

## **Divorces are bad enough tax mistakes only make them worse**

A steady stream of recent court cases illustrate an unfortunate fact of life: Individuals who get divorced often receive poor or no tax advice. It may be because their attorneys are not well acquainted with the tax intricacies of divorce. Or it may be that the divorcing parties are going the "do-it-yourself" route. Or it may be that taxes are not a high priority when going through the trauma of a divorce. In any case, when it comes to filing their tax returns, the divorced individuals often get a rude awakening.

### **Alimony**

Payments that qualify as alimony are deductible "above the line" by the payor and includible in the gross income of the payee.

But not all payments are alimony for tax purposes. A payment is treated as alimony if it meets all six of these requirements:

1. The payment is made under a divorce or separation instrument.
2. The parties do not file a joint return with each other.
3. The payment is in cash.
4. The instrument does not designate the payment as non-alimony.
5. The parties reside in separate households (if legally separated under a decree of divorce or separate maintenance).
6. There is no liability to make any payment after the death of the recipient spouse. (**Warning about Potential Pitfalls Requirement 6**) is often a potential pitfall.

**Follow Terms Carefully.** Another possible place for slip-ups lies in the phrase "under a divorce or separation instrument" in Requirement 1. Courts apply this rule strictly.

**Need for Formal Agreements.** Courts do not look favorably on informal agreements between the parties outside of the divorce instrument. If the divorce agreement or decree is clear and specific, that's what controls.

**Need a Paper Trail.** And, of course, as with any deductible expense, a divorced taxpayer must be able to substantiate payment.

### **Designated Non-Alimony**

So far I have talked about instances where the payor thought a payment constituted alimony but it failed to meet one of the requirements. But sometimes the parties may not want a payment to be identified as alimony. Requirement 4 above (that the divorce instrument does not designate the payment as non-alimony) refers to this topic. Designation as non-alimony is accomplished by including a provision in the agreement that states the payments are not deductible as alimony by the paying party and are excludable from the income of the receiving party. For this purpose, any written statement signed by both parties that makes this designation and that refers to a previous written agreement will be sufficient.

**Tax-Filing Requirement.** The payments are excludible by the receiving party only if he or she attaches a copy of the designation agreement to his or her return. The copy must be attached each year the designation applies.

### **Payments to a Third Party**

Payments to a third party on behalf of the tax payer's spouse under the terms of a divorce or separation agreement may be alimony. These include payments for a spouse's medical expenses, housing cost (rent, utilities.etc.), taxes, tuition, etc. The payments are treated as received by the taxpayer's spouse and then paid to the third party.

### **Property Settlements**

The tax law provides that property transfers "incident to a divorce" are ignored for income tax purposes. Thus, for example, if one party to a divorce transfers appreciated property to the other party in exchange for cash or release of marital rights, no gain is recognized on the transfer.

This provision cuts both ways. While no gain is recognized by the assignee in the transfer, no deduction is available to the assignor.

### **Child Support**

**Child support payments are not deductible by the payor and are not taxable to the payee.** There are two ways that a payment under a divorce or separation agreement can be construed as child support (and therefore not subject to income tax or deduction):

1. The payment is specifically designated as child support in the agreement.
2. The payment is treated as though it were specifically designated as child support.

### **Importance of Good Documents**

As with alimony, a sloppily drafted divorce agreement or decree can cause problems in the area of child support.

**This is just an overview of some of the most common problems associated with divorce and separation agreements and there tax consequences. There are many other issues that can impact your taxes in this area. I had to decide at what point it would become information overload. If you have any questions please feel free to give me a call (508) 525-6522.**