errors.

- Divorcing people often give up control of their divorce. "Listen carefully to the advice of your lawyer and CPA, but it is your divorce, not your advisors'," is good advice.
- Prepare a thorough inventory. Before beginning negotiations, know what you own and what you owe.
- Do not spend too much money, letting professionals gather information. Avoid excessive discovery, including interrogatories, requests for production of documents, requests for admissions, and depositions. Discovery turns little cases into big cases. Perhaps you and your soon-to-be ex-spouse can simply exchange the needed information. Mediation can be used. Many financial preparation kits are available and could help avoid excessive professional fees.
- Do not let family and friends become legal or financial advisors. Rely on the professionals you have hired to help you.
- Pay attention to income taxes. Any negotiation must consider the tax cost of realizing asset values.

Nine Costliest Errors

The Institute for Divorce Financial Analysts lists the nine costliest errors when going through a divorce as follows:

1. Not Evaluating a Defined Benefit Pension Plan Correctly. Errors are caused by a number of mistakes:

   – Not understanding state law on the valuation of pensions. For example, at what date is the valuation to be based? What projections are to be made on continued salary increases? Against what number is the marital fraction to be applied?

   – Not understanding the pension plan. For example, is the retirement indexed to inflation? How is the ultimate retirement calculated? When is the earliest date the person can retire with an unreduced pension?

2. Not Understanding IRC §72(t)(2)(C). This tax rule says that funds distributed from a qualified plan to the non-employee spouse will not incur the 10% penalty even if that person is less than 59½ years old. Only regular income taxes will be due. (An IRA is not a qualified plan.) If the funds are transferred from the qualified plan of the paying spouse to an IRA for the receiving spouse, the 10% penalty will apply to early withdrawals and regular income taxes.

3. Not Understanding the Purpose of a QDRO [IRC §414(p)]. The Qualified Domestic Relations Order (QDRO) is a legal document that tells the plan administrator the amount (either percentage or dollar amount) to be paid to the non-employee spouse pursuant to the divorce. Many plans do not allow for a QDRO, and the plan document takes precedence over a court order. Plan documents must be reviewed to ascertain how that plan handles a division of retirement assets in the case of divorce. A QDRO should only be prepared by an attorney familiar with this special order for the division of qualified plan assets. The IRS provided sample language for a QDRO in Notice 97-11, 1997-2 IRB 1. Missing the benefit of a QDRO because the wrong language, or no language, was used in the controlling document will be grounds for a claim of professional negligence.

4. Not Protecting the Survivor Benefits of the Non-Employee Spouse. Whether the ex-employee spouse dies before or after the pension starts paying out to the non-employee spouse, these benefits should be protected in the QDRO language.

5. Violating the Front Loading of Alimony Rule. IRC §71(f) was created to curtail the disguise of a non-deductible property settlement as deductible alimony payments. IRC §71(f) basically says that if alimony is more than $15,000 per year, and the payer of alimony wants to deduct the whole amount, alimony needs to be paid for at least three years. The amount can change, but if alimony drops by more than $15,000 from one year to the next, some portion of earlier deductions must be *recaptured* as income in a later year.

6. Not Understanding the Link Between Term of Alimony and Child Support

   – IRC §71(c)(2)(A) says payments that end, or are reduced on the happening of a contingency related to an event in the life of a child, are not alimony (therefore, not deductible by the payor).

   – IRC §71(c)(2)(B) says if any amount will be reduced at a time that "can be clearly associated with a contingency of a type" specified in subparagraph (A), it be recharacterized as child support and may not be deducted by the payor.

   Reg. §1.71-1T, Q&A 18 explains two situations as examples of the kind of complex calculation that may be needed to determine a reduction of deductible alimony required by the law.

7. Not Insuring Alimony. Three common methods of insuring alimony are:

   a. by life insurance;

   b. by disability insurance; and

   c. by purchasing an annuity which will pay out the alimony.

8. Not Understanding That the Wife Should Not Always Get the House. Many women count on alimony to support a very high house payment, which is often two to three times what they could pay in rent. This does not make good financial planning sense. One can never count on alimony.

9. Not Considering the Basis in Property. It should be taken into consideration when property is divided if the recipient plans to sell property that has a low basis that will trigger income tax.

CONFLICTS OF INTEREST

When clients are terminating a marriage, the CPA advisor should consider:

- severing the relationship with one of the parties (do so in writing);
- withdrawing completely, especially if objectivity may be lost (in the case of friends or persons associated through investments or club memberships; or
- having both parties sign a waiver of conflict of interest. (Most divorce attorneys will advise their clients against signing such a waiver.)

TAX CONSEQUENCES OF DIVORCE

There are three types of property transfers or payments of money incident to a divorce that are of particular tax consequence:

1. Alimony (spousal support)
2. Child support
3. Transfers pursuant to a property settlement

Each will be examined in subsequent chapters.

SAMPLE ENGAGEMENT LETTER

Month/Day/Year

Susan S. Smith
888 Bexton Drive
Anytown, USA 12345

Re: Smith vs. Smith

Dear Ms. Smith:

This letter constitutes an agreement between Susan S. Smith and Nichols CPA, Inc., under which we will provide consulting services to you in connection with the divorce litigation referenced above. Our services will be directed by your attorney, Jane D. Donahue, Esquire, and accordingly, it is intended that our work product will be covered under the attorney/client privilege.

We expect to provide these services:

1. Preparing a schedule of disposable income and personal living expenses for use during alimony and child support negotiations.

2. Preparing a schedule of assets, liabilities, and net worth for use during property settlement negotiations.

3. Performing a valuation of Smith Consulting, Inc., as of December 1, 200X. The objective of our valuation will be to estimate the fair market value of Jeff and Susan Smith's ownership interests. Although our valuation is intended to estimate fair market value, we assume no responsibility for a seller's or buyer's inability to obtain a purchase contract at that price.

    a. In performing our valuation, we will rely on the accuracy and reliability of the company's historical financial statements, forecasts of future operations, and other financial data. Our services cannot be relied on to disclose errors, irregularities, or illegal acts, including fraud or defalcations that may exist.

    b. We will document the results of our valuation services in a formal, written report. We have no responsibility to update our valuation report for events and circumstances that occur after the date of its issuance. We understand that our valuation report will be used during divorce litigation between you and your spouse, and it will not be distributed to anyone not involved in the litigation process. If we are unable to complete our valuation services, we will not issue a report.

    c. Providing tax planning assistance regarding payment of alimony, child support, and property distributions. Tax planning requires that future changes in tax law and regulations be anticipated; however, the actual future statutory, administrative, or judicial authority may differ from those that will be anticipated. Accordingly, the actual tax consequences of divorce-related transactions may differ from those originally planned.

In addition to our business valuation report on Smith Consulting, Inc., it may be necessary for us to prepare other written reports that support our conclusions. These reports are to be used only in connection with the referenced divorce litigation and may not be published or used in any other manner without our written consent.

We have conducted an internal survey for conflicts of interest and have found none that would prevent us from providing the above divorce-related services to you.

We will submit bills to you monthly, payable on receipt, that will be based on our standard hourly rate for this type of consulting of $200 per hour, plus out-of-pocket expenses. Although our services will be directed by your attorney, you will be responsible for paying our fees. Our customary practice in divorce consulting engagements is to receive a retainer before beginning work. The retainer will be applied towards payment of our final billing in connection with this engagement. Your $5,000 retainer should be paid to us with the signed copy of this letter.

This agreement will become effective as soon as you sign and date the enclosed copy of this letter and return it to us with the retainer. If the need for additional services arises, our agreement with you will need to be revised. It is customary for us to enumerate these revisions in an addendum to this letter.

Sincerely,

Partner

Accepted

By ____

Date ____

SAMPLE ENGAGEMENT LETTER ADDENDUM

Month/date/year

Susan S. Smith
888 Bexton Drive
Anytown, USA 12345

Re: Smith vs. Smith

Dear Ms. Smith:

This letter constitutes an addendum to our original engagement letter dated Month/Date/Year. The purpose of this letter is to outline additional consulting services you wish us to perform in connection with the divorce litigation referenced above.

We expect to provide these additional consulting services:

1. Assisting with case strategy, developing deposition inquiries regarding financial matters, and preparing requests for the production of records currently controlled by Jeffrey M. Smith.

2. Performing investigative procedures to determine if Jeffrey M. Smith has expended business assets for personal use. Our procedures will not be designed to uncover fraud.

All terms of our original engagement letter (and security agreement) will apply to this addendum. This addendum will become effective as soon as you sign and date the original-copy of this letter and return the signed copy to us.

Sincerely,

[Engagement partner's signature]

Accepted

By ________________________________

Date _______________________________

CONSENT TO CONFLICT OF INTEREST

I, ____(client name)_________, hereby acknowledge that I have been advised by _____ (CPA name) ______ that a conflict of interest exists in representing me in a matter that involves ____(other party's name)____.

That matter is appropriately described as _________ (brief description of the matter in which the conflict exists such as calculation of support requirements, assessment of after tax benefit of property settlement, trust fund penalty assessment, request for innocent spouse relief, examination of tax returns, etc.) ________________.

I understand the possibility of such conflict of interest and, having been given the opportunity to discuss this matter with my personal attorney, I hereby release ____ (CPA name) ________ and discharge (her/him) from any and all liability whatsoever that may result from any conflict of interest arising in this matter. In addition to any other purpose, this consent is intended to satisfy the requirements of section 10.29 of Treasury Circular 230, August 2011 revision.

In witness whereof, and intending to be bound by it, I have signed this consent this ____ day of ______, 20__.

____
(Client Signature)

____
(Client Name – printed)

____
(Witness Signature)

____
(Witness Name – printed)

[This example is not provided nor intended to replace legal advice. You should consult with your legal counsel regarding the appropriate form for a consent to conflict of interest in your jurisdiction.]

TERMINATION LETTER

Date

Client name
Client address

Subject: Resignation

Dear _________ (Client Name):

(I/We) regret to inform you that (I/we) must resign from providing accounting, tax, and/or advisory services to you.

(I/We) will, of course, complete any matters currently pending and, so that you will not be disadvantaged in any way, we will continue to be available to assist you for a period of 90 days from the date of this letter. The terms of any such engagement will be subject to negotiation and confirmed in writing.

(I/We) will cooperate with your new accountants, allowing them access to our files, and provide any information they may request.

Charges for our time and copies made at their request will be at our normal rates.

We wish you well.

Sincerely yours,

____
(Authorized Signer)

[This example is not intended to provide or replace legal advice. You should always consult with legal counsel before terminating a client relationship if there is even a remote possibility of misunderstanding or conflict.]

Unit 2

Alimony

LEARNING OBJECTIVES

- Describe the tax attributes of alimony to both payor and recipient.
- Understand the requirements for alimony treatment.
- Obtain a general understanding of recapture of front-loaded alimony.

TAX EFFECT OF ALIMONY

The Tax Cuts and Jobs Act significantly changed the tax treatment of alimony. It used to be that IRC §71(a) provided that gross income would include amounts received as alimony or separate maintenance payments, and IRC §215(a) allowed the payor of alimony to receive a similar deduction in arriving at adjusted gross income. This remains true for divorce or separate maintenance agreements entered into prior to January 1, 2019. In short, these agreements are grandfathered into the old rules.

However, the Tax Cuts and Jobs Act repealed these rules for divorce, or separate maintenance agreements, entered into starting January 1, 2019. The new rules provide that the receipt of alimony is excluded from taxable income, and the payor of alimony is no longer allowed a deduction.

What if divorced spouses whose agreement was grandfathered in under the old rules wanted to be under the new rules? This could be accomplished by redrafting the divorce agreement and stating they want to be under the new rules.

Regardless of whether an agreement is under the new rules or the old rules, divorced spouses have several planning opportunities available to them. For purposes of this unit, the bulk of the discussion will be primarily focused on the pre-TCJA rules, as these generally allow for deductibility of alimony payments and the receipt of alimony as taxable income.

REQUIREMENTS

It is not sufficient to specify in the decree that payments will be considered alimony. IRC §71(b) sets forth definitions to determine whether payments are considered alimony for federal tax purposes (see Temp. Regs. §1.71-1T Q&A in Appendix).

Paid in Cash [Temp. Reg. §1.71-1T(b) Q&A 5]

- Cash payments (including checks and money orders payable on demand) qualify as alimony. Services rendered, notes payable, or the use of payor's property will not qualify.
- Payments must be made to or received on behalf of the former spouse. Alimony payments can be made directly to a third party as long as the payments are made pursuant to the settlement agreement or written request of the payee spouse. [Temp. Reg. §1.71-1T(b) Q&A 7]
    - Such written request must state that the parties intend the payment be treated as alimony, and the request must be received before the due date of payor's return. In other words, a paying spouse may convert a third-party payment to alimony by obtaining ratification from the receiving spouse before the tax return is filed, even if the payment was made before the request was received.
    - Common payments treated as alimony include medical expenses, rent or mortgage payments, real or personal property tax payments, and tuition. *Tuition* payments must be for the spouse's tuition; otherwise, if the tuition payment is for a child, it is deemed child support, and consequently not deductible.
    - Payments made by a payor to maintain the property do not constitute alimony, even if the divorced spouse is using the property. For example, a husband pays monthly mortgage payments on a house he owns in which his former spouse resides. These payments are not considered alimony. For the payment to be considered alimony, the house would have to be in the receiving spouse's name, and the obligation to pay would have to cease at the receiving spouse's death. (Please note that since these payments are not considered alimony, they would not be deductible even if they were grandfathered in under the pre-TCJA rules.)
    - Insurance premium payments may be alimony if:
        - the premiums are required to be paid by terms of the decree or ratification of the spouse, and
        - the receiving spouse is owner of the policy.

If the paying spouse owns the policy, the premiums are not alimony, even if the receiving spouse is beneficiary.

Written Agreement

A written agreement is required for the cash payment to be treated as alimony.

- A decree of divorce or separate maintenance or a related written instrument.
- A written separation agreement entered into by the spouses.
- A court order requiring a spouse to make payments for the temporary support or maintenance of the other spouse pending a final order.

Determinable Alimony Amount

There is no requirement that alimony is a fixed amount, but the amount must be clearly determinable from the document.

- The agreement can be uncertain as to the amount and timing of the payment.
- Payments can be contingent, such as a requirement to pay all of the spouse's medical expenses.
- A court order changing the number of payments required due to changed circumstances will not preclude alimony treatment.

EXAMPLE

Robert and Beth's divorce agreement was finalized in December 2016. They have not made any modifications to the agreement since that time, nor have they agreed to follow the post-TCJA rules for the tax treatment of alimony. According to their divorce decree, Beth is to pay Robert $500 per month for six years. Robert lost his job and experienced some unusual medical expenses. Beth increases her payments by $100. As no post-decree modification was made, Beth may not deduct the additional amounts paid to Robert.

EXAMPLE

Rush and Betsy's divorce agreement was finalized in June 2017. They have not made any modifications to the agreement since that time, nor have they agreed to follow the post-TCJA rules for the tax treatment of alimony. Rush, under the terms of their agreement, must pay the mortgage, taxes, and insurance on a home owned solely by his ex-wife, Betsy. Rush may deduct the payments as alimony. Betsy must include the payments in her income, but she may claim deductions for the taxes and interest if she itemizes her deductions.

No Cohabitation

After the divorce or legal separation, the paying spouse cannot be a member of the same household as the receiving spouse and still take a tax deduction—even if the divorce agreement was finalized before 2019. There is a 1-month grace period. Prior to a final divorce or separate maintenance decree, payments made under a separation agreement or temporary support order can generally qualify as alimony, even though spouses are members of the same household when payments are made.

Election Out [IRC §71(b)(1)(B)]

Divorcing spouses may agree in the separation instrument that payments otherwise qualifying as alimony are not to be treated as such for income tax purposes. This code section does not apply to divorce or separation agreements entered into in 2019 and later. For these divorce agreements, payments are no longer deductible by the payor, and income is no longer included by the payee.

- The agreement may be modified later by consent of both parties.
- A copy of the separation agreement should be attached to the recipient spouse's income tax return for each year in which the election applies.
- The taxpayers may also elect by written agreement to be treated under the new post-TCJA tax rules.

Termination at Death [IRC §71(b)(1)(D)]

Support payments must terminate upon the death of the receiving spouse. The separation or divorce agreement should specifically provide for termination of payments upon the death of the receiving spouse. However, it may not be necessary to do so. State law may provide for termination upon death, but prudence dictates specific provision in the decree.

If a payor spouse is obligated to make support payments after the payee spouse's death, none of the payments, whether made before or after the payee spouse's death, qualifies as alimony or separate maintenance for tax purposes. The IRC does not require that support payments cease upon the payee spouse's remarriage or the payor spouse's death. Support payments may continue after the occurrence of either of these events and still receive alimony treatment.

Separate Returns

The paying spouse and the receiving spouse must file separate income tax returns.

Not Child Support

Payment cannot be child support [IRC §71(c)(1)].

If expenses of a jointly owned home are part of the alimony payments under the pre-TCJA rules, some care must be taken to understand who is entitled to itemized deductions and how much. The following is a table from IRS Publication 504 showing how to deal with mortgage payments, property taxes, and home insurance.

Table 4. **Expenses for a Jointly-Owned Home**

Use the table below to find how much of your payment is alimony and how much you can claim as an itemized deduction.

IF you must pay all of the ...	AND your home is ...	THEN you can deduct and your spouse (or former spouse) must include as alimony ...	AND you can claim as an itemized deduction ...
mortgage payments (principal and interest)	jointly owned	half of the total payments	half of the interest as interest expense (if the home is a qualified home).[1]
real estate taxes and home insurance	held as tenants in common	half of the total payments	half of the real estate taxes[2] and none of the home insurance.
	held as tenants by the entirety or in joint tenancy	none of the payments	all of the real estate taxes and none of the home insurance.

[1] Your spouse (or former spouse) can deduct the other half of the interest if the home is a qualified home.
[2] Your spouse (or former spouse) can deduct the other half of the real estate taxes.

ALIMONY RECAPTURE

Excessive Front-Loading

In order to ensure that pre-TCJA deductible alimony payments are not, in effect, disguised non-deductible property settlements, the law provides recapture for excessive payments made in the early years. Excess front-loading of alimony occurs when the payor spouse makes greater alimony payments in first and second post-separation years than in the third year. (First post-separation year means the first calendar year in which the payor spouse paid the payee spouse alimony or separate maintenance). [IRC §71(f)(6)] Congress chose the three-year periods to separate the types of payments because property settlements are traditionally paid within a short time after the divorce decree or decree of legal separation.

- Effect on Subsequent Year. The recharacterization takes place in a subsequent year and does not change the deduction for alimony in the early years.
- Effective Dates. Instruments executed after 12/31/86 are governed by a 3-year rule if payments exceed $15,000.
- How the Rule Works.

- Threshold Amount. Excess payments must be *recapture*d by both spouses in the third post-separation year:
  - To the extent, alimony payments made in the second year exceed payments made in the third year by more than $15,000.
  - To the extent, alimony payments made in the first year exceed the average, plus $15,000.
    - Payments made in the second year reduced by the excess for that year.
    - Payments made in the third year.

Computation

The excess for the second year must be computed first. There is a $15,000 threshold that must be exceeded in each of the first two post-separation years if the recapture is to apply.

EXAMPLE[1]

The payor spouse makes pre-TCJA alimony payments of $60,000 in the first post-separation year and makes no payments in the second or third years.

Second Year Recapture:

Second year payment	$ 0	
Less third year payment	0	
Subtotal	0	
Less $15,000 threshold	15,000	
Second year recapture		$ 0

First Year Recapture:

First year payment		$60,000
Third year payment	0	
Second year payment	0	
Subtotal	0	
Less second year recapture	0	
Divided by 2	0	
Average payments		0
First year payment less average		60,000
Less $15,000 threshold		15,000
First year recapture		$45,000

[1] This example was taken from Crumbley and Apostoloy, "Handbook of Financial Planning for Divorce and Separation" (John Wiley & Sons, 1990), 136-137.

The recapture happens in year three. The results would be:

- Spouse recipient: Includes the $60,000 in year 1 as income and gets a reduction as recapture of $45,000 in year 3.
- Payor spouse: Deducts the $60,000 in year one as alimony payments, and recaptures income of $45,000 in year 3.

EXAMPLE

Now suppose payor spouse makes pre-TCJA alimony payments of $60,000 in the first post-separation year, $20,000 in the second year, and no payments in the third year.

Second Year Recapture:

Second year payment	$20,000	
Less third year payment	0	
Subtotal	20,000	
Less $15,000 threshold	15,000	
Second year recapture		$5,000

First Year Recapture:

First year payment		$60,000
Third year payment	$ 0	
Second year payment	20,000	
Subtotal	20,000	
Less second year recapture	5,000	
Net second year payment	15,000	
Divided by 2		7,500
Average payments		0
First year payment less average		52,500
Less $15,000 threshold		15,000
First year recapture		$37,500

The recapture happens in year 3. The results would be:

- Spouse recipient: Gets a reduction as recapture of $42,500 ($37,500 first year recapture plus $5,000 second year recapture) in year 3.
- Payor spouse: Includes $42,500 as a recapture of income in year 3.

Exceptions under IRC §71(f)(3)

The front-loading rules will not apply:

- to a year in which either spouse dies or the receiving spouse remarries and payments cease upon death or remarriage;
- to payments that vary in amount based on a continuing liability to pay a fixed portion of income from a business or property or from compensation for employment or self-employment; and
- to temporary support payments made pursuant to a court order.

Planning Strategies to Avoid the Pitfalls of Excess Front-Loading

Specify in the separation agreement or divorce decree that alimony payments remain constant for the first three years after divorce.

If the former spouses desire a lump-sum payment, the divorce decree or separation agreement should provide for the payment to be made no earlier than the third year after divorce, so that the payment will not produce a significant fluctuation in alimony payments.

DECLINING ALIMONY

With the front-loading rules in mind, there could be advantages to structuring an agreement where alimony decreases from year to year.

EXAMPLE

Susan had returned to college after 20 years and was midway through when she and David decided to divorce. Their divorce decree requires David to pay $3,000 a month for two years, when Susan will graduate. David's required payment drops to $2,000 per month for two years, while Susan becomes established in her new profession. In the fifth and sixth year, alimony falls to $1,000 per month. The fluctuation of payment gives Susan the cash flow needed to focus her full-time efforts on completing her education.

ALIMONY V. PROPERTY SETTLEMENT

In general, a transfer meeting the requirements of IRC §71 is alimony. Some property settlements might be better structured as alimony. The risk is to the recipient spouse, as payments must cease at death; therefore, the recipient risks economic loss if death occurs before a full transfer has been made.

EXPENSES OF SPOUSE AS ALIMONY

Any liability of the recipient spouse, required to be paid by the paying spouse, must also be subject to the rule that alimony is not payable after the death of the recipient spouse. Numerous tax court decisions on this point have disallowed alimony deductions for attorney's fees and other spousal obligations. In order to be deductible by the paying spouse, all such obligations must be extinguished by the receiving spouse's death.

CURRENT DEVELOPMENTS

Quintal v. Commissioner, TC Summary Opinion 2017-3, 2/2/17—At first glance, the payments made by the taxpayer would appear to be deductible alimony. But last-minute changes made to the divorce documents end up changing payments' nature in the view of the Court. Mr. Quintal and his former spouse had entered into last-minute negotiations in their divorce just before the agreement was signed, making major changes to many exhibits. In one case, entire paragraphs of an exhibit were lined through with handwritten statements replacing the deleted items. The resulting document was not a model of consistency, and the rushed nature of the document showed in various ways. Exhibit B was originally titled "Alimony" but was revised to be titled "Unallocated Support." Despite that change, the text continued to indicate the payments were designed to be deductible alimony to Mr. Quintal. The court noted:

Reading the separation agreement as a whole, we conclude that exhibits B and J must be read in tandem and the unallocated support payments prescribed in Exhibit B are subject to the provisions of both that exhibit and Exhibit J. In this regard, the handwritten revisions to the settlement agreement were poorly conceived. Specifically, although Exhibit B was revised to state the parties "acknowledge that husband anticipates that the above [unallocated support] payment is deductible to him and includable to wife" (emphasis added). Exhibit J states more definitively, "In accordance with section 71(b)(1)(B) of the code, the husband and wife expressly agree to designate and hereby do designate all payments required in this exhibit as excludable and non-deductible payments for purposes of sections 71 and 215 of the code, respectively." We conclude that the latter, more definitive statement controls in this case. Because the settlement agreement provides that the unallocated support payments are excludable from income and not allowable as deductions, it follows that the payments do not satisfy the definition of alimony under section 71(b)(1)(B).

Leslie v. Commissioner, TC Memo 2016-171, 9/14/16—Determination of what is alimony is known to be a contentious issue in taxes, especially because Congress in 1984 created a full independent federal definition by which payments are tested for classification as tax alimony, regardless of the intent of the parties or what state law may call a payment. The court found that Ms. Leslie did not have constructive receipt of the 2009 payment based on the facts in this case. Ms. Leslie testified that she was not even aware of the funds until after the end of 2009; thus, they could not be taxable in that year.

NOTES

Unit 3

Child Support

LEARNING OBJECTIVES

- Describe the tax attributes of child support.
- Define and understand the effect of contingencies related to a child.
- Describe the importance of careful planning for phased reductions in child support.
- Gain a general understanding of child support guidelines.

BACKGROUND

Duration of Payment

All states require divorcing parents to continue support of their children. Generally, non-custodial parents are required to make support payments until the child is legally emancipated. Legal emancipation occurs when one of the following takes place:

- The child reaches the age of majority (generally 18).
- The child graduates from high school and does not continue his or her education.
- The child graduates from college.
- The child drops high school and goes to work full time.
- The child gets married.
- The child enters the military.

Calculating Child Support

While the mechanics for calculating child support may vary widely from state to state, there are three essential components to arriving at child support anywhere:

- Basic Support—payments for the costs for a child's housing, food, clothing, transportation, education, and other expenses to care for the child
- Medical Support—providing health and dental insurance, payments for the costs of health and dental insurance that the other parent provides, and payments for uninsured or unreimbursed medical and dental expenses
- Child Care Support—payments for child care (day care) costs when parents go to work or school

Important Legal Factors in Calculating Support

- Gross income of *both* parents
- Amount of court-ordered parenting time (visitation)
- Presumption that both parents can or should work and earn an income
- If the parties do not provide specific details about their income, the court will set child support based on other available evidence

Types of Child Support

While alimony is deductible by the paying spouse and included in the taxable income of the recipient spouse, child support is not. There are two types of child support:

- Fixed child support
- Deemed child support

GROSS INCOME FOR CALCULATING CHILD SUPPORT

What is Included in Gross Income?

Generally, any form of periodic payment to an individual:

- Salaries and wages, including regular bonuses
- Commissions
- Self-employment income
- Workers' compensation

- Unemployment benefits
- Annuity payments
- Military and naval retirement
- Pension and disability payments
- Spousal maintenance received under a previous order or the current proceeding
- Social Security or veterans' benefits provided for a joint child
- Student loans in excess of tuition and books may be considered income
- Interest and dividend payments if routinely received on a periodic basis

A number of documents that will demonstrate a party's gross income for a person who is not self-employed, including but not limited to the following:

- Paystubs (year-end paystubs are helpful to show actual annual gross income and all deductions)
- W-2s (check the Medicare box to see actual gross income before deductions)
- K-1s (for trust and estate beneficiaries and also self-employment income)
- 1099s (for independent contractors)
- State and federal income tax returns
- Social Security statements (to see income over time)
- Unemployment compensation statements
- Disability income statements

Self-employment income is defined under state statute, but will probably be something like "gross receipts minus costs of goods sold minus ordinary and necessary expenses required for self-employment or business operation."

The parent seeking to have an expense deducted must show that it is ordinary and necessary. This can be challenging when personal expenses are intertwined with business expenses.

There are a number of documents that will demonstrate a self-employed party's income, including but not limited to the following:

- Business tax returns
- Schedule C from individual tax returns

- K-1s (for partnership and S-Corp income)
- Profit and loss statements [especially those prepared for third parties (e.g., when a business owner is seeking a bank loan, not just for tax purposes)]
- Bank statements
- Check registers

Potential income from a party may also be considered when a parent is voluntarily unemployed, underemployed, or employed on a less than full-time basis, or there is no direct evidence of any income.

There is a rebuttable presumption that a parent can be gainfully employed on a full-time basis. This generally means a 40-hour workweek except in those industries, trades, or professions in which most employers, due to custom, practice, or agreement, consider a normal workweek as more or less than 40 hours.

- Exceptions can apply to impute income.
  - The Caretaker Exception gives a court discretion not to impute income to a stay-at-home parent who cares for a child at issue in the proceeding if the court considers the following factors:
    - The parties' parenting and child care arrangements before the child support action
    - The stay-at-home parent's employment history and earning ability
    - Job availability in the area
    - Expenses associated with the stay-at-home parent being employed, including child care costs and transportation
    - The child's age and health, including whether the child has special needs
    - The availability of child care providers
  - Incarceration
  - Incapacity
  - Economic conditions that directly impact self-employment income
- Calculating potential income can be done in a number of ways, based on the parent's:
  - probable earnings level based on employment potential, recent work history, and occupational qualifications in light of prevailing job opportunities and earnings levels in the community;

- unemployment or worker's compensation benefits; and
- the amount of income the parent could earn working 30 hours per week at 100% of the current federal or state minimum wage, whichever is higher.

What is Not Included in the Definition of "Gross Income"?

- Excess Employment Income
  - Compensation received by a party for employment in excess of a 40-hour workweek is not considered as income for purposes of calculating child support. However, the amount of child support will still need to at least equal the guideline amount.
  - Excess income includes income demonstrated by the party to be not ordinary in nature or not representative of income earned during the duration of the marriage, including:
    - the excess employment began after the filing of the petition for dissolution or legal separation or a petition related to custody, parenting time, or support;
    - the excess employment reflects an increase in the work schedule or hours worked over the two years immediately preceding the filing of the petition;
    - the excess employment is voluntary and not a condition of employment;
    - the excess employment is in the nature of additional, part-time, or overtime employment compensable by the hour or fraction of an hour; and
    - the party's compensation structure has not been changed for the purpose of affecting a support or maintenance obligation.
- Child Support Received by a Party
- Spouse's Income
- Other Support Payments
- Public Assistance

Deductions from Gross Income

Deduction for obligation to support non-joint children, usually limited by statue to two. Income in excess of the maximum specified in the guidelines for the parents' combined monthly parental income for determining child support. The court may exceed the cap if there are special circumstances, such as a child with a disability or where there is a substantial, demonstrated need for the additional support and additional support will directly benefit the child.

The Parenting Expense Adjustment is a deduction from the obligor's child support obligation. The purpose of this adjustment is to account for expenses that are incurred while a parent is exercising parenting time, including food, transportation, recreation, and household expenses. The more parenting time a parent exercises, the larger the amount of this adjustment or deduction.

An example of Parenting Expense Adjustment schedule:

- 0–10% parenting time – no adjustment
- 10–45% parenting time – 12% deduction

If parenting time is equal, 45.1–50% parenting time, and the parents' respective incomes are equal, there is no Parenting Expense Adjustment unless the court determines the expenses for the child are not equally shared.

If parenting time is equal and the parents' respective incomes are not equal, the court may allocate the combined basic support obligation based on the parents' proportionate shares of income.

FIXED CHILD SUPPORT

Where the divorce decree or separation agreement specifies a fixed cash payment for the support of a child, this amount is not to be treated as alimony.

Payment Amount

The actual amount of the payment need not be specified. For example, if the agreement specified the paying spouse would pay for the child's summer camp, this is sufficient to fix the camp fees as child support.

Disguised Child Support

A payment will not qualify as alimony if it is in reality a disguised payment for child support.

In the past, it was common to set up child support as deductible alimony. The Supreme Court decision in Lester, 366 U.S. 299 (1961), which allowed child support under certain conditions to be deducted, was invalidated by IRC §71.

If payment to a spouse will be reduced, based on contingencies relating to a child such as attaining a specific age, marrying, dying, leaving home or school, etc., such amounts will not be considered alimony.

Medical Support

The parent providing medical insurance for a minor child is entitled to a contribution from the other parent towards the cost of the premium based on the difference between the premium cost for individual-only coverage and the premium cost of family coverage available under the parent's insurance plan. This sharing will also include all unreimbursed medical expenses under the health

plan. The amount of contribution is based on the proportionate share of the parties' combined monthly parental income for determining child support.

Childcare Support

A parent who incurs reasonable work- or education-related childcare costs is entitled to a contribution from the other parent towards these costs. Childcare costs shall be adjusted by the amount of the estimated federal and state childcare credit payable on behalf of a joint child. The guidelines may have this adjustment built into the schedule. The amount of contribution is based on the proportionate share of the parties' combined monthly parental income for determining child support.

DEEMED CHILD SUPPORT

General

Deemed child support is a payment not identified in a settlement agreement or divorce as child support but is treated as child support for income tax purposes when the instrument provides for a reduction in a payment as a result of a contingency related to a child.

Child Related Contingencies

Contingencies related to a child include the:

- child's death;
- child's marriage;
- child's completion of school;
- child reaches the local age of majority;
- child leaves the household; and
- child becomes employed.

EXAMPLE

A written instrument states that husband will pay alimony of $3,000 per month until such time as the couple's minor child turns 18, at which time the alimony payments will be reduced to $2,000 per month. The monthly reduction is directly associated with a contingency related to a child. Therefore, $1,000 of each monthly payment is non-deductible child support. Pre-TCJA payments considered alimony would generally be deductible.

Contingencies Presumed to be Child Related

There are two situations described in Temp. Reg. §1.71-IT(c) Q&A 18, where a reduction in payments will be presumed to be associated with a contingency related to a child.

1. When payments are reduced not more than six months before or after the child is to attain age 18, age 21, or the local age of majority; and
2. When payments are to be reduced on two or more occasions that occur not more than one year before or after two different children attain a certain age between the ages of 18 and 24. The measuring age in this situation must be the same for each child.

Rebutting the Presumption

Although not easy, it may be possible to rebut the presumption that lowering the alimony in the periods described above is not related to some type of child contingency. If a situation requires reducing an alimony payment, the tax planner must be aware of these presumptions and plan ahead.

EXAMPLE

Allen and Barbara are divorced on July 1, 2010, when their children, Caren (born July 15, 1995) and Denise (born September 23, 1997) are ages 14 and 12, respectively. Under the divorce decree, Allen is to make alimony payments to Barbara of $2,000 per month. Such payments are to be reduced to $1,500 per month on January 1, 2016 and to $1,000 per month on January 1, 2020.

On January 1, 2016, the date of the first reduction in payments, Caren will be 20 years, 5 months, and 17 days old. On January 1, 2020, the date of the second reduction in payments, Denise will be 22 years, 3 months, and 9 days old. Each of the reductions in payments is to occur not more than one year before or after a different child of Allen's attains the age of 21 years and 4 months. (Actually, the reductions are to occur not more than one year before or after Caren and Denise attain any of the ages 21 years, 3 months, and 9 days through 21 years, 5 months, and 17 days.)

Accordingly, the reductions will be presumed to clearly be associated with the happening of a contingency relating to Caren and Denise. Unless this presumption is rebutted, payments under the divorce decree equal to the sum of the reductions ($1,000 per month) will be treated as fixed for the support of the children, and therefore will not qualify as alimony or separate maintenance payments.

Partial Payments

If the paying spouse does not make all of the payments required by the decree or separation agreement, payments for child support are deemed to be paid first before any amount is credited to alimony.

EXAMPLE

Pete is required under his divorce agreement to pay a total of $4,000 per month to Paula, consisting of $2,000 of child support and $2,000 of alimony. After making payments during the first nine months of the year, Pete ran across some hard times and stopped making payments. Of the total $36,000 Pete paid, $24,000 (12 months × $2,000) will be considered child support. The remaining $12,000 will be considered alimony and may be eligible for a federal income tax deduction.

ALIMONY V. CHILD SUPPORT

EXAMPLE

	Recipient Spouse	Paying Spouse
Alimony payment	$28,000	$28,000
Less tax at effective federal and state rate of 20% and 40%, respectively	(5,600)	(11,200)
Net after tax	$22,400	$16,800

The paying spouse, enjoying a tax deduction for payment of alimony, has an after-tax cost of $16,800 on the transfer of $28,000. The recipient spouse has an after-tax benefit of $22,400. If child support were paid instead of alimony, the actual out-of-pocket cost is equal to the amount transferred. If the spouses will be in significantly different tax brackets after the divorce, alimony can be a better choice than child support. In the illustration, one could argue that the U.S. Government contributes $5,600 to the support of the children.

If all parties can cooperate in designing an acceptable agreement that provides a single unallocated amount for *family support*, it may be possible to have all amounts paid treated as alimony.

STATE SUPPORT GUIDELINES

Uniform Application

To assure some uniformity, some states have enacted child support guidelines, which may or may not be mandatory. The guidelines are based on the number of minor children and the income of the spouses. Support guidelines are published and can be found on each state's web site, or in any law library. These guidelines may need to be satisfied in order to satisfy a domestic relations judge that an order for unallocated support meets state law requirements.

EXAMPLE

Pete's gross income is $4,100; Paula earns $1,100; and together they earn $5,200. First, each spouse's contribution to total income is calculated:

Pete	$4,100	79%
Paula	1,100	21%
	$5,200	100%

The child support guidelines for the state in which they live sets $1,000 per month for two children. Pete owes $790 per month in child support.

Deviation from the Guidelines

A party may request a deviation from the support guidelines. Factors to consider include the following:

- All earnings, income, circumstances, and resources of each parent, including real and personal property, but excluding income from excess employment of the obligor or oblige
- The extraordinary financial needs and resources, physical and emotional condition, and educational needs of the child to be supported
- The standard of living the child would enjoy if the parents were currently living together, but recognizing that the parents now have separate households
- Whether the child resides in a foreign country for more than one year that has a substantially higher or lower cost of living than this country
- Which parent receives the income taxation dependency exemption and the financial benefit the parent receives from it
- The parents' debts
- The obligor's total payments for court-ordered child support exceed the statutory limitations

In certain cases, where a parent exercising between 10-45% parenting time, a court can order no basic child support where such a significant income disparity exists between the parents that an order for basic support would be detrimental to the parents' child.

Standard for Modification

A modification to the statutory standard child support requires showing there has been a substantial change in circumstances making the terms of the current order unreasonable and unfair. This can be based on a number of factors:

- Substantially increased or decreased gross income of an obligor or obligee
- Substantially increased or decreased need of an obligor or obligee or the child or children that are the subject of these proceedings
- Receipt of assistance under the AFDC
- A change in the cost of living for either party as measured by the Federal Bureau of Labor Statistics
- Extraordinary medical expenses of the child not otherwise provided
- A change in the availability of appropriate health care coverage or a substantial increase or decrease in health care coverage costs
- The addition of work-related or education-related child care expenses of the obligee or a substantial increase or decrease in existing work-related or education-related child care expenses
- Upon the emancipation of the child

For the purposes of showing there has been a substantial change in circumstances and the terms of a current support order are unreasonable and unfair, the following rebuttable presumptions may apply:

- The application of child support guidelines to the parties' current circumstances results in a calculated court order that is at least 20% and $75 per month higher or lower than the current support order or, if the current support order is less than $75, it results in a calculated court order that is at least 20% per month higher or lower.
- The medical support provisions of the order are not enforceable by the public authority or the obligee.
- Health coverage is not available to the child for whom the order is established by the parent ordered to provide.
- The existing support obligation is in the form of a statement of percentage and not a specific dollar amount.
- The gross income of an obligor or obligee has decreased by at least 20% through no fault or choice of the party.

Parent A:	IV-D Case Number:	Number of joint children:
Parent B:	Court File Number:	Begin Date:

Income:	Parent A	Parent B	Combined
1a. Monthly Income Received			
1b. Child(ren)'s Social Security/ Veterans' Benefits Derived from a Parent's Eligibility			
1c. Potential Income			
1d. Spousal Maintenance Orders Obligated to be Paid			
1e. Child Support Order(s) Obligated to be Paid for Nonjoint Child(ren)			
1f. Monthly Gross Income (1a+1b+1c-1d-1e)			
Adjustments:			
2a. Number of Nonjoint Children in the Home (Maximum of 2)			
2b. Deduction for Nonjoint Child(ren) in the Home			
3. Parental Income for Determining Child Support (PICS)			
4. Percentage Share of Combined PICS			
5. Combined Basic Support Obligation			
6. Pro Rata Basic Support Obligation			
Basic Support Obligation:			
7. Basic Support Obligation after Parenting Expense Adjustment			
Child Care Support Obligation:			
8. Child Care Support Obligation for Joint Children			
Medical Support Obligation:			
Appropriate Coverage Available:			
9a. Monthly Cost of Health Care Coverage for Joint Child(ren)			
9b. Pro Rata Share of Health Care Coverage Costs			
9c. Contribution to Health Care Coverage			
9d. Monthly Cost of Dental Coverage for Joint Child(ren)			
9e. Pro Rata Share of Dental Coverage Costs			
9f. Contribution to Dental Coverage			
9g. Medical Support Obligation – Appropriate Coverage Available			
No Appropriate Coverage Available:			
10. Medical Support Obligation for Public Coverage			
Uninsured and/or Unreimbursed Medical Expenses:			
11. Share of Uninsured and/or Unreimbursed Medical Expenses			
12. Net Child Support Obligation			

Benefits Adjustment:			
13. Child(ren)'s Social Security/ Veterans' Benefits Derived from Parent's Eligibility			
Computing a Final Obligation:			
14. Total Child Support Obligation			
15a. Monthly Gross Income			
Ability to Pay Calculation:			
15b. Income Available for Support			
16. Monthly Child Support Obligation – No Adjustment Necessary			
17. Amount of Reduction			
Child Support Obligation Adjustment:			
18. Medical Support Original Obligation Amount of Reduction New Obligation			
19. Child Care Support Original Obligation Amount of Reduction New Obligation			
20. Basic Support Original Obligation Amount of Reduction New Obligation			
21. Monthly Child Support Obligation After Adjustment			
Presumptive Minimum Order (Basic Support Only):			
22a. Presumptive Minimum Order for 1 or 2 Joint Children			
22b. Presumptive Minimum Order for 3 or 4 Joint Children			
22c. Presumptive Minimum Order for 5 or More Joint Children			

Minnesota Statutes Section 518A.35 GUIDELINE USED IN CHILD SUPPORT DETERMINATIONS.

Subd. 2.Basic support; guideline.

Unless otherwise agreed to by the parents and approved by the court, when establishing basic support, the court must order that basic support be divided between the parents based on their proportionate share of the parents' combined monthly parental income for determining child support (PICS). Basic support must be computed using the following guideline:

Combined Parental Income for	Number of Children					
Determining Child Support	One	Two	Three	Four	Five	Six
$0- $799	$50	$50	$75	$75	$100	$100
800- 899	80	129	149	173	201	233
900- 999	90	145	167	194	226	262
1,000- 1,099	116	161	186	216	251	291
1,100- 1,199	145	205	237	275	320	370
1,200- 1,299	177	254	294	341	396	459
1,300- 1,399	212	309	356	414	480	557
1,400- 1,499	251	368	425	493	573	664
1,500- 1,599	292	433	500	580	673	780
1,600- 1,699	337	502	580	673	781	905
1,700- 1,799	385	577	666	773	897	1,040
1,800- 1,899	436	657	758	880	1,021	1,183
1,900- 1,999	490	742	856	994	1,152	1,336
2,000- 2,099	516	832	960	1,114	1,292	1,498
2,100- 2,199	528	851	981	1,139	1,320	1,531
2,200- 2,299	538	867	1,000	1,160	1,346	1,561
2,300- 2,399	546	881	1,016	1,179	1,367	1,586
2,400- 2,499	554	893	1,029	1,195	1,385	1,608
2,500- 2,599	560	903	1,040	1,208	1,400	1,625
2,600- 2,699	570	920	1,060	1,230	1,426	1,655
2,700- 2,799	580	936	1,078	1,251	1,450	1,683
2,800- 2,899	589	950	1,094	1,270	1,472	1,707
2,900- 2,999	596	963	1,109	1,287	1,492	1,730
3,000- 3,099	603	975	1,122	1,302	1,509	1,749
3,100- 3,199	613	991	1,141	1,324	1,535	1,779
3,200- 3,299	623	1,007	1,158	1,344	1,558	1,807
3,300- 3,399	636	1,021	1,175	1,363	1,581	1,833
3,400- 3,499	650	1,034	1,190	1,380	1,601	1,857
3,500- 3,599	664	1,047	1,204	1,397	1,621	1,880
3,600- 3,699	677	1,062	1,223	1,418	1,646	1,909
3,700- 3,799	691	1,077	1,240	1,439	1,670	1,937
3,800- 3,899	705	1,081	1,257	1,459	1,693	1,963
3,900- 3,999	719	1,104	1,273	1,478	1,715	1,988
4,000- 4,099	732	1,116	1,288	1,496	1,736	2,012
4,100- 4,199	746	1,132	1,305	1,516	1,759	2,039
4,200- 4,299	760	1,147	1,322	1,536	1,781	2,064
4,300- 4,399	774	1,161	1,338	1,554	1,802	2,088
4,400- 4,499	787	1,175	1,353	1,572	1,822	2,111
4,500- 4,599	801	1,184	1,368	1,589	1,841	2,133
4,600- 4,699	808	1,200	1,386	1,608	1,864	2,160
4,700- 4,799	814	1,215	1,402	1,627	1,887	2,186
4,800- 4,899	820	1,231	1,419	1,645	1,908	2,212

Minnesota Statutes Section 518A.35 GUIDELINE USED IN CHILD SUPPORT DETERMINATIONS.

Combined Parental Income for Determining Child Support	Number of Children: One	Two	Three	Four	Five	Six
4,900- 4,999	825	1,246	1,435	1,663	1,930	2,236
5,000- 5,099	831	1,260	1,450	1,680	1,950	2,260
5,100- 5,199	837	1,275	1,468	1,701	1,975	2,289
5,200- 5,299	843	1,290	1,485	1,722	1,999	2,317
5,300- 5,399	849	1,304	1,502	1,743	2,022	2,345
5,400- 5,499	854	1,318	1,518	1,763	2,046	2,372
5,500- 5,599	860	1,331	1,535	1,782	2,068	2,398
5,600- 5,699	866	1,346	1,551	1,801	2,090	2,424
5,700- 5,799	873	1,357	1,568	1,819	2,111	2,449
5,800- 5,899	881	1,376	1,583	1,837	2,132	2,473
5,900- 5,999	888	1,390	1,599	1,855	2,152	2,497
6,000- 6,099	895	1,404	1,604	1,872	2,172	2,520
6,100- 6,199	902	1,419	1,631	1,892	2,195	2,546
6,200- 6,299	909	1,433	1,645	1,912	2,217	2,572
6,300- 6,399	916	1,448	1,664	1,932	2,239	2,597
6,400- 6,499	923	1,462	1,682	1,951	2,260	2,621
6,500- 6,599	930	1,476	1,697	1,970	2,282	2,646
6,600- 6,699	936	1,490	1,713	1,989	2,305	2,673
6,700- 6,799	943	1,505	1,730	2,009	2,328	2,700
6,800- 6,899	950	1,519	1,746	2,028	2,350	2,727
6,900- 6,999	957	1,533	1,762	2,047	2,379	2,747
7,000- 7,099	963	1,547	1,778	2,065	2,394	2,753
7,100- 7,199	970	1,561	1,795	2,085	2,417	2,758
7,200- 7,299	974	1,574	1,812	2,104	2,439	2,764
7,300- 7,399	980	1,587	1,828	2,123	2,462	2,769
7,400- 7,499	989	1,600	1,844	2,142	2,483	2,775
7,500- 7,599	998	1,613	1,860	2,160	2,505	2,781
7,600- 7,699	1,006	1,628	1,877	2,180	2,528	2,803
7,700- 7,799	1,015	1,643	1,894	2,199	2,550	2,833
7,800- 7,899	1,023	1,658	1,911	2,218	2,572	2,864
7,900- 7,999	1,032	1,673	1,928	2,237	2,594	2,894
8,000- 8,099	1,040	1,688	1,944	2,256	2,616	2,925
8,100- 8,199	1,048	1,703	1,960	2,274	2,637	2,955
8,200- 8,299	1,056	1,717	1,976	2,293	2,658	2,985
8,300 -8,399	1,064	1,731	1,992	2,311	2,679	3,016
8,400- 8,499	1,072	1,746	2,008	2,328	2,700	3,046
8,500- 8,599	1,080	1,760	2,023	2,346	2,720	3,077
8,600- 8,699	1,092	1,780	2,047	2,374	2,752	3,107
8,700- 8,799	1,105	1,801	2,071	2,401	2,784	3,138
8,800- 8,899	1,118	1,822	2,094	2,429	2,816	3,168
8,900- 8,999	1,130	1,842	2,118	2,456	2,848	3,199
9,000- 9,099	1,143	1,863	2,142	2,484	2,880	3,223
9,100- 9,199	1,156	1,884	2,166	2,512	2,912	3,243
9,200- 9,299	1,168	1,904	2,190	2,539	2,944	3,263
9,300- 9,399	1,181	1,925	2,213	2,567	2,976	3,284
9,400- 9,499	1,194	1,946	2,237	2,594	3,008	3,304
9,500- 9,599	1,207	1,967	2,261	2,622	3,031	3,324
9,600- 9,699	1,219	1,987	2,285	2,650	3,050	3,345
9,700- 9,799	1,232	2,008	2,309	2,677	3,069	3,365

Minnesota Statutes Section 518A.35 GUIDELINE USED IN CHILD SUPPORT DETERMINATIONS.

Combined Parental Income for Determining Child Support	Number of Children: One	Two	Three	Four	Five	Six
9,800- 9,899	1,245	2,029	2,332	2,705	3,087	3,385
9,900- 9,999	1,257	2,049	2,356	2,732	3,106	3,406
10,000-10,099	1,270	2,070	2,380	2,760	3,125	3,426
10,100-10,199	1,283	2,091	2,404	2,788	3,144	3,446
10,200-10,299	1,295	2,111	2,428	2,815	3,162	3,467
10,300-10,399	1,308	2,132	2,451	2,843	3,181	3,487
10,400-10,499	1,321	2,153	2,475	2,870	3,200	3,507
10,500-10,599	1,334	2,174	2,499	2,898	3,218	3,528
10,600-10,699	1,346	2,194	2,523	2,921	3,237	3,548
10,700-10,799	1,359	2,215	2,547	2,938	3,256	3,568
10,800-10,899	1,372	2,236	2,570	2,955	3,274	3,589
10,900-10,999	1,384	2,256	2,594	2,972	3,293	3,609
11,000-11,099	1,397	2,277	2,618	2,989	3,312	3,629
11,100-11,199	1,410	2,294	2,642	3,006	3,331	3,649
11,200-11,299	1,422	2,306	2,666	3,023	3,349	3,667
11,300-11,399	1,435	2,319	2,689	3,040	3,366	3,686
11,400-11,499	1,448	2,331	2,713	3,055	3,383	3,705
11,500-11,599	1,461	2,344	2,735	3,071	3,400	3,723
11,600-11,699	1,473	2,356	2,748	3,087	3,417	3,742
11,700-11,799	1,486	2,367	2,762	3,102	3,435	3,761
11,800-11,899	1,499	2,378	2,775	3,116	3,452	3,780
11,900-11,999	1,511	2,389	2,788	3,131	3,469	3,798
12,000-12,099	1,524	2,401	2,801	3,146	3,485	3,817
12,100-12,199	1,537	2,412	2,814	3,160	3,501	3,836
12,200-12,299	1,549	2,423	2,828	3,175	3,517	3,854
12,300-12,399	1,562	2,434	2,841	3,190	3,534	3,871
12,400-12,499	1,575	2,445	2,854	3,205	3,550	3,889
12,500-12,599	1,588	2,456	2,867	3,219	3,566	3,907
12,600-12,699	1,600	2,467	2,880	3,234	3,582	3,924
12,700-12,799	1,613	2,478	2,894	3,249	3,598	3,942
12,800-12,899	1,626	2,489	2,907	3,264	3,615	3,960
12,900-12,999	1,638	2,500	2,920	3,278	3,631	3,977
13,000-13,099	1,651	2,512	2,933	3,293	3,647	3,995
13,100-13,199	1,664	2,523	2,946	3,308	3,663	4,012
13,200-13,299	1,676	2,534	2,960	3,322	3,679	4,030
13,300-13,399	1,689	2,545	2,973	3,337	3,696	4,048
13,400-13,499	1,702	2,556	2,986	3,352	3,712	4,065
13,500-13,599	1,715	2,567	2,999	3,367	3,728	4,083
13,600-13,699	1,727	2,578	3,012	3,381	3,744	4,100
13,700-13,799	1,740	2,589	3,026	3,396	3,760	4,118
13,800-13,899	1,753	2,600	3,039	3,411	3,777	4,136
13,900-13,999	1,765	2,611	3,052	3,425	3,793	4,153
14,000-14,099	1,778	2,623	3,065	3,440	3,809	4,171
14,100-14,199	1,791	2,634	3,078	3,455	3,825	4,189
14,200-14,299	1,803	2,645	3,092	3,470	3,841	4,206
14,300-14,399	1,816	2,656	3,105	3,484	3,858	4,224
14,400-14,499	1,829	2,667	3,118	3,499	3,874	4,239
14,500-14,599	1,842	2,678	3,131	3,514	3,889	4,253
14,600-14,699	1,854	2,689	3,144	3,529	3,902	4,268

Minnesota Statutes Section 518A.35 GUIDELINE USED IN CHILD SUPPORT DETERMINATIONS.

Combined Parental Income for Determining Child Support	Number of Children One	Two	Three	Four	Five	Six
14,700-14,799	1,864	2,700	3,158	3,541	3,916	4,282
14,800-14,899	1,872	2,711	3,170	3,553	3,929	4,297
14,900-14,999	1,879	2,722	3,181	3,565	3,942	4,311
15,000, or the amount in effect under subd. 4	1,883	2,727	3,186	3,571	3,949	4,319

NOTES

Unit

4

Property Settlements

LEARNING OBJECTIVES

- Describe the tax law governing transfers between spouses or incident to divorce.
- Describe the tax treatment of transfers to third parties for benefit of former spouse.
- Understand the recordkeeping requirements for both spouses with regard to property transferred.
- Define the terms *incident to divorce* or *related to the cessation of marriage*.
- Determine exceptions to general rule imposing time limits on transfers.

TRANSFERS BETWEEN SPOUSES INCIDENT TO A DIVORCE

Background

In general, transfer of property that is not a gift is a taxable event, requiring the transferor to recognize gain or loss on the difference between fair market value and the adjusted basis in the property.

Prior to 1984, transfers of appreciated property to a spouse incident to a divorce resulted in gain to the transferor.

The Tax Reform Act of 1984 added IRC §1041, which generally provides that no gain or loss shall be recognized on the transfer of property from an individual to a spouse (or in trust for the benefit of the former spouse). IRC §1041 is mandatory whenever property is transferred between spouses, or between former spouses, if the transfer is incident to divorce.

"Exclusions from gross income are construed narrowly, and taxpayers must bring themselves within the clear scope of the exclusion." *Zimmerman v. Comm.*, T.C. Memo. 2008-36, 2008 WL 449786, at *1.

Incident to Divorce

Q&A numbers below are from Temp. Reg. §1.1041-1T(b). Q 6 & 7, and provide guidance on the term *incident to divorce*.

Q-6 When is a transfer of property incident to divorce?

A-6 A transfer of property is incident to divorce in either of the following circumstances:

1. The transfer occurs not more than one year after the date on which the marriage ceases.
2. The transfer relates to the cessation of the marriage.

Thus, a transfer of property occurring not more than one year after the date on which the marriage ceases need not be related to the cessation of the marriage to qualify for IRC §1041 treatment. (See A-7 for transfers occurring more than one year after the cessation of the marriage.)

EXAMPLE

Clyde and Chris were divorced in June 2016. In July 2016, Clyde bought Dell Computer stock for $15,000. By December 2016, the value of the stock had increased to $30,000. Chris agrees to accept the stock in lieu of alimony for the subsequent year.

Clyde does not recognize a gain on the transfer. Chris' takes Clyde's basis and holding period. Clyde may not deduct any amount as alimony because the payment was not in cash, even though they were pre-TCJA payments.

Q-7 When is a transfer of property related to the cessation of the marriage?

A-7 A transfer of property is treated as related to the cessation of the marriage if the transfer is pursuant to a divorce or separation instrument, as defined in IRC §71(b)(2), and the transfer occurs not more than six years after the date on which the marriage ceases. A "divorce or separation instrument" includes a modification or amendment to such decree or instrument. Any transfer not pursuant to a divorce or separation instrument and any transfer occurring more than six years after the cessation of the marriage is presumed to be not related to the cessation of the marriage. This presumption may be rebutted only by showing that the transfer was made to effect the division of property owned by the former spouses at the time of the cessation of the marriage. For example, the presumption may be rebutted by showing that (a) the transfer was not made within the 1- and 6-year periods described above because of factors that hampered an earlier transfer of the property, such as legal or business impediments to transfer or disputes concerning the value of the property owned at the time of the cessation of the marriage; and (b) the transfer is effected promptly after the impediment to transfer is removed.

Transfers Not Related to Cessation of Marriage

As noted above under Q&A 7 in Reg. §1.1041-1T(b), any transfer that fails to meet either requirement listed above is presumed to not be related to the cessation of the marriage, unless it is shown that the transfer is made to effect a division of property owned by the spouses at the cessation of the marriage. The presumption may be rebutted by showing:

- the transfer was not made within the 1-year and 6-year periods described above because of factors that hampered an earlier transfer of the property, such as legal or business impediments to transfer or disputes concerning the value of the property owned at the time of the cessation of the marriage; and
- the transfer was completed promptly after the impediment to transfer was removed.

Deferred Payments

A promissory note from one former spouse to the other may be used to extend the time of payment by the transferor spouse. The transfer of the note pursuant to a property settlement agreement is deemed a transfer of property related to the cessation of the marriage and is nontaxable under IRC §1041.

The rules concerning imputed interest do not apply to notes arising out of property divisions. [Reg. §1.1274-1(b)(3)(iii)]

Belot v. Commissioner, TC Memo 2016-113, 6/13/16 – When things do not work out the way they hoped.

The issue in this case involved a transfer that was not pursuant to a divorce or separation instrument. After the taxpayer's marriage ended, the couple agreed to continue to operate their business as equal owners. It turned out they did not work well as partners in business and eventually Mr. Belot's former wife filed suit to end the arrangement, contending he "had mismanaged the business" and asked the court "to remove petitioner as director and employee of the business and to compel him to sell his shares of the business, either to the corporation or to Ms. Belot." The former partners in marriage did eventually enter into a settlement agreement in this matter.

Mr. Belot contended the transaction was a nonrecognition transaction governed by IRC §1041 since the transaction related to the cessation of his marriage. But, the IRS objected this was a separate transaction not governed by any divorce document; thus, it simply represented a sale by Mr. Belot of his interest in the businesses. The Tax Court notes while there is a presumption in the regulation that a transaction not covered by divorce instrument is not related to the cessation of the marriage, presumption can be overcome by sufficient evidence. The court also disagreed with IRS's view that the presumption can only be overcome if some legal or business issue prevented the matter from being included in the divorce decree. The court found that while that is offered as an example of how the presumption may be overcome, the regulation does not provide that as a specific condition to be able to overcome the presumption.

TRANSFERS FOR THE BENEFIT OF A SPOUSE

Qualifying Transfers

Transfers to third parties on behalf of a spouse qualify for nonrecognition treatment if one of three situations listed below applies. Written evidence that the transfers are on behalf of the former spouse of the transferor is required.

1. The transfer is required by the divorce or separation agreement.
2. The transfer is made at the written request of the other spouse (or former spouse).
3. The other spouse gives the transferor a written consent or ratification of the transfer to the third party.

Bifurcated Transfers

A transfer to a third party may be treated for tax purposes as two separate transfers.

- First, there is a deemed transfer to the spouse (or former spouse), which qualifies for nonrecognition under IRC §1041.
- The receiving spouse is treated as immediately transferring the property to a third party in a transaction that does not qualify for nonrecognition.
- The receiving spouse will recognize the tax consequences of the transfer to the third party. [Temp. Reg. §1.1041-1T(c), Q&A 9]

EXAMPLE

Bruce transfers appreciated property to the credit union in satisfaction of his divorcing spouse's loan. For tax purposes, this is considered as two separate transfers. Bruce is considered to have transferred the property to his former spouse tax-free under IRC §1041. The former spouse is deemed to have sold the property, and will report a gain as fair market value exceeds basis.

Transfer of Property with Liabilities in Excess of Basis

With the exception of transfers to a trust, there is no recognition of gain on the transfer of property subject to liabilities to a spouse or former spouse or where the transferee spouse assumes liabilities in excess of the basis of the property. [Reg. §1.1041-1T(d) Q&A 12]

Transfers in Trust [IRC §1041(e) and (g)]

The nonrecognition rules apply to transfers in trust for a spouse (or former spouse). The trust has a carryover basis for the property, which is the same as the transferee spouse would have.

There is an exception to the nonrecognition rule for the transfer of property to a trust to the extent that the sum of the liabilities assumed and the liabilities to which the property is subject exceed the adjusted basis of the property transferred. The basis of the property is increased by any gain recognized.

Transfers to a Nonresident Alien Spouse [Reg. §1.1041-1T(a) Q&A 3]

Nonrecognition treatment does not apply to transfers to a nonresident alien spouse or former spouse.

Transfers of Non-Marital Property

The nonrecognition rule applies to any transfers of property incident to a divorce, even though the transaction is not part of the division of marital property. [TRA 1984, Act. Section 421, House Committee Report]

Discharge of indebtedness between spouses is not a taxable event.

In a sole proprietorship, the arm's-length sale of inventory by one spouse to the other is not taxable. [Temp. Reg. §1.1041-1T(a), Q&A 2 ex. 2]

A sale of inventory by one spouse's wholly owned corporation to the other spouse does not qualify for nonrecognition treatment because the sale is not between spouses. The regulation warns us that the step-transaction doctrine may be applied to recharacterize such a transaction. [Temp. Reg. §1.1041-1T(a) Q&A 2 ex. 3]

Only transfers of tangible, intangible, or real property are governed by IRC §1041. If one spouse performs services for the other spouse, income will be recognized to the extent of compensation paid. [Temp. Reg. §1.1041-1T(a) Q&A 4]

Timing of Acquisition and Ownership of Property Transferred

The nonrecognition rules can apply to property acquired before, during, and after the marriage ceases. [Temp. Reg. §1.1041-1T(a) Q&A 5]

No gain or loss is recognized on the transfer of property whether it is owned by the paying spouse or is a division (equal or unequal) of community or jointly owned property. [Temp. Reg. §1.1041-1T(a) Q&A 10]

Transfers of Installment Obligations

If a spouse transfers an installment obligation that was received in a prior sale, the transferring spouse will not recognize gain on the transfer. [IRC §453B(g)]

The receiving spouse is entitled to the same tax treatment on collection of the installment payments as the transferring spouse would have received. [IRC §453B(g)(2)]

Transfer of an installment obligation to a trust for the benefit of a spouse will result in recognition of any previously untaxed gain by the transferring spouse.

- The trust's basis is equal to the remaining unpaid principal of the obligation.
- The trust would be taxed only on subsequent payments of interest income.

Assignment of Income

The transfer of the transferor's right to income (e.g., a deferred bonus or accounts receivable earned by the transferor) to the transferee spouse should not immediately cause the recognition of income by the transferor.

For example, the transfer of non-statutory stock options and non-qualified deferred compensation (not yet subject to income tax under IRC §83) as part of a divorce settlement is not a taxable event. When the option is exercised, or the deferred compensation distributed, the recipient spouse will be taxed on any income recognized in the transaction. [Rev. Rul. 2002-22, clarifying Rev. Rul. 87-112]

However, in the transfer of Series E and EE bonds to a spouse as part of a property settlement, the IRS held that while IRC §1041 bars recognition of gain on the sale or exchange of property, it does not apply to income that is assigned by one former spouse to another. The accrued interest on the bonds was taxable to the transferor at the time of the transfer and increased the basis to the transferee. [Rev. Rul. 87-112, 1987-2 C.B. 207]

Basis to the Transferee

The receiving spouse's basis in the transferred property is equal to the adjusted basis of the transferring spouse.

- The basis carryover rules apply regardless of the fair market value of the property or any associated debt assumed by the receiving spouse.
- No depreciation recapture will result if IRC §1041 applies. However, the transferee steps into the shoes of the transferor with respect to potential future recapture.

- If property subject to a mortgage in excess of its basis is transferred to a trust for the benefit of a spouse, then the excess of liability over basis will result in a gain to the transferor. [IRC §1041(e)]
  - This provision is corollary to the provisions of IRC §357(c) relative to transfers to a controlled corporation.
  - The amount of any gain will be added to the trust's basis in the property.
- The nonrecognition treatment does not apply if the receiving spouse is a nonresident alien. In that case, gain or loss will be recognized.

EXAMPLE

Transferring spouse, Ken, owns a capital asset with a basis of $100,000. Ken holds the asset for seven months before transferring it to receiving spouse, Karen. The fair market value of the asset at the time of transfer is $110,000. Karen holds the asset for six months and then sells it to a third party for $125,000. Karen recognizes $25,000 long-term capital gain. Karen takes Ken's basis of $100,000, not a basis equal to the asset's fair market value at the time of the transfer. [IRC §1041(b)(2)] Karen's gain is long-term because the combined holding period exceeded one year.

PLANNING CONSIDERATIONS

A spouse with an AMT credit may be able to offset tax on a large gain or recapture of depreciation on sale of a property.

The allocation of depreciable property between spouses must take into account after-tax value as well as the fair market value of the property. Since the tax situations of the spouses may be different, the after-tax value of each property must be carefully evaluated for each spouse. Because the receiving spouse has the same adjusted basis in the property as the transferring spouse [IRC §1041(b)(2)], the receiving spouse may recognize ordinary income on a subsequent disposition of the property. With potential ordinary income built into the depreciable property transferred between the former spouses, what may first appear to be a fair property settlement agreement may, in fact, result in unfavorable tax consequences to either spouse.

EXAMPLE

A couple owns land and business equipment worth $150,000 each. The land's basis is $135,000. The equipment cost is $100,000, but has a basis of $50,000. Wife receives the land, and husband receives the equipment pursuant to the property settlement agreement or divorce decree. Wife sells the land for fair market value, and must report a capital gain of $15,000. Husband sells the equipment, and recognizes $50,000 of ordinary income and $50,000 of IRC §1231 gain.

If one spouse is in the 12% bracket while the other is in the 35% bracket, the after-tax value of the same property would be different for each spouse.

A spouse with a net operating loss or capital loss carryforward might not incur tax on the sale of a property. Property with a lower basis and market value similar to other properties might not be worth less to this spouse.

- Realization of a large capital gain on sale of property might result in an alternative minimum tax and should be considered in determining its after-tax value.
- Transfer of IRAs is not covered by IRC §1041. Transfer of an IRA is tax-free if under a decree of divorce or separate maintenance under IRC §408(d)(6).

Care should be taken with transfers of IRA accounts. Any such transfer should be directly from the IRA custodian to an IRA for the benefit of the recipient spouse to avoid becoming currently taxable. Further, such a transfer must be included in a decree of divorce or separate maintenance or a written instrument incident to the decree.

RECORD KEEPING REQUIREMENTS

The transferring spouse must supply the receiving spouse with information to determine the following:

- Adjusted basis of the property
- Holding period
- Amount of potential depreciation recapture
- An affirmative election must be attached to the return for the year in which a transfer is made to have the provisions of §1041 of the Internal Revenue Code apply to all qualifying transfers. [Temp. Reg. §1.1041-1T(g) Q&A 18]

Unit 5

Retirement Plans & Benefits

LEARNING OBJECTIVES

- Obtain a general understanding of accepted allocation methods for dividing qualified plan benefits and deferred compensation between divorcing spouses.
- Discuss importance of Qualified Domestic Relations Order (QDRO) and required wording.
- Understand the federal income tax issues relating to QDRO distributions.
- Obtain a general understanding of how qualified plans are valued and importance of actuarial calculations.

ALLOCATION METHODS

There are two different methods for dividing retirement or deferred compensation plans between spouses.

Offset Method

The spouse who does not participate in the plan receives other marital assets in exchange for rights in the retirement plan. The entire interest in the plan is retained by the employee spouse.

The non-participant spouse would usually prefer this method, as money or other assets are received immediately and can be invested or used at their own discretion.

If the retirement plan has been accumulated over a long time period, the value of the plan is likely to be a large portion of the couple's assets. Substantial other assets would be required for the transfer to the non-employee spouse, as retirement plans generally do not allow for early withdrawal.

Deferred Method

Each spouse receives a share of the deferred benefits when they are paid in the future.

TRANSFER OF RIGHTS

The transfer of rights in a qualified retirement plan (pension or profit-sharing plan or employee stock ownership plan) in which one spouse participates in exchange for money or other property from the other spouse is a nontaxable transaction.

- The exchange of money for rights in a pension plan is not deemed a contribution to the plan.
- The receipt of money in exchange for rights in a pension plan is not considered a withdrawal from the plan.

QUALIFIED DOMESTIC RELATIONS ORDERS

Participants in qualified retirement plans may not assign or alienate their benefits unless it is pursuant to a qualified domestic relations order (QDRO). For additional information on QDROs, see the U.S. Department of Labor web site.

Defined

A QDRO is a domestic relations order relating to the provision of child support, alimony, or marital property rights that is issued under a state domestic relations law (including a community property law). [IRC §414(p)(1)(B)(ii)]

- The order can create or recognize the existence of an alternate payee's right to benefits. An alternate payee may be the spouse, child, or other dependent of the participant. [IRC §414(p)(8)]
- The order can be an assignment of the participant's rights to benefits. [IRC §414(p)(1)(A)(i)]
- A QDRO may be included as part of a divorce decree or court-approved property settlement, or issued as a separate order without affecting its qualified status if the following requirements are met:
  - Must use term *alternate payee*.
  - Must be pursuant to state domestic relation laws.
  - Must satisfy QDRO requirements (see specifications below).

Specifications

The QDRO must specify:

- name and last known mailing address of the participant and each alternate payee covered by the order;
- amount or percentage of the participant's benefits to be paid to each alternate payee or the manner in which the amount or percentage is to be determined;
- number of payments or the period for which the payments are required; and
- each plan to which the order applies.

Notice 97-11, 1997-1 C.B. 379, provides sample language that can be used in a QDRO. See Appendix F.

Benefits Subject to QDRO

The QDRO may assign all or any part of a participant's vested or accrued benefits and may include benefits to be accrued in the future.

Limitations

The benefits payable under a QDRO are subject to the limitations listed:

- The QDRO may not alter the amount or form of the benefits, or increase them.
- The assignment can only be for benefits accrued up to the time when benefits begin to be paid to the alternate payee.
- A prior QDRO takes precedence for benefits to be paid to the previous alternate payee.

TAXATION OF QDRO DISTRIBUTIONS

General

If the alternate payee is the participant's spouse, the participant's spouse is taxed when distributions are received. If the alternate payee is a child or other dependent of the plan participant, the participant is taxed on the distribution.

Excise Tax

The 10% excise tax for early distributions does not apply to an alternate payee pursuant to a QDRO. [IRC §72(t)(2)(C)] Withdrawals can be made immediately, if the plan provides, or the earlier of:

1. the date on which the participant is entitled to a distribution under the plan, or
2. the later of age 50, or when the participant would be eligible for benefits if the participant separated from service.

Note that this exception does not apply to IRA accounts of any type.

Special Provisions

The spouse or former spouse who is an alternate payee is taxed as if a participant. [IRC §402(e)(1)(A)]

- The alternate payee is eligible for the rollover exclusion on a timely transfer to an IRA or other qualified plan.
- The alternate payee may use special averaging for a qualified lump-sum distribution if the participant meets the eligibility requirements. [IRC §402(e)(4)(D)] and the specific plan provides for lump-sum options for alternate payees.

PAYMENTS BEFORE PARTICIPANT SEPARATES FROM SERVICE

Retirement Plans

Although a QDRO may not require the plan provide any form of benefit not otherwise provided under the plan, it is permissible for QDRO payments to begin as early as the participant reaches (or would have reached) the earliest retirement date. These early payments to an alternate payee are allowed regardless of whether the participant has separated from service. Under IRC §414(p)(4)(B), a participant's earliest retirement date is the earlier of the earliest date on which the participant is entitled to a distribution under the plan; or the later of the date the participant reaches age 50, or the earliest date on which the participant could start receiving distributions due to separation from service.

Profit-Sharing Plans

A profit-sharing plan permits distributions no earlier than separation from service. Therefore, the earliest date on which a QDRO can require benefit payments to an alternate payee is the earlier of the date the participant separates from service or the date the participant reaches age 50. QDRO payments are permitted at participant age 50 even if the participant has not separated from service.

VALUATION OF QUALIFIED PLANS

Defined Contribution Plans

A defined contribution plan has a readily determinable account balance, on which retirement benefits are based; therefore, determining the present value of future benefits is relatively simple. The important thing to remember here is that it may take a while to complete the QDRO, and during that time the value of the contribution plan may change significantly. Consequently, it should be stated in the divorce agreement whether or not the final calculation of value should be based on the value at the date of separation (or agreed-upon date of division) or should coincide with the market at the final date of distribution of funds.

Defined Benefit Plans

A defined benefit plan provides predetermined benefits based on amount of compensation and years of service. To calculate the annuity amount, one must factor in the plan benefit rate and the vesting percentage.

- The marital property value would be calculated by substituting for actual years in the plan, the number of service years while married, and the average annual income earned during those years.
- The present value computation is based on:
  - the participant's life expectancy,
  - interest rate, and
  - the date retirement payments begin (which affects the number of payments projected to be received by the participant).

Specialized Skill and Knowledge

Valuing qualified plan benefits requires specialized skill and knowledge. Very few accountants are qualified to make such calculations; therefore, most should defer to a certified actuary to avoid possible professional liability claims.

NONQUALIFIED RETIREMENT BENEFITS

Most non-qualified retirement plans are non-divisible in a divorce proceeding.

Retirement benefits paid out of an employer's general funds, such as deferred compensation or annual benefits in excess of amounts permitted under IRC §415, cannot be included in a QDRO because these nonqualified benefits are not paid out of a plan trust and are not subject to the anti-alienation and assignment rules of IRC §401(a). Important to note is that because most of these plans are non-divisible, the result will be to offset the value of this asset in the settlement. A key factor will be deciding what future benefits will be available and how those benefits will be calculated and taxed to the participant or spouse.

The divorce decree may assign a portion of such benefits paid by an employer to a non-participant spouse, but the court order cannot require payment prior to the time specified in the plan.

Nonqualified retirement benefits are not paid pursuant to a QDRO, but payments may be taxed to the nonparticipant spouse if paid as part of a divorce property settlement. [Rev. Rul. 2002-22]

There are no early distribution penalties for nonqualified plans.

QDRO ADVANTAGES

Benefit to Participant

Assuming a proper QDRO is executed, the alternate payee or spouse, not the participant, is responsible for the appropriate taxes on the distribution or withdrawal. If funds are distributed to an alternate payee or spouse when a QDRO does not exist, the distribution is treated as a taxable distribution to the participant. This might also create a second unfortunate result in that you have to consider the early withdrawal penalty if under the age of 59 ½.

Benefit to Alternate Payee or Spouse

The alternate payee or spouse is given opportunity to control management of money. This also allows for deferral of taxes until the funds are withdrawn if the alternate payee wishes to rollover funds.

INDIVIDUAL RETIREMENT ACCOUNTS

A transfer of an interest in an IRA to a spouse or former spouse pursuant to a decree of divorce or legal separation (or written instrument incident thereto) is not a taxable transfer. [IRC §408(d)(6)]

A QDRO is often used to document the tax-free transfer of a portion of one spouse's IRA to the other; however, technically a QDRO is for qualified retirement plans, not IRAs. To transfer an IRA to a spouse or former spouse, the language must be included in a decree of divorce or separate maintenance or a written instrument incident to the decree.

As of the transfer date, the interest in the IRA is treated as the spouse or former spouse's IRA.

An individual cannot deduct a payment to an IRA made during the year in which the decree of divorce or separate maintenance becomes final. You can only deduct contributions to your own IRA, not a former spouse.

SOCIAL SECURITY BENEFITS

Since many individuals are not covered by a qualified retirement plan and do not have any type of IRA, the main source of retirement benefits for those divorced spouses will be Social Security. However, if a divorced spouse has no work credits or only qualifies for minimal benefits, it is important to know that if the divorced spouse was a party to a long-term marriage, that spouse may be eligible to receive Social Security benefits on the former spouse's Social Security record.

Qualifying for Benefits

A divorced spouse can receive benefits under the former spouse's records if the following qualifications are met:

- The divorced spouse was married to the former spouse for at least 10 years.
- The divorced spouse is at least 62 years old.
- The divorced spouse is unmarried at the time of applying for benefits. If remarried to someone else, the divorced spouse can receive benefits under the former spouse's records only if either:
  - the subsequent marriage has ended by death, divorce, or annulment, or
  - the subsequent spouse is entitled only to certain types of Social Security auxiliary or survivor's benefits.
- The divorced spouse is not entitled to higher benefits under that spouse's own record.

Former Spouse's Record

The former spouse must be entitled to receive retirement or disability benefits.

If the former spouse is eligible but has not yet applied for benefits, the divorced spouse can still receive benefits as long the individual qualifies and has been divorced from the former spouse for *at least two years* (an independently entitled divorced spouse). A spouse divorced *less than* two years who meets all the requirements is entitled to a divorced spouse benefit *only* when the ex-spouse is receiving a Social Security benefit. A waiver to the 2-year independently entitled rule comes into play when a spouse whose divorce occurred after the couple had already started to collect Social Security benefits.

Deceased Former Spouse

The divorced spouse can receive survivor's benefits on the former spouse's record as long as the former spouse was entitled to full benefits and:

- the divorced spouse is at least 60 years old (or 50 years old and disabled),
- marriage to the former spouse lasted for at least 10 years, and
- the divorced spouse is not entitled to higher benefits under the spouse's own record.

If the survivor divorced spouse, applying for benefits remarried after attaining age 60 or age 50 and disabled, the subsequent marriage will be disregarded.

If the survivor divorced spouse is already entitled to benefits, those benefits will continue regardless of that person's age at the time of remarriage.

Other Beneficiaries

Any benefits being paid to a divorced spouse or a surviving divorced spouse will not affect benefits payable to any other person under the former spouse's record.

Therefore, retirement and/or survivor benefits can be paid to any number of current, former, or surviving spouses as long as each qualifies.

Amount of Benefits

- The maximum benefit is 50% of the benefit the former spouse would receive at full retirement age.
- A surviving divorced spouse would receive 100% of the deceased former spouse's benefit amount if at full retirement age or older.
- Actual benefits paid before the full retirement age of the divorced spouse are reduced based upon the age of the divorced spouse.
- A surviving divorced spouse would receive 71½% to 99% of the deceased former spouse's basic amount if the surviving divorced spouse starts receiving benefits between age 60 and full retirement age.
- A surviving divorced spouse who is disabled and aged 50 through 59 would receive 71½% of the deceased former spouse's basic amount.
- Other benefits amounts would apply if the surviving divorced spouse is caring for a child of the deceased former spouse.

Unit 6

Other Tax Considerations of Divorce

LEARNING OBJECTIVES

- Describe the requirements for claiming Child Care Credit.
- Explain the special rules for determining principal residence of divorced spouse for purposes of IRC §121.
- Discuss the tax planning opportunities related to passive activities.
- Discuss the effect of divorce on tax carryforward items: NOL, credits, capital losses, etc.

DEPENDENCY

General Rule

After the TCJA, there are no more dependency exemptions; however, dependency still matters for certain credits, as well as to obtain certain filing statuses. Under the general dependency rule for divorced parents, the custodial parent may claim a dependency exemption for the child if:

- both parents together provide more than one-half of the child's support during the year,
- the child is under age 19,
- the child is a student under age 24, or
- the child is 19 or older and is not a student, but the child has gross income of less than the current-year exemption amount.

Custody Defined

Custody is determined by the divorce decree. If the decree does not specify which parent has custody or there is joint custody, the dependency exemption should be claimed by the parent who has physical custody of the child for the greater portion of the year.

Adult Children

For a child over the age of majority, IRC §152(a) determines which parent may claim the dependency exemption. Under IRC §152(a), the parent who provided more than one-half of the support (the other support tests also being met) is entitled to claim the exemption.

Noncustodial Parents

The noncustodial parent is entitled to claim the dependency exemption if:

- The custodial parent relinquishes the exemption by completing IRS Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents. The noncustodial parent must attach a copy of the form to the tax return. Form 8332 can transfer for a single year, a specified number of years, or all future years. See exhibit at the end of this unit.
- The divorce decree or agreement was executed prior to 1985, and provides that the noncustodial parent is entitled to the dependency exemption, and the noncustodial parent provided at least $600 of child support.
- If the divorce decree went into effect after 1984 and before 2009, the noncustodial parent may claim the dependency exemption by attaching those pages from the decree that contain all of the following statements or information:
  - The noncustodial parent may claim the child as a dependent without any condition (such as being on child support)
  - The full name and birth date of the child
  - Social security numbers of custodial spouse
  - The custodial parent will not claim the child as a dependent
  - Signatures of both spouses (not their lawyers)
- That is the same information that would be required on Form 8332 (January 2010 revision).
- There is a multiple support agreement, Form 2120, Multiple Support Declaration, in effect and it designates the noncustodial parent as the person entitled to claim the exemption. See exhibit at the end of this unit.
- Phase-outs may cancel any perceived advantage for a high-income spouse to claim dependents.

Due Diligence

Beginning with 2016 tax returns, those preparing the returns for taxpayers will be charged with meeting *due diligence* requirements when taxpayers claim the child tax credit and the American Opportunity Tax Credit or face a $510 penalty if the taxpayer does not qualify for the credits [IRC §6695(g)]. For this reason, preparers must remember how strict the rules are for a noncustodial parent to be able to claim a child—and the mere fact the taxpayer's ex-spouse is in direct violation of the terms of the decree to release the exemption is not sufficient to allow the noncustodial parent to claim the credit.

What if the Form 8332 is not signed?

This problem is successfully illustrated in the case of *Cappel, Sr. v. Commissioner*, TC Memo 2016-150. The situation is one that could put a preparer who prepared a return claiming these children at risk for the penalty.

In this case, a Florida family court entered a child support order in the divorce case between petitioner and his first ex-spouse. The court ordered that petitioner "will receive the child dependency exemption" each and every year beginning in 2001 but "only if he remains current from this point forward in his payments of child support." Petitioner testified that he has been current in his child support payments at all relevant times, and respondent does not contend otherwise. However, the ex-spouse did not sign a Form 8332 for the year in question and, the petitioner did not attach that to the return. The petitioner did have a divorce decree providing he would be able to claim the children if he was current on his child support—and neither the Tax Court nor the IRS suggested he was not current in his obligations.

The problem, however, is that this is a *bright-line* test. Lacking the Form 8332 (including the spouse's signature), the petitioner simply could not claim the exemptions—and losing those, he also could not claim a child tax credit. A divorce decree or state court order, no matter how clear, simply is not adequate.

Revoking Form 8332

In CCA 201602009, Chief Counsel's office dealt with a matter of what happens when there is an attempt to revoke a Form 8332. Part II of the form was completed and on the line of Part II dealing with the years for which the release is effective, the words "all future years" were written. Part I of the form was not completed.

Chief Counsel noted that the Form 8332 had been attached to the return of the noncustodial parent. Form 8332 may be executed for all future years. Under IRC Reg. §1.152-4(e)(1)(ii), a Form 8332 that specifies all future years is treated as specifying the first taxable year after the taxable year of execution and all taxable years after that. Thus, although Part I was not completed, Part II was and the "all future years" language used in Part II of the form covers the taxable year. If the form is completed, signed, and attached to the noncustodial parent's return, the IRS should allow the dependency exemption for the children named on the form to the noncustodial parent and deny the custodial parent's claim to the dependency exemption.

If the custodial parent did not execute the Form 8332, the remedy is against the noncustodial parent. In addition, if the custodial parent did release the dependency exemption for all future years, the regulations under IRC §152 allow the custodial parent to revoke the release for the first calendar year *after* the year in which the release is revoked. Part III of Form 8332 is used for future year revocations. Revocations cannot be made retroactive to a prior year. According to the instructions for Part III of Form 8332 for revocation of a release, the custodial parent must provide a copy to the noncustodial parent and maintain proof of delivery or of the "reasonable efforts" to deliver it. In addition, the custodial parent must attach a copy to the return for *every year* an exemption is claimed due to the revocation of the earlier release.

CHILD CARE CREDIT

Generally, the custodial parent of a child under the age of 13 is eligible to claim a child care credit. The Child Care Credit is available only to the custodial parent. Requirements to claim the Child Care Credit include the following:

- The custodial parent must meet the dependency requirements for the child.
- The custodial parent is eligible to take the Child Care Credit, even if dependency has been transferred to the noncustodial parent. The noncustodial parent is never entitled to the Child Care Credit.
- If the separated parents collectively provide more than one-half of the support of a child, even if neither provides it individually, the custodial parent is entitled to take the Child Care Credit.
- Only expenses paid by the custodial parent qualify for the credit. If the custodial parent does not spend enough to qualify for the maximum credit, the custodial parent cannot use amounts spent by the noncustodial parent.
- The marital status of the custodial parent is important for determining eligibility for the credit. If the couple is considered to be married for tax purposes, a joint return must be filed to qualify for the Child Care Credit.

CHILD TAX CREDIT

The refundable Child Tax Credit is now $1,400 for each qualifying child, phased-out at higher income levels. [IRC §24] A qualifying child is one that can be claimed as a dependent for the dependency exemption.

The Tax Cuts and Jobs Act (TCJA) has lowered the earned income threshold for the refundable credit to $2,500.

Therefore, the Child Tax Credit, available up to $2,000 for qualifying dependents under age 17, may be refundable to the extent of 15% of the taxpayer’s earned income in excess of $2,500.

MEDICAL EXPENSES

A taxpayer's medical expense deduction includes expenses paid for a person who meets the IRC §152 definition of a dependent (relationship or member of household, citizenship, and support). IRC §213(d)(5) allows either divorced parent to deduct medical expenses paid for a child as long as both parents together provide more than half of the child's support.

FILING STATUS

Determination Date

Filing status is determined as of the last day of the tax year.

Marriage Termination

When is a marriage terminated for tax purposes? A couple remains married for tax purposes until:

- a final decree of divorce is issued by a domestic relations court;
- a final decree constituting a legal separation under local law is issued by a domestic relations court requiring the couple to live apart; and
- the *abandoned spouse rule* applies.

The abandoned spouse test is met if all of the following conditions are satisfied:

- The individual pays more than half the cost of maintaining the individual's household for the taxable year.
- The individual files a separate tax return.
- The individual's household is the principal home of a dependent child for more than six months of the year. This condition is met if the taxpayer is entitled to claim the dependency exemption for the child even if he or she does not actually claim the deduction.
- The individual lives apart from his or her spouse for the last six months of the taxable year.

A spouse must have received either a divorce decree or a decree of separate maintenance as of the last day of the tax year, or qualify as an *abandoned spouse* in order to file as an unmarried person. Without either of the exceptions, a divorcing spouse must file as *married filing separate*.

Head of Household Status

Requirements

To qualify for head of household status, the taxpayer must:

- be unmarried for tax purposes,
- maintain a home for a child for more than one-half of the year that constitutes the principal place of abode for that child, and
- pay more than one-half of the expenses of maintaining that home.

The requirement to pay more than one-half of the expenses of maintaining the home is not the same as providing more than one-half the support of a child for the dependency exemption. The expenses of maintaining the home include such costs as property taxes, insurance, mortgage payments, maintenance, and providing food on the premises. It does not, however, include support costs such as clothing, medical expenses, education, etc.

Dependency

To qualify for head of household status, the custodial parent does not have to be entitled to dependency for an unmarried child. For example, if the divorced parent had custody of a child, paid more than one-half of the expenses of maintaining the home, but both spouses together provided less than one-half of the support of the child, the custodial parent would still qualify for head of household status.

The following from IRS Publication 504 summarizes who is a qualifying person, qualifying you to file as head of household.

Table 2. **Who Is a Qualifying Person Qualifying You To File as Head of Household?**[1]

Caution. *See the text of this publication for the other requirements you must meet to claim head of household filing status.*

IF the person is your ...	AND ...	THEN that person is ...
qualifying child (such as a son, daughter, or grandchild who lived with you more than half the year and meets certain other tests)[2]	he or she is single	a qualifying person, whether or not you can claim an exemption for the person.
	he or she is married and you can claim an exemption for him or her	a qualifying person.
	he or she is married and you cannot claim an exemption for him or her	not a qualifying person.[3]
qualifying relative[4] who is your father or mother	you can claim an exemption for him or her[5]	a qualifying person.[6]
	you cannot claim an exemption for him or her	not a qualifying person.
qualifying relative[4] other than your father or mother (such as a grandparent, brother, or sister who meets certain tests)	he or she lived with you more than half the year, and he or she is related to you in one of the ways listed under *Relatives who don't have to live with you* in Pub. 501 and you can claim an exemption for him or her[5]	a qualifying person.
	he or she did not live with you more than half the year	not a qualifying person.
	he or she is not related to you in one of the ways listed under *Relatives who don't have to live with you* in Pub. 501 and is your qualifying relative only because he or she lived with you all year as a member of your household	not a qualifying person.
	you cannot claim an exemption for him or her	not a qualifying person.

[1] A person cannot qualify more than one taxpayer to use the head of household filing status for the year.

[2] See Table 3 for the tests that must be met to be a qualifying child. **Note.** If you are a noncustodial parent, the term "qualifying child" for head of household filing status does not include a child who is your qualifying child for exemption purposes only because of the rules described under *Children of Divorced or Separated Parents (or Parents Who Live Apart)* under *Exemptions for Dependents*, later. If you are the custodial parent and those rules apply, the child is generally your qualifying child for head of household filing status even though the child is not a qualifying child for whom you can claim an exemption.

[3] This person is a qualifying person if the only reason you cannot claim the exemption is that you can be claimed as a dependent on someone else's return.

[4] See Table 3 for the tests that must be met to be a qualifying relative.

[5] If you can claim an exemption for a person only because of a multiple support agreement, that person is not a qualifying person. See *Multiple Support Agreement* in Pub. 501.

[6] See *Special rule for parent*.

Separate Returns

If divorce has not been finalized, the issue of whether to file a joint return or separate returns can be a matter of considerable discussion. While it is true that there is almost always some tax savings overall by filing jointly, two considerations will often dictate that separate returns be filed.

1. Divorcing spouses cannot get along well enough to exchange information on a timely basis to get a joint return filed. One party can, unless prevented by the divorce court judge, file a separate return without waiting for the other party. If circumstances change, an amended return may be filed later to claim joint filing status; however, once a joint return has been filed, the parties cannot undo that return and file separately.

2. Issues regarding liability for unpaid taxes or questionable positions taken on the joint return (real or imagined) may lead one or both parties to want to file separately so not revisited by those issues in the future if there were to be an audit or the other spouse not pay the tax bill and be subject to interest and penalties which could be assessed against the other spouse as a joint filer. Even if the divorce decree allocates tax liabilities to each party, getting the other party to pay after the divorce and an assessment may be much more expensive than just paying the additional tax on a separate return.

The following table from IRS Publication 504 shows how certain itemized deductions should be handled when filing separate returns. Please note that spouses in a community property state will have different rules.

Table 1. **Itemized Deductions on Separate Returns**

This table shows itemized deductions you can claim on your married filing separate return whether you paid the expenses separately with your own funds or jointly with your spouse.
Caution: *If you live in a community property state, these rules do not apply. See Community Property.*

IF you paid ...	**AND you ...**	**THEN you can deduct on your separate federal return...**
medical expenses	paid with funds deposited in a joint checking account in which you and your spouse have an equal interest	half of the total medical expenses, subject to certain limits, unless you can show that you alone paid the expenses.
state income tax	file a separate state income tax return	the state income tax you alone paid during the year.
	file a joint state income tax return and you and your spouse are jointly and individually liable for the full amount of the state income tax	the state income tax you alone paid during the year.
	file a joint state income tax return and you are liable for only your own share of state income tax	the smaller of: • the state income tax you alone paid during the year, or • the total state income tax you and your spouse paid during the year multiplied by the following fraction. The numerator is your gross income and the denominator is your combined gross income.
property tax	paid the tax on property held as tenants by the entirety	the property tax you alone paid.
mortgage interest	paid the interest on a qualified home[1] held as tenants by the entirety	the mortgage interest you alone paid.
casualty loss	have a casualty loss on a home you own as tenants by the entirety	half of the loss, subject to the deduction limits. Neither spouse may report the total casualty loss.

[1] For more information on a qualified home and deductible mortgage interest, see Pub. 936, Home Mortgage Interest Deduction.

PRIMARY RESIDENCE

Exclusion of Gain [IRC §121]

All taxpayers are allowed to exclude gains on a principal residence sale of up to $250,000 ($500,000 MFJ). The exclusion is generally available once every two years. To qualify, the taxpayer must have owned and used the dwelling as a principal residence for two years of the five years prior to sale.

Restrictions on this exclusion of gain relate to the *non-qualified* use of the dwelling. A period of non-qualified use is one during which the property is rented to a third party, used by the taxpayer as a vacation home, or left unoccupied. The gain allocated to periods of non-qualified use; and therefore, *taxed* is derived by multiplying the gain by a fraction which is the sum of the periods of non-qualified use during the taxpayer's ownership over the period of taxpayer's ownership. This was enacted to deter taxpayers from purchasing a property for rental with the intention of later making it their principal residence for two years prior to sale to qualify for the entire exclusion.

A divorced spouse may treat periods of occupancy by her or his former spouse as his or her own. A spouse who receives the home in a divorce-related transfer counts the transferor's ownership period as his or her own.

Relief for Divorcing Taxpayers

A former spouse may also count the time the spouse or former spouse uses a residence for the spouse's own use. The spouse must have an ownership interest in the residence. This relief provision applies only for the period of time the spouse is granted use of the property under a divorce or separation instrument. [IRC §121(d)(3)(B)]

EXAMPLE

Jack and Jill are getting divorced. The divorce allows Jill to reside in the marital home that cost $200,000 until the couple's youngest child graduates from high school. After graduation, seven years later, the house is sold and the proceeds divided. The house sells for $400,000. Jack qualifies for an exclusion of up to $250,000 even though he has not lived in the home for more than seven years.

LEGAL FEES

Because a divorce is personal in nature, the IRS does not allow taxpayers to deduct expenses related to divorce [Reg. §1.262-1(a)(b)(7); *U.S. v. Patrick*, 372 U.S. 53 (1963)]. This rule is consistent with the Code's general theme of not allowing deductions for personal expenditures.

Divorce decrees will often specify that one party will pay the legal fees of the other "as and for alimony." Any such obligation must be conditional on the other party being alive. If the payment would be due even if the other spouse was no longer living, it cannot be alimony, and it will not be deductible.

If a portion of the legal fees is for tax advice, this amount can be deducted by the payor, as an itemized deduction, in the year paid. Ask the attorney to itemize the invoice. [IRC §2123, Temp. Reg. §1.67-1T(a)(1)(iii)]

Payments to the wife's advisor for tax advice cannot be deducted by the husband as he did not receive the tax advice. [*U.S. v. Davis*, 370 U.S. 65, (1962)]

Any part of attorney's fees and other costs paid in connection with a divorce, legal separation, separation agreement, or a decree for support which are properly attributable to the production or collection of amounts includible under IRC §71 (determination or collection of alimony) are deductible. [Reg. §1.262-1(b)(7)]

Legal fees incurred in defending nonpayment of alimony or in attempting to reduce alimony payments are not deductible. [*Sunderland v. Comm.*, T.C. Memo. 1977-116]

The paying spouse cannot generally deduct payment of the receiving spouse's legal fees. [*Martin v. Comm.*, 73 T.C. 255]

The deduction for legal fees is an itemized deduction, subject to the 2% aggregate floor for miscellaneous itemized deductions, and an AMT adjustment.

IRA CONTRIBUTIONS

IRC §408(d)(b) states that the transfer of an individual's interest in an IRA to a former spouse is a nontaxable event.

Alimony payments received by a spouse are treated as compensation for purposes of making contributions to an IRA. They are subject to the standard IRA limitations.

INVESTMENTS IN PASSIVE ACTIVITIES

Dispositions

When a taxpayer disposes of the entire interest in a passive activity, any suspended losses or credits must be accounted for.

- In a fully taxable disposition, the suspended losses (or credits) first offset gain or passive income, and then may be used to offset any other income.
- Under IRC §1041, a transfer between spouses is generally not taxable, therefore the transferring spouse is unable to utilize the suspended losses.
  - The loss is also not allowed because there is a transfer between related parties. [IRC §469(g)(1)(B)] The related party definition used for the passive activity rules includes spouses as related parties. [IRC §267(b)]
  - Suspended losses related to the transferred interest are added to its basis.

Tax Planning for Current Ownership of Passive Activities

The basic planning strategy is to offset passive income with passive loss.

- When dividing passive activity property, projected income and losses should be matched to determine the most advantageous ownership of the properties.
- Suspended losses of the transferring spouse are added to the basis of the interest in the passive activity, giving the receiving spouse the possibility of future deductions.

Tax Planning for Sale of Passive Activities

In the division of a passive activity property between spouses, it is essential to take into account the tax consequences of a disposition of the property.

- The spouse who sells the passive activity property would be able to utilize all of the suspended losses or credits.
- For property that was owned during years prior to TRA '86, a taxable disposition of the activity will probably generate gain in excess of the suspended losses.
  - The transferor spouse would escape taxation on the disposition even though the transferor spouse had the advantage of deducting losses in prior years.
  - The transferee spouse would probably be subject to a large amount of taxable income.
- One spouse may have unused capital losses or net operating losses that could offset any gain on disposition of the property.
- After the divorce, one spouse may be in a lower tax bracket than the other.

LIFE INSURANCE

Transfers

Transfer of an insurance policy would generally not be subject to gift tax if made under an agreement signed within two years before or one year after a decree of divorce is entered. [IRC §§ 2516, 2036, and 1041]

Proceeds

Life insurance proceeds are generally excluded from gross income under IRC §§101(a) and (b).

Transfers for Value [IRC §101(a)(2)]

If an insurance policy is transferred to a new owner for consideration paid to someone other than the insurance company, there is a transfer for value.

- The beneficiary can exclude the insurance proceeds from income only up to the value of the consideration paid plus any premiums paid after the transfer.
- Any additional proceeds are taxed as ordinary income. [IRC §61(a)(10)]

A transfer of an insurance policy under IRC §1041 is not a transfer for value because:

- The transferor is not deemed to receive any consideration.
- The transferee takes a carryover basis in the policy. [IRC §101(a)(2)(A)]

A former spouse, therefore, would not be taxed on the proceeds of an insurance policy transferred pursuant to IRC §1041.

TAX CARRYFORWARDS

Capital Loss Carryforwards

Losses on jointly owned or community property are generally divided equally between the parties. Losses on separately held property track to the property owner. Allocation of joint losses can be part of the negotiation process.

Charitable Contributions

For joint contributions, the carryforward can be apportioned in the ratio of what would have been absorbed had the couple been filing separate returns.

Net Operating Loss (NOL) Carryforwards

A joint NOL is apportioned between the spouses in the ratio of what separate NOL carryforwards would have been had the couple filed separately.

Alternative Minimum Tax (AMT) Credit

No guidance exists on the division of AMT credits for divorcing couples. Reason would suggest the credit be allocated to the holder of the property which generated the credit. The credit really belongs to the spouse who is smart enough to identify it.

Investment Interest Carryforwards

An investment interest carryforward can be allocated in any manner agreed to by the divorcing spouses. If both spouses could ultimately benefit from the deduction, negotiations should consider marginal tax brackets after the divorce.

S Corporation Losses

Recent tax legislation provides that S corporation losses limited by lack of basis or at risk investment are transferred with ownership of S corporation stock to a divorcing spouse. That assures each divorcing spouse will have the same tax attributes relating to their S corporation shares. [IRC §1366(d)(2)(B)]

Estimated Tax Payments

Jointly made estimates can be allocated by agreement of the taxpayers. If no agreement exists, the IRS will credit the taxpayer whose social security number appears first on the tax return (generally, the husband). An agreement should be in writing and attached to both separate returns.

PAYMENT GUARANTEES

Alimony Trust

Before the Tax Cuts & Jobs Act, it was not uncommon for a payor spouse to make alimony payments through a trust. For pre-TCJA divorces, a trust remains to be a desirable means of providing security to the payee spouse or simply to relieve the payor spouse of administrative responsibility. Under this arrangement, the payee spouse will receive the income generated from the trust principal. The payee spouse is taxed on the income generated by the trust [IRC §682(a)]. The payor spouse cannot claim a deduction for trust payments made to the payee spouse if, by reason of IRC §682, the amount of such payment is not includible in the payor's gross income. [IRC §215(d)]

Rationale

- Guarantees the payee spouse a series of future alimony payments.
- Eliminates risk involving the payor spouse's ability to make alimony or separate maintenance payments.
- Ensures trust principal is properly invested and managed to maximize return.

Mechanics of Distribution and Taxation

- The trust must include the income generated by the trust principal within its own gross income for the taxable year. [IRC §641(b)]
- The trust may deduct any income distributions made to the beneficiary to the extent the distributions do not exceed the trust's distributable net income. [IRC §§651,661]
- The beneficiary of the alimony trust must include the income distributions from the trust within gross income. [IRC §652(a)]
- If the income distributions exceed the trust's distributable net income, the excess amount passes tax-free to the beneficiary. [IRC §§652(a) and 643(a)]
- The income earned by the trust retains the same character as it passes through to the beneficiary.

To prevent the trust income from being characterized as child support, the payor spouse should avoid reductions in the amount of the income distributions based on the age of the children. To avoid the appearance of a property settlement, the trust principal should revert to the payor spouse on the payee spouse's death, remarriage, or other defined event.

Life Insurance

- Because alimony payments might stop on the death of the payor, consideration should be given to life insurance as a vehicle to assure payment.
- An existing policy could be used, or a new policy purchased. Insurability should be confirmed during the settlement negotiations.
- The alimony recipient spouse should either own the life insurance or be an irrevocable beneficiary.
  - This may ensure payment of premiums.
  - If the beneficiary spouse either owns the policy or is an irrevocable beneficiary, and the premiums are made under a legal obligation imposed by the decree, the premiums are considered alimony.

Disability Insurance

The recipient spouse will have the comfort of a guarantee of support payments if the paying spouse becomes disabled.

Mortgage on Real Property

One method of assuring payment is for the recipient spouse to secure a mortgage on real property owned by the paying spouse. In the event of default, the secured interest can be used to fulfill obligations of the paying spouse.

Transfer to Trust of Property of Paying Spouse

Property of the paying spouse could be transferred to a trust that would expire when the obligation for support terminated. For example, securities in a closely held or publicly held entity could be transferred to a trust. The owner of the stock cannot dispose of the securities until the obligation is fulfilled.

Form **2120**
(Rev. October 2018)
Department of the Treasury
Internal Revenue Service

Multiple Support Declaration

▶ Attach to Form 1040.
▶ Go to *www.irs.gov/Form2120* for the latest information.

OMB No. 1545-0074
Attachment Sequence No. **114**

Name(s) shown on return | **Your social security number**

During the calendar year ____________________, the eligible persons listed below each paid over 10% of the support of:

____
Name of your qualifying relative

I have a signed statement from each eligible person waiving his or her right to claim this person as a dependent for any tax year that began in the above calendar year.

Eligible person's name | Social security number
Address (number, street, apt. no., city, state, and ZIP code)

Eligible person's name | Social security number
Address (number, street, apt. no., city, state, and ZIP code)

Eligible person's name | Social security number
Address (number, street, apt. no., city, state, and ZIP code)

Eligible person's name | Social security number
Address (number, street, apt. no., city, state, and ZIP code)

Instructions

What's New

Exemption deduction suspended. The deduction for personal exemptions is suspended for tax years 2018 through 2025 by the Tax Cuts and Jobs Act. Although taxpayers can't claim a deduction for exemptions, eligibility for the exemption remains important for determining who may claim the credit for other dependents, as well as other tax benefits. See the instructions and Pub. 501 for details.

Purpose of Form

Use Form 2120 to:

- Identify each other eligible person (see below) who paid over 10% of the support of your qualifying relative whom you are claiming as a dependent, and
- Indicate that you have a signed statement from each other eligible person waiving his or her right to claim that person as a dependent.

An eligible person is someone who could have claimed a person as a dependent except that he or she didn't pay over half of that person's support.

If there are more than four other eligible persons, attach a statement to your return with the required information.

Note: The rules for multiple support agreements apply to claiming an exemption for a qualifying relative and don't apply to claiming an exemption for a qualifying child. For the definitions of "qualifying relative" and "qualifying child," see the instructions for your tax return and Pub. 501.

Claiming a Qualifying Relative

Generally, to claim a person as a qualifying relative, you must pay over half of that person's support. However, even if you didn't meet this support test, you may be able to claim him or her as a dependent if all five of the following apply.

1. You and one or more other eligible person(s) (see above) together paid over half of that person's support.

2. You paid over 10% of the support.

3. No one alone paid over half of that person's support.

4. The other dependency tests are met. See *Step 4, Is Your Qualifying Relative Your Dependent?* in the instructions for Form 1040.

5. Each other eligible person who paid over 10% of the support agrees not to claim that person as a dependent by giving you a signed statement. See *Signed Statement* on this page.

Note: To find out what is included in support, see Pub. 501.

Signed Statement

You must have received, from each other eligible person listed above, a signed statement waiving his or her right to claim the person as a dependent for the calendar year indicated on this form. The statement must include:

- The calendar year the waiver applies to,
- The name of your qualifying relative the eligible person helped to support, and
- The eligible person's name, address, and social security number.

Don't file the signed statement with your return. But you must keep it for your records and be prepared to furnish it and any other information necessary to show that you qualify to claim the person as your dependent.

Additional Information

See Pub. 501 for details.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You aren't required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The average time and expenses required to complete and file this form will vary depending on individual circumstances. For the estimated averages, see the instructions for your income tax return.

If you have suggestions for making this form simpler, we would be happy to hear from you. See the instructions for your income tax return.

Cat. No. 11712F   Form **2120** (Rev. 10-2018)

Form **8332**
(Rev. October 2018)
Department of the Treasury
Internal Revenue Service

Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent

▶ Attach a separate form for each child.
▶ Go to *www.irs.gov/Form8332* for the latest information.

OMB No. 1545-0074
Attachment Sequence No. **115**

Name of noncustodial parent | Noncustodial parent's social security number (SSN) ▶

Note: This form also applies to some tax benefits, including the child tax credit, additional child tax credit, and credit for other dependents. It doesn't apply to other tax benefits, such as the earned income credit, dependent care credit, or head of household filing status. See the instructions and Pub. 501.

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

I agree not to claim an exemption for ____________________
Name of child

for the tax year 20 _____.

Signature of custodial parent releasing claim to exemption | Custodial parent's SSN | Date

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

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

I agree not to claim an exemption for ____________________
Name of child

for the tax year(s) ____________________.
(Specify. See instructions.)

Signature of custodial parent releasing claim to exemption | Custodial parent's SSN | Date

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

I revoke the release of claim to an exemption for ____________________
Name of child

for the tax year(s) ____________________.
(Specify. See instructions.)

Signature of custodial parent revoking the release of claim to exemption | Custodial parent's SSN | Date

General Instructions

What's New

Exemption deduction suspended. The deduction for personal exemptions is suspended for tax years 2018 through 2025 by the Tax Cuts and Jobs Act. Although the exemption amount is zero, eligibility to claim an exemption may make you eligible for other tax benefits. See Pub. 501 for details. Although taxpayers can't claim a deduction for exemptions, eligibility to claim an exemption for a child remains important for determining who may claim the child tax credit, the additional child tax credit, and the credit for other dependents, as well as other tax benefits. See the instructions and Pub. 501 for details.

Purpose of Form

If you are the custodial parent, you can use this form to do the following.

• Release a claim to exemption for your child so that the noncustodial parent can claim an exemption for the child and claim the child tax credit, the additional child tax credit, and the credit for other dependents (if applicable).

• Revoke a previous release of claim to exemption for your child.

Release of claim to exemption. Complete this form (or sign a similar statement containing the same information required by this form) and give it to the noncustodial parent. The noncustodial parent must attach this form or similar statement to his or her tax return each year the exemption is claimed. Use Part I to release a claim to the exemption for the current year. Use Part II if you choose to release a claim to exemption for any future year(s).

Note: If the decree or agreement went into effect after 1984 and before 2009, you can attach certain pages from the decree or agreement instead of Form 8332, provided that these pages are substantially similar to Form 8332. See *Post-1984 and pre-2009 decree or agreement* on page 2.

Revocation of release of claim to exemption. Use Part III to revoke a previous release of claim to an exemption. The revocation will be effective no earlier than the tax year following the year in which you provide the noncustodial parent with a copy of the revocation or make a reasonable effort to provide the noncustodial parent with a copy of the revocation. Therefore, if you revoked a release on Form 8332 and provided a copy of the form to the noncustodial parent in 2018, the earliest tax year the revocation can be effective is 2019. You must attach a copy of the revocation to your tax return each year the exemption is claimed as a result of the revocation. You must also keep for your records a copy of the revocation and evidence of delivery of the notice to the noncustodial parent, or of reasonable efforts to provide actual notice.

Custodial Parent and Noncustodial Parent

The custodial parent is generally the parent with whom the child lived for the greater number of nights during the year. The noncustodial parent is the other parent. If the child was with each parent for an equal number of nights, the custodial parent is the parent with the higher adjusted gross income. For details and an exception for a parent who works at night, see Pub. 501.

Dependent Child

A dependent is either a qualifying child or a qualifying relative. See the instructions for your tax return for the definition of these terms. Generally, a child of divorced or separated parents will be a qualifying child of the custodial parent. However, if the special rule on page 2 applies, then the child will be treated as the qualifying child or qualifying

For Paperwork Reduction Act Notice, see back of form. Cat. No. 13910F Form **8332** (Rev. 10-2018)

relative of the noncustodial parent for purposes of the dependency exemption, the child tax credit, the additional child tax credit, and the credit for other dependents.

Special Rule for Children of Divorced or Separated Parents

A child is treated as a qualifying child or a qualifying relative of the noncustodial parent if all of the following apply.

1. The child received over half of his or her support for the year from one or both of the parents (see the *Exception* below). If you received payments under the Temporary Assistance for Needy Families (TANF) program or other public assistance program and you used the money to support the child, see Pub. 501.

2. The child was in the custody of one or both of the parents for more than half of the year.

3. Either of the following applies.

a. The custodial parent agrees not to claim an exemption for the child by signing this form or a similar statement. If the decree or agreement went into effect after 1984 and before 2009, see *Post-1984 and pre-2009 decree or agreement* below.

b. A pre-1985 decree of divorce or separate maintenance or written separation agreement states that the noncustodial parent can claim the child as a dependent. But the noncustodial parent must provide at least $600 for the child's support during the year. This rule does not apply if the decree or agreement was changed after 1984 to say that the noncustodial parent cannot claim the child as a dependent.

For this rule to apply, the parents must be one of the following.

• Divorced or legally separated under a decree of divorce or separate maintenance.

• Separated under a written separation agreement.

• Living apart at all times during the last 6 months of the year.

If this rule applies, and the other dependency tests in the instructions for your tax return are also met, the noncustodial parent can claim an exemption for the child.

Exception. If the support of the child is determined under a multiple support agreement, this special rule does not apply, and this form should not be used.

Post-1984 and pre-2009 decree or agreement. If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent can attach certain pages from the decree or agreement instead of Form 8332, provided that these pages are substantially similar to Form 8332. To be able to do this, the decree or agreement must state all three of the following.

1. The noncustodial parent can claim the child as a dependent without regard to any condition (such as payment of support).

2. The other parent will not claim the child as a dependent.

3. The years for which the claim is released.

The noncustodial parent must attach all of the following pages from the decree or agreement.

• Cover page (include the other parent's SSN on that page).

• The pages that include all of the information identified in (1) through (3) above.

• Signature page with the other parent's signature and date of agreement.

The noncustodial parent must attach the required information even if it was filed with a return in an earlier year.

Post-2008 decree or agreement. If the divorce decree or separation agreement went into effect after 2008, the noncustodial parent can't attach certain pages from the decree or agreement instead of Form 8332.

Specific Instructions

Custodial Parent

Part I. Complete Part I to release a claim to exemption for your child for the current tax year.

Part II. Complete Part II to release a claim to exemption for your child for one or more future years. Write the specific future year(s) or "all future years" in the space provided in Part II.

To help ensure future support, you may not want to release your claim to the exemption for the child for future years.

Part III. Complete Part III if you are revoking a previous release of claim to exemption for your child. Write the specific future year(s) or "all future years" in the space provided in Part III.

The revocation will be effective no earlier than the tax year following the year you provide the noncustodial parent with a copy of the revocation or make a reasonable effort to provide the noncustodial parent with a copy of the revocation. Also, you must attach a copy of the revocation to your tax return for each year you are claiming the exemption as a result of the revocation. You must also keep for your records a copy of the revocation and evidence of delivery of the notice to the noncustodial parent, or of reasonable efforts to provide actual notice.

Example. In 2015, you released a claim to exemption for your child on Form 8332 for the years 2016 through 2020. In 2018, you decided to revoke the previous release of exemption. If you completed Part III of Form 8332 and provided a copy of the form to the noncustodial parent in 2018, the revocation will be effective for 2019 and 2020. You must attach a copy of the revocation to your 2019 and 2020 tax returns and keep certain records as stated earlier.

Noncustodial Parent

Attach this form or similar statement to your tax return for each year you claim the exemption for your child. You can claim the exemption only if the other dependency tests in the instructions for your tax return are met.

If the custodial parent released his or her claim to the exemption for the child for any future year, you must attach a copy of this form or similar statement to your tax return for each future year that you claim the exemption. Keep a copy for your records.

Note: If you are filing your return electronically, you must file Form 8332 with Form 8453, U.S. Individual Income Tax Transmittal for an IRS *e-file* Return. See Form 8453 and its instructions for more details.

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The average time and expenses required to complete and file this form will vary depending on individual circumstances. For the estimated averages, see the instructions for your income tax return.

If you have suggestions for making this form simpler, we would be happy to hear from you. See the instructions for your income tax return.

Unit

7

Innocent Spouse Relief

LEARNING OBJECTIVES

- Know the filing and administrative process for innocent spouse claims.
- Understand the conditions necessary for innocent spouse relief.
- Demonstrate when different circumstances when relief may be granted.
- Understand the special rules for equitable relief.

QUALIFICATION EXPANDED

IRS Restructuring and Reform Act of 1998 - Basic Relief [IRC §6015(a)]

The IRS Restructuring and Reform Act of 1998 made it easier to qualify for Innocent Spouse Relief. A taxpayer may request relief of any amount (previously, the understatement had to be more than $500). To qualify, a taxpayer must have filed a joint return that has an understatement of tax due to an erroneous item of the other spouse.

Other Relief

The 1998 act added two additional relief provisions.

1. Separation of Liability [IRC §6015(c)]. If divorced, separated, or no longer living with the spouse, a taxpayer may request relief by separating the liability for an understatement of tax between the spouses (or former spouses). To qualify, the taxpayer must have filed a joint return that has an understatement of tax due to an item of the other spouse. A taxpayer is eligible for relief if:

   – the taxpayer is no longer married, or is legally separated.

– the taxpayer has not lived in the same household as the former spouse (or spouse) for one year before relief is applied for.

2. Equitable Relief [IRC §6015(f)]. The IRS may grant equitable relief if it would be unfair to hold the requesting spouse liable for the tax that should be paid by the other. To qualify, the taxpayer must have filed a return that has either an understatement or an underpayment of tax.

Effective Date

The expansion applies to tax liabilities arising after July 22, 1998, and to tax liabilities arising on or before that date unpaid as of July 22, 1998.

HOW TO REQUEST RELIEF (PUBLICATION 971)

Form 8857

Filing Form 8857, Request for Innocent Spouse Relief, is a petition for any type of innocent spouse relief.

Deadline [IRC §6015(b)(1)(E)]

Form 8857 must be filed no later than two years after the date on which the IRS first attempted to collect the tax from the spouse who is requesting relief.

Notification of Non-Petitioning Spouse (Revenue Procedure 2003-19, 1/31/2003)

The IRS is required to inform the former spouse (or spouse) if there is a request for innocent spouse relief or separation of liability. The location or address of the spouse requesting relief is kept confidential. The spouse, or former spouse, will be allowed to participate in the determination of the amount of relief from liability. Under this ruling, the non-petitioning spouse is allowed to file a written protest and request an administrative conference. After preliminary determination by the service of whether or not relief is granted, if the requesting spouse petitions the tax court from final determination, the non-petitioning spouse becomes a party to the proceeding. This can be an unfortunate circumstance and risky if this is a case involving abuse or domestic violence because the location of the victim may be revealed at this point.

INNOCENT SPOUSE RELIEF

General Rule

By requesting Innocent Spouse Relief, a taxpayer can be relieved of responsibility for paying tax, interest, and penalties if the other spouse had erroneous items on the return.

- The tax, interest, and penalties that qualify for relief can only be collected from the spouse responsible for the erroneous items. However, each is jointly and individually responsible for any tax, interest, and penalties that do not qualify for relief. The IRS can collect these amounts from either spouse, regardless of impending divorce proceedings.
- A taxpayer must meet all of the following conditions to qualify for Innocent Spouse Relief.
  - A taxpayer filed a joint return that has an understatement of tax due to erroneous items of the taxpayer's spouse.
  - The taxpayer establishes that when joint return was signed, the taxpayer did not know, and had no reason to know, that there was an understatement of tax.
  - Taking into account all the facts and circumstances, it would be unfair to hold the taxpayer liable for the understatement of tax.

Erroneous Items

Erroneous items are either of the following.

- Unreported Income. This is any gross income item received by a spouse that is not reported.
- Incorrect Deduction, Credit, or Basis. This is any improper deduction, credit, or property basis claimed by a spouse.
- Examples of Erroneous Items
  - The expense for which the deduction is taken was never paid. For example, Bob deducted $10,000 of advertising expenses on Schedule C (Form 1040), but never paid for any advertising.
  - The expense does not qualify as a deductible expense. For example, Bill claimed a business fee deduction of $10,000 that was for the payment of state fines; fines are not deductible.
  - No legal argument can be made to support the deductibility of the expense. For example, Betty claimed $4,000 for security costs related to a home office, which were actually veterinary and food costs for the family's two dogs.

Understatement of Tax

In general, an understatement of tax is the difference between the total amount of tax that should have been shown on a return and the amount of tax that was actually shown on the return.

The IRS will figure the understatement of tax due to erroneous items of a spouse after Form 8857 is filed.

A taxpayer may qualify for partial relief if at the time the return was filed, knew or had reason to know, there was an understatement of tax due to the spouse's erroneous items, but did not know how large the understatement was. The taxpayer will be relieved of the understatement to the extent that taxpayer did not know about it and had no reason to know about it.

EXAMPLE

At the time Jane signed the joint return, she knew that her spouse did not report $5,000 of gambling winnings. The IRS examined her tax return several months after she filed it and determined that her spouse's unreported gambling winnings were actually $25,000. This resulted in a much larger understatement of tax than she knew about at the time she signed her return. She established that she did not know about, and had no reason to know about, the additional $20,000 because of the way her spouse handled the gambling winnings. The understatement of tax due to the $20,000 will qualify for Innocent Spouse Relief if she meets the other requirements. The understatement of tax due to the $5,000 of gambling winnings will not qualify for relief.

Indications of Unfairness

The IRS will consider all of the facts and circumstances of the case to determine whether it is unfair to hold the taxpayer responsible for the understatement. Two indicators the IRS may use to decide that it is unfair to hold a taxpayer responsible for the tax:

1. Taxpayer received any significant benefit from the understatement of tax.

2. Taxpayer was later divorced from or deserted by the spouse.

SEPARATION OF LIABILITY

General

Under this type of relief, the understatement of tax (plus interest and penalties) on a joint return is allocated between spouses. To request relief by separation of liability, the taxpayer must have filed a joint return and meet either of the following requirements:

1. The taxpayer is no longer married to, or is legally separated from, the spouse with whom the joint return was filed. (Under this rule, the taxpayer is no longer married if widowed.)

2. The taxpayer was not a member of the same household as the spouse with whom the joint return was filed at any time during the 12-month period ending on the date Form 8857 is filed.

Invalid Requests

Even if the taxpayer meets the requirements discussed previously, a request for separation of liability will not be granted in the following situations:

1. The IRS proves the spouses transferred assets are part of a fraudulent scheme.

2. The IRS proves that at the time the joint return was signed, the taxpayer had actual knowledge that any items giving rise to the deficiency and allocable to the spouse were incorrect.

3. The taxpayer transferred property to the spouse (or former spouse) just to avoid tax or the payment of tax.

In situations (2) and (3), a request will be denied only for the part of the deficiency due to the incorrect items about which the taxpayer had actual knowledge, or to the extent of the value of the property transferred. If a taxpayer can establish the return was signed under duress, it is not a joint return, and the taxpayer is not liable for amounts from that return. However, a separate return for that tax year may be required.

Transfers of Property to Avoid Tax

If one spouse transfers property to the other spouse for the main purpose of avoiding tax or payment of tax, the tax liability allocated will be increased by the value of the property transferred. A transfer will be presumed to have as its main purpose the avoidance of tax or payment of tax if the transfer is made after the date that is one year before the date on which the IRS sent its first letter of proposed deficiency allowing an opportunity for a meeting in the IRS Appeals Office. This presumption will not apply if the transfer was made under a divorce decree, separate maintenance decree, or a written instrument incident to such a decree.

Calculation of Separate Liability

The IRS will figure the taxpayer's separate liability and any related interest and penalties after a completed Form 8857 with the required attachment is filed.

Equitable Relief

Cathy Marie Lantz; 132 T.C. No. 8, (4/7/09)

A decision of the U.S. Tax Court, Cathy Marie Lantz; 132 T.C. No. 8, (4/7/09), invalidated the 2-year statute of limitations on filing an equitable relief claim imposed under Treasury Regulation §1.6015-5(b)(1). The Lantz decision was overturned on appeal by the 7th Circuit Court of Appeals on June 9, 2010. However, the Tax Court continued to side with taxpayers asserting the statute of limitations was inconsistent with congressional intent to have the Treasury Secretary exercise

discretion in granting equitable relief from an underpayment of income tax if a requesting spouse "does not know, and had no reason to know, that funds intended for the payment of tax were instead taken by the other spouse for such other spouse's benefit." Congress also expressed its desire for the Secretary to exercise the equitable relief authority if, "taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or part of any unpaid tax or deficiency arising from a joint return." The mounting pressure from the Tax Court, taxpayers, and Congress forced IRS to reconsider its position.

Notice 2011-70

The IRS has issued this notice providing the IRS will no longer deny an individual's request for equitable relief under §6015(f) on grounds that the request was filed more than two years after the IRS first acted to collect the liability from the individual. Effective July 25, 2011, an individual was eligible to have the IRS consider a request for equitable relief if the request was filed with the IRS during the period when the IRS could collect the tax liability or during the period for a refund of a payment of the liability, whichever period applies. A taxpayer whose equitable relief request was previously denied solely due to the 2-year limit could reapply using IRS Form 8857, Request for Innocent Spouse Relief, if the collection statute of limitations for the tax years involved had not expired. Taxpayers with cases in suspense were automatically afforded the new rule. The IRS stated it would not apply the 2-year limit in any pending litigation involving equitable relief, and, where litigation was final, the agency would suspend collection action under certain circumstances.

Proposed Regulations

On August 12, 2013, IRS published proposed regulations amending Reg. §1.6015-5 conforming the regulations to Notice 2011-70. The proposed regulations remove the 2-year statute of limitations for equitable relief. The deadline is replaced with a requirement that an equitable relief request be filed within the IRC §6502 or IRC §6511 limitation period, whichever applies to the request. The proposed regulations provide that a requesting spouse may elect the application of IRC §6015(b) or (c) or request equitable relief under IRC §6015(f) as part of the collection due process hearing.

Revenue Procedure 2013-34

Effective September 16, 2013, Revenue Procedure 2013-34 was issued which supersedes Revenue Procedure 2003-61, thereby revising the rules for spouses requesting equitable relief under IRC §§66(c) and 66(f). Revenue Procedure 2013-34 provides:

1. the threshold requirements for any request for equitable relief (Section 4.01);

2. conditions under which the IRS will make streamlined relief determinations granting equitable relief under IRC §6015(f) from an understatement of income tax or an underpayment of income tax reported on a joint return, or the operation of community property law under IRC §66(c) (Section 4.02); and

3. a nonexclusive list of factors for consideration in determining whether relief should be granted because it would be inequitable to hold a requesting spouse jointly and severally liable (Section 4.03).

General Conditions for Relief

A requesting spouse must satisfy all of the following threshold conditions to be eligible to submit a request for equitable relief.

1. The requesting spouse filed a joint return for the taxable year for which he or she seeks relief.

2. Relief is not available to the requesting spouse under IRC §6015(b) or (c).

3. The claim for relief is timely filed:

   - For an unpaid liability, the date the period of limitation on collection of the income tax liability expires, as provided in IRC §6502. Generally, that period expires 10 years after the assessment of tax.

   - For claims for credit or refund of amounts paid, before the expiration of the period of limitation on credit or refund. Generally, that period expires three years from the time the return was filed or two years from the time the tax was paid, whichever is later.

4. No assets were transferred between the spouses as part of a fraudulent scheme by the spouses.

5. The non-requesting spouse did not transfer disqualified assets to the requesting spouse. If the non-requesting spouse transferred disqualified assets to the requesting spouse, relief will be available only to the extent that the income tax liability exceeds the value of the disqualified assets. If the non-requesting spouse abused the requesting spouse or maintained control over the household finances by restricting the requesting spouse's access to financial information, or the requesting spouse did not have actual knowledge that disqualified assets were transferred, the requesting spouse may still be eligible for relief.

6. The requesting spouse did not knowingly participate in the filing of a fraudulent joint return.

7. The income tax liability from which the requesting spouse seeks relief is attributable (either in full or in part) to an item of the non-requesting spouse or an underpayment resulting from the non-requesting spouse's income. If the liability is partially attributable to the requesting spouse, then relief can only be considered for the portion of the liability attributable to the non-requesting spouse. IRS can still give relief if any of the following exceptions apply:

   - Attribution of ownership is solely due to the operation of community property law.

   - The requesting spouse has only nominal ownership.

- The requesting spouse did not know, and had no reason to know, that funds intended for the payment of tax were misappropriated by the non-requesting spouse for the non-requesting spouse's benefit.

- The requesting spouse establishes that he or she was the victim of abuse prior to the time the return was filed, and that, as a result of the prior abuse, the requesting spouse was not able to challenge the treatment of any items on the return, or was not able to question the payment of any balance due reported on the return, for fear of the non-requesting spouse's retaliation.

- The requesting spouse establishes that the non-requesting spouse's fraud is the reason for the erroneous item.

Circumstances for Streamlined Determinations Granting Equitable Relief

The Service will make streamlined determinations granting equitable relief in cases in which the requesting spouse establishes that the requesting spouse:

1. is no longer married to the non-requesting spouse.

2. would suffer economic hardship if relief were not granted.

3. did not know or have reason to know that there was an understatement or deficiency on the joint income tax return, or did not know or have reason to know that the non-requesting spouse would not or could not pay the underpayment of tax reported on the joint income tax return. Much deference is given to requesting spouses who can show abuse by a non-requesting spouse.

Equitable Factors

If a streamlined determination does not apply, Revenue Procedure 2013-34 provides an expanded list of equitable factors that may be considered based on the requesting spouse's marital status, economic hardship, knowledge or reason to know, any legal obligations under the divorce decree or other binding agreement, significant benefits the requesting spouse received from the unpaid liability or understatement, good faith compliance with income tax laws in tax years following the year for which relief is sought, and poor physical or mental health.

Chief Counsel Notice, CC-2013-011

This Notice issued June 7, 2013, provides Chief Counsel attorneys with guidance regarding the standard and scope of review that the Tax Court applies when reviewing requests for IRC §6015(f) relief from joint and several liability. This Notice also provides litigation guidance for cases that involve claims for relief under IRC §6015.

1. In all IRC §6015(f) cases, the scope of review is de novo (allows the Tax Court to consider new evidence not previously submitted). The standard of review is also de novo (the Tax Court can look at all aspects of the case as if it was the first set of eyes to see it, instead of having to look through the eyes of the IRS appeals officers).

2. If the IRS has not made a determination regarding entitlement to equitable relief, the trial attorney must request a determination and share it with the taxpayer.

3. Where time allows, the determination should be to perform an appeals review.

4. The trial attorney is given discretion to settle the matter before going to trial in Tax Court or to proceed to trial if the trial attorney believes that the evidence would warrant not following the IRS's determination.

5. This Notice highlights the Chief Counsel's intention to provide taxpayers with an opportunity to pursue an equitable relief claim at several levels and to adhere more closely to Congress' intent to provide the possibility for relief when all other avenues are blocked.

Other Current Developments

- *Asad and Akel v. Commissioner*, TC Memo 2017-80—In this case, the IRS agreed each of the now divorced spouses should be liable for only a portion of the tax due, each qualifying for Innocent Spouse Relief under IRC §6015 for tax liabilities arising from rental properties owned by the other spouse. However, the taxpayers, while accepting that neither should be liable for the entire balance due, argued that rather than using the allocation the IRS arrived at based on the ownership of the properties leading to the tax liability, each should be relieved of 50% of the liability. That is, they proposed to split the tax evenly.

  The IRS had the right to collect the entire balance due (the taxpayers did not dispute what was owed in total) and the ex-spouses had a court document (their divorce decree) providing for an even split. However, the Tax Court noted the decree bound only those who were a party to it, and that did not include the IRS. Rather, the Tax Court noted, each generally remained joint and severally liable for the tax due, with any reduction in their personal liability being governed by the innocent spouse provisions found at IRC §6015.

- *Rubel v. Commissioner*, CA3, No. 16-3526—If the IRS erroneously informs a taxpayer the last day for filing a Tax Court petition is later than the actual deadline [90 days after the IRS mailed its determination of final relief in this case as provided in IRC §6015(e)(1)(A)], does it extend the time the taxpayer has to file with the Tax Court? In this case, the Third Circuit Court of Appeals ruled that the answer is no—the Tax Court lacks jurisdiction to hear the case once the 90-day period expires, despite the erroneous information provided by the IRS. The opinion notes that IRC §6015 specifically refers to the Tax Court's jurisdiction to hear the case if the petition is filed within 90 days of the IRS determination. The burden is on the taxpayer and their advisers to determine the proper deadline for challenging a matter in Tax Court, and the taxpayer cannot rely on deadline dates provided by the IRS.

Form **8857**
(Rev. January 2014)
Department of the Treasury
Internal Revenue Service (99)

Request for Innocent Spouse Relief

► **Information about Form 8857 and its separate instructions is at *www.irs.gov/form8857*.**

OMB No. 1545-1596

Important things you should know

- **Do not file this form with your tax return.** See *Where To File* in the instructions.
- Review and follow the instructions to complete this form. Instructions can be obtained at *www.irs.gov/form8857* or by calling 1-800-TAX-FORM (1-800-829-3676).
- While your request is being considered, the IRS generally cannot collect any tax from you for the year(s) you request relief. However, filing this form extends the amount of time the IRS has to collect the tax you owe, if any, for those years.
- The IRS is required by law to notify the person on line 5 that you requested this relief. That person will have the opportunity to participate in the process by completing a questionnaire about the tax years you enter on line 3. This will be done before the IRS issues preliminary and final determination letters.
- The IRS will not disclose the following information: your current name, address, phone numbers, or employer.

Part I Should you file this form?

Generally, both you and your spouse are responsible, jointly and individually, for paying any tax, interest, or penalties from your joint return. If you believe your current or former spouse should be solely responsible for an erroneous item or an underpayment of tax from your joint tax return, you may be eligible for innocent spouse relief.

Innocent spouse relief may also be available if you were a resident of a community property state (see list of community property states in the instructions) and did not file a joint federal income tax return and you believe you should not be held responsible for the tax attributable to an item of community income.

1 **Do either of the paragraphs above describe your situation?**

☐ Yes. You should file this Form 8857. Go to question 2.

☐ No. Do not file this Form 8857, but go to question 2 to see if you need to file a different form.

2 **Did the IRS take your share of a joint refund from any tax year to pay any of the following past-due debt(s) owed ONLY by your spouse?** • Child support • Spousal support • Student loan (or other federal nontax debt) • Federal or state taxes

☐ Yes. You may be able to get back your share of the refund. See Form 8379, Injured Spouse Allocation, and the instructions to that form. Go to question 3 if you answered "Yes" to question 1.

☐ No. Go to question 3 if you answered "Yes" to question 1. If you answered "No" to question 1, do not file this form.

3 **If you determine you should file this form, enter each tax year you want innocent spouse relief.** It is important to enter the correct year. For example, if the IRS used your 2011 income tax refund to pay a 2009 joint tax liability, enter tax year 2009, not tax year 2011.

Tax Year ________ Tax Year ________ Tax Year ________
Tax Year ________ Tax Year ________ Tax Year ________

Part II Tell us about yourself and your spouse for the tax years you want relief

4 Your current name (see instructions)	**Your social security number**	
Address where you wish to be contacted. If this is a change of address, see instructions.		
Number and street or P.O. box	Apt. no.	**County**
City, town or post office, state, and ZIP code. If a foreign address, see instructions.	Best or safest daytime phone number (between 6 a.m. and 5 p.m. Eastern Time)	

5 **Who was your spouse for the tax years you want relief?** File a separate Form 8857 for tax years involving different spouses or former spouses.

That person's current name	**Social security number** (if known)
Current home address (number and street) (if known). If a P.O. box, see instructions.	Apt. no.
City, town or post office, state, and ZIP code. If a foreign address, see instructions.	Daytime phone number (between 6 a.m. and 5 p.m. Eastern Time)

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Cat. No. 24647V Form **8857** (Rev. 1-2014)

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part II Tell us about yourself and your spouse for the tax years you want relief *(Continued)*

6 What is the current marital status between you and the person on line 5?

- ☐ Married and still living together
- ☐ Married and living apart since ______ MM DD YYYY
- ☐ Widowed since ______ MM DD YYYY — Attach a photocopy of the death certificate and will (if one exists).
- ☐ Legally separated since ______ MM DD YYYY — Attach a photocopy of your entire separation agreement.
- ☐ Divorced since ______ MM DD YYYY — Attach a photocopy of your entire divorce decree.

Note. A divorce decree stating that your former spouse must pay all taxes does not necessarily mean you qualify for relief.

7 What was the highest level of education you had completed when the return(s) were filed? If the answers are **not** the same for all tax years, explain.

- ☐ Did not complete high school
- ☐ High school diploma or equivalent
- ☐ Some college
- ☐ College degree or higher. List any degrees you have ▶ ______

List any college-level business or tax-related courses you completed ▶ ______

Explain ▶ ______

8 Were you or other members of your family a victim of spousal abuse or domestic violence, or suffering the effects of such abuse during any of the tax years you want relief or when any of the returns were filed for those years?

☐ Yes. If you want the IRS to consider this information in making its determination, complete Part V of this form in addition to other parts of the form. First read the instructions for Part V, to understand how the IRS will proceed with evaluating your claim for relief in these circumstances.

If you checked "Yes" above, we will put a note on your separate account. This will enable us to respond appropriately and be sensitive to your situation. We will remove the note from your account if you request it (as explained in the instructions).
If you do not want us to put a note on your account, check here . . . . ▶ ☐

☐ No. Complete the other parts of this form except for Part V.

9 When any of the returns listed on line 3 were filed, did you have a mental or physical health problem or do you have a mental or physical health problem now? If the answers are **not** the same for all tax years, explain below.

☐ Yes. **Attach a statement** to explain the problem and **when** it started. Provide photocopies of any documentation, such as medical bills or a doctor's report or letter.

☐ No.

Explain ▶ ______

10 Is there any information you are afraid to provide on this form, but are willing to discuss?

☐ Yes ☐ No

Part III Tell us if and how you were involved with finances and preparing returns for those tax years

11 Did you agree to file a joint return? ☐ Yes ☐ No

Explain why or why not ▶ ______

12 Did you sign the joint return? See instructions. ☐ Yes ☐ No

Explain why or why not ▶ ______

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part III Tell us if and how you were involved with finances and preparing returns for those tax years *(Continued)*

13 What was your involvement with preparing the returns? Check all that apply and explain, if necessary. If the answers are **not** the same for all tax years, explain.

- ☐ You were not involved in preparing the returns.
- ☐ You filled out or helped fill out the returns.
- ☐ You gathered receipts and cancelled checks.
- ☐ You gave tax documents (such as Forms W-2, 1099, etc.) for the preparation of the returns.
- ☐ You reviewed the returns before they were filed.
- ☐ You did not review the returns before they were filed. Explain below why you did not review the returns.
- ☐ You did not know a joint return was filed.
- ☐ Other ▶

Explain how you were involved ▶

14 When the returns were filed, what did you know about any incorrect or missing information? Check all that apply and explain, if necessary. If the answers are **not** the same for all tax years, explain below.

- ☐ You knew something was incorrect or missing, but you said nothing. Explain below.
- ☐ You knew something was incorrect or missing and asked about it. Explain below.
- ☐ You did not know anything was incorrect or missing.
- ☐ Not applicable. There was no incorrect or missing information.

Explain ▶

15 When any of the returns were filed, what did you know about the income of the person on line 5? Check all that apply and explain, if necessary. If the answers are **not** the same for all tax years, explain.

- ☐ You knew that the person on line 5 had income.

  List each type of income on the lines provided below. (Examples are wages, social security, gambling winnings, or self-employment business income.) Enter each tax year and the amount of income for each type you listed. If you do not know any details, enter "I don't know."

- ☐ You knew that the person on line 5 was self-employed and you helped with the books and records.
- ☐ You knew that the person on line 5 was self-employed and you did not help with the books and records.
- ☐ You knew that the person on line 5 had no income.
- ☐ You did not know whether the person on line 5 had income.

Explain why you did not know whether the person on line 5 had income ▶

16 When the returns were filed, did you know if the returns showed a balance due to the IRS for those tax years? If the answers are **not** the same for all tax years, explain.

- ☐ Yes. Explain when and how you thought the amount of tax reported on the return would be paid ▶
- ☐ No. Explain why you did not know the return showed a balance due. ▶
- ☐ Not applicable. There was no balance due on the return.

17 When any of the returns were filed, were you having financial problems (for example, bankruptcy or bills you could not pay)? If the answers are **not** the same for all tax years, explain.

- ☐ Yes. Explain ▶
- ☐ No.
- ☐ Did not know. Explain ▶

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part III Tell us if and how you were involved with finances and preparing returns for those tax years *(Continued)*

18 **For the years you want relief, how were you involved in the household finances?** Check all that apply. If the answers are **not** the same for all tax years, explain.

- ☐ You were not involved in handling money for the household. Explain below.
- ☐ You knew the person on line 5 had separate accounts.
- ☐ You had joint accounts with the person on line 5, but you had limited use of them or did not use them. Explain below.
- ☐ You used joint accounts with the person on line 5. You made deposits, paid bills, balanced the checkbook, or reviewed the monthly bank statements.
- ☐ You made decisions about how money was spent. For example, you paid bills or made decisions about household purchases.
- ☐ Other ▶ ______

Explain anything else you want to tell us about your household finances ▶ ______

19 **Did you (or the person on line 5) incur any large expenses, such as trips, home improvements, or private schooling, or make any large purchases, such as automobiles, appliances, or jewelry, during any of the years you want relief or any later years?**

☐ Yes. Describe (a) the types and amounts of the expenses and purchases and (b) the years they were incurred or made.

☐ No.

20 **Has the person on line 5 ever transferred assets (money or property) to you?** (Property includes real estate, stocks, bonds, or other property that you own or possess now or possessed in the past.) See instructions.

☐ Yes. List the assets, the dates they were transferred, and their fair market values on the dates transferred. If the property was secured by any debt (such as a mortgage on real estate), explain who was responsible for making payments on the debt, how much was owed on the debt at the time of transfer and whether the debt has been satisfied. Explain why the assets were transferred to you. If you no longer possess or own the assets, explain what happened with the assets.

☐ No.

Part IV Tell us about your current financial situation

21 **Tell us about your assets.** Your assets are your money and property. Property includes real estate, motor vehicles, stocks, bonds, and other property that you own. In the table below, list the amount of cash you have on hand and in your bank accounts. Also list each item of property, the fair market value (as defined in the instructions) of each item, and the balance of any outstanding loans you used to acquire each item. Do not list any money or property you listed on line 20.

Description of Assets	Fair Market Value	Balance of Any Outstanding Loans You Used To Acquire the Asset

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part IV Tell us about your current financial situation *(Continued)*

22 **How many people are currently in your household, including yourself?** Adults ______ Children ______

23 **Tell us your current average monthly income and expenses for your entire household.**

Monthly Income — If family or friends are helping to support you, include the amount of support as gifts below.	**Amount**
Gifts	
Wages (Gross pay)	
Pensions	
Unemployment	
Social security	
Government assistance, such as housing, food stamps, grants	
Alimony	
Child support	
Self-employment business income	
Rental income	
Interest and dividends	
Other income, such as disability payments, gambling winnings, etc. List each type below:	
Type	
Type	
Type	
Total Monthly Income	

Monthly Expenses — Enter all expenses, including expenses paid with income from gifts.	**Amount**
Food and Personal Care:	
Food	
Housekeeping supplies	
Clothing and clothing services	
Personal care products and services	
Transportation:	
Auto loan/lease payment, gas, insurance, licenses, parking, maintenance, etc.	
Public transportation	
Housing and Utilities:	
Rent or mortgage	
Real estate taxes and insurance	
Electric, oil, gas, water, trash, etc.	
Telephone and cell phone	
Cable and Internet	
Medical:	
Health insurance premiums	
Out-of-pocket expenses	
Other:	
Child and dependent care	
Caregiver expenses	
Income tax withholding (federal, state, and local)	
Estimated tax payments	
Term life insurance premiums	
Retirement contributions (employer required)	
Retirement contributions (voluntary)	
Union dues	
Unpaid state and local taxes (minimum payment)	
Student loans (minimum payment)	
Court-ordered debt payments (for example, court- or agency-ordered child support, alimony and garnishments). List each type below:	
Type	
Type	
Type	
Miscellaneous	
Total Monthly Expenses	

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part V Complete this part if you were (or are now) a victim of domestic violence or spousal abuse

As stated in line 8, providing this additional information is not mandatory but may strengthen your request. **Additionally, if you prefer to provide this information orally, check the "Yes" box on line 10.**

If you were (or are now) a victim of domestic violence or spousal abuse by the person on line 5, the IRS will consider the information you provide in this part to determine whether to grant innocent spouse relief. However, the IRS is required by law to notify the person on line 5 that you requested this relief. There are no exceptions to this rule. That person will have the opportunity to participate in the process by completing a questionnaire about the tax years you entered on line 3. This will be done before the IRS issues preliminary and final determination letters. However, the IRS is also required by law to keep all the personal identifying information (such as current names, addresses, and employment-related information) of both you and the person on line 5 confidential. This means that the IRS cannot disclose one person's information to the other person. If the IRS does not grant you relief and you choose to petition the Tax Court, your personal identifying information is available, unless you ask the Tax Court to withhold it.

The person on line 5 will receive a questionnaire about the tax years you entered on line 3. Except for your current name, address, phone numbers, and employer, this form and any attachments could be disclosed to the person on line 5. If you have any privacy concerns, see instructions.

The IRS understands and is sensitive to the effects of domestic violence and spousal abuse, and encourages victims of domestic violence to call 911 if they are in immediate danger. **If you have concerns about your safety,** please consider contacting the 24-Hour (Confidential) National Domestic Violence Hotline at 1-800-799-SAFE (7233), or 1-800-787-3224 (TTY), or 1-855-812-1001 (Video Phone Only for Deaf Callers) before you file this form.

A representative from the IRS may call you to gather more information and discuss your request. Be sure you enter your correct contact information on line 4.

24a During any of the tax years for which you are seeking relief or when any of the returns were filed for those years, did the person on line 5 do any of the following? Check all that apply. (Note. If this does not apply to you, skip lines 24a, b, and c, and complete lines 25 through 29.)

- ☐ Physically harm or threaten you, your children, or other members of your family.
- ☐ Sexually abuse you, your children, or other members of your family.
- ☐ Make you afraid to disagree with him/her.
- ☐ Criticize or insult you or frequently put you down.
- ☐ Withhold money for food, clothing, or other basic needs.
- ☐ Make most or all the decisions for you, including financial decisions.
- ☐ Restrict or control who you could see or talk to or where you could go.
- ☐ Isolate you or keep you from contacting your family members and/or friends.
- ☐ Cause you to fear for your safety in any other way.
- ☐ Stalk you, your children, or other members of your family.
- ☐ Abuse alcohol or drugs.

b Describe the abuse you experienced, including approximately when it began and how it may have affected you, your children, or other members of your family. Explain how this abuse affected your ability to question the reporting of items on your tax return or the payment of the tax due on your return.

c Attach photocopies of any documentation you have, such as:

- Protection and/or restraining order.
- Police reports.
- Medical records.
- Doctor's report or letter.
- Injury photographs.
- A statement from someone who was aware of or witnessed the abuse or the results of the abuse (notarized if possible).
- Any other documentation you may have.

25 Are you afraid of the person listed on line 5?

☐ Yes ☐ No

26 Does the person listed on line 5 pose a danger to you, your children, or other members of your family?

☐ Yes ☐ No

27 Were the police, sheriff, or other law enforcement ever called?

☐ Yes ☐ No

28 Was the person listed on line 5 charged or arrested for abusing you, your children, or other members of your family?

☐ Yes. Provide details below.

☐ No

29 Have you sought help from a local domestic violence program?

☐ Yes. Provide details below.

☐ No

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part VI Additional Information

30 Please provide any other information you want us to consider in determining whether it would be unfair to hold you liable for the tax.

Part VII Tell us if you would like a refund

31 By checking this box and signing this form, you are indicating that you would like a refund if you qualify for relief and if you already paid the tax. See instructions . . . . . ☐

Caution

By signing this form, you understand that, by law, we must contact the person on line 5. See instructions for details.

Sign Here

Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this form and any accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

Form **8857** (Rev. 1-2014)

Unit

8

Valuation of a Closely Held Business

LEARNING OBJECTIVES

- Recognize common valuation methods.
- Determine which method is most appropriate for a particular type of business.

BACKGROUND

A common issue, probably the most common, which results in the retention of a CPA in a divorce case, is the valuation of a closely held business. If the size of the business warrants, there will commonly be two CPAs, or other valuation experts, offering their opinions, one for each of the parties. Since each of the parties has a stake in whether the value is high or low, the CPA can be thrust into the role of an advocate.

The CPA performing this service should be aware that there are different considerations in a divorce valuation from those for other purposes. In most valuations, the owner of the business will be forthcoming with the facts and data necessary to perform this service with a minimum of time and expense. In the divorce situation, depending on which side you are representing, the owner may take just the opposite tack.

We will discuss common valuation methods and their application and problems in the divorce arena (a carefully chosen phrase). Common valuation methods and a brief description of each follow.

CERTIFICATION AND LICENSING

As the field of business valuation has grown, it has evolved in to a recognized discipline where special training, certifications, and licensing for CPAs are imperative and essential if you plan to do significant work in valuing businesses, particularly with respect to divorce cases and litigation.

As a CPA, it is expected and required to know applicable law and regulations concerning the IRC and application thereof. It is now expected that CPAs have special training in the area of expert testimony. Attorneys now actually have courses in their seminar offerings entitled "How To Tear Down an Expert Witness." Most expert witnesses have either CPA licensing or equivalent expertise. You do not want to put yourself in a situation where you are considered to be the expert in valuing a company for a divorce case, and you do not know the methods and processes and/or case law to substantiate your determination of value. Not only are attorneys apprising themselves of valuation methodology, judges are also becoming fairly savvy in this discipline.

There are several well-respected organizations that train and issue certifications in valuation and other related disciplines.

COMMON VALUATION APPROACHES

Balance Sheet Approaches

- Book Value. Unadjusted net worth from the latest available balance sheet.
- Adjusted Book Value. Latest available net worth plus/(minus) adjustments for appraisals of specific assets, LIFO reserves, etc.
- Liquidation Value. Value based on sale of all or part of the business—usually assumes an orderly sale over a reasonable period of time.

Earnings-Based Approaches

- Earnings Capitalization. Historical earnings are first weighted and averaged. The average-weighted earnings are divided by a capitalization rate. The higher the rate, the lower the valuation, and vice versa.
- Earnings Multiple. Average-weighted historical earnings are multiplied by a price-earnings multiple. An appropriate P-E multiple is usually estimated from similar companies that are publicly traded. Make sure you are using the same, or comparable, earnings (i.e., EBIT, EBITDA, free cash flow, discretionary cash flow).
- Discounted Future Earnings or Cash Flows. Earnings are estimated for the next 5-, 7-, or 10-year period and discounted to the present. The use of this method often produces relatively high valuations. Cash flows may be substituted for earnings. Higher estimated interest rates produce lower present value factors and lower valuations. Most courts will deem this an inappropriate method due to the speculative nature of future earnings or cash flows.

Combination Approaches

- Excess Return on Assets. Adjusted net assets are multiplied by an expected earnings rate commonly obtained through reference to a statistical source (compiled by SIC code) to derive expected earnings. The expected earnings are then compared to average historical earnings. Any excess earnings are capitalized as an estimate of goodwill. The goodwill value is then added to net asset value adjusted to fair value.

- Excess Return on Sales. Average historical sales are multiplied by an expected earnings rate to derive expected earnings based on sales. The expected earnings are compared to average historical earnings. Excess earnings are capitalized as goodwill. The goodwill value is then added to the adjusted net asset value.

APPLICATION OF VALUATION METHODS IN DIVORCE

Valuations have the intent of quantifying two things, (1) net tangible and intangible asset values and (2) goodwill. In the divorce situation, the date will commonly be the date of the divorce, or date of separation. The value of the net assets should be determined in accordance with forensic accounting techniques and proper accounting conventions. This leaves goodwill.

The valuation of goodwill is by definition, subjective. The CPA must carefully look at the situation and choose the method that fits. The value of any business is essentially based on the realization of asset values. Goodwill is based on the expectation of future earnings.

You should check your state laws relevant to whether or not your client resides in a community property state or an equitable distribution state. You also need to be aware of whether or not goodwill is part of the marital estate, and which part. The majority of states distinguish between tangible goodwill and personal goodwill. Personal goodwill is not a marital asset; business (or enterprise goodwill) is a marital asset subject to division.

Note that while personal goodwill is not a martial asset to be divided in some states, it is relevant to the alimony/child support calculations in the divorce proceedings.

Let's look at the valuation methods listed above and their application in divorce situations.

Balance Sheet Approaches

These deal with only the net assets of the business, either from an accounting standpoint or from a liquidation standpoint. Since this ignores goodwill and in most situations, the business will not be liquidated, these are not appropriate measures of value.

Earnings Based Approaches

- Earnings Capitalization. In some jurisdictions, this method of valuing goodwill is not allowed. You must be aware of the laws governing marital property in your particular jurisdiction.
- Earnings Multiple. Some jurisdictions will not allow earnings multiples of large publicly traded corporations to be used to value small, closely held businesses.
- Discounted Future Earnings. This method may have the same problem as the earnings capitalization method in certain jurisdictions.

Combination Methods

- Excess Return on Assets. The value of a business in excess of its assets, goodwill is based on the expectation of future profits. Some jurisdictions do not recognize the existence of professional goodwill as a marital asset. For a business to continue as a going concern, it is necessary for goodwill to constantly be redeveloped. Since marital goodwill is only that which existed at the time of the divorce, the discounting of future income must take into account goodwill created after the divorce date and factor it into the calculation.
- Excess Return on Sales. The same problems as with excess return on assets are inherent in the use of this method. Each situation must be judged individually. There is no single method that will always be used. The value of a business as marital property will be different from the price a willing buyer might pay. In a divorce situation, the owner is not leaving the business. This must be taken into account, as must the factor of the diminishing value of the goodwill existing at the time of the divorce.

Sufficient investigatory field work must be the underlying foundation to the work. All pertinent factors such as business trends, history, and capacities must be considered. The key to success is for the appraiser to apply well-based theories and be prepared to defend all assumptions as appropriate to the particular situation.

OTHER INFORMATION

The usefulness of the valuation will be dependent on the accuracy of the underlying information.

There are developments that could affect the requirements for CPAs to be licensed to perform valuation services. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989, commonly referred to as FIRREA was enacted as part of Congress' response to the savings and loan debacle.

A portion of the act requires that individuals with demonstrated competency, and subject to effective supervision perform appraisals made in connection with federally related transactions in writing, with uniform standards. This would involve any real estate transaction of a federal financial institution, regulatory agency, or the RTC. This could result in the inclusion of the business valuator under the same standards as real estate appraisers in some states. The issue is whether the valuation of personal

property, which makes up most business assets, would be included under the rules for appraiser certification and licensing.

The guidelines for a state certified general appraiser call for an individual who meets at least the Appraisal Qualifications Board's (AQB) minimum criteria to be considered a certified general real property appraiser and passes an examination issued and endorsed by the AQB. Various requirements for CPE and experience are set forth. States are specifically prohibited from grandfathering any individual or group from meeting these criteria. Various responses can be expected.

EXAMPLE – VALUATION OF A CLOSELY HELD BUSINESS

BUSINESS VALUATION REPORT
SMITH PROPERTIES, INC.
As of September 30, 20XX

Prepared by Ronald M. Donald, CPA
November 31, 20XX

PURPOSE OF THE VALUATION

This appraisal was made for the purpose of determining the value of the corporation for use in selling the Corporation. The appraisal was performed directly for the Corporation. This appraisal should not be used for any other purpose as the result may not be appropriate for other applications.

SCOPE OF VALUATION

Financial analysis was made on the basis of the Corporation's financial records, including income tax returns, internally prepared financial statements, assets listings, depreciation records, and other documents. The latest year for which income tax returns were available was for the year ended December 31, 20DD. Interim financial statements for the period ended September 30, 20XX were provided.

Operational analysis was based on interviews with Mrs. Jones.

In making this appraisal, all relevant factors affecting the fair market value of the corporation were considered:

1. The nature and history of the business.

2. The economic outlook.

3. The book value and financial condition of the business.

4. The earning capacity of the business.

5. Whether or not the business has goodwill or intangible value.

BASIS OF VALUE

The basis of value in this appraisal is predicated on the concept of *fair market value*. The fair market value concept identifies the estimated price a willing buyer would pay a willing seller for the interest in the corporation being appraised.

This *fair market value* represents an estimate of what a willing buyer would pay and what a willing seller would accept, under the facts and circumstances existing at the valuation date.

NATURE OF THE BUSINESS

The business is located on Burning Tree Road, Any City, Any State, and is organized and taxed as a C Corporation. Smith Properties, Inc., operates as an entity primarily engaged in the management of rental real estate.

The Corporation was incorporated in 1980.

FINANCIAL HISTORY OF THE BUSINESS

Historically, except for the year ended December 31, 20DD and nine months ended September 30, 20XX, the Corporation has been profitable. The following schedule reports the gross revenue and net profit reported on the federal income tax returns or internal financial statements for each of the years shown.

Smith Properties, Inc.	Gross Revenue	Net Profit
Year Ended December 31, 20AA	$179,472	$21,534
Year Ended December 31, 20BB	198,824	24,304
Year Ended December 31, 20CC	215,417	2,243
Year Ended December 31, 20DD	169,633	(2,271)
Nine Months Ended September 30, 20XX	109,847	(9,816)

BUSINESS VALUATION METHODS

Three valuation methods were applied in this case:

(1) Capitalization of earnings

(2) Capitalization of excess earnings

(3) Economic balance sheet

CAPITALIZATION OF EARNINGS

The capitalization of earnings method is determined by evaluating prior net earnings and projecting future earnings divided by an expected rate of return.

For the purposes of this valuation, earnings were projected to be $6,579, and the expected rate of return was 20%.

CAPITALIZATION OF EXCESS EARNINGS

The application of this method is based on the assumption that the business has value in both tangible and intangible assets. The capitalization of excess earnings places value on the intangible assets as the excess earnings represent profits from the intangibles of the business and contribute to the substantive value of the business.

ECONOMIC BALANCE SHEET

The economic balance sheet method is determined by restating the balance sheet to reflect the current fair market value of all reported and unreported assets. The resulting net worth value reflects an economic fair replacement value of the assets and liabilities of the business.

VALUATION RESULT

The appraised value of Smith Properties, Inc., is $20,000 (see Exhibit 5). This valuation is primarily based on financial information that can be reviewed by examining various exhibits as follows:

Exhibit 1 – Summary

Exhibit 2 – Capitalization of earnings

Exhibit 3 – Capitalization of excess earnings

Exhibit 4 – Economic balance sheet

Exhibit 1

SMITH PROPERTIES, INC.

SUMMARY OF VALUATION

9/30/200X

Capitalization of Earnings	$28,845
Capitalization of Excess Earnings	$35,415
Economic Balance Sheet	$23,710

Exhibit 2

SMITH PROPERTIES, INC.

CAPITALIZATION OF EARNINGS

9/30/20XX

Projected Net Earnings are based on a normalization of net income for the years ended November 30, 20AA through December 31, 20DD.

Projected Net Earnings	$6,579 / 20% =	$32,895
Total Value		$32,895
Less Liabilities Other Than Escrow Payable		(4,050)
		$28,845

Exhibit 3

SMITH PROPERTIES, INC.

CAPITALIZATION OF EXCESS EARNINGS

9/30/20XX

Capitalization of Excess Earnings

Fair Market Value of Assets:		
Cash	$113,834	
Mortgage/Accounts Receivable	19,478	
Other Current Assets	7,100	
Fixed Assets	1,559	
Total Assets	141,971	
Total Liabilities	118,261	
Estimated Fair Market Value $23,710 × 8% =	$1,897	
Project Net Earnings	$6,579	
Less: Reasonable Return on Assets	(1,897)	
Excess Earnings Attributable to Goodwill	$4,682	
Goodwill Valuation $4,682 =	$11,705	40%
Estimated Fair Market Value	$23,710	
Goodwill Valuation	11,705	
Value Based on Capitalization of Excess Earnings	$35,415	

Exhibit 4

SMITH PROPERTIES, INC.

ECONOMIC BALANCE SHEET

9/30/20XX

ASSETS	VALUE
Cash	$113,834
Mortgage/Accounts Receivable	19,478
Other Current Assets	7,100
Fixed Assets	1,559
Total Assets	$141,971
LIABILITIES	
Accounts Payable	2,519
Accrued Payroll Taxes	1,531
Estimated Taxes	3,380
Escrow Deposits	110,831
Total Liabilities	118,261
Net Value	$23,710

Exhibit 5

SMITH PROPERTIES, INC.

VALUATION COMPUTATION

September 30, 20XX

Appraised Value	$25,000
*Discount (20%)	(5,000)
Value	$20,000

* Discount Due to Lack of Marketability

SMITH PROPERTIES, INC.

BALANCE SHEET

	11/30/aa	ONE MONTH ENDED 12/31/aa	12/31/bb	12/31/cc	12/31/dd	NINE MONTHS ENDED 09/30/xx	ADJUSTING ENTRIES	ADJUSTED BALANCES	FAIR MARKET VALUE
CASH	$1,691	$374	$630	$43	$686	$3,283	$(280)	$3,003	$3,003
ESCROW CASH ACCOUNTS	104,375	114,402	129,885	149,671	165,180	165,179	(54,348)	110,831	110,831
ACCOUNTS RECEIVABLE	0	0	0	6,300	0	0		0	0
MORTGAGE/REAL ESTATE LOANS	33,203	33,170	24,150	15,290	15,176	15,090	160	15,250	15,250
LOANS TO STOCKHOLDERS	0	0	0	0	4,228	4,228		4,228	4,228
TOTAL CURRENT ASSETS	139,269	147,946	54,665	71,304	185,270	187,780	(54,468)	133,312	133,312
FIXED ASSETS	111,706	111,706	91,812	88,684	100,441	56,413	(8,849)	47,564	47,564
LESS ACCUMULATED DEPRECIATION	(50,032)	(50,487)	(48,775)	(43,034)	(48,675)	(54,648)	8,788	(45,860)	(46,005)
INTANGIBLE ASSETS	820	820	2,140	2,140	2,140	3,260	(3,260)	0	0
LESS ACCUMULATED AMORTIZATION	701	(715)	(952)	(1,216)	(1,480)	(1,480)	1,480	0	0
PREPAID TAXES	1,850	1,800	0	0	0	(1,054)	8,154	7,100	7,100
TOTAL ASSETS	$204,314	$211,070	$198,890	$217,878	$237,696	$190,271	(48,155)	$142,116	$141,971
SHORT-TERM NOTES PAYABLE	$791	$5,591	3,440	$0	$9,841	$0	$0	$0	$0
ACCOUNTS PAYABLE	0	0	0	0	0	0	2,519	2,519	2,519
ACCRUED PAYROLL TAXES	1,695	2,069	1,518	1,917	1,928	1,426	105	1,531	1,531
ESTIMATED TAXES							3,380	3,380	3,380
LOANS FROM STOCKHOLDERS	15,929	18,837	2,772	2,772	0	0		0	0
TOTAL CURRENT LIABILITIES	18,415	26,497	7,730	4,689	11,769	1,426	6,004	7,430	7,430
NOTES PAYABLE	45,622	33,200	0	0	0	0		0	0
ESCROW DEPOSITS	104,375	114,402	29,885	149,671	165,180	165,179	(54,348)	110,831	110,831
TOTAL LIABILITIES	168,412	174,099	137,615	154,360	176,949	166,605	(48,344)	118,261	118,261
COMMON STOCK	1,000	1,000	1,000	1,000	1,000	1,000		1,000	1,000
RETAINED EARNINGS	34,902	35,971	60,275	62,518	59,747	73,996	189	74,185	74,040
DIVIDENDS PAID	0	0	0	0	0	0		0	0
TREASURY STOCK	0	0	0	0	0	(51,330)		(51,330)	(51,330)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$204,314	$211,070	$198,890	$217,878	$237,696	$190,271	$(48,155)	$142,116	$141,971

SMITH PROPERTIES, INC.

INCOME STATEMENT

FOR THE PERIODS ENDED NOVEMBER 30, 200A, DECEMBER 31, 200A, 200B, 200C, 200D, AND SEPTEMBER 30, 200X

	11/30/aa	ONE MONTH ENDED 12/31/aa	12/31/bb	12/31/cc	12/31/dd	NINE MONTHS ENDED 09/30/XX	ADJUSTING ENTRIES	ADJUSTED BALANCES
SALES	$170,653	$13,500	$188,659	$198,900	$151,400	$103,545		$103,545
INTEREST	2,219	108	2,830	1,837	1,380	959	160	1,119
RENTAL INCOME	6,600	550	7,335	8,380	7,425	2,874		2,874
MISCELLANEOUS INCOME				6,300	9,428	1,255	1,054	2,309
TOTAL RECEIPTS	179,472	14,158	198,824	215,417	169,633	108,633	1,214	109,847
ADVERTISING	8,108	1,048	6,726	15,258	10,433	4,852	334	5,186
AIR TIME COMMUNICATIONS	1,216	0	915		2,032	2,661	198	2,661
AMORTIZATION	0	0	237		0	0	47	198
AUTO EXPENSE	8,403	0	11,350		5,909	4,808		4,855
BANK CHARGES	299	73	298		53	358	79	358
CREDIT REPORTS	0	86	1,301		1,176	659		738
CONTRACT LABOR/ COMMISSIONS	2,349	216	0		5,246	4,598		4,598
CONTRIBUTIONS	0	0	0		527	0		0
DEPRECIATION	13,813	455	15,010	6,670	5,641	998	1,817	2,815
DUES AND SUBSCRIPTIONS	663	39	536		953	1,234	36	1,270
EDUCATION FEES	0	0	0		1,168	311		311
EMPLOYEE BENEFITS	0	0	0		1,275	0		0
INSURANCE	2,356	0	3,115		6,302	3,866		3,866
INTEREST	2,790	118	810	119	7,125	684		684
MISCELLANEOUS	930	85	1,177	48,812	48	767	280	1,047
OFFICE PAGER	0	0	115		0	0	277	277
OFFICE SUPPLIES	8,978	367	7,154		4,280	5,077	281	5,358
POSTAGE	1,175	200	1,275		2,055	1,173	25	1,198
PROFESSIONAL FEES	925	0	1,588		1,568	6,518	135	6,653
PROMOTIONS	0	0	1,130		215	0		0
REFERRAL FEES	1,825	0	790		0	100		100
RENT	1,222	0	0	10,500	11,100	8,325		8,325
RENTAL EXPENSE	827	0	936		567	1,795	13	1,808
REPAIRS	0	0	482	217	297	0		0
SALARIES-OFFICERS	19,200	2,250	25,250	31,200	16,542	12,440		12,440
SALARIES	63,275	7,214	77,332	83,622	79,639	37,653		37,653
TAXES	13,762	575	10,656	16,776	0	8,627	105	8,732
TRASH REMOVAL	460	0	632		563	518		518
UTILITIES AND PHONE	5,362	363	5,705		7,690	6,896	1,118	8,014
EST TAX ON GAIN ON SALE	0	0	0	0	0	7,100	(7,100)	0
TOTAL EXPENSES	157,938	13,089	174,520	213,174	172,404	122,018	(2,355)	119,663
NET INCOME/(LOSS) BEFORE OTHER INCOME	$21,534	$1,069	$24,304	$2,243	$(2,771)	$(13,385)	$3,569	$(9,816)

SMITH PROPERTIES, INC.

INCOME STATEMENT

FOR THE PERIODS ENDED NOVEMBER 30, 20AA, DECEMBER 31, 20AA, 20BB, 20CC, 20DD, AND SEPTEMBER 30, 20XX

	11/30/aa	ONE MONTH ENDED 12/31/aa	12/31/bb	12/31/cc	12/31/dd	NINE MONTHS ENDED 09/30/xx	ADJUSTING ENTRIES	ADJUSTED BALANCES
OTHER INCOME:								
GAIN ON SALE OF ASSETS	$0	$0	$0	$0	$0	$27,634		$27,634
TOTAL OTHER INCOME	0	0	0	0	0	27,634	0	27,634
INCOME/(LOSS) BEFORE TAXES	21,534	1,069	24,304	2,243	(2,771)	14,249	3,569	17,818
TAXES:								
STATE INCOME TAX							1,077	1,077
FEDERAL INCOME TAX							2,303	2,303
TOTAL TAXES	0	0	0	0	0	0	3,380	3,380
NET INCOME/(LOSS)	$21,534	$1,069	$24,304	$2,243	$(2,771)	$14,249	$189	$14,438

BUSINESS VALUATION REPORT

JOHN SMITH ENTERPRISES
MULTIPLEX, INC.
EAST WEST, INC.
SOUTHEASTERN, INC.
SMITH'S, INC.
SMITH COMPANY, INC.

As of June 31, 200A
Prepared by Ronald M. Donald, CPA
September 31, 200B

PURPOSE OF THE VALUATION

This valuation was made for the sole purpose of determining a value of the businesses of John E. Smith for use in a domestic relations litigation matter. The valuation was requested by and performed directly for Samuel Jones, the attorney representing Sue Smith, the wife of John E. Smith. This valuation should not be used for any other purpose as the results may not be applicable for other purposes.

SCOPE OF VALUATION

Financial analysis was made on the basis of company financial records, including income tax returns, internal financial statements, asset listings, depreciation records, lease documents, and other documents. The latest year for which financial statements were available was for the year ended March 31, 200A.

Additional information reviewed in the valuation process was the Draft of the Valuation Report of John E. Smith's businesses prepared by Tactless and Company, CPA, dated August 12, 200A, said report having been prepared by Robert Tactless, CPA, who has been the corporations' accountant and Mr. Smith's accountant since the early 1980s. Other outside sources of information were referred to when, and if, deemed necessary.

BASIS OF VALUE

The basis of value in this appraisal is predicated on the concept of fair market value. The fair market value concept identifies the estimated price a willing buyer would pay a willing seller for the company.

Since this appraisal is for divorce valuation purposes, a modification to the fair market value concept was made. The *market* in this valuation was not a hypothetical *willing buyer* but rather, the current owner. Specifically, because the business is not being sold, the appraisal is based on the value in the hands of the current owner under its present circumstances, rather than its value to a third-party purchaser. In appraising the business under the *willing buyer* standard, adjustments are often made to

reflect the fair market value of the business to a *willing buyer*. However, since this valuation was made to identify a value in the hands of the current owner for marital property purposes, the following adjustments, ordinarily considered in a *willing buyer* valuation, were not made. No discounts were taken for:

- the loss of *key personnel*;
- potential loss of business contacts;
- a change in management;
- lack of marketability;
- lack of diversification;
- non-financeability; and
- lack of audited financial statements.

NATURE OF THE BUSINESSES

The businesses are located throughout The Southeast, organized as corporations, and taxed as C or S corporations. Mr. Smith's stock ownership in each entity varies from 100% to 50%. Each of the corporations listed below operates as a single entity.

Multiplex, Inc.

Multiplex, Inc., is a theater in X, South Carolina, which opened in 1987. Smith Company, Inc., owns theater operations, land, and equipment. John E. Smith owns the building and all of the corporate stock. The corporation reports on a March 31 fiscal year-end and is a C corporation for income tax purposes.

East West, Inc.

East West Cinemas, Inc., operates in X, North Carolina. The theater opened in 1994. The corporation reports on a calendar year and is an S corporation for income tax purposes. John E. Smith owns 50% of the corporate stock. The corporation owns the real estate.

Southeastern, Inc.

Southeastern, Inc., operates in X, Georgia. The company assumed the lease and began operating in 1994. The corporation reports on a calendar year-end and is an S corporation for income tax purposes. John E. Smith owns 50% of the corporate stock. The corporation leases the real estate.

Smith Cinema, Inc.

Smith Cinema, Inc., operates in X, Florida. The theater opened in 1995. The corporation reports on a calendar year-end and is an S corporation for income tax purposes. John E. Smith owns 100% of the corporate stock. The corporation owns the building and equipment but leases the land.

Smith Company, Inc.

Smith Company, Inc., performs management, accounting, administrative, and booking services for the businesses.

FINANCIAL HISTORY OF THE BUSINESSES

Historically, except for the start-up period, the companies have been profitable and the sales revenue has been growing or is stable. The following schedule reports the gross revenue and net profit reported on the Federal income tax returns or internal financial statements for each of the years shown.

	Gross Revenue	Net Profit	Percentage
Multiplex, Inc.**			
200A (3/31/A)	$1,044,700	$375,000	35.90%
200B (3/31/B)	935,500	350,000	37.41%
200C (3/31/C)	888,300	300,000	33.77%
200D (3/31/D)	915,400	325,000	35.50%
East West, Inc.			
200B	* $85,400	$(30,000)	(35.13)%
200C	* 890,100	75,000	8.43%
200D	1,008,400	145,000	17.26%
Southeastern, Inc.			
200B	* $69,000	$(16,000)	(23.19)%
200C	597,000	50,000	8.38%
200D	612,300	100,000	17.26%
Smith, Inc.			
200C	* $104,000	$(80,000)	(76.92)%
200D	867,700	(53,000)	(6.11)%

* Denotes start-up period

** Denotes adjusted profits by adjusting corporate overhead and real estate expenses for theater property owned by Mr. Smith.

Owner Salary Adjustment

In a closely held business, the officers will often take a salary substantially in excess of what would be paid to an employee performing the officers' duties. The result is an overstatement of the salary expense which would be incurred if independent employees performed all such business duties and an understatement of net profits from operations.

In making a business valuation, consideration is given to the amount of owner salaries deducted in relation to the reasonable cost of hiring a person to perform a similar function for the company. This consideration is made by adjusting reported earnings for a reasonable salary expense of filling the duties performed by the officers in order to reflect business profitability from operations.

In the case of an unincorporated business, no deduction is made for an owner's salary in computing taxable income. In this case, the reported profits must be adjusted for the cost of a person performing the duties currently performed by the owner. In this business, the appraiser has determined that a reasonable average salary payable to a manager with the ability to direct theater operation, supervise the employees, and handle general management functions is $100,000 per year.

Consequently, the net profit figure is increased by salary in excess of $100,000 paid to the officers in any year.

OTHER ADJUSTMENTS

Management Expense

Smith Company, Inc., performs management, accounting, and administration functions for Multiplex Cinema, Inc., East West Cinema, Inc., and Smith's Cinema, Inc. It also provides movie bookings for Multiplex Cinema, Inc. Fees charged between the companies may or may not cover the cost of these services. An adjustment was made to allocate these expenses based on estimates provided by the CPA of Smith Company, Inc.

Multiplex Cinema, Inc.

The building is owned by John E. Smith, while the land, equipment, and operations are owned by Smith Company, Inc. The building is also an integral part of the theater operations. Accordingly, an adjustment was made to cash flow from operations to treat the building, for valuation purposes, as though it were owned by the corporation.

BUSINESS VALUATION METHODS

Two valuation methods were applied in this case:

(1) Liquidation value, and

(2) Cash Flow value.

Liquidation Value Method

The liquidation valuation method begins with the economic balance sheets and adjusts the net values for the cost of liquidating the assets.

As a liquidation is not contemplated, the liquidation value is not considered the appropriate value for divorce valuation purposes. However, it should be noted that the minimum value of the business should be the liquidation value. Therefore, since the cash flow value determined for Smith Cinema, Inc. was less than the liquidation value, the liquidation value is considered the appropriate value.

Cash Flow Value Method

The cash flow value method is determined by computing the expected cash flow from operations for each theater, and then applying a multiple to this cash flow. This valuation method will result in a gross value of the theater which will then be reduced by all the liabilities and increased by any non-income producing asset, such as cash, accounts receivable, etc.

Valuation Result

The appraised value of these businesses for divorce valuation purposes is estimated to be $1,356,853 (see Exhibit 1 for summary). This valuation is primarily based on financial information which can be reviewed by examining various exhibits as follows:

Multiplex, Inc. – See Exhibit 2

East West, Inc. – See Exhibit 3

Southeastern, Inc. – See Exhibit 4

Smith's, Inc. – See Exhibit 5

Smith Company, Inc. – See Exhibit 6

Business Holding & Administrative Analysis – See Exhibit 7

The reasonableness of this appraisal can be evaluated by considering the return on this business in relations to alternative investments.

With an annual expected return of $779,565, an investment of $3,600,853 reflects a return on investment of 21.2%.

From an appraisal perspective, it appears reasonable that a value which reflects a 21.2% return to the current owner is significantly better than an alternative investment in U.S. Government securities or in any other low-risk investment. Hence, it appears the business value of $1,356,853 is reasonable under the circumstances and for the purposes considered.

CERTIFICATION OF APPRAISER

I certify that, to the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no preset or prospective interest in the property that is the subject of this report, and I have no personal interest or bias with respect to the parties involved.
- My compensation is not contingent on any action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- No one provided significant professional assistance to the person signing this report.

____

Signature of Appraiser

Exhibit 1

JOHN E. SMITH

VALUATIONS

THEATER HOLDINGS

	MULTIPLEX INC.	EAST WEST INC.	SOUTHEASTERN INC.	SMITH'S INC.	SMITH INC.,
PROJECTED CASH FLOW	$167,315	$333,500	$93,750	$185,000	$N/A
MULTIPLE	4.5	5.5	3.5	5.0	N/A
GROSS VALUE	752,915	1,834,250	328,125	925,000	N/A
LESS DEBT	(275,000)	(970,000)	(9,000)	(845,000)	(145,000)
CASH FLOW VALUATION	477,915	864,250	319,125	80,000	(145,000)
OTHER NON INCOME PRODUCING ASSETS	0	75,000	9,500	1,500	225,000
GROSS VALUATION	477,915	939,250	328,625	81,500	80,000
MR. SMITH'S % OWNERSHIP	100%	50%	50%	100%	100%
VALUATION OF MR. SMITH'S INTEREST	$477,915	$469,625	$164,313	$81,500	$80,000

SUMMARY OF VALUATION:

MULTIPLEX CINEMA, INC.	$477,915
EAST WEST CINEMAS, INC.	469,625
SOUTHEASTERN CINEMA, INC.	164,313
SMITH'S CINEMA, INC.	**165,000
SMITH COMPANY, INC.	80,000
	$1,356,853

**BOOK VALUE OF CORPORATION:	
AT 12/31/97	$245,000
AT 12/31/98	$195,000

**AVERAGE BOOK VALUE OF SMITH'S CINEMA, INC.	
	$220,000
VALUATION %	75%
	$165,000

Exhibit 2

MULTIPLEX CINEMA, INC.

FINANCIAL INFORMATION

	200A 03/31/A	200B 03/31/B	200C 03/31/C	200D 03/31/D
NET INCOME BEFORE TAXES	$375,000	$350,000	$300,000	$325,000
INTEREST INCOME				
INTEREST EXPENSE				
DEPRECIATION	19,500	24,500	28,200	19,020
AMORTIZATION				
MANAGEMENT FEE	0	0	0	0
BUILDING RENT	175,000	175,000	175,000	175,000
ADMIN. ALLOCATION	(165,000)	(170,000)	(317,055)	(231,000)
BUILDING EXPENSE-				
PAID OUTSIDE CORP.	(47,750)	(47,500)	(49,200)	(48,000)
SALARY ADJUSTMENT	50,320	44,920	48,960	48,800
NET CASH FLOW	$407,070	$376,920	$185,905	$288,820
GROSS SALES	1,044,700	935,500	888,300	915,400
COST OF GOODS	254,380	222,300	234,875	209,770
GROSS PROFIT	$790,320	$713,200	$653,425	$705,630
OFFICER SALARY:				
HUSBAND	$209,400	$202,000	$217,000	$212,000
WIFE	16,400	10,300	5,400	10,000
	225,800	212,300	222,400	222,000
LESS	100,000	100,000	100,000	100,000
% TO MULTIPLEX CINEMA	40%	40%	40%	40%
SALARY ADJUSTMENT	$50,320	$44,920	$48,960	$48,800
MANAGEMENT FEE INCOME	$117,000	$153,000	$244,300	$282,140

					AVERAGE	PROJECTED CASH FLOW
NET CASH FLOW	407,070	376,920	185,905	288,820	314,679	$185,905
TOTAL INCREASE/(DECREASE)		(30,150)	(191,015)	102,915	(39,417)	90%
% INCREASE/(DECREASE) OVER PRIOR YEAR		-7.4%	-50.7%	55.4%	-0.91%	$167,315

Exhibit 3

EAST WEST CINEMAS, INC.

FINANCIAL INFORMATION

	200B 03/31/B	200C 03/31/C	200D 03/31/D
NET INCOME BEFORE TAXES	$(30,000)	$75,000	$145,000
INTEREST INCOME	(750)	(4,550)	(4,225)
INTEREST EXPENSE	12,500	91,300	90,200
DEPRECIATION	10,150	110,700	110,400
AMORTIZATION	10	80	850
MANAGEMENT FEE	9,500	71,000	96,000
ADMIN. ALLOCATION	0	(79,264)	(147,000)
SALARY ADJUSTMENT	0	18,360	18,750
NET CASH FLOW	$1,410	$282,626	$309,975
GROSS SALES	$85,400	$890,100	$1,008,400
COST OF GOODS	51,100	308,100	246,350
GROSS PROFIT	$34,300	$582,000	$762,050
OFFICER SALARY:			
HUSBAND		$212,000	$220,000
WIFE		10,400	5,000
	0	222,400	225,000
LESS		100,000	100,000
	0	122,400	125,000
% TO MULTIPLEX CINEMA	40%	15%	15%
SALARY ADJUSTMENT	$0	$18,360	$18,750

				AVERAGE	PROJECTED CASH FLOW
NET CASH FLOW	1,410	282,626	309,975	198,004	$290,000
TOTAL INCREASE/(DECREASE)		281,216	27,349	154,283	115%
% INCREASE/(DECREASE) OVER PRIOR YEAR		19944.40%	9.68%	9977.04%	$333,500

Exhibit 4

SOUTHEASTERN CINEMA, INC.

FINANCIAL INFORMATION

	200B 03/31/B	200C 03/31/C	200D 03/31/D
NET INCOME BEFORE TAXES	$(16,000)	$50,000	$100,000
INTEREST INCOME		(165)	(1,665)
INTEREST EXPENSE	20	820	
DEPRECIATION	350	8,325	11,700
ADMIN. ALLOCATION	0	0	0
NET CASH FLOW	$(15,630)	$58,980	$110,035
GROSS SALES	$69,000	$597,000	$612,300
COST OF GOODS	28,200	158,000	157,700
GROSS PROFIT	$40,800	$439,000	$454,600

				AVERAGE	PROJECTED CASH FLOW
NET CASH FLOW	(15,630)	58,980	110,035	51,128	$75,000
TOTAL INCREASE/(DECREASE)		74,610	51,055	62,833	125%
% INCREASE/(DECREASE) OVER PRIOR YEAR		N/A	86.6%	43.28%	$93,750

Exhibit 5

SMITH'S CINEMAS, INC.

FINANCIAL INFORMATION

	200C	200D	PROJECTED 200E
NET INCOME BEFORE TAXES	$(80,000)	$(53,000)	$10,000
INTEREST INCOME	(510)	(2,355)	(1,200)
INTEREST EXPENSE	8,330	58,110	61,450
DEPRECIATION	18,700	140,100	139,675
AMORTIZATION	5	1,980	2,075
MANAGEMENT FEE	14,000	69,200	69,200
ADMIN. ALLOCATION	0	(42,000)	(62,000)
SALARY ADJUSTMENT	0	12,220	0
NET CASH FLOW	$(39,475)	$184,255	$219,200
GROSS SALES	104,000	867,700	
COST OF GOODS	59,000	334,600	
GROSS PROFIT	$45,000	$533,100	
OFFICER SALARY:			
HUSBAND	$0	$222,200	
WIFE	0	0	
	$0	$222,200	
LESS	0	100,000	
		122,200	
% TO MULTIPLEX CINEMA	10%	10%	
SALARY ADJUSTMENT	$0	$12,220	

			AVERAGE	PROJECTED CASH FLOW
NET CASH FLOW	(39,475)	184,255	72,390	$185,000
TOTAL INCREASE/(DECREASE)		223,730	223,730	100%
% INCREASE/(DECREASE) OVER PRIOR YEAR		N/A	0	$185,000

Exhibit 6

SMITH COMPANY, INC.

NET INCOME MULTIPLEX CINEMA, INC.

	03/31/A	03/31/B	03/31/C	03/31/D
NET INCOME PER DEPARTMENT	$381,750	$366,650	$311,500	$325,480
DEPRECIATION AMOUNT	(6,750)	(16,650)	(11,500)	(480)
NET INCOME BEFORE TAXES	$375,000	$350,000	$300,000	$325,000
DEPRECIATION PER T/R	$19,500	$24,500	$28,200	$19,020
DEPRECIATION PER F/S	12,750	7,850	16,700	18,540
DIFFERENCE	$6,750	$16,650	$11,500	$480
GROSS SALES	$1,044,700	$935,500	$888,300	$915,400
COST OF GOODS	254,380	222,300	234,875	209,770
GROSS PROFIT	$790,320	$713,200	$653,425	$705,630
RENT	$175,000	$175,000	$175,000	$175,000
MANAGEMENT FEE	$0	$0	$0	$0

Exhibit 7

JOHN E. SMITH

THEATER HOLDINGS

ADMINISTRATIVE ANALYSIS

	03/31/A		03/31/B		03/31/C		03/31/D	
SHARED OVERHEAD IN SMITH COMPANY, INC.	$165,000	100%	$170,000	100%	$396,319	100%	$420,000	100%
ALLOCATION:								
MULTIPLEX CINEMA	$165,000	100%	$170,000	100%	$317,055	80%	$231,000	55%
EAST EST CINEMA					79,264	20%	147,000	35%
SOUTHEASTERN CINEMA								
SMITH'S CINEMA							42,000	10%
	$165,000	100%	$170,000	100%	$396,319	100%	$420,000	100%

NOTES

Unit 9

Tips for Reviewing and Analyzing Tax Returns

The tips listed below are general areas where an accountant may want to look on tax returns for issues relating to possible income and assets not disclosed. Tax laws and regulations change frequently, and it is recommended to check up-to-date laws and regulations pertaining to each of these areas. This is also not meant to be a comprehensive list, but only areas to begin your research.

1. Pay attention to double-dipping issues. Is the same income being used to calculate alimony/child support and in the valuation of business income?

2. Do not only look at income on a 1040, but also ask for W-2s. The following does not show up as income on 1040:

   a. Life insurance

   b. Health insurance

   c. Flexible spending account

   d. 125 medical account

   e. Health Savings Account (HSA) contributions

   f. Medical contributions

   g. Child care provisions

   h. Pension

   i. 401K

3. Include cash flow from rental properties. Pay attention to depreciation. When you see *accumulated depreciation*, consider that courts tend to use straight-line depreciation, while the return may show double-declining, etc.

4. Consider what the courts are looking at: If a spouse managing rental properties is not managing properly and if it had been managed properly, would have brought in $100,000 more? Can we push to use this in settlement? (Imputed income)

5. Inheritance. Creditors are *not* senior to kids, so support includes inheritance even if already spent on paying off debt.

6. Cash surrender value. Husband owns policy; beneficiary is wife – divorcing. Husband is not in perfect health and has cash surrender value of $200,000. Usually, husband will have $200,000 in his column of assets, wife walks away with $200,000 in another asset in her column.

   Viatical settlement companies may pay money to insured for policy, will assess what owner has, etc. See if they will pay more than cash surrender value because the company *will own* policy. If husband gave up policy, he would have gotten $200,000, but company paid more. Company will only buy policy if they can review medical records through a waiver to HIPAA. If owner of policy is *not* insured, must be an agreement by insured for a HIPAA waiver. Proceeds may be taxable.

7. Find out rulings for your state for *support*. Is it based on gross income or net after tax income?

8. If they paid real estate taxes, you can find out what properties are owned on city or county website. Take advantage of public information.

9. Investment interest, nature of investments, obtain statements.

10. In general, subtract about 8% for payroll taxes if have a schedule C.

11. Safety deposit box. What is in there?

12. Schedule B: Interest/dividends. Go to website for the company, see what dividends were paid, then can divide by dividend shown, and get the number of shares of stock owned. Remember growth stock does not always pay dividends.

13. Schedule C

    a. Car expense so must be some type of auto subsidy.

    b. Mortgage, debt, raise questions about what type of debt this is, what is it for?

    c. Legal and professional fees. Find out what it's for. Might be they are paying for divorce through business?

    d. Rent expense. What is this for? Is it related solely to the business or a housing benefit?

e. Lease. Other business property? What is this?

f. Travel expense. Remember what is on return (C) is ½ of what was actually spent. Might have a disparity in what is equitable?

g. Check wages. Who is being paid? Maybe fictional characters?

h. Inventory, COGS. Is inventory being deducted before being sold?

14. Schedule D

a. Gross sale proceeds. What happened to the money?

b. Compare to gross sales reported on Schedules B. Might show they have sold all stock. Trying to hide money?

c. Long-term losses. Who gets them? IRS mandates, but look and what produced the capital loss?

15. Schedule E

a. Rents, royalties, income from pass through.

b. Check to see if about Sec 179 expense, many companies now expense things that have long useful lives. If valuing a business, might switch to SL (which courts tend to favor) so income stays higher.

c. When mortgage interest is deducted, approximately 6% (or close) so you can estimate loan amount.

16. Schedule F

a. Farming, can be distortions of income. Most farms are cash basis, so might have expenses for next year on current year. Also, remember some farmers record 65% of income current year, and 35% the next.

b. Repairs. Check if a true repair or did you add value to an asset (capitalize)?

17. Form 6252 – Installment Sale

a. Can report "gain" over period installments paid.

b. Can add prior payments and current. Get a copy of contract and figure out amount due for how many years.

18. Sole proprietorship. Does not require a balance sheet, so there's much opportunity to search for undiscovered assets.

19. Stock options (qualified, non-qualified options). Check AMT calculations with reference to these options.

Appendix

NOTICE 97-11; 1997-1 C.B. 379 – SAMPLE LANGUAGE FOR A QUALIFIED DOMESTIC RELATIONS ORDER

PART I. DISCUSSION OF QDRO REQUIREMENTS AND RELATED ISSUES

[16] In order to be recognized as a QDRO, an order must first be a "domestic relations order." A domestic relations order is any judgment, decree or order (including approval of a property settlement) which (i) relates to the provision of child support, alimony payments or marital property rights to a spouse, former spouse, child or other dependent of the plan participant, and (ii) is made pursuant to a State domestic relations law (including a community property law). A State authority must actually issue an order or formally approve a proposed property settlement before it can be a domestic relations order. A property settlement signed by a participant and the participant's former spouse or a draft order to which both parties consent is not a domestic relations order until the State authority has adopted it as an order or formally approved it and made it part of the domestic relations proceeding.

[17] The sample language in Part II assumes that the QDRO applies to one qualified plan and one alternate payee. If a QDRO is intended to cover more than one qualified plan or alternate payee, the QDRO should clearly state which qualified plan and which alternate payee each provision is intended to address.

[18] The terms of a qualified plan must be set forth in a written document. The plan must also establish written QDRO procedures to be used by the plan administrator in determining whether a domestic relations order is a QDRO and in administering QDROs. The plan administrator maintains copies of the plan document and the plan's QDRO procedures. If the plan is required under federal law to have a summary plan description, or "SPD," the plan administrator will also have a copy of the SPD. The information in these documents is helpful in drafting a QDRO. The drafter of a QDRO may wish to obtain copies of these documents before drafting a QDRO.

A. IDENTIFICATION OF PARTICIPANT AND ALTERNATE PAYEE

[19] A QDRO must clearly specify the name and last known mailing address (if any) of the participant and of each alternate payee covered by the QDRO. In the event that an alternate payee is a minor or legally incompetent, the QDRO should also include the name and address of the alternate payee's legal representative. A QDRO can have more than one alternate payee, such as a former spouse and a child.

[20] The "participant" is the individual whose benefits under the plan are being divided by the QDRO. The participant's spouse (or former spouse, child, or other dependent) who receives some or all of the plan's benefits with respect to the participant under the terms of the QDRO is the "alternate payee."

B. IDENTIFICATION OF RETIREMENT PLAN

[21] A QDRO must clearly identify each plan to which the QDRO applies. A QDRO can satisfy this requirement by stating the full name of the plan as provided in the plan document.

C. AMOUNT OF BENEFITS TO BE PAID TO ALTERNATE PAYEE

[22] A QDRO must clearly specify the amount or percentage of the participant's benefits in the plan that is assigned to each alternate payee, or the manner in which the amount or percentage is to be determined. Many factors should be taken into account in determining which benefits to assign to an alternate payee and how these benefits are to be assigned. The following discussion highlights some of these factors. Because of the complexity and variety of the factors that should be considered, and the need to tailor the assignment of benefits under a QDRO to the individual circumstances of the parties, specific sample language regarding the assignment of benefits has not been provided in Part II of this Appendix.

1. TYPES OF BENEFITS

[23] In order to decide how to divide benefits under a QDRO, the drafter first should determine the types of benefits the plan provides. Most benefits provided by qualified plans can be classified as (1) retirement benefits that are paid during the participant's life and (2) survivor benefits that are paid to beneficiaries after the participant's death. Generally, a QDRO can assign all or a portion of each of these types of benefits to an alternate payee. The drafters of a QDRO should coordinate the assignment of these types of benefits. QDRO drafters should also consider how the benefits divided under the QDRO may be affected, under the plan, by the death of either the participant or the alternate payee.

2. TYPES OF QUALIFIED PLANS

[24] Another important factor to consider in the drafting of a QDRO is the type of plan to which the QDRO will apply. As discussed below, the type of plan may affect the types of benefits available for assignment, how the parties choose to assign the benefits, and other matters.

[25] There are two basic types of qualified plans to which QDROs apply: defined benefit plans and defined contribution plans.

a. DEFINED BENEFIT PLANS

[26] A "defined benefit plan" promises to pay each participant a specific benefit at retirement. The basic retirement benefits are usually based on a formula that takes into account factors such as the number of years a participant has worked for the employer and the participant's salary. The basic retirement benefits are generally expressed in the form of periodic payments for the participant's life beginning at the plan's normal retirement age. This stream of periodic payments is generally known as an "annuity." There are special rules that apply if the participant is married; these rules are discussed in greater detail in section E below. A plan may also provide that these retirement benefits may be paid in other forms, such as a lump sum payment.

b. DEFINED CONTRIBUTION PLANS

[27] A "defined contribution plan" is a retirement plan that provides for an individual account for each participant. The participant's benefits are based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account. Examples of defined contribution plans include a profit sharing plan (including a "401(k)" plan), an employee stock ownership plan (an "ESOP") and a money purchase pension plan. Defined contribution plans commonly permit retirement benefits to be paid in the form of a lump sum payment of the participant's entire account balance.

3. APPROACHES TO DIVIDING RETIREMENT BENEFITS

[28] There are two common approaches to dividing retirement benefits in a QDRO: one awards a separate interest in the retirement benefits to the alternate payee, and the other allows the alternate payee to share in the payment of the retirement benefits. In drafting a QDRO using either of these approaches, consideration should be given to factors such as whether the plan is a defined benefit plan or defined contribution plan, and the purpose of the QDRO (such as whether the QDRO is meant to provide spousal support or child support, or to divide marital property).

a. SEPARATE INTEREST APPROACH

[29] A QDRO that creates a "separate interest" divides the participant's benefits into two separate parts: one for the participant and one for the alternate payee. Subject to the terms of the plan and as discussed in more detail below, a QDRO may provide that the alternate payee can determine the form in which his or her benefits are paid and when benefit payments commence. If benefits are allocated under the separate interest approach, the drafters of a QDRO should take into account certain issues depending on the type of plan.

(1) ISSUES RELEVANT TO DEFINED BENEFIT PLANS

[30] The treatment of subsidies provided by a plan and the treatment of future increases in benefits due to increases in the participant's compensation, additional years of service, or changes in the plan's provisions are among the matters that should be considered when drafting a QDRO that uses the separate interest approach to allocate benefits under a defined benefit plan.

[31] SUBSIDIES. Defined benefit plans may promise to pay benefits at various times and in alternative forms. Benefits paid at certain times or in certain forms may have a greater actuarial value than the basic retirement benefits payable at normal retirement age. When one form of benefit has a greater actuarial value than another form, the difference in value is often called a subsidy. Plans usually provide that a participant must meet specific eligibility requirements, such as working for a minimum number of years for the employer that maintains the plan, in order to receive the subsidy.

[32] For example, a defined benefit plan may offer an "early retirement subsidy" to employees who retire before the plan's normal retirement age but after having worked for a specific number of years for the employer maintaining the plan. In some cases, this subsidized benefit provides payments in the form of an annuity that pays the same annual amount as would be paid if the payments

commenced instead at the normal retirement age. Because these benefits are not reduced for early commencement, they have a greater actuarial value than benefits payable at normal retirement age. This subsidy may be available only for certain forms of benefit.

[33] A QDRO may award to the alternate payee all or part of the participant's basic retirement benefits. A QDRO can also address the disposition of any subsidy to which the participant may become entitled after the QDRO has been entered.

[34] FUTURE INCREASES IN THE PARTICIPANT'S BENEFITS. A participant's basic retirement benefits may increase due to circumstances that occur after a QDRO has been entered, such as increases in salary, crediting of additional years of service, or amendments to the plan's provisions, including amendments to provide cost of living adjustments. The treatment of such benefit increases should be considered when drafting a QDRO using the separate interest approach.

(2) ISSUES RELEVANT TO DEFINED CONTRIBUTION PLANS

[35] Investment of the amount assigned to the alternate payee when the account is invested in more than one investment vehicle and division of any future allocation of contributions or forfeitures to the participant's account are among the matters that should be considered when drafting a QDRO that allocates the alternate payee a separate interest under a defined contribution plan.

[36] INVESTMENT CHOICES. The participant's account may be invested in more than one investment fund. If the plan provides for participant-directed investment of the participant's account, consideration should be given to how the alternate payee's interest will be invested.

[37] FUTURE ALLOCATIONS. A participant's account balance may later increase due to the allocation of contributions or forfeitures after the QDRO has been entered. A QDRO may provide that the amounts assigned to the alternate payee will include a portion of such future allocations.

b. SHARED PAYMENT APPROACH

[38] A QDRO may use the "shared payment" approach, under which benefit payments from the plan are split between the participant and the alternate payee. The alternate payee receives payments under this approach only when the participant receives payments. A QDRO may provide that the alternate payee will commence receiving benefit payments when the participant begins receiving payments or at a later stated date, and that the alternate payee will cease to share in the benefit payments at a stated date (or upon a stated event, provided that adequate notice is given to the plan). In splitting the benefit payments, the QDRO may award the alternate payee either a percentage or a dollar amount of each of the participant's benefit payments; in either case, the amount awarded cannot exceed the amount of each payment to which the participant is entitled under the plan.

If a QDRO awards a percentage of the participant's benefit payments (rather than a dollar amount), then, unless the QDRO provides otherwise, the alternate payee generally will automatically receive a share of any future subsidy or other increase in the participant's benefits.

D. FORM AND COMMENCEMENT OF PAYMENT TO ALTERNATE PAYEE

[39] QDRO drafters should take into account certain issues that may arise in connection with the alternate payee's choice of a form of benefit payments and the date on which payment will commence.

1. SEPARATE INTEREST APPROACH

a. FORM OF ALTERNATE PAYEE'S BENEFIT PAYMENTS

[40] A QDRO either may specify a particular form in which payments are to be made to the alternate payee or may provide that the alternate payee may choose a form of benefit from among the options available to the participant. However, federal law provides that the alternate payee cannot receive payments in the form of a joint and survivor annuity with respect to the alternate payee and his or her subsequent spouse.

[41] The choice of the form of benefits should take into account the period over which payments will be made. For example, if the alternate payee elects to receive a lump sum payment, no further payments will be made by the plan with respect to the alternate payee's interest.

[42] Any decision concerning the form of benefit should take into account the difference, if any, in the actuarial value of different benefit forms available under the plan. For example, as discussed above, a plan might provide an early retirement subsidy that is available only for payment in certain forms.

[43] In addition, the forms of benefit available to the alternate payee may be limited by section 401(a)(9) of the Code, which specifies the date by which benefit payments from a qualified plan must commence and limits the period over which the benefit payments may be made. Section 1.401(a)(9)-1, Q&A H-4, of the Proposed Income Tax Regulations addresses the application of the required minimum distribution rules of section 401(a)(9) to payments to an alternate payee. The proposed regulation limits the period over which benefits may be paid with respect to the alternate payee's interest. For example, the proposed regulation provides that distribution of the alternate payee's separate interest will not satisfy section 401(a)(9)(A)(ii) of the Code if the separate interest is distributed over the joint lives of the alternate payee and a designated beneficiary (other than the participant).

b. COMMENCEMENT OF BENEFIT PAYMENTS TO ALTERNATE PAYEE

[44] Under the separate interest approach, the alternate payee may begin receiving benefits at a different time than the participant. A QDRO either may specify a time at which payments are to commence to the alternate payee or may provide that the alternate payee can elect a time when benefits will commence in accordance with the terms of the plan. In two circumstances, an alternate payee who is given a separate interest may begin receiving his or her separate benefit before the participant is eligible to begin receiving payments.

First, federal law provides that benefit payments to the alternate payee may begin as soon as the participant attains his or her earliest retirement age. Federal law defines "earliest retirement age" as

the earlier of (i) the date on which the participant is entitled to a distribution under the plan, or (ii) the later of (I) the date the participant attains age 50, or (II) the earliest date on which the participant could begin receiving benefits under the plan if the participant separated from service. Second, the retirement plan may (but is not required to) allow payments to begin to an alternate payee at a date before the earliest retirement date.

2. SHARED PAYMENT APPROACH

[45] As indicated above, under the shared payment approach, benefit payments are split between the participant and the alternate payee. The alternate payee receives payments in the same form as the participant. Further, payments to the alternate payee do not commence before the participant has begun to receive benefits. Payments to the alternate payee can cease at any time stated in the QDRO but do not continue after payments with respect to the participant cease. As noted above, a QDRO must state the number of payments or the period to which the order applies.

E. SURVIVOR BENEFITS AND TREATMENT OF FORMER SPOUSE AS PARTICIPANT'S SPOUSE

[46] Survivor benefits include both benefits payable to surviving spouses and other benefits that are payable after the participant's death. These benefits can be awarded to an alternate payee. In determining the assignment of survivor benefits, QDRO drafters should take into account that benefits awarded to the alternate payee under a QDRO will not be available to a subsequent spouse of the participant or to another beneficiary. QDRO drafters may consult with the plan administrator for information on the survivor benefits provided under the plan.

[47] A QDRO may provide for treatment of a former spouse of a participant as the participant's spouse with respect to all or a portion of the spousal survivor benefits that must be provided under federal law. The following discussion explains the spousal survivor benefits that must be offered under a plan, and identifies issues that should be considered in determining whether to treat the alternate payee as the participant's spouse.

[48] Only a spouse or former spouse of the participant can be treated as a spouse under a QDRO. A child or other dependent who is an alternate payee under a QDRO cannot be treated as the spouse of a participant.

[49] Retirement plans generally need not provide the special survivor benefits to the participant's surviving spouse unless the participant is married for at least one year. If the retirement plan to which the QDRO relates contains such a one-year marriage requirement, then the QDRO cannot require that the alternate payee be treated as the participant's spouse if the marriage lasted for less than one year.

1. QUALIFIED JOINT SURVIVOR ANNUITY

[50] Federal law generally requires that defined benefit plans and certain defined contribution plans pay retirement benefits to participants who were married on the participant's annuity starting date (this is the first day of the first period for which an amount is payable to the participant) in a special form called a qualified joint and survivor annuity, or QJSA.

Under a QJSA, retirement payments are made monthly (or at other regular intervals) to the participant for his or her lifetime; after the participant dies, the plan pays the participant's surviving spouse an amount each month (or other regular interval) that is at least one half of the retirement benefit that was paid to the participant. At any time that benefits are permitted to commence under the plan, a QJSA must be offered that commences at the same time and that has an actuarial value that is at least as great as any other form of benefit payable under the plan at the same time. A married participant can choose to receive retirement benefits in a form other than a QJSA if the participant's spouse agrees in writing to that choice.

2. QUALIFIED PRERETIREMENT SURVIVOR ANNUITY

[51] Federal law generally requires that defined benefit plans and certain defined contribution plans pay a monthly survivor benefit to a surviving spouse for the spouse's life when a married participant dies prior to the participant's annuity starting date, to the extent the participant's benefit is nonforfeitable under the terms of the plan at the time of his or her death. This benefit is called a qualified preretirement survivor annuity, or QPSA. As a general rule, an individual loses the right to the QPSA survivor benefits when he or she is divorced from the participant. However, if a former spouse is treated as the participant's surviving spouse under a QDRO, the former spouse is eligible to receive the QPSA unless the former spouse consents to the waiver of the QPSA. If the spouse does not waive the QJSA, the plan may allow the spouse to receive the value of the QPSA in a form other than an annuity.

3. DEFINED CONTRIBUTION PLANS NOT SUBJECT TO THE QJSA OR QPSA REQUIREMENTS

[52] Those defined contribution plans that are not required to pay benefits to married participants in the form of a QJSA or a QPSA are required by federal law to pay the balance remaining in the participant's account after the participant dies to the participant's surviving spouse. If the spouse gives written consent, the participant can direct that upon his or her death the account will be paid to a beneficiary other than the spouse, for example, the couple's children.

4. ALTERNATE PAYEE TREATED AS SPOUSE

[53] A QDRO may provide that an alternate payee who is a former spouse of the participant will be treated as the participant's spouse for some or all of the benefits payable upon the participant's death, so that the alternate payee will receive benefits provided to a spouse under the plan. To the extent that a former spouse is to be treated under the plan as the participant's spouse pursuant to a QDRO, any subsequent spouse of the participant cannot be treated as the participant's surviving spouse. Thus, QDRO drafters should consider the potential impact of designating a former spouse as the participant's spouse on the disposition of survivor benefits among the former spouse and any subsequent spouse of the participant, as well as the impact on children or any other beneficiaries designated by the participant in accordance with the terms of the plan.

[54] In determining the portion of the participant's benefits for which the alternate payee is treated as the spouse, the drafters should take into account the manner in which benefits are otherwise divided under the QDRO. In particular, consideration should be given to whether the formula for dividing

the participant's benefits for this purpose should be coordinated with the formula otherwise used for dividing the benefits.

[55] Under a defined benefit plan, or a defined contribution plan that is subject to the QJSA and QPSA requirements, to the extent the former spouse is treated as the current spouse, the former spouse must consent to payment of retirement benefits in a form other than a QJSA or to the participant's waiver of the QPSA. For example, in a defined benefit plan, the participant would not be able to elect to receive a lump sum payment of the retirement benefits for which the alternate payee is treated as the participant's spouse unless the alternate payee consents. Similarly, the former spouse's consent might be required for any loan to the participant from the plan that is secured by his or her retirement benefits. In a defined contribution plan that is not subject to the QJSA and QPSA requirements, to the extent the QDRO treats the former spouse as the participant's spouse under the plan, the survivor benefits under the plan must be paid to the former spouse unless he or she consents to have those benefits paid to someone else.

F. TAX TREATMENT OF BENEFIT PAYMENTS MADE PURSUANT TO A QDRO

[56] The federal income tax treatment of retirement benefits is governed by federal law, and a QDRO cannot designate who will be liable for the taxes owed when retirement benefits are paid. For a description of the tax consequences of payments to an alternate payee pursuant to a QDRO, see Internal Revenue Service Publication 575, "Pension and Annuity Income." A local IRS office can provide this publication, or it may be obtained by calling 1-800-TAX-FORM.

PART II. SAMPLE LANGUAGE FOR INCLUSION IN QDRO

A. SAMPLE LANGUAGE FOR IDENTIFICATION OF PARTICIPANT AND ALTERNATE PAYEE

[57] The "Participant" is [insert name of Participant]. The Participant's address is [insert Participant's address]. The Participant's social security number is [insert Participant's social security number]

[58] The "Alternate Payee" is [insert name of Alternate Payee]. The Alternate Payee's address is [insert Alternate Payee's address]. The Alternate Payee's social security number is [insert Alternate Payee's social security number]. The Alternate Payee is the [describe the Alternate Payee's relationship to Participant] of the Participant.

B. SAMPLE LANGUAGE FOR IDENTIFICATION OF RETIREMENT PLAN

[59] This order applies to benefits under the [insert formal name of retirement plan] ("Plan").

C. AMOUNT OF BENEFITS TO BE PAID TO ALTERNATE PAYEE

INSTRUCTION: The QDRO should clearly specify the amount or percentage of benefits assigned to the Alternate Payee or the manner in which the amount or percentage is to be determined, and the number of payments or period to which the Order applies. There are many different forms in which benefits may be paid from a qualified plan. Because of the diversity of factors that should be

considered, and the need to tailor the assignment of benefits under a QDRO to meet the needs of the parties involved, specific sample language regarding the assignment of benefits has not been provided. See the discussion in Part I for further information.

D. SAMPLE LANGUAGE FOR FORM AND COMMENCEMENT OF PAYMENT TO ALTERNATE PAYEE

INSTRUCTION: Drafters using the separate interest approach may use paragraph 1. Drafters using the shared payment approach may use paragraph 2. Drafters using the separate interest approach for a portion of the benefits allocated to the alternate payee and the shared payment approach for the remainder should modify the sample language to specify the benefits to which each paragraph provided below applies.

1. SEPARATE INTEREST APPROACH

[60] The Alternate Payee may elect to receive payment from the Plan of the benefits assigned to the Alternate Payee under this Order in any form in which such benefits may be paid under the Plan to the Participant (other than in the form of a joint and survivor annuity with respect to the Alternate Payee and his or her subsequent spouse), but only if the form elected complies with the minimum distribution requirements of section 401(a)(9) of the Internal Revenue Code. Payments to the Alternate Payee pursuant to this Order shall commence on any date elected by the Alternate Payee (and such election shall be made in accordance with the terms of the Plan), but not earlier than the Participant's earliest retirement age (or such earlier date as allowed under the terms of the Plan), and not later than the earlier of (A) the date the Participant would be required to commence benefits under the terms of the Plan or (B) the latest date permitted by section 401(a)(9) of the Internal Revenue Code. For purposes of this Order, the Participant's earliest retirement age shall be the earlier of (i) the date on which the participant is entitled to a distribution under the Plan, or (ii) the later of (I) the date the Participant attains age 50, or (II) the earliest date on which the Participant could begin receiving benefits under the plan if the Participant separated from service.

2. SHARED PAYMENT APPROACH

[61] The Alternate Payee shall receive payments from the Plan of the benefits assigned to the Alternate Payee under this Order (including payments attributable to the period in which the issue of whether this Order is a qualified domestic relations order is being determined) commencing as soon as practicable after this Order has been determined to be a qualified domestic relations order or, if later, on the date the Participant commences receiving benefit payments from the Plan. Payment to the Alternate Payee shall cease on the earlier of: [insert date or future event, such as the Alternate Payee's remarriage], or the date that payments from the Plan with respect to the Participant cease.

E. SAMPLE LANGUAGE FOR TREATMENT OF FORMER SPOUSE AS PARTICIPANT'S SPOUSE

INSTRUCTION: The Alternate Payee may be treated as the Participant's spouse only if the Alternate Payee is the Participant's spouse or former spouse, and not if the Alternate Payee is a child or other dependent of the Participant. If the Alternate Payee is the Participant's spouse or former spouse, drafters may select sample paragraph 1, sample paragraph 2, or sample paragraph 3. Sample

paragraph 1 applies if the Alternate Payee is treated as the Participant's spouse for all of the spousal survivor benefits payable with respect to the Participant's benefits under the Plan. Sample paragraph 2 applies if the Alternate Payee is treated as the Participant's spouse for a portion of the spousal survivor benefits payable with respect to the Participant's benefits under the Plan. Sample paragraph 3 applies if the Alternate payee is not treated as the Participant's spouse for any of the spousal survivor benefits payable with respect to the Participant's benefits under the Plan.

1. ALTERNATE PAYEE TREATED AS SPOUSE FOR ALL SPOUSAL SURVIVOR BENEFITS

[62] The Alternate Payee shall be treated as the Participant's spouse under the Plan for purposes of sections 401(a)(11) and 417 of the Code.

2. ALTERNATE PAYEE TREATED AS SPOUSE FOR A PORTION OF THE SPOUSAL SURVIVOR BENEFITS

[63] The Alternate Payee shall be treated as the Participant's spouse under the Plan for purposes of sections 401(a)(11) and 417 of the Code with respect to [insert percentage of benefit or a formula, such as a formula describing the benefit earned under the plan during marriage]

3. ALTERNATE PAYEE NOT TREATED AS SPOUSE

[64] The Alternate Payee shall not be treated as the Participant's spouse under the Plan.

Marriage Dissolution Checklist

MARRIAGE DISSOLUTION CHECKLIST

1. Custody
   - ☐ Investigation/evaluation
   - ☐ Sole – physical, legal
   - ☐ Joint
   - ☐ Split

2. Visitation
   - ☐ Supervision
   - ☐ Schedule

3. Child support
   - ☐ Payment through S&C
     - ☐ Notice
   - ☐ Guidelines
   - ☐ Variance
   - ☐ Private school
   - ☐ Camping, lessons, tutors, sports
   - ☐ Cost of living increase
   - ☐ Medical or other expenses
   - ☐ Terminating events

4. College education of child(ren)
   - ☐ Define

5. Income tax exemptions
   - ☐ Multiple support declaration
   - ☐ H of H

6. Moving out of state
   - ☐ Visitation
   - ☐ Support/transportation

7. Medical and hospitalization insurance
   - ☐ Employment/group
   - ☐ Individual
   - ☐ Continuation/conversion

8. Dental insurance
   - ☐ Employment/group
   - ☐ Individual
   - ☐ Amount/duration

9. Maintenance
   - ☐ Waived by both – Karon
   - ☐ Trust/direct payment
   - ☐ Terminating events

10. Social Security
    - ☐ 10+ year marriage

11. Employment training, education
    - ☐ Time
    - ☐ Cost

12. Property settlement
    - A. Homestead
      - ☐ lien
      - ☐ sale events
      - ☐ title
      - ☐ proceeds of sale
      - ____________
    - B. Investment and/or other real estate
    - C. Business/professional interest
    - D. Household goods, furnishings, equipment
    - E. Other personal property
    - F. Retirement fund (pension, profit sharing, IRA or other)
    - G. Savings accounts and/or checking accounts
    - H. Stocks, bonds and other securities
    - I. Life insurance cash value
    - J. Automobiles
    - K. Tax refunds and rebates
      - ☐ indemnity
      - ☐ percent of contribution
      - ☐ prior taxes
      - ☐ circuit breaker
    - L. Other assets
    - M. Cash property settlement

13. Life insurance
    - ☐ Premiums
    - ☐ Beneficiaries
    - ☐ Amount
    - ☐ Termination
    - ☐ Present value
    - ☐ Letter to insurance company
    - ☐ Verification

14. Indebtedness
    - ☐ Secured
    - ☐ Unsecured

15. Leases
    - ☐ Realty
    - ☐ Vehicle
    - ☐ Bankruptcy discharge

16. Change of name
    - ☐ Driver's license
    - ☐ Social Security
    - ☐ Other

17. Hold harmless/indemnity

18. Implementation

19. Professional fees and costs
    - ☐ Attorneys
    - ☐ CPA
    - ☐ Apps
    - ☐ Therapist

20. Estate planning
    - ☐ Change of beneficiaries
    - ☐ Trust

The following items should be readily available to you in case we need them. Please take the time to locate and send as many as possible to us. Label all documents **on a separate cover sheet.**

1. Your paycheck stubs, from January 1 of the current year, if possible. Paycheck stubs for the last three months are required.

2. Your spouse's paycheck stubs, if available, from January 1 of the current year and at least for the last three months.

3. Copies of your joint or individual income tax returns, both state and federal, for the past five years.

4. Deeds, abstracts and Torrens certificates showing the legal description of your homestead and any other real estate owned by you or your spouse, individually or jointly. **Please note the legal description on your tax statements may not be a complete description so we need a Quit Claim Deed, Warranty Deed or Certificate of Title.** Secure from your mortgage company or lending institution of you do not have them.

5. Mortgage or Contract for Deed balance on homestead and any other real estate, e.g. the last monthly mortgage payment statement, if you have one.

6. All papers and documents covering the initial purchase of and improvements to your homestead, including Purchase Agreement.

7. Tax assessor's statements on homestead and other real properties.

8. Savings passbooks and savings certificates of individual or joint accounts held by you and/or your spouse.

9. List of corporate stocks and/or stock certificates, if possible, owned by you and your spouse, individually or jointly. Also give name of broker or brokers.

10. Current life insurance policies, with statements of loans against them.

11. A copy of any pension or retirement programs, profit sharing and/or investment programs you or your spouse may be involved in through employment, savings accounts and other Individual Retirement Account(s) (IRA).

12. Title cards to all automobiles or other motor vehicles owned by you or your spouse, individually or jointly.

13. A copy of any financial statements or statements of net worth prepared by you or your spouse for the purpose of securing bank loans or for any other purpose.

14. Any other information that will help establish your net worth, your spouse's net worth, your joint net worth, you income and your spouse's income.

15. Any pleadings and legal papers in your possession relating to this proceeding or any prior divorce (dissolution) proceeding for yourself or your spouse.

16. Any U.S. Social Security records or documents reflecting you and/or your spouse's earnings and qualifications for retirement benefits.

17. All documents pertaining to premarital property, property received as gifts or inheritance and personal injury recoveries.

18. Any premarital or postmarital contracts, with all relevant correspondence and other writings.

NOTES

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Non-Technical (including Professional Development)	**Finance**
Tax	**Information Technology**
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	Tax

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—Debbie Y.

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