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***The Tax Cuts & Jobs Act  
(TCJA 2017):  
Family Law Update***

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# TCJA 2017

## The Tax Cuts and Jobs Act



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# Family Law Tax Update – 2018

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1. Standard deduction
2. State/local tax deduction
3. Mortgage interest
4. Individual tax rates
5. Filing status options
6. Dependency exemption
7. Child tax credit
8. Alimony
9. 529 savings plans
10. Postcard tax return
11. Innocent spouse relief
12. Legal fees deductibility
13. Business taxes
  - Corporate rates
  - Pass-through

# Standard v. Itemized Deduction

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- **Prior law Standard deduction:**
  - Single and married filing separate was \$6,350
  - HOH was \$9,350
  - Married filing jointly was \$12,700.
- **New law Standard deduction:**
  - Single and married filing separate is now \$12,000
  - HOH is now \$18,000
  - Married filing jointly is now \$24,000

**But WAIT**  
**What's the trade-off?**

# Standard v. Itemized Deductions

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- SALT – State and Local Taxes – now limited to only \$10,000. This includes not only income tax but real estate tax also.
  - Prior law this was unlimited.
- Mortgage interest deductible on loans no higher than \$750,000. Prior law the maximum loan amount was \$1,000,000.
- Home Equity Loan Interest – limited to amounts borrowed for home improvements only

# Individual Tax Rates

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Tax Brackets - Single Filer				Tax Brackets - Head of Household			
2017 - Current Law		2018 - TCJA		2017 - Current Law		2018 - TCJA	
10.0%	\$0 - \$9,325	10%	\$0 - \$9,525	10.0%	\$0 - \$13,350	10%	\$0 - \$13,600
15.0%	\$9,325 - \$37,950	12%	\$9,526 - \$38,700	15.0%	\$13,350 - \$50,800	12%	\$13,601 - \$51,800
25.0%	\$37,950 - \$91,900	22%	\$38,701 - \$82,500	25.0%	\$50,800 - \$131,200	22%	\$51,801 - \$82,500
28.0%	\$91,900 - \$191,650	24%	\$82,501 - \$157,500	28.0%	\$131,200 - \$212,500	24%	\$82,501 - \$157,500
33.0%	\$191,650 - \$416,700	32%	\$157,501 - \$200,000	33.0%	\$212,500 - \$416,700	32%	\$157,501 - \$200,000
35.0%	\$416,700 - \$418,400	35%	\$200,001 - \$500,000	35.0%	\$416,700 - \$444,500	35%	\$200,001 - \$500,000
39.6%	418,400+	37%	\$500,001+	39.6%	\$444,550+	37%	\$500,001+

  

Tax Brackets - Married Filing Jointly				Tax Brackets - Married Filing Separate			
2017 - Current Law		2018 - TCJA		2017 - Current Law		2018 - TCJA	
10.0%	\$0 - \$18,650	10%	\$0 - \$19,050	10.0%	\$0 - 9,325	10%	\$0 - \$9,525
15.0%	\$18,650 - \$75,900	12%	\$19,051 - \$77,400	15.0%	\$9,326 - \$37,950	12%	\$9,526 - \$38,700
25.0%	\$75,900 - \$153,100	22%	\$77,401 - \$165,000	25.0%	\$37,951 - \$76,550	22%	\$38,701 - \$82,500
28.0%	\$153,100 - \$233,350	24%	\$165,001 - \$315,000	28.0%	\$76,551 - \$116,675	24%	\$82,501 - \$157,500
33.0%	\$233,350 - \$416,700	32%	\$315,001 - \$400,000	33.0%	\$116,676 - \$208,350	32%	\$157,501 - \$200,000
35.0%	\$416,700 - \$470,700	35%	\$400,001 - \$600,000	35.0%	\$208,351 - \$235,350	35%	\$200,001 - \$300,000
39.6%	\$470,700+	37%	\$600,001+	39.6%	\$235,351+	37%	\$300,001+

# Filing Status

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- The determination of whether an individual is married is made as of the close of the individual's tax year unless the individual's spouse dies during the tax year. In that case, the determination is made as of the time of the death.
- If a taxpayer receives an annulment, which means that a valid marriage never existed, the taxpayer is considered unmarried even if a joint return was filed in an earlier year. The taxpayer must file a Form 1040X, Amended U.S. Individual Income Tax Return, claiming single or head of household status for each tax year affected by the annulment that is not closed by the statute of limitations for filing a tax return

# Filing Status

## Head of Household

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### ○ Requirements

1. TP paid more than  $\frac{1}{2}$  the cost of the home for the year
2. Spouse did NOT live with TP during the last 6 months of the year
3. TP's home was the main home of the TP's (qualifying) child for more than  $\frac{1}{2}$  the year (i.e. custodial parent)

### ○ Expenses of maintaining the home:

- ✦ **Include** – property tax, mortgage interest (not principal), rent, utilities, repairs, property insurance, and food consumed on the premises.
- ✦ **Exclude** – clothing, education, medical treatment, vacation, life insurance, transportation, and mortgage principal



# Filing Status

## Head of Household

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- Benefits
  - ✦ Tax may be lower
  - ✦ Standard deduction is higher
    - May choose standard deduction even if spouse itemizes deductions
  - ✦ Earned income credit may become available
- ✦ Publication 501

# Filing Status

## Married Filing Separate

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- A husband and wife may choose married filing separately as their filing status. This filing status may be beneficial if either spouse only wants to be responsible for his or her own tax or if it results in less tax than filing a joint return. If a husband and wife do not agree to file a joint return, they must to use this filing status unless one or both qualifies for head of household status
- **IMPORTANT** – If one spouse itemizes deductions, the other spouse cannot claim the standard deduction and instead must itemize deductions also. If claiming the standard deduction, then each person's basic standard deduction is half the amount allowed on a joint return.
- Although it is generally more advantageous for married taxpayers to use married filing jointly status, there are some situations in which it will be more advantageous for married taxpayers to use married filing separately status. These situations usually occur when one spouse has a significant amount of deductions that are subject to an adjusted gross income (AGI) limitation, such as medical expenses (subject to 7.5 percent or 10 percent AGI limitation), miscellaneous itemized deductions (subject to a 2 percent AGI limitation), and casualty losses (subject to a 10 percent AGI limitation).

# Filing Status

## Married Filing Separate

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- **Some Disadvantages**
  - Tax rate is higher than filing joint
  - ATM exemption is  $\frac{1}{2}$  that of filing joint
  - No child care credit
  - No earned income credit
  - No education credits
  - No deduction for student loan interest, tuition or fees
  - Capital loss deduction is limited to \$1,500 ( $\frac{1}{2}$  that of filing joint)

# Filing Status

## Married Filing Separate

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- More Disadvantages if they lived together at all during the year:
  - No elderly or disabled credit
  - More social security and railroad retirement benefits are taxable
  - Cannot roll any retirement funds into a ROTH
  - Quicker phase-outs on:
    - ✦ Child tax credit
    - ✦ Retirement savings contribution credit

# Dependency Exemptions

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- For 2018-2025, the new law **SUSPENDS** personal and dependent exemption deductions (was \$4,150/person)
- However, the new law still makes reference to the dependent exemption for the following things:
  - Head of household status
  - Child tax credit
  - Child/dependent care credit
  - Earned income credit
  - Education credits
- Special rules for Divorced parents – Publication 501 has not yet been updated for the new tax law.



# Dependency Exemptions

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- **Divorce rules for qualifying child:**
  - Parents must be divorced or legally separated
  - Parents lived apart at all times during the last 6 months of the year
  - Child receives over 1/2 of child's support from his/her parents
  - Child is in the custody of one or both parents for more than 1/2 the year
  - Custodial parent releases the claim to exemption to the noncustodial parent on Form 8332 for attachment to noncustodial's tax return Reg §1.152-4(e)(1)

**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) ▶ \_\_\_\_\_

**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**

**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.

# Dependency Exemptions

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## More about Form 8332 and Reg Sec 1.152-4(e)(1)

- Beginning with tax year 2009, a written declaration for a custodial parent to release his/her claim to a child's dependency exemption must be in specific form,
- The written declaration must be an unconditional release. Any condition (such as payment of child support) will make declaration ineffective. *George v. Comm'r, 139 T.C. 19 (12/19/2012)*
- A written declaration not on the form designated by the IRS must conform to the substance of that form and must be a document executed for the sole purpose of service as a written declaration under Reg Sec 1.152-4
- A court order or decree or a separation agreement may NOT serve as a written declaration Reg.Sec. 1.152-4(e)(1)(ii). *Armstrong v. Comm'r, 139 T.C. 18 (12/19/2012)*



# Dependency Exemptions

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- Special divorce rule of Code Sec 152(e) of allowing noncustodial parent to claim the child as a qualifying child works only for:
  - ✦ Child tax credit
  - ✦ Dependency exemption
- NOT for:
  - ✦ Head of household
  - ✦ Child Care Credit
- If divorced or separated during the year and child lived with both parents before the separation – count the nights post separation to determine “more than 1/2”
- These special divorce rules for dependency exemptions under 152(e) apply to parents who never married as well, so long as they lived apart at all times during the last 6 months of the year

# Dependency Exemptions

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- What if?
  - Both parents claim the same child
    - ✦ If no Form 8332, then IRS will give it to the Custodial Parent (more # nights)
    - ✦ If no Form 8332 and child spent equal nights with each parent, IRS will give exemption to the parent with the higher AGI

# Child Tax Credit

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- Maximum \$2,000 per qualifying child under age 17
  - Prior law was \$1,000
- This credit travels with the Dependency Exemption
- Income limitation – AGI phase out
  - MFJ \$400,000 (was \$110,000)
  - Single or HOH \$200,000 (was \$75,000)
  - MFS \$200,000 (was \$55,000)

# Additional Child Tax Credit

## Potential refund of unused child tax credit

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This was eliminated by way of consolidation with the \$2,000 Child Tax Credit.

The new law provides for a potential refund of up to \$1,400 of unused credit on Form 8812.

- 15% of “earned income” over \$2,500.
- To get the full \$1,400 refund you would need \$12,000 earned income.

Publication 972 has not yet been updated. And, of course, the complicated Form 8812 has not yet been updated either.

# The new Alimony rules

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- **For divorces finalized before 12/31/2018:**
  - Deductible by payor
  - Taxable to recipient
  - Can choose to change this to nondeductible/nontaxable
- **For divorces finalized after 12/31/2018:**
  - Not deductible and Not taxable – just like child support
  - Can NOT choose to change this to taxable/deductible
- **Support modifications after 12/31/2018:**
  - Will remain deductible and taxable unless you choose to change to nondeductible/nontaxable.
- **When is “Final”?**
  - When the Judge signs off.

# The new Alimony rule

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## **Why did Congress change this?**

- “The alimony reporting compliance gap”. Too much lost revenue due to lack of tax compliance and the inability of the IRS to keep track of it.
- Looking at tax year 2010 returns, Treasury Inspector General of Tax Administration found that almost half (47%) of 567,887 tax returns with an alimony deduction claim had either no corresponding alimony income reported by a recipient at all--or the amount of alimony income reported didn't match the deduction taken. In total, there was a discrepancy of \$2.3 billion in deductions claimed without corresponding income reported.
- The 2014 TIGTA report estimates the cost to the Treasury to be approximately \$1.7 billion in lost tax revenues over five years.

# The new Alimony rule

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How will this impact how we do things?

- More money goes to the IRS, so less available to split up for spousal support.
- Less money available for child support.
- The formulas must change to accommodate taxes
- The amount will be less than would be under the old law

Who is impacted the most?

- Lower income couples.
- Prenuptial agreements with alimony clauses

# 529 Savings Plan

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Any monies, including investment growth, used for qualifying expenses for the named beneficiary is distributed tax-free. Qualified expenses include tuition, fees, books, required supplies to include computers. The 529 plans can even cover limited room and board costs.

Old rule – could only be used for eligible colleges and universities.

New rule – can also be used to cover qualifying expenses for private, public, and religious K-12.

K-12 withdrawals are limited to \$10,000/year/child. Overwithdrawal is subject to tax plus 10% penalty.



# Postcard Tax Return

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<b>Form 1040</b>		Department of the Treasury—Internal Revenue Service (99)		<b>2018</b>		OMB No. 1545-0074		IRS Use Only—Do not write or staple in this space.	
Filing status: <input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input type="checkbox"/> Married filing separately <input type="checkbox"/> Qualifying widow(er) <input type="checkbox"/> Head of household									
Your first name and initial			Last name			Your social security number			
Your standard deduction: <input type="checkbox"/> Someone can claim you as a dependent <input type="checkbox"/> You were born before January 2, 1954 <input type="checkbox"/> You are blind									
Spouse or qualifying person's first name and initial (see inst.)			Last name			Spouse's social security number			
Spouse standard deduction: <input type="checkbox"/> Someone can claim your spouse as a dependent <input type="checkbox"/> Your spouse was born before January 2, 1954 <input type="checkbox"/> Your spouse is blind <input type="checkbox"/> Your spouse itemizes on a separate return or you were dual-status alien									
Home address (number and street). If you have a P.O. box, see instructions.						Apt. no.	<input type="checkbox"/> Full-year health care coverage (see instructions)		
City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6.						If more than four dependents, see instructions and check here <input type="checkbox"/>			
<b>Dependents (see instructions):</b>									
(1) First name		Last name		(2) Social security number		(3) Relationship to you		(4) <input checked="" type="checkbox"/> if qualifies for (see inst.):	
								Child tax credit	Credit for other dependents
								<input type="checkbox"/>	<input type="checkbox"/>
								<input type="checkbox"/>	<input type="checkbox"/>
								<input type="checkbox"/>	<input type="checkbox"/>
								<input type="checkbox"/>	<input type="checkbox"/>
<b>Sign Here</b>	Under penalties of perjury, I declare that I have examined this return and 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.								
Joint return? See instructions. Keep a copy for your records.	Your signature			Date	Your occupation			If the IRS sent you an Identity Protection PIN, enter it here (see inst.)	
	Spouse's signature. If a joint return, <b>both</b> must sign.			Date	Spouse's occupation			If the IRS sent you an Identity Protection PIN, enter it here (see inst.)	
<b>Paid Preparers</b>	Print/Type preparer's name		Preparer's signature			PTIN		Check if:	
	Firm's name ▶		Firm's EIN ▶					<input type="checkbox"/> 3rd Party Designee <input type="checkbox"/> Self-employed	
For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.					Cat. No. 11320B			Form <b>1040</b> (2018)	

# Postcard Tax Return

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Form 1040 (2018)

Page **2**

<b>1</b>	Wages, salaries, tips, etc. Attach Form W-2		<b>1</b>	
<b>2a</b>	Tax-exempt interest	<b>2a</b>	<b>2b</b>	Taxable interest
<b>3a</b>	Qualified dividends	<b>3a</b>	<b>3b</b>	Ordinary dividends
<b>4a</b>	IRAs, pensions, and annuities	<b>4a</b>	<b>4b</b>	Taxable amount
<b>5a</b>	Social security benefits	<b>5a</b>	<b>5b</b>	Taxable amount
<b>6</b>	Additional income and adjustments to income. Attach Schedule 1		<b>6</b>	
<b>7</b>	Adjusted gross income. Combine lines 1 through 6		<b>7</b>	
<b>8</b>	Enter the standard deduction; otherwise, attach Schedule A		<b>8</b>	
<b>9</b>	Qualified business income deduction (see instructions)		<b>9</b>	
<b>10</b>	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-		<b>10</b>	
<b>11</b>	Tax (see instructions). Attach Schedule 2 if required		<b>11</b>	
<b>12</b>	If your only nonrefundable credit is the child tax credit and/or credit for other dependents, enter the total here; otherwise, attach Schedule 3		<b>12</b>	
<b>13</b>	Subtract line 12 from line 11		<b>13</b>	
<b>14</b>	Other taxes. Attach Schedule 4		<b>14</b>	
<b>15</b>	Total tax. Add lines 13 and 14		<b>15</b>	
<b>16</b>	Federal income tax withheld from Forms W-2 and 1099		<b>16</b>	
<b>17</b>	Refundable credits: <b>a</b> EIC (see inst.) <b>b</b> Sch 8812 <b>c</b> Form 8863 <b>d</b> Other payments or refundable credits from Schedule 5			
<b>18</b>	Add lines 16 and 17 a through d. These are your total payments		<b>18</b>	
<b>19</b>	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you overpaid		<b>19</b>	
<b>20a</b>	Amount of line 19 you want refunded to you. If Form 8888 is attached, check here <input type="checkbox"/>		<b>20a</b>	
<b>b</b>	Routing number <input type="text"/>	<b>c</b>	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
<b>d</b>	Account number <input type="text"/>			
<b>21</b>	Amount of line 19 you want applied to your 2019 estimated tax <input type="checkbox"/>	<b>21</b>		
<b>22</b>	<b>Amount you owe.</b> Subtract line 18 from line 15. For details on how to pay, see instructions <input type="checkbox"/>	<b>22</b>		
<b>23</b>	Estimated tax penalty (see instructions) <input type="checkbox"/>	<b>23</b>		

**Standard Deduction for—**

- Single or married filing separately, \$12,000
- Married filing jointly or Qualifying widow(er), \$24,000
- Head of household, \$18,000
- If you checked any box under Standard deduction, see instructions.

**Refund**

Direct deposit?  See instructions.

- Lines with Potential Attachments:
- 6 - Schedule 1
  - 8 - Schedule A
  - 9 - QBI
  - 11 - Schedule 2
  - 12 - Schedule 3
  - 14 - Schedule 4
  - 17 - EIC
  - 17 - Form 8812
  - 17 - Form 8863
  - 17 - Schedule 5

Form **1040** (2018)

# Postcard Tax Return

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SCHEDULE 1 (Form 1040)		Additional Income and Adjustments to Income		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service		▶ Attach to Form 1040. ▶ Go to <a href="http://www.irs.gov/Form1040">www.irs.gov/Form1040</a> for instructions and the latest information.		2018 Attachment Sequence No. 01	
Name(s) shown on Form 1040				Your social security number	
<b>Additional Income</b>	<b>1-9b</b>	Reserved		<b>1-9b</b>	
	<b>10</b>	Taxable refunds, credits, or offsets of state and local income taxes		<b>10</b>	
	<b>11</b>	Alimony received		<b>11</b>	
	<b>12</b>	Business income or (loss). Attach Schedule C or C-EZ		<b>12</b>	
	<b>13</b>	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>		<b>13</b>	
	<b>14</b>	Other gains or (losses). Attach Form 4797		<b>14</b>	
	<b>15a</b>	Reserved		<b>15b</b>	
	<b>16a</b>	Reserved		<b>16b</b>	
	<b>17</b>	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		<b>17</b>	
	<b>18</b>	Farm income or (loss). Attach Schedule F		<b>18</b>	
	<b>19</b>	Unemployment compensation		<b>19</b>	
	<b>20a</b>	Reserved		<b>20b</b>	
	<b>21</b>	Other income. List type and amount		<b>21</b>	
	<b>22</b>	Combine the amounts in the far right column. If you don't have any adjustments to income, enter here and on Form 1040, line 6. Otherwise, go to line 23		<b>22</b>	
<b>Adjustments to Income</b>	<b>23</b>	Educator expenses	<b>23</b>		
	<b>24</b>	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	<b>24</b>		
	<b>25</b>	Health savings account deduction. Attach Form 8889	<b>25</b>		
	<b>26</b>	Moving expenses for members of the armed forces. Attach Form 3903	<b>26</b>		
	<b>27</b>	Deductible part of self-employment tax. Attach Schedule SE	<b>27</b>		
	<b>28</b>	Self-employed SEP, SIMPLE, and qualified plans	<b>28</b>		
	<b>29</b>	Self-employed health insurance deduction	<b>29</b>		
	<b>30</b>	Penalty on early withdrawal of savings	<b>30</b>		
	<b>31a</b>	Alimony paid	<b>31a</b>	<b>b</b> Recipient's SSN ▶	
	<b>32</b>	IRA deduction	<b>32</b>		
	<b>33</b>	Student loan interest deduction	<b>33</b>		
	<b>34</b>	Reserved	<b>34</b>		
	<b>35</b>	Reserved	<b>35</b>		
	<b>36</b>	Add lines 23 through 35	<b>36</b>		
	<b>37</b>	Subtract line 36 from line 22. Enter here and on Form 1040, line 6	<b>37</b>		

- Lines with Potential Attachments:
- 12 – Schedule C
  - 13 – Schedule D
  - 14 – Form 4797
  - 17 – Schedule E
  - 18 – Schedule F
  - 24 – Form 2106
  - 25 – Form 8889
  - 26 – Form 3903
  - 27 – Schedule SE

# The Innocent Spouse

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A legislative history by the Ninth District

*Wilson v. Commissioner*  
*9<sup>th</sup> Cir. 2013*

# The Innocent Spouse

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Prior to 1918 – each spouse filed separate

1918 – Congress permitted joint returns

1921 – tax on joint return computed on aggregate income,  
AND that each spouse was individually responsible for the  
entire tax

1935 – Tax Court rejected joint and several liability and held  
that IRS should apportion tax liability based on respective  
income *Cole v. Comm'r*, 81 F.2d 485

1938 – Congress legislatively overruled *Cole* going back to  
joint and several liability

1948 – Separate tax schedule for joint returns



# The Innocent Spouse

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1967 – *Scudder v. Comm’r* – The Tax Court acknowledged the heavy burden on some spouses who discovered they were liable for extraordinary tax debts created by a former spouse’s fraudulent activities. During the first 5 decades of income tax, the only way to avoid joint and several liability was to prove that he/she signed a joint return under duress. An individual who discovered a tax debt on illicit income concealed by her spouse had no reprieve.

The Court commented on the unfairness of the rule, having “much sympathy for the petitioner’s “unhappy situation” and are appalled at the harshness of the result, but the statute is inflexible. The court concluded that only remedial legislation can soften the impact on the many married women who are unknowingly subjected to its provisions by filing joint returns.

# The Innocent Spouse

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- 1971 – Congress pass the Innocent Spouse Act, but with strict requirements.
- 1984 – The scope of the hardship relief was expanded
- 1995 – the American Bar Association proposed replacing joint and several liability with a proportional liability standard.
- 1998 – Congress repealed the Innocent Spouse Act all together and enacted the current innocent spouse laws
- 2002 through 2006 – debate on whether the Tax Court had jurisdiction to review petitions for equitable relief
- 2006 – Congress amended the Code granting the Tax Court jurisdiction

# The Innocent Spouse

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1. All claims are handled at The Commissioner's Cincinnati Centralized Innocent Spouse Operation (CCCISO)
2. CCCISO staff screen innocent spouse tax relief request to determine if basic eligibility requirements are met.
3. If claim meets the requirements, the file is transferred to an examiner. Upon decision, taxpayer is given 30 days to appeal to the IRS's Office of Appeals.
4. After decision on the administrative appeal, IRS sends a final determination letter.
5. Taxpayer has the right to appeal the IRS decision to the federal court.



# Innocent Spouse Relief – IRC 6015(b)

32

Joint and Several Liability – When filing a joint tax return, both spouses are responsible for the entire tax liability, regardless of who earned the income. Divorce decree or Separation Agreement language is not controlling.

There are 3 types of relief:

1. Full or apportioned relief – “innocent spouse relief”
2. Proportionate relief for divorced or separated taxpayers – “separation of liability relief”
3. Equitable relief – catch all for when the other two are not available options

Forms 8857 and 12507

Publication 971

# Innocent Spouse Relief – IRC 6015(b)

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## Qualification Requirements:

1. Joint return
2. Understatement of tax is due to unreported income or improper deduction, credit, or property basis of the other spouse
3. Considering all facts and circumstances, it would be unfair to hold the individual liable for the understated tax
4. Requesting spouse elects the benefits of innocent spouse relief no later than the date which is two years after the date the IRS has begun collection activities
5. Requesting individual must be able to show that when he/she signed the joint return, he/she did not know, and had no reason to know, that the understated tax existed

# Innocent Spouse Relief – IRC 6015(b)

34

## Knowledge Requirement – what is considered?

- a. Nature of the erroneous item and its amount relative to other items
- b. The couple's financial situation
- c. Requesting spouse's educational background and business experience
- d. Extent of the requesting spouse's participation in the activity that resulted in the erroneous item
- e. Whether the requesting spouse failed to inquire about items omitted or on the return that a reasonable person would question
- f. Whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns

# Innocent Spouse Relief – IRC 6015(b)

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What else is considered? Other factors:

- a. Did the requesting spouse significantly benefit directly or indirectly from the understatement? A significant benefit is any benefit in excess of normal support
- b. Requesting spouse has been deserted by the nonrequesting spouse
- c. Spouses have been divorced or separated
- d. No fraudulent scheme in property transfer

# Separation of Liability Relief – IRC 6015(c)

36

Here a spouse may elect to allocate a deficiency if certain requirements are met. This is available **ONLY** for unpaid liabilities resulting from the understated tax. Refunds are not allowed.

## Requirements:

1. No longer married or legally separated at time of filing Form 8857
2. Not a member of the same household at any time during the 12 month period ending on the date he/she files Form 8857.
  - **H and W live in separate areas of the same resident is still considered members of the same household.**
3. No fraudulent scheme transferring assets
4. Requesting spouse did not have actual knowledge of erroneous item – Actual knowledge will invalidate the election. IRS has the burden of production and the burden of persuasion to establish by a preponderance of the evidence that the requesting spouse had actual knowledge to invalidate the election.

# Equitable Relief – Last Ditch Effort – IRC 6015(f)

37

This is the last ditch effort catch-all:

- Under procedures prescribed by the Secretary, if -
- **(1) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency (or any portion of either); and**
- **(2) relief is not available to such individual under subsection (b) or (c),** the Secretary may relieve such individual of such liability.

# Equitable Relief – Last Ditch Effort – IRC 6015(f)

38

Rev.Proc. 2003-61 adds a few things:

1. **Nominal ownership** – ex: H opens IRA in W’s name and forges W’s signature. H makes contribution and then takes a taxable distribution but doesn’t report the distribution. W can rebut the presumption that the IRA is attributable to her
2. **Misappropriation of funds** – funds intended for payment of tax were misappropriated by nonrequesting spouse
3. **Abuse** not amounting to duress – due to history of abuse, requesting spouse did not question any items on return for fear of retaliation. The presence of abuse favors relief. A history of abuse may mitigate a requesting spouse’s knowledge or reason to know.
4. **“Reason to know”** will not be weighted more heavily than other factors. However, actual knowledge weighs heavily against relief
5. **Refunds** – on a limited basis, and only if requesting spouse can establish that he/she provided said funds.

# Equitable Relief – Last Ditch Effort – IRC 6015(f)

39

**Notice 2012-8** adds a few more things:

1. Time for filing for relief was expanded from 2 years to 10 years after assessment of tax
2. Claim for refund expanded to the later of: 3 years from time returned was filed or 2 years from time tax was paid
3. Fraudulent activity by nonrequesting spouse involving assets of requesting spouse
4. Expanded to apply to understatements as well as underpayments
5. Economic Hardship factor revised – unable to pay reasonable basic living expenses – consider current income, expenses, assets, whether expenses are shared
  - Income – 250% Federal poverty guidelines
  - Monthly income > reasonable basic monthly living expenses by \$300 or less
6. Abuse and Financial Control favors relief and overcomes knowledge factor of the item and knowledge factor that the spouse would pay the tax reported as due
7. Legal Obligation – IRS will now consider as one of the factors (but not controlling) who has legal obligation to pay the tax liability pursuant to a divorce decree or agreement.



# Injured Spouse Relief

40

If a couple files jointly and has their tax refund reduced or eliminated because of an unpaid tax or other debt that only one of them owes (ex: H owes from a year prior to their marriage), then other spouse has a right to his/her share of the refund based on an allocation of all items.

Use Form 8379

# Are Legal Fees Deductible?

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For tax advice – yes

Fees you pay to get or collect taxable alimony – yes

Miscellaneous itemized deduction subject to 2% limit

Must be separately stated on the legal fee statement

Fees for financial settlement – no

Fees for trial – no except for the part for alimony

Fees to protect income-producing property - no

Fees related to property division – no, but you can add the fees to the basis of the property

Fees related to paying alimony – no

To determine – ask this: *Do the fees relate to taxable income?*

# Business Taxes

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## C-corporations:

- Flat tax rate of 21% (was graduated rates of 15% to 25% to 34% to 35%)
- Zero entertainment deduction (was 50%)
- Interest expense limited to 30% of taxable income (was 100%)
- NOL carryback gone. Limited to 80% of taxable income per year going forward

# Business Taxes

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## Pass-through Entities – IRC 199A

- Deduct 20% of Qualified Business Income (QBI)
- There are 2 major limitations:
  - Taxable income limit
    - ✦ No limitation if taxable income is less than \$157,500 for singles and \$315,000 for married filing jointly.
    - ✦ Phase-out range for singles is \$157,500 - \$207,500
    - ✦ Phase-out range for marrieds is \$315,000 - \$415,000
  - Type of business – next page

# Business Taxes

44

Service business – phased out completely at the taxable limits

Service business specifically includes – health, law, consulting, athletics, financial or brokerage services.

Specifically excludes – architecture and engineering firms. *How did that happen?*

Catchall definition – when a business’ principal asset is the reputation or skill of one or more of its owners or employees. *(this is dangerous)*

# Business Taxes

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Non-service businesses after the income limit:

Deduction is the lesser of:

A. 20% of QBI or

B. Greater of:

1. 50% of all W-2 wages or
2. 25% of all W-2 wages PLUS 2.5% of the cost of “qualified” property cost (real estate and equipment)

Grey area – compensation to owners/partners

# Business Taxes

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## **Grey Area – Compensation to owners**

S-corporations are subject to “reasonable compensation” rules; however,

Partnerships, LLCs, and Sole Proprietorships do not (and can not) pay W-2 wages to its owners.

- Will the IRS enact a “reasonable compensation” requirement?
- Will the IRS require a % of something to be considered compensation?
- Will the IRS provide any guidance on this issue soon? Or ever?

# Family Law Tax Update 2018



*Valuation & Litigation  
Consulting, LLC*



*The International Society of Professional Valuers*

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