Tax Tips for the Family Practitioner

Sherri Holder, CPA/ABV/CFF, CVA
Thurman Holder Gibbon, LLC

Linda J. Schaeffer, CPA, CFE, CVA, CFF
Frazier & Deeter CPAs & ADVISORS

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Topics to be Covered

- Alimony
- Carryover Losses
- Dependency Exemptions
- Marital Residence

Alimony

- Can be deductible by the payor and taxable to the payee.
- If all rules are met, it makes no difference whether the payments are for support or for the payment of property division.
  - No need to be periodic
  - Does not have to be called alimony or support

Alimony – (cont'd.)

- Requirements to be considered tax deductible by payor and income to payee
  1. Cash received by or on behalf of a spouse.
  2. Under a divorce or separation agreement.
  3. Payment must not be designated as NOT includible in gross income and NOT allowable as a deduction.
  4. Former spouse must NOT be a member of same household.
  5. Payments must cease upon death of payee.
  6. Payment not fixed as child support.
  7. Separate returns must be filed.

Alimony – (cont'd.)

- Nuances
  1. Informal, voluntary payments from one spouse to the other do not qualify as alimony.
  2. A letter from one spouse to the other will not qualify as a written instrument, must be a bilateral written agreement.
  3. A notation on a check designated as support is insufficient in itself to qualify as alimony.
  4. If payments are made to a third party at the written request of a payee spouse, the payment will qualify as alimony, as long as it is stated that it is intended to be alimony pursuant to IRC Code Sec. 71.
  5. Settlement of permanent alimony in a lump sum can be non-taxable if designated as such.

Alimony Recapture

1. If alimony changes by more than $15,000 over a 3 year period of time, there may be recapture.

   Example:

Alimony – Year 1	$180,000*
Year 2	$130,000
Year 3	$100,000

2. *First post separation year is the year in which payments are made pursuant to a final judgment (excludes payments under a temporary support agreement).

Alimony Recapture – (cont'd.)

1.	Average Year 2 & 3	(115,000)
2.	Add 15,000 to average – allowable variance	(130,000)
3.	Year 1 Alimony	$ 180,000
	Allowable Variance	{130,000}
	Recapture for Year 1	50,000
4.	Year 3 Payment	$ 100,000
	Add	15,000
	Allowable Variance	115,000
5.	Year 2 Payment	130,000
	Allowable Variance	(115,000)
	Recapture for Year 2	15,000
6.		$ 50,000 Year 1 Recapture
		15,000 Year 2 Recapture
	Income to payor spouse in Year 3	$ 65,000

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Considerations When Dividing a Deferred Tax Asset on a Joint Return

- Capital Loss Carryforwards
- Net Operating Losses
- Passive Activity Losses
- Charitable Contribution Carryovers

Deferred tax assets have value and should be considered when valuing the marital estate for equitable division purposes. However, an absolute value may be difficult to determine. The most important thing to remember is that these deferred tax assets cannot be divided based on a settlement agreement or divorce decree. The taxpayer who receives the benefit is determined based upon IRS rules.

Capital Loss Carryforwards

- A taxpayer may deduct capital losses generated in the given year to the extent they offset capital gains, plus a maximum of $3,000 per year ($1,500 if married filing separate).

- Title of the account or asset at the time the loss was incurred determines who would receive any capital loss carryforwards.

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Net Operating Losses (NOLs)

- NOLs typically result from losses from closely held businesses.
- NOLs are used in a given taxable year to offset taxable income from other sources.
- NOLs can be carried back to the two taxable years preceding the loss or each of the twenty following taxable years.
- If a NOL is generated on a joint return and the parties subsequently file separate returns, the NOL is split according to the portion attributable to each individual.

Passive Activity Losses

- Typically passive activity losses are only used to offset passive activity income.
- Any additional losses are carried forward to future years or deducted in their entirety in the year of disposition for the activity.
- The passive activity losses follow the activity that generated the losses.
- If a passive activity is awarded to a spouse, the passive losses increase the basis in the activity of the recipient spouse.

Charitable Contribution Carryover

- Generally, taxpayers may deduct charitable contributions up to 50% of Adjusted Gross Income. Any remaining contributions are carried forward for up to five years.
- In the event of divorce, the charitable contribution carryover is allocated to the taxpayers based on what it would have been if they had originally filed “married filing separately”.

Dependency Exemptions

- Who gets it?
  - The custodial parent – the parent with who the child resides for the greater number of nights during year if under 19.
  - If over 19, the dependency exemption goes to the parent who provides over half of the child's support.
  - Custodial parent releases the exemption by signing a Form 8332, attached to return.
  - Tax benefit is a deduction of $3,900.

Dependency Exemptions – (cont'd.)

- Phase out of exemption now in effect:

	Phase out begins	Phase out ends
Married Joint	$300,000	$422,500
Head of Household	$275,000	$397,500
Single	$250,000	$372,500
Married Filing Separately	$150,000	$211,250

Other Considerations

- Child tax credit given to person with dependency exemption (phase out after $75,000).
- Child and dependent care credit – for children under age 13. Credit can be taken by parent with custody, notwithstanding if the dependency exemption is allocated to other parent.
- Medical expenses – deducted by party who pays them.

Jointly Titled Marital Residence – Excluding Gain on Sale

- IRC § 121 provides that an individual may exclude up to $250,000 of the gain on the sale of property if "during the 5 year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more."
- The exclusion increases to $500,000 for taxpayers filing "married filing jointly" if during the 5 year period either spouse meets the ownership requirements and both spouses meet the use requirements.
- For divorced taxpayers, the code allows an individual to meet the use requirements if that individual's spouse is granted use of the property under a divorce or separation instrument.

Marital Residence - Deductions

- The taxpayer entitled to take the deduction is determined by tax law, not the divorce agreement.
- Property taxes may be deducted by the individual who pays taxes on property they own.
- To deduct mortgage interest, you must own the property and pay the interest.
- If the property is no longer owned by a divorced individual, but the taxpayer pays all of the mortgage interest, they may be able to claim an alimony deduction for the payment.