

# 2010 DIVORCE (TAX EFFECTS)

(Approved through 5/31/2011)

BY

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**Preparers must be aware that the laws are constantly changing and that the information in this manual may be superceded at any time.**

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# **DIVORCE**

## **HANDLING OF ALIMONY**

## **CLAIMING DEPENDENTS**

## **PROPERTY SETTLEMENTS**

All of the above are dependent on the circumstances for EACH case, as well as upon the tax law in effect at the time of the divorce.

The 1984 Tax Reform Act made considerable changes in many of the items related to divorce and the 1986 Tax Reform Act changed the method of recapture of alimony AGAIN.

## **AFTER THE FACT PROBLEM**

In most cases, the tax practitioner is dealing with the facts after it is too late to advise for tax planning. At long last it appears that attorneys are advising taxpayers about tax effects of their divorce decree.

The 1984 overturning of the Davis rule was a significant change that eliminated the problems taxpayer's faced when they gave up all of the property to the former spouse and then had to pay taxes on a "gain" that was recognized but which resulted in no realized cash flow. Clients must now be advised of future consequences of divorce actions.

## **JOINT INFORMATION RECORDS**

In tax treatment, as in other aspects of divorce, the two parties are often hostile and not willing to contribute any information or records they may have. In many cases the taxpayer does not even wish to request information from the former spouse. Establishing basis of assets presents a considerable problem in this case and should be documented in the year of divorce for future use.

## **I.D. NUMBER REQUIREMENT**

I.R.S. regulations require any individual who **Receives** alimony to supply their social security (ID) number to the payer and the **Payer** must show the PAYEE number ON THE TAX RETURN. Penalty for failure to do so is \$50.

## FILING STATUS

**Filing status determines filing requirement standard deduction and correct tax. May also determine eligibility for certain credits and deductions.**

### CONSIDERED UNMARRIED FOR ENTIRE YEAR IF:

**FINAL** decree of divorce or separate maintenance by last day of the tax year.

Obtained decree of annulment, which holds that no valid marriage ever existed.

If annulment - must file amended returns for all tax years affected that are not closed by statute of limitation and change from joint to single.

### IF UNMARRIED, FILING STATUS IS GENERALLY SINGLE

**Exception:** If certain tests are met, can file as head of household

**Exception:** If divorce is obtained in one year for the **SOLE** purpose of letting you and your spouse file tax returns as unmarried individuals and, at the time of divorce you intended to **AND DID** remarry each other in the next year, you must file as married individuals.

### CONSIDERED MARRIED FOR ENTIRE YEAR IF:

Separated, but not final decree of divorce or separate maintenance by last day of tax year.

Separated under interlocutory decree.  
Interlocutory decree is **NOT** a **FINAL** decree.

MAY FILE JOINT OR MARRIED FILING SEPARATE

EXCEPTION: Married living apart (see special rule later in this course)

## **FINAL DECREE**

### **STATE LAW GOVERNS**

You must follow your state law to determine if divorced or legally separated.

### **OREGON LAW**

A decree of dissolution of marriage, "shall NOT be effective in so far as it affects the marital status of the parties until the expiration of thirty (30) days from the date of the decree, or, if an appeal is taken, until the suit is determined upon appeal, whichever is longer."

In order for a couple to be divorced on 12-31, the divorce must be signed by 12-1.

ORS 107.115(5) requires divorce decrees to specify the date upon which the decree becomes final.

Since very often the taxpayer is unaware of when the FINAL date was, it is best to secure a copy of the decree.

Tax consequences are critical in cases where divorces occur late in the year

### **CHANGE OF STATUS**

If filed joint, can NOT change to married filing separate.  
(Can not amend later to avoid the joint responsibility)

If file separate MAY change to joint within 3 years from due date of separate returns  
(not including extensions)

If marriage annulled the marriage is to be considered as if it never happened. Any tax returns filed Joint must be amended for all open years(generally three years).

## CONSEQUENCES OF JOINT/SEPARATE FILING

### JOINT FILING RESPONSIBILITY

Generally, both may be responsible (jointly and individually) for the tax and any penalty due on the joint tax return.

One spouse may be held responsible for ALL of the tax due even though all income was earned by the other spouse.

### TAXPAYER SHOULD BE ADVISED OF THIS RESPONSIBILITY.

Spouses, if separated, are unaware of other's activities and may not wish to file joint and assume the responsibility.

### MARRIED FILING SEPARATE

Each taxpayer is only responsible for the tax due on their own return.

Basic requirements for separate returns:

**Deductions** - if one spouse itemizes, the other must also itemize, unless a taxpayer qualifies as unmarried under the head of household rules - in this case they may claim standard deduction.

**Community Property State** - must include one half of the total community income of both spouses on each separate return.

Consequences of married filing separate returns:

May result in higher tax

Can not take credit for child and dependent care expenses in most cases

Can not take earned income credit.

If lived with spouse AT ANY TIME during the year -

Can not claim credit for elderly or disabled

**Must include up to 85% of any social security or equivalent RR retirement benefits received**

(No base exclusion for married filing separate status.)

Cannot roll over amounts from a traditional IRA into a Roth IRA in a year you file a separate return.

**Subject to limits on itemized deductions, child tax credits and phase out of exemptions at half the income levels of those for joint return.**

Cannot exclude the interest from series EE savings bonds issued after 1989 even if paid expenses for higher education in current tax year.

## **INJURED SPOUSE RELIEF**

### **INJURED SPOUSE'S SHARE OF OVERPAYMENT:**

If all or part of your share of the overpayment is expected to be held by the internal revenue service and applied to back taxes or child support of your spouse.

#### **Three conditions:**

1. You are not required to pay the past-due amount
2. You reported income such as wages, taxable interest, etc. on the joint return.
3. You made and reported payments such as federal income tax withheld from your wages or estimated tax payments or you claimed refundable credits (such as the earned income credit) on the joint return.

**There are exceptions to the three if your principle residence is in a community property state.**

To claim Injured Spouse Relief use form 8379.

# Injured Spouse Allocation

▶ See instructions.

**Part I** Should you file this form? You must complete this part.

- 1 Enter the tax year for which you are filing this form. ▶ \_\_\_\_\_ Answer the following questions for that year.
  
- 2 Did you (or will you) file a joint return?
  - Yes.** Go to line 3.
  - No. Stop here.** Do not file this form. You are not an injured spouse.
  
- 3 Did (or will) the IRS use the joint overpayment to pay any of the following legally enforceable past-due debt(s) owed only by your spouse? (see instructions)
  - Federal tax • State income tax • Child support • Spousal support • Federal nontax debt (such as a student loan)
  - Yes.** Go to line 4.
  - No. Stop here.** Do not file this form. You are not an injured spouse.

**Note.** If the past-due amount is for a joint federal tax, you may qualify for innocent spouse relief for the year to which the overpayment was applied. See *Innocent Spouse Relief*, in the instructions for more information.
  
- 4 Are you legally obligated to pay this past-due amount?
  - Yes. Stop here.** Do not file this form. You are not an injured spouse.
  - Note.** If the past-due amount is for a joint federal tax, you may qualify for innocent spouse relief for the year to which the overpayment was applied. See *Innocent Spouse Relief*, in the instructions for more information.
  - No.** Go to line 5.
  
- 5 Were you a resident of a community property state (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin) at any time during the tax year entered on line 1? (see instructions)
  - Yes.** Enter name(s) of community property states(s) \_\_\_\_\_ .  
 Skip lines 6 through 9 and **go to Part II** and complete the rest of this form.
  - No.** Go to line 6.
  
- 6 Did you make and report payments, such as federal income tax withholding or estimated tax payments?
  - Yes.** Skip lines 7 through 9 and **go to Part II** and complete the rest of this form.
  - No.** Go to line 7.
  
- 7 Did you have earned income, such as wages, salaries, or self-employment income?
  - Yes.** Go to line 8.
  - No.** Skip line 8 and go to line 9.
  
- 8 Did (or will) you claim the earned income credit or additional child tax credit?
  - Yes.** Skip line 9 and **go to Part II** and complete the rest of this form.
  - No.** Go to line 9.
  
- 9 Did (or will) you claim a refundable tax credit (see instructions)?
  - Yes. Go to Part II** and complete the rest of this form.
  - No. Stop here.** Do not file this form. You are not an injured spouse.

**Part II** Information About the Joint Tax Return for Which This Form Is Filed

- 10 Enter the following information exactly as it is shown on the tax return for which you are filing this form.  
 The spouse's name and social security number shown first on that tax return must also be shown first below.
 

First name, initial, and last name shown first on the return	Social security number shown first	<b>If Injured Spouse, check here ▶</b> <input type="checkbox"/>
First name, initial, and last name shown second on the return	Social security number shown second	<b>If Injured Spouse, check here ▶</b> <input type="checkbox"/>
  
- 11 Check this box only if you are divorced or legally separated from the spouse with whom you filed the joint return and you want your refund issued in your name only . . . . .
  
- 12 Do you want any injured spouse refund mailed to an address different from the one on your joint return?  **Yes**  **No**  
 If "Yes," enter the address. \_\_\_\_\_  
 Number and street City, town, or post office, state, and ZIP code

**Part III Allocation Between Spouses of Items on the Joint Tax Return** (see instructions)

Allocated Items	(a) Amount shown on joint return	(b) Allocated to injured spouse	(c) Allocated to other spouse
<b>13</b> Income: <b>a.</b> Wages			
<b>b.</b> All other income			
<b>14</b> Adjustments to income			
<b>15</b> Standard deduction or Itemized deductions			
<b>16</b> Number of exemptions			
<b>17</b> Credits ( <b>do not</b> include any earned income credit)			
<b>18</b> Other taxes			
<b>19</b> Federal income tax withheld			
<b>20</b> Payments			

**Part IV Signature.** Complete this part only if you are filing Form 8379 by itself and not with your tax return.

Under penalties of perjury, I declare that I have examined this form and any accompanying schedules or 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.

<b>Paid Preparer Use Only</b>	Keep a copy of this form for your records	Injured spouse's signature	Date	Phone number (optional)
		Print/Type preparer's name	Preparer's signature	Date
		Firm's name ▶	Firm's EIN ▶	Check <input type="checkbox"/> if self-employed
		Firm's Address ▶	Phone no.	PTIN

# **DIVORCE**

## **INNOCENT SPOUSE RELIEF**

### **RELIEF OF JOINT LIABILITY:**

May be exempt from the ADDITIONAL tax liability and RELATED interest and penalties if tax on a JOINT return was underpaid or understated without your knowledge.

#### **If spouse:**

Omitted an item of his or her gross income

Claimed a deduction, credit, or property basis for which there was no basis in fact or law.

**Community property laws are considered when granting this relief.**

Types of Relief Available:

Separation of Liability  
Innocent Spouse Relief, and/or  
Equitable Relief

No matter which form of relief you are requesting, use form 8857 and attach a statement explaining why you would qualify for relief. Being very specific of amounts and dates and prove you had no knowledge.

### **LIMITS:**

Related to understatement resulted from claiming a deduction, credit, or basis, exception applies ONLY IF additional tax, penalties, interest are more than:

10% of AGI for pre-adjustment year, if AGI was \$20,000 or less

25% of AGI for pre-adjustment year, if AGI was more than \$20,000.

PRE-ADJUSTMENT YEAR:

Most recent tax year ending before a deficiency notice was mailed.

**If married to a different person at end of pre-adjustment year, AGI includes new spouse's income, whether or not you filed a joint return for that year.**

## **EXEMPTIONS FOR SPOUSE ON SEPARATE RETURN**

May take exemption for spouse **only if:**

Spouse had NO gross income

AND

Spouse was not dependent of another

If spouse had gross income (**including alimony**), **NO** exemption allowed for spouse

Caution:

This only applies to married filing separate returns.

If you are legally unmarried you may NOT claim exemption for spouse.

An **ex-spouse** who lived with you **all** year could qualify as a **dependent**

**A SPOUSE NEVER QUALIFIES AS A DEPENDENT**

## MARRIED LIVING APART

### SPECIAL RULES

Some married people can file as head of household instead of married filing separate status.

Benefits:

Can claim standard deduction even if spouse itemizes

Standard deduction is higher than single or married filing separate

Tax rate may be lower than single or married

May be able to claim certain credits not allowed on married filing separate return  
(earned income credit, child care credit, child tax credits, education credits)

Subject to limit on itemized deduction and phase out of exemptions at a level twice that for married filing separate.

Requirements to file as Head of Household:

File separate return

Paid more than half the cost of maintaining a home that was the MAIN home  
for more than half of the year for you and:

Unmarried child, grandchild, stepchild, foster child, or adopted child.

A foster child must qualify as your dependent and must have lived  
in your home for the entire year.

Your married child, grandchild, stepchild, foster child, or adopted child  
who you can claim as a dependent except for:

custodial release

non custodial parent provided at least \$600 for the support and  
claims the dependent under a pre-1985 agreement.

Any other relative whom you can claim as a dependent.

Dependent parent does not have to live with you.

***Married child or other relative will not qualify taxpayer  
for head of household if can claim that person as a  
dependent under a multiple support agreement.***

## **CHILDREN OF DIVORCED OR SEPARATED PARENTS**

### **GENERAL RULE - PARENT WHO HAS CUSTODY OF CHILD FOR GREATER PART OF THE YEAR IS ALLOWED THE EXEMPTION FOR THE DEPENDENT.**

#### **Custody:**

If not determined by terms of the decree or written agreement, the parent who has the physical custody for the greater part of the year is considered to be custodial parent.

If divorced or separated **during the year**, after joint custody before separation, the parent having custody for the greater part of the remainder of the year is considered the custodial parent.

#### **Support**

In determination of whether parents furnished more than half of the child's support, one of the parents may NOT count amounts provided by a third party as having been provided by them (i.e. parents, grandparents, welfare) but the amount furnished by the third party must be included in TOTAL support.

#### **Remarried parent**

For divorced parent who has custody and remarries, the support provided by the new spouse IS treated as provided by custodial parent.

## CHILDREN OF DIVORCED/SEPARATED PARENTS

### SPECIAL RULE

Support test for a child of divorced or separated parents is based on special rule

### CONDITIONS REQUIRED FOR SPECIAL RULE TO APPLY:

Parents are divorced, legally separated under a decree of divorce, or separate maintenance OR separated under a WRITTEN separation agreement

AND

Lived apart for at least the last six months of the year.

AND

One or both parents provide more than half of the child's support for year.

AND

One or both parents have custody of the child for more than half of year

### NOT ELIGIBLE FOR SPECIAL RULE IF:

A third party (relative or friend) provides more than half of the child's support.

The child is in custody of persons other than the parents for half the year or more.

The support of the child is determined under a multiple support agreement.

Parents are separated under a written agreement but file a joint return for the year.

Dependent is **NOT** the **CHILD** of the divorced parents

### NON-CUSTODIAL PARENT

Under the special rule, the parent who did not have custody, or who had custody for a shorter period of time, is treated as the parent providing more than half of child's support if:

Custodial parent signs custodial release statement and non custodial parent attaches the statement to return

OR

A decree or written agreement **made before 1985** provides that the noncustodial parent can take the exemption AND he or she gave at least \$600 for the child's support during the year, unless the pre-1985 decree or agreement was modified after 1984 to specify that this provision will NOT apply.

**Former \$1200 a year support, regardless of what is stated in decree NO LONGER APPLICABLE, even if decree was pre 1985.**

## **CHILDREN OF DIVORCED/SEPARATED PARENTS**

### **BACK CHILD SUPPORT**

If you fail to pay child support in the year it is due, but pay it in a later year, any payment of the overdue amount is not considered child support either for the year it was due or for the year in which it is paid. It is payment of an amount owed to the custodial parent, but it is not support provided by you

### **MEDICAL EXPENSES**

A child of divorced or separated parents whose support test is based on the special rules is treated as a dependent of both parents for the medical expenses deduction. A parent can deduct medical expenses he or she paid for the child even if an exemption for the child is claimed by the other parent.

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

▶ Attach a separate form for each child.

Name of noncustodial parent _____	Noncustodial parent's social security number (SSN) ▶ _____
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## 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
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**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
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## 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
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### General Instructions What's New

**Post-2008 decree or agreement.** If the divorce decree or separation agreement went into effect after 2008, the noncustodial parent cannot attach certain pages from the decree or agreement instead of Form 8332. See *Release of claim to exemption* below.

**Definition of custodial parent.** New rules apply to determine who is the custodial parent and the noncustodial parent. See *Custodial Parent and Noncustodial Parent* on this page.

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

**Release of claim to exemption.** This release of the exemption will also allow the noncustodial parent to claim the child tax credit and the additional child tax credit (if either applies). 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 2010, the earliest tax year the revocation can be effective is 2011. 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.

### Exemption for a Dependent Child

A dependent is either a qualifying child or a qualifying relative. See your tax return instruction booklet 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 relative of the noncustodial parent for purposes of the dependency exemption, the child tax credit, and the additional child tax credit.

## 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). Public assistance payments, such as Temporary Assistance for Needy Families (TANF), are not support provided by the parents.

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 your tax return instruction booklet 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.*

The noncustodial parent can no longer attach certain pages from a divorce decree or separation agreement instead of Form 8332 if the decree or agreement was executed after 2008.

## 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 2007, you released a claim to exemption for your child on Form 8332 for the years 2008 through 2012. In 2010, 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 2010, the revocation will be effective for 2011 and 2012. You must attach a copy of the revocation to your 2011 and 2012 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 your tax return instruction booklet 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.

**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 are not 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.

# INTERNAL REVENUE CODE EXCERPT

## IRC 152 (e) Support Test In Case of Child of Divorced Parents, Etc.

- (1) Custodial parent gets exemption  
Except as otherwise provided in this subsection, if—
  - (A) a child (as defined in section 151(c)(3)) receives over half of his support during the calendar year from his parents—
    - (i) Who are divorced or legally separated under a decree of divorce or separate maintenance,
    - (ii) Who are separated under a written separation agreement or
    - (iii) Who live apart at all times during the last 6 months of the calendar year and
  - (B) Such child is in the custody of one or both of his parents for more than one half of the calendar year, such child shall be treated, for purposes of subsection (a) as receiving over half of his support during the calendar year from the parent having custody for a greater portion of the calendar year (hereinafter in this subsection referred to as the “custodial parent”).
- (2) Exception Where Custodial Parent Releases Claim to Exemption for The Year

A child of parents described in paragraph (1) shall be treated as having received over half of his support during a calendar year from the noncustodial parent if—

- (A) the custodial parent signs a written declaration (in such manner and form as the Secretary may by regulations prescribe) that such custodial parent will not claim such child as a dependent for any taxable year beginning in such calendar year, and
- (B) the noncustodial parent attaches such written declaration to the noncustodial parent’s return for the taxable year beginning during such calendar year. For purposes of this subsection, the term “noncustodial parent” means the parent who is not the custodial parent.

## ALIMONY

**ALIMONY**- Amount paid to a spouse or former spouse under a decree of divorce or separation agreement.

**DEDUCTIBLE BY PAYER**- As adjusted gross income deduction - do not need to itemize.

**INCOME PAYEE**- Ordinary income in year received

### **DIVORCE OR SEPARATION AGREEMENT:**

1. Decree of divorce or separate maintenance OR a WRITTEN instrument INCIDENT to that decree
2. A written separation agreement
3. A decree or type of court order requiring a spouse to make payments for support or maintenance of other spouse,

#### INCLUDING:

- a) Temporary decree
- b) interlocutory decree
- c) decree of alimony pendants life (while waiting action on final decree.)

#### Note:

**Decree need not be final for alimony qualifications , but must be final for single filing status.**

## ALIMONY

### ALIMONY RULES APPLICABLE TO:

1. Divorce or separation instruments after 1984
- OR
2. Pre 85 instruments that have been modified to:
    - a) specify that post 84 rules will apply
    - b) Change amount or period of payment or add or delete a contingency or condition.
  3. **Post 84 rules do not apply to instruments executed after 1984 if the terms for alimony are unchanged from an instrument executed before 1985.**

### TO BE QUALIFIED AS ALIMONY:

Must be cash  
Payments must be required by decree  
Instrument does not designate the payment as NOT alimony  
Spouses are not members of same household  
No liability to make payments (in cash or property) after death of the recipient spouse  
Payment is not treated as child support.  
Parties may not file a joint return.

### PAYMENTS IN CASH

#### **Qualified**

Payments by cash, including check or money order only

#### **Not qualified**

Transfers of services or property ( including debt instrument of a third party or an annuity contract) execution of a debt instrument, or the use of property.

#### **Payments to third party**

Under terms of divorce or separation instrument on behalf of spouse at request of spouse of ALL requirements met:

Payments are in lieu of payments of alimony directly to spouse

Written request states that both spouses intend the payments to be treated as alimony.

Written request is received by payer before payer's return is filed for the year payments were made.

Includes spouse's medical expenses, housing costs (rent, utilities, etc) taxes, tuition etc.

Premiums paid under decree or instrument for insurance on your life qualify as alimony to extent your spouse owns policy.

## ALIMONY

### **PAYMENTS THAT ARE NOT ALIMONY**

Any payment not required by decree or agreement

Any payment that did not arise out of a marital relationship pre 1985

Any payment made before decree or agreement

Any payment agreed to pay before decree or agreement and paid later

Any payment made after spouse's death, even if required by decree or agreement.

Lump sum cash or property settlements.

Child support

Payments that are spouse's share of community income under community property rules

Use of property

Payments to maintain the PAYER's property

**If both child support and alimony required and payment is less than total required, the payments are first applied to child support, then alimony.**

### **PAYMENTS ON JOINTLY OWNED HOME**

Total payments made by one spouse are half alimony **if other** spouse is living in the residence:

the balance of mortgage interest is **investment** interest (this is not the personal residence or second residence of the payer)

the balance of real estate taxes is deductible by payer as an itemized deduction.

### **HOME OWNED BY ENTIRETY OR JOINT TENANTS (with right of survivorship):**

None of the payments for taxes or insurance are alimony, but **payer** may deduct ALL of the real estate taxes paid as itemized deduction.

## ALIMONY

### PAYMENTS DESIGNATED AS NOT ALIMONY FOR INSTRUMENTS AFTER 1984

Otherwise qualifying payments may be designated as NOT alimony. Any writing signed by both parties that makes this designation and refers to a prior written separation agreement is treated as a written separation agreement. To exclude payments from income, spouse must attach a copy of the instrument to return for each year designation is applicable.

### MEMBERS OF SAME HOUSEHOLD

Payments made while members of same household are NOT alimony **If separated under a decree or divorce or separate maintenance.** A home formerly shared is considered one household, even if physically separated from each other in the home.

NOT members of same household if preparing to leave and does leave within one month after date of payment.

*EXCEPTION: If NOT legally separated under decree of divorce or separate maintenance, payment under a written separation agreement, support decree or other court order may qualify as alimony even if living in same household when paid.*

### LIABILITY FOR PAYMENTS AFTER DEATH OF RECIPIENT SPOUSE

If must continue to make payments for any period after spouse's death, NONE of the payments, before or after the death, are alimony.

Divorce or separation agreement does not have to expressly state that the payment cease upon death of spouse, if, for example the liability for continued payments would end under state law.

Substitute payments - in cash or property after death as a substitute for continuing otherwise qualifying payments can also include payments to the extent they increase in amount or begin or accelerate as a result of death.

**ALIMONY**

**INSTRUMENTS AFTER 1984**

**CHILD SUPPORT**

Specifically designated as child support

Treated as specifically designated as child support:

- a) reduced on the happening of a contingency related to child
- b) reduced at a time that can be clearly associated with the contingency.

Payment may be treated as specifically designated even if other payments ARE designated.

**Contingency related to child**

Reaching specified age or income level

Dying

Marrying

Leaving school

Leaving the household

Becoming employed

**Closely associated with a contingency**

Payments reduced not more than 6 months before or after the date the child will reach 18, 21, or local age of majority.

Payments reduced on two or more occasions that occur not more than one year before OR after a different child reaches a certain age from 18 to 24.

This certain age must be the same for each child, but need not be a whole number of years.

**May overcome presumption of contingency by showing that the payment reduction was determined independently of anything related to the children**

## ALIMONY

### INSTRUMENTS AFTER 1984

#### RECAPTURE OF ALIMONY

If alimony payments decrease or terminate during the first 3 calendar years

Three year period starts with first calendar year made (exclude time payments were being made under temporary support order)

Second and third years are next 2 calendar years, whether or not payments are made.

Reasons for reduction:

Failure to make timely payments

Change in instrument

Reduction in spouse's support needs

Reduction in ability to provide support.

Subject to recapture if YES to all:

1. Was third preceding year first year in which alimony payments were made  
(2005 for 2008, 2006 for 2009, 2007 for 2010)
2. Were payments made in the two preceding years more than \$15,000.  
(2006 and 2007 for 2008, 2007 and 2008 for 2009, 2008 and 2009 for 2010)
3. Were payments reduced by more than \$15,000 during the 3 calendar year period ending with current tax year.

**EXCEPTIONS** Not subject to recapture if:

Payments reduced because of death of either spouse or remarriage of recipient

#### REPORTING RECAPTURE

**INCLUDING IN INCOME** - report on form 1040 (income section) by crossing out "received" and write in "recapture".

**DEDUCTING RECAPTURE** - report on form 1040 (adjustment section) by crossing out "paid" and write in "recapture".

**WORKSHEET FOR RECAPTURE OF ALIMONY**

**Note: Do not enter less than zero on any line.**

- |     |  |                    |
|-----|--|--------------------|
| 1.  | Alimony paid in <u>2<sup>nd</sup></u> year.....                                  | 1_____             |
| 2.  | Alimony paid in <u>3<sup>rd</sup></u> year .....                                 | 2_____             |
| 3.  | Floor .....  | 3. <u>\$15,000</u> |
| 4.  | Add lines 2 and 3.....   | 4_____             |
| 5.  | Subtract line 4 from line 1 .....  | 5_____             |
| 6.  | Alimony paid in <u>1<sup>st</sup></u> year.....                                  | 6_____             |
| 7.  | Adjusted alimony paid in <u>2<sup>nd</sup></u> year<br>(line 1 less line 5)..... | 7_____             |
| 8.  | Alimony paid in <u>3<sup>rd</sup></u> year.....                                  | 8_____             |
| 9.  | Add lines 7 and 8 .....  | 9_____             |
| 10. | Divide line 9 by 2.....  | 10_____            |
| 11. | Floor .....  | 11 <u>\$15,000</u> |
| 12. | Add lines 10 and 11 .....  | 12_____            |
| 13. | Subtract line 12 from line 6 .....   | 13_____            |
| 14. | <b>Recaptured alimony.</b> Add lines 5 and 13 .....                              | 14_____            |

## **INSTRUMENTS EXECUTED BEFORE 1985**

(Unless modified to specify that rules for instruments executed after 1984 apply or to change the terms regarding amount or period of payment or other contingencies or conditions.)

### **ALIMONY REQUIREMENTS**

Payment under divorce or separation instrument that meets ALL requirements:

Periodic instead of lump sum

Based on marital or family relationship

Not child support

Spouses must be separated and living apart at time of payment.

### **PERIODIC PAYMENTS**

Fixed amounts for indefinite period (i.e. \$400 per month for life)

Indefinite amount for either a fixed or indefinite period  
(i.e. 10% of salary that changes from year to year, to be paid for six years)

A fixed amount for a fixed period of more than 10 years, subject to limits

### **INDEFINITE PERIOD**

If payments are to end or change in amount on the happening of one or more of the following:

Either spouse's death

Recipient spouse's remarriage

Change in either spouse's economic status.

May be either specified in instrument or imposed by local law.

## **INSTRUMENTS EXECUTED BEFORE 1985.**

### **PRE - 1985 INSTRUMENTS**

For additional information see IRS Publication 504, Revision for the year of 2004.

### **MORE THAN 10 YEARS - Limits**

Fixed amount for fixed period of more than 10 years:

Amount of each annual payment considered periodic is limited to 10% of the total to be paid over the entire period.

Applies to payments made in advance but not to payments for an earlier period (delinquent payments)

### **MARITAL OR FAMILY RELATIONSHIP**

Based on obligation because of the marital or family relationship, to continue supporting spouse.

Not if settlement of property rights.

### **CHILD SUPPORT**

Specifically designated as child support is not alimony.

If agreement calls for payments that otherwise qualify as alimony and does not separate an amount as child support ALL the payments are alimony. This is true even if payments are subject to a contingency relating to the child.

**THIS IS FOR PRE INSTRUMENTS!!**

## **ALIMONY TRUSTS, ANNUITIES, ENDOWMENT CONTRACTS**

If transfer of property to a trust or purchase or transfer of annuity or endowment contract to pay alimony owed:

### **TRUST INCOME:**

Trust income or other proceeds that would ordinarily be **INCLUDIBLE** in income must be included in income of former spouse as alimony received.

Do not include the payments in payer's income and do not deduct the alimony.

Applicable whether proceeds are from earnings or principal of the property transferred.

Does **NOT** apply to any trust income that is fixed for child support.

### **ANNUITY AND ENDOWMENT CONTRACTS**

Proceeds from annuity and endowment contracts bought for or transferred to a spouse after July 18, 1984, cannot be treated as alimony.

Does not apply to contracts bought or transferred to pay alimony under a divorce or separation agreement executed on or before July 18, 1984 unless both spouses choose to have it apply.

## **QUALIFIED DOMESTIC RELATIONS ORDER**

A judgment, decree, or court order issued under a domestic relations law (including an approved property settlement agreement)

Related to rights of some one other than a participant to receive benefits form a qualified retirement plan (pension and profit sharing)

Specifies amounts or portion of participant's benefits to be paid to the participant's spouse, former spouse, child, or dependent.

Benefits paid to child or dependent:

Treated as paid to participant

Benefits paid to spouse or former spouse

Treated as paid to spouse or former spouse

May be rolled over, to an IRA

If not rolled over, taxable to spouse or former spouse

If participant has cost basis, a prorated share is allowed to the spouse or former spouse as deduction.

Lump sum benefits are available, if, had the participant received the benefits they would have been treated as lump sum.

Consider only balance to spouse's or former spouse's credit in determining whether the distribution is a total distribution.

## **INDIVIDUAL RETIREMENT ARRANGEMENTS** **EFFECTS OF DIVORCE**

### **SPOUSAL IRA:**

If divorce decree final by end of tax year, cannot deduct contributions to former spouse's IRA.

Can only deduct contributions to OWN IRA.

### **IRA TRANSFERRED AS A RESULT OF DIVORCE**

Not considered a taxable transfer.

Starting from date of the transfer the IRA is treated as owner of IRA.

### **IRA DEDUCTION LIMITS**

All taxable alimony received is treated as compensation for the IRA deduction limits.

For information on IRAs see our separate course titled 'IRAs'.

**RETIREMENT/PENSION PLANS**  
**EFFECTS OF DIVORCE**

A state court can allocate an interest in a qualified retirement plan to a former spouse in a qualified domestic relations order. A state court **cannot** determine in a QDRO who should pay federal tax.

The **alternate payee** is treated as the distributee under a QDRO and must include distributions in income.

**Benefits are taxed to former spouse who received payment**

**Not subject to 10% penalty tax**

**May be rolled over tax free into IRA or qualified retirement plan  
(Due to 20% withholding requirement - advisable to  
make the rollover a “direct rollover” to new plan.)**

**Payments made as a result of QDRO to former spouse will not affect participant in the pension plan. There is no premature distribution penalty and participant can still use averaging and/or capital gains in computing tax liability when payout is received.**

**Funds must be distributed DIRECTLY from the plan to the spouse.**

## **TRANSFERS BETWEEN SPOUSES**

### **No gain or loss on transfer of property to (or in trust for benefit of):**

Spouse

Former spouse (only if incident to a divorce)

(Not applicable if spouse (or former spouse) is a nonresident alien.)

### **Property**

Includes:

All property whether real or personal, tangible or intangible, separate or community.

Property acquired after end of marriage

Does not include services

### **Incident to divorce:**

Within one year after date marriage ends OR Related to ending of marriage.

- a) Transfer made under original or modified divorce or separation instrument  
AND b) Transfer occurs within 6 years after date marriage ends.

### **Transfers to third parties on behalf of spouse (or former spouse if incident to divorce), treated as two transfers:**

1) transfer to spouse or former spouse

AND 2) immediate transfer to the third party

No gain or loss of first transfer

Spouse may have to recognize gain or loss on second deemed transfer must be:

- 1) Required by decree or separation instrument
- 2) Requested in writing by spouse or former spouse
- 3) Consented to in writing by spouse or former spouse stating that both taxpayer and spouse intend to treat the transfer as transfer subject to section 1041 of the IRC.

Must receive the consent before filing the return.

### **Transfers in trust:**

Transferor must recognize gain to extent that liabilities assumed by the trust, plus the liabilities to which the property is subject, exceed the total adjusted basis in property transferred.

## **TRANSFERS OF INCOME PRODUCING PROPERTY**

### **REPORTING INCOME FROM PROPERTY**

Report income up to date of transfer

Spouse or former spouse receiving property must report income or loss generated after date of transfer

### **US SAVINGS BOND INTEREST**

Report all income on the bond that has been earned up to date of transfer but not previously reported.

Spouse or former spouse receiving bonds may be able to defer reporting interest after transfer until bond is cashed.

### **UNUSED PASSIVE ACTIVITY LOSSES**

Can NOT deduct accumulated unused passive activity losses at transfer

Adjusted basis of transferred interest is increased by amount of unused loss

### **INVESTMENT CREDIT RECAPTURE**

No recapture at transfer

Spouse or former spouse may have to recapture if disposed of or USE CHANGED before the end of recapture period.

### **MUST GIVE RECIPIENT SPOUSE BASIS INFORMATION**

### **PROPERTY RECEIVED IN A QUALIFIED TRANSFER IS TREATED AS ACQUIRED BY GIFT FOR TAX PURPOSES.**

## **TRANSFERS OF INCOME PRODUCING PROPERTY**

### **BASIS IN PROPERTY RECEIVED IN DIVORCE TRANSFER**

Basis is same as transferor's adjusted basis.

Applies to either gain or loss when disposed of.

Applies whether property's adjusted basis is less than, equal to, or more than fair market value at transfer.

Applies even if liabilities are more than adjusted basis.

Property received prior to 7-19-84 in exchange for release of marital rights :  
basis is fair market value to the recipient unless elected to apply post 7-19-84 rules.

#### **Property transferred in trust:**

If transferor recognizes gain per transfer in trust rules  
Trust basis is increased by recognized gain.

#### **U.S. Savings bonds:**

Transferor's original basis is increased by the amount of interest taxed to the transferor.

## **PROPERTY SETTLEMENTS**

No gain or loss on transfer of property between spouses or former spouses if the transfer is because of a divorce.

MAY be required to report transaction as a gift!!

If property (owned jointly) is sold in order to split proceeds as part of the property settlement, each must report own share of gain or loss on sale.

## **TRANSFERS OF INCOME PRODUCING PROPERTY**

### **GIFT TAX ON PROPERTY SETTLEMENTS**

Transfer in exchange for release of marital rights (unless qualified for exception) are subject to gift tax requirements for the calendar year the transfer was made.

### **RELEASE OF MARITAL RIGHTS**

Giving up by spouse or former spouses of dower, curtesy, or other marital rights in property or estate.

Does NOT include release of SPOUSAL or child support rights. Transfer of property in exchange for support rights is not subject to gift tax.

If transfer is in exchange for BOTH marital and support rights, the reportable amount is value of the property less value of support rights given up.

### **NOT SUBJECT TO GIFT TAX IF MEET ALL OF FOLLOWING EXCEPTIONS**

Qualifies for annual exclusion

Qualifies for tuition or medical care

Qualifies for marital deduction

Required by divorce decree

Made under written agreement and divorced within a specified period.

### **ANNUAL EXCLUSION:**

First \$12,000 per year of gifts not subject to gift tax.

Annual exclusion is \$128,000 for transfers to spouse who is not U.S. citizen that would qualify for the marital deduction if donee were a U.S. citizen.

# **TRANSFERS OF INCOME PRODUCING PROPERTY**

## **GIFT TAX ON PROPERTY SETTLEMENTS**

### **TUITION AND MEDICAL CARE:**

Paid to a qualifying educational organization for benefit of spouse (or former spouse) and amounts paid to provide medical care for spouse (or former spouse) not subject to gift tax.

### **MARITAL DEDUCTION**

Transfer of property to a spouse before receiving a final decree of divorce or separate maintenance is not subject to gift tax. Not applicable to:

Transfers of certain terminable interests

or

Transfers to a spouse who is not a U.S. citizen.

### **TRANSFERS UNDER DIVORCE DECREE**

Transfer of property under of divorce court having the power to proscribe a property settlement is not subject to gift tax. Includes a property settlement agreed to pre-divorce if made a part or approved by the decree.

### **TRANSFER UNDER WRITTEN AGREEMENT**

Transfer of property under written agreement in exchange for release of marital rights or to provide a reasonable child support allowance is not subject to gift tax if you are divorced within the 3 year period beginning one year before and ending 2 years after date of the agreement.

**Applies whether or not the agreement is part of or approved by the divorce decree.**

## **SALE OF JOINTLY OWNED PROPERTY**

### **BASIC RULE:**

Each party reports their share of gain or loss on tax return for year of sale.

### **SALE OF HOME-(PRIOR TO 5-7-97)**

May be able to postpone gain on separate portions

**Divorced after filing a joint return on which you postponed tax and do not buy or build a new home in time required but former spouse does.**

Must file amended **JOINT** return to report tax on your share of gain.

If former spouse refuses to sign return, attach letter explaining.

### **SALE OF HOME AFTER MAY 6 , 1997**

If home was transferred by spouse (or former spouse if incident to divorce), transferee is considered to have owned it during any period of time that spouse owned it.

### **USE OF HOME AFTER DIVORCE**

**Considered to have used the property as main home during any period when:**

- 1. YOU owned it**
- 2. Your SPOUSE or former spouse is allowed to use it under a divorce Or separation instrument.**

## **COST OF GETTING A DIVORCE**

NON DEDUCTIBLE if for advice concerning the DIVORCE

DEDUCTIBLE if for tax advice in connection with receiving alimony that you must include in income.

May also be able to deduct fees to appraisers, actuaries, and accountants for services in determining correct tax or helping to get alimony.

FEES MUST BE BROKEN DOWN SHOWING AMOUNT CHARGED FOR EACH SERVICE

DEDUCTIBLE ONLY IF ITEMIZED - AS MISC. ITEMIZED DEDUCTION SUBJECT TO 2% LIMITS

FEES PAID SPECIFICALLY FOR A PROPERTY SETTLEMENT MAY BE ADDED TO BASIS OF PROPERTY (i.e. - fees to transfer title to property)

FEES PAID FOR FORMER SPOUSE NON DEDUCTIBLE UNLESS PAYMENTS QUALIFY AS ALIMONY.

## **JOINT ESTIMATED TAX PAYMENTS**

If made **joint estimated tax payments** and filed separate returns, either of you may claim the estimated tax payments or you may divide them in any way you agree on. If unable to agree, must divide payments in proportion to individual tax amounts shown on the separate returns.

If claiming payments on estimated tax, enter spouse's or former spouse's social security number in the block provided on front of form 1040.

If remarried, enter former spouse's social security number to the left of estimated tax payments line on 1040 and write DIV after social security number.

## COMMUNITY PROPERTY

Must report half of any income described by state law as community income and may claim credit for half the income tax withheld from community income.

### **Special rules for spouses living apart - reporting community income**

If all of the following exist:

- 1) Live apart all year
- 2) Do not file joint return
- 3) Have earned income for year that is community income
- 4) Have not transferred, directly or indirectly, any of the earned income between yourselves before the end of the year. Do not take into account transfers to satisfy child support or transfers of very small amounts.

Must then report **community** income as follows:

Earned income - treat as income of spouse who performed the services

Includes: wages, salaries, professional fees and other compensation for service

Does NOT include amounts paid by a corporation that are a distribution of earnings and profits rather than a reasonable allowance for personal services rendered

Trade or business income (not partnerships)

Treated as income of spouse carrying on the trade or business. If capital investment and personal services both produce business income, treat all as trade or business income.

Partnership income or loss

Treat as income or loss of the spouse who is the partner.

Separate property income

Treat as income of the spouse who owns the property

Social Security benefits

Treat as income of the spouse who receives the benefits

Other income

Treat all other community income such as dividends, interest, rents, royalties, or gains as provided under state community property laws.

## **ENDING THE COMMUNITY**

An absolute decree of divorce or annulment ends the community in all community property states.

A decree of legal separation or of separate maintenance may or may not end the community. The court may terminate the community and divide the property.

A separation agreement may divide the community property and provide that future earnings and property acquired will be separate property. This ends the community.

In some states, the community ends when spouses permanently separate, even if there is no formal agreement. Check your local state law.

## **ALIMONY IN COMMUNITY PROPERTY STATES**

Payments that may otherwise qualify as alimony are not deductible by the payer if they are the recipient spouse's share of community income.

Deductible as alimony only to extent they are more than that spouse's part of the community income.

2010