

Determining the tax consequences that can arise during a divorce or marital separation can be vital for the financial protection and well-being of you and your family. That's why it's important to understand the applicable tax laws before making any major decisions.

### Alimony

Generally, alimony is the amount paid to a spouse for his or her living expenses, education, health or life insurance, property taxes, or mortgage payment. Alimony is not for providing child support. The person receiving alimony is called the "payee spouse," and the person paying alimony is called the "payor spouse." The payee spouse must pay taxes on the alimony in the year it is received, and the payor spouse may deduct the amount in the year it is paid providing the alimony meets all the following conditions:

- The divorce or separation agreement must be executed prior to December 31, 2018.
- The payment is made in a cash form (i.e., check, bank deposit, etc.). Payment in the form of such things as bonds, stocks, money market shares, or actual objects are not considered alimony for tax purposes.
- The payment is made as the result of a legal separation agreement or divorce decree.
- The payor spouse and payee spouse do not live in the same household at the time the payment is made.
- The divorce instrument does not designate the payment as nontaxable to the payee spouse and nondeductible by the payor spouse.
- The payments are not designated as child support.

There can be no liability for payments after the death of the payee spouse.

### Child Support

Child support, unlike alimony, is not taxable to the payee spouse, nor is it tax deductible by the payor spouse. This is true regardless of how the payment is described in the divorce papers.

A divorce decree may specifically call a payment "alimony," but the payment may have the characteristics of child support. One characteristic of a child support payment might be the designation in the divorce document that the payment be terminated if the child's situation changes. Despite what it's called in the divorce papers, if the payment appears to be more characteristic of child support than of alimony, the payee spouse won't pay taxes on it and the payor spouse can't deduct it.

### Dependency Exemption

For tax years beginning before January 1, 2018, only a parent with a qualifying child may claim the child's dependency exemption and child-related tax benefits. A qualifying child meets all the following tests:

- **Relationship.** The child must be your son, daughter, step-child, eligible foster child, or a descendent of any of them, or your brother, sister, half-brother, half-sister, step-brother, step-sister, or a descendent of any of them.
- **Age.** The child must be under the age of 19, under the age of 24 if a full-time student, or be permanently and totally disabled.
- **Residency.** The child must live with you in the same home for more than half the tax year.

While the dependency exemption deduction is suspended for tax years beginning after 2017 through 2025, the same qualifying child tests are used to determine which parent is eligible to claim the dependent-related tax benefits.

A child can only be a qualifying child of one parent during any given tax year. This parent is called the custodial parent and is generally the only parent who is entitled to child-related tax benefits. Thus, where the child actually lives is key. Which parent is the custodial parent is determined each year based on what actually happened with the child during the tax year and not by what the divorce decree states is supposed to happen with the child. The child-related tax benefits available to the custodial parent include all the following:

- Child tax credit.
- Education tax credits.
- Student loan interest deduction.
- Tuition deduction (currently not extended beyond 2017).
- Head of household filing status.
- Child and dependent care tax credit.
- Earned income tax credit.
- Tax-free dependent care assistance benefits.

In general, the non-custodial parent cannot claim any of these benefits. However, he or she may be able to claim the child tax credit and the education-related benefits if all the following apply:

- Child received more than 50% of support from parents.
- Child's parents are divorced or legally separated.
- Child was in custody of one or both parents over 50% of the year.
- Non-custodial parent must have Form 8332 or an equivalent written statement from the custodial parent waiving his or her right to claim the child.
- Non-custodial parent must attach the Form 8332 or an equivalent written statement to his or her return.

**Note:** Under no circumstances can a non-custodial parent ever claim head of household, child and dependent care tax credit, earned income credit, and tax-free dependent care assistance benefits. Only the custodial parent can claim these, regardless of whether he/she claims the child on his/her return. Wording in the divorce decree will not change this.

It is not possible for parents to take turns being the custodial parent. The custodial parent can change from year to year, but the determination is based upon the parent with whom the child resides for a majority of the time. Because the divorce decree does not override tax law, make sure the party drafting the divorce agreement is knowledgeable of these rules.

### Property Transfers

There is typically no gain or loss on the transfer of property from one spouse to another, or to a former spouse if the transfer is “incident to divorce.” This rule applies to both separate and community property in divorces that occurred after July 18, 1984.

If a transfer is to be considered “incident to divorce,” it must occur within one year of the divorce date, or must be made according to the terms of the divorce or separation document, and not more than six years after the divorce date. Because there is no gain or loss recognized at the time of the transfer, the basis of the property received is not adjusted.

### Attorney Fees

Legal fees paid to obtain a divorce are not deductible for tax purposes.

### Related Issues

- If a joint tax return is filed prior to the year the divorce is final, both the husband and wife can be held jointly and individually liable for the tax due, as well as any interest and penalty related to the joint tax return, without regard to what is stated in the divorce decree.
- An IRA interest transferred or a retirement plan transferred per a qualified domestic relations order (QDRO) to a spouse and treated as that spouse’s is not taxable, but may be if distributions are taken.
- The parent who claims the child as a dependent is eligible to claim the American Opportunity Tax Credit or Lifetime Learning Credit. This is true regardless of which parent paid the tuition.
- A separate liability election is allowed, which limits your liability for tax, interest and penalty on the tax liability allocated to your former spouse on a joint return.

### Summary

Tax challenges during and following a divorce are common, but they can be minimized with some knowledge about tax laws and IRS procedures. Financial planning is an important part of the divorce process. As always, see your tax advisor for additional information on issues related to your specific situation.

This brochure contains general tax information for taxpayers. As each tax situation may be different, do not rely upon this information as your sole source of authority. Please seek professional advice for all tax situations.

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