Practically Cooperative Seminar
Family Law and Taxes – What Has Changed and What Hasn't
Divorce Cooperation Institute
and
Leander J. Foley Matrimonial Inns of Court

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I. Dependency Exemptions

A. Internal Revenue Code Section 152 – Mostly unaltered by tax reform.

1. Must either be a Qualifying Child or a Qualifying Relative

a. A Qualifying Child is the taxpayer's child, sibling, step-sibling, or descendent of such a person. "Child" includes blood, step, adoptive (either pending finalization or finalized) and foster (placed by Court or state agency) children.

b. A Qualifying Child must have the same principal home as the taxpayer for more than one-half of the year.

c. A Qualifying Child must be under age 19 or a student under age 24 at the end of the calendar year. (A student is a full time student during parts of at least five months during the year.)

d. A Qualifying Child can not provide more than one-half of his/her own support during the year. There is no longer the requirement that the taxpayer must provide more than one-half of the support for a Qualifying Child.

e. A Qualifying Relative must meet a slightly different relationship test: child or child's descendent, sibling or step-sibling, parent or other ancestor, step-parent, niece or nephew, aunt or uncle, close in-law, or any other person (non-spouse) with the same principal place of abode as the taxpayer for the calendar year.

f. A Qualifying Relative must have gross income below the amount of the personal exemption value ($4,150 for 2018). This is still an indexed amount despite the changes to the actual personal and dependency exemption deduction amount as discussed below since the definition is used for other tax benefits.

g. The taxpayer must provide more than one-half of the Qualifying Relative's support during the year. The pre-2019 tax code indicates that alimony or separate maintenance payments as defined in IRC sec. 71 are not treated as being paid to support a dependent. Effective 1/1/2019, the definition of alimony has been split between IRC sec. 121(d)(3)(C) (as part of the rules for the tax free sale of a principal residence) and IRC sec. 152(d)(5); the end result is essentially the same, though.

h. A Qualifying Relative can not be a Qualifying Child for any other taxpayer.

i. If a person qualifies to be a dependent on another's tax return (Qualifying Child or Qualifying Relative), that other person MUST claim the exemption; can not "elect" to not take a dependency exemption if qualified to do so.

B. Claiming the Dependency Exemption – Mostly unaltered by tax reform.

1. A Qualifying Child is a dependency exemption for his/her parents' joint tax return.

2. If the parents are not eligible to claim the child as their Qualifying Child and the child meets the definition of a Qualifying Child for more than one other person who is not a parent, the person with the highest AGI gets to claim the child.

3. If the child meets the definition of a Qualifying Child for more than one parent who do not file a joint tax return together, the parent with longer custody during the year gets the exemption. If both parents have equal custody, the one with higher AGI gets the exemption.

4. Rules for Divorced or Separated or Never Married Parents under I.R.C. sec. 152(e) allow for the allocation of the exemption.

a. Both parents combined must provide at least half of the child's support.

b. The parents must be divorced or legally separated under the appropriate court decree or separated under a separation agreement or who lived apart for the last six months of the calendar year.

c. Both parents combined must have custody of the child for at least one-half of the year. "Custodial Parent" for the purpose of Form 8332 is the parent with whom the child resides for more nights. If both parents have equal nights, the parent with the higher A.G.I. is the Custodial Parent.

d. The custodial parent must agree to allow non-custodial parent to claim the exemption and sign I.R.S. Form 8332 (or a substantially identical document) consenting to the allocation. Post-2008 agreements regarding allocation must be on the I.R.S. form only.

e. The non-custodial parent must attach Form 8332 to his/her tax return for each year of such allocation.

f. A Form 8332 signed for future tax years can now be revoked by signing a new Form 8332 indicating the revocation. The custodial parent then includes the revoking Form 8332 on his/her return. The revocation is effective no earlier than the tax year after the year in which the revocation was transmitted to the non-custodial parent and the custodial parent needs to keep documentation of the delivery of the revocation.

g. The King case (Jeffrey R. King and Sabrina M. King, et al v. Commissioner, 121 T.C. No. 12) is an excellent analysis of old tax code language regarding exemptions; the current code language is substantially identical.

h. Unknown impact on the effectiveness of a multi-year Form 8332 when placement changes enough to alter designation as "custodial parent" for tax purposes.

i. Best practices procedure is to sign and deliver a fresh Form 8332 each year as necessary.

j. 2018 revision to Form 8332 adds language highlighting that it applies to other tax benefits besides the actual dependency exemption (Child Tax Credit, Additional Child Tax Credit, and Credit for Other Dependents) while not applying to other benefits (Earned Income Credit, Dependent Care Credit, Head of Household status, etc.).

5. Multiple Support Declaration (I.R.S. Form 2120)

   a. Used by three or more taxpayers to annually allocate a dependency exemption for a Qualifying Relative. Even without exemption deduction, Credit for Other Dependents and other tax benefits still follow the exemption.

   b. Each person in the group must provide more than 10% but less than 50% of the dependent's total support.

   c. Must file a written declaration they will not claim such individual as a dependent.

6. Compliance

   a. I.R.S. processing centers will catch the duplicate use of a dependent's Social Security Number very easily and quickly.

   b. Both persons claiming a duplicated exemption must prove entitlement or both will lose the exemption. When e-filing, however, the first to claim wins (at least temporarily) and the "harmed" parent actually entitled to the exemption who tries to file after the other parent must then paper file his/her return and defend his/her right to the exemption.

   c. Forms 8332 and 2120 usually will be presumptive proof of entitlement.

   d. Sections 151 and 152, not state law, determine whether a divorced or separated parent may claim an exemption. A state court order or decree does not operate to allocate the exemption between parents for tax purposes. A Form 8332 must be used for post-2008 allocations and failure to cooperate with executing one should result in contempt issues in the family court for the value of the lost exemption.

C. "Core" Value of a Dependency Exemption – Here's the most obvious change under tax reform.

   1. Each exemption reduced federal taxable income by up to $4,100 for 2017. For 2018 through 2025, the deduction amount for the exemption has been modified to "zero". See IRC sec. 151(d)(5). All other elements of dependency exemptions remain the same.

2. Under the old rules, this would have been a deduction valued at the taxpayer's marginal tax rate. For instance, if the deduction was still available in 2018, it would have saved around $996 in federal income tax liability at the new 24% marginal rate.

3. For 2017 and earlier years, the personal exemption phase out impacted returns with incomes over $266,700 for single taxpayers and $320,000 for joint returns. This is technically still in effect for 2018 through 2025, but has no impact given the zero value of the underlying deduction.

4. Wisconsin allows an exemption amount of $700 per dependent. At the 6.5% tax rate, this is worth about $45.50.

D. "Collateral" Benefits of a Dependency Exemption – More significant changes under tax reform.

1. Child Tax Credit – Enhanced for 2018 through 2025.

a. Generally must be a Qualifying Child under age 17. Additional requirement was added mandating that the child be a U.S. citizen or resident with a taxpayer identification number (TIN).

b. The Child Tax Credit is claimed on page two of the redesigned Form 1040 as a reduction of tax liability (but not below zero tax).

1. The maximum credit is $2,000 and is generally non-refundable. This amount will be indexed for inflation.

2. It will be phased out starting at Adjusted Gross Income of $400,000 for joint returns and $200,000 for all other taxpayers. These thresholds will not be indexed for inflation.

3. This credit results in a $2,000 reduction of tax liability per child. (This is better than a $2,000 deduction.)

4. May need to use I.R.S. Publication 972 to compute proper value.

2. Credit for Other Dependents – New for 2018 through 2025

a. A new $500 non-refundable credit is available for dependents not otherwise qualifying for the Child Tax Credit.

b. Generally will be Qualifying Children over age 16 and Qualifying Relatives.

c. Need to be a U.S. citizen, national, or resident of the U.S. who is not a resident of Canada or Mexico.

d. Needs at least a TIN if they do not have a SSN.

e. Much confusion at first as to whom this applied, but subsequent guidance (JCT Report JCX-3-18, IRS Notice 2018-70, and draft revised forms) seems to have clarified.

f. Redesigned Form 1040 Page 1 and related instructions includes a new check box regarding this credit, which is also claimed on Page 2 of the Form 1040.

3. Additional Child Tax Credit – Enhanced for 2018 through 2025.

a. Calculated with I.R.S. Schedule 8812 (formerly known as Form 8812) and is reflected on redesigned page two of the Form 1040 as a "Refundable Credit".

b. Up to $1,400 will be refundable even if in excess of tax liability. This is determined in concert with the calculation of the main Child Tax Credit above.

c. For low income taxpayers who otherwise wouldn't receive the benefit of the non-refundable credit.

d. Essentially is a vehicle to make a refundable credit of most of the unused non-refundable amount.

e. This is not available for tax returns claiming the Foreign Earned Income Exclusion from Form 2555.

4. Child and Dependent Care Expenses: Credit or Income Exclusion – No apparent changes from tax reform.

a. I.R.S. Form 2441 calculates the tax credit amount.

b. First part: Non-refundable tax credit

1. Maximum benefit is based on $3,000 of expenses for one child or $6,000 for two or more children. Expense must be incurred in order to allow a parent to work or look for work.

2. Depending on income, the credit amounts to a sliding scale of 35% down to 20% of eligible expenses.

3. Eligible expenses can not exceed a single parent's earned income or the lower of both parents' earned income if filing a joint return.

4. There is limited availability in the situation where one parent doesn't work due to disability or is a full-time student.

5. Married taxpayers must file a joint return to benefit from this credit unless the spouses have lived apart for the last six months of the year (i.e., meet the married-but-filing-as-Head-of-Household rules).

c. Second part: Tax free employer provided benefits

1. An employer may establish a fringe benefit providing up to $5,000 per employee tax free to be used for child care expenses.

2. At the 24% marginal tax bracket, this could save $1,200 in taxes.

3. Benefits received in excess of actual expenses are taxable income.

d. Receipt of employer benefits will reduce the per child tax credit available.

e. The Credit or Exclusion is for care expenses related to any dependent of the taxpayer who is either the taxpayer's disabled spouse or disabled child or the taxpayer's Qualifying Child under age 13.

f. If Form 8332 allocates the dependency exemption to the other parent, the non-claiming custodial parent can still take the credit or tax free benefits provided that he or she had custody of the child for more time than the other parent.

g. Only one parent can claim the credit per child, so parents should coordinate as to who pays for child care or receives the tax free payroll benefits.

h. Wisconsin allows a subtraction from income for up to $3,000 for one child or $6,000 for two or more children based on expenses incurred as shown on the Form 2441. See Wisconsin Subtraction Code 28.

5. Educational Tax Credits - No apparent changes from tax reform.

   a. Determined by I.R.S. Form 8863 for page two of the Form 1040. As with the Child Tax Credit, portions may be non-refundable to reduce tax liability down to no less than zero (new Schedule 3 flows this information to page two) and some might be refundable even if there is no tax liability.

   b. Taxpayer claiming the Dependency Exemption gets to claim the educational credits even if he/she was not the actual person paying the bills.

   c. American Opportunity Credit

      1. A modified version of the original Hope Scholarship Credit which covers four years of post high school educational expenses.

      2. Generally based on 100% of first $2,000 of qualified expenses and 25% of next $2,000 per student; i.e., a maximum $2,500 credit.

      3. May be partial refundable (up to 40%) for low tax liability taxpayers and is subject to an A.G.I. phase out.

      4. This will phase out for Single and Head of Household returns with income over $90,000 and for Joint returns with income over $180,000 in 2018. There is no credit available for Married Filing Separate returns.

   d. Lifetime Learning Credit

      1. For all years beyond second year post high school.

      2. Based on 20% of first $10,000 of expenses per tax return.

      3. Also a non-refundable credit to offset tax liability.

      4. For 2018, phases out at $67,000 of income for single and Head of Household taxpayers and $134,000 of

income for joint filers. This is also not available for Married Filing Separate returns.

e. Consider allowing child to claim his/her own personal exemption for total savings from the family unit perspective, if eligible to do so. Keep good records to do this!

f. Remember to consider the alternative Tuition and Fees deductions. See below.

g. Not available for expenses paid with tax free funds from Section 529 accounts or other tax benefits.

6. Tuition and Fees Deductions

a. Wisconsin tax returns

1. Wisconsin allows a subtraction for up to $6,974 (for 2018) per dependent for post-secondary tuition and mandatory fees paid to an approved Wisconsin school, college or university or Minnesota schools participating in the tuition reciprocity program.

2. Only available for “regular” money spent on tuition and mandatory fees; room and board and other expenses are not eligible.

3. Use of Section 529 plan funds may qualify for Wisconsin’s subtraction if it wasn’t deducted when the money went into the plan in the first place. (i.e., EdVest money which was deducted already can’t be used again/double counted for a second tax benefit.)

4. For 2018, this benefit phases out beginning at $54,190 of income for single and Head of Household taxpayers, $43,350 for Married Filing Separate returns, and $86,700 for married taxpayers.

5. See Wisconsin Subtraction Code 3. If also claiming the federal deduction below, may need to also prepare Wisconsin Schedule I.

b. Federal tax returns – Not yet extended for 2018.

1. Form 8917 calculated an “Above the Line” deduction for Tuition and Fees on the bottom of Page 1 of the Form 1040 (would now be on Schedule 1 flowing to Page 2 of the redesigned Form 1040) to reduce income prior to determining Adjusted Gross Income.

2. The maximum deduction was $2,000 to $4,000 depending on phase out limitations. The upper income limits had been $80,000 for single taxpayers or Heads of Household and $ $160,000 for married taxpayers.

3. If restored, can not also claim Educational Credits for the same expenses. Best strategy is to calculate taxes both ways to get best benefit from expenses.

7. Excludible Savings Bond Interest - No apparent changes from tax reform

a. I.R.S. Form 8815 documents qualifying information.

b. Bonds must have been purchased after 1989 in the name of the taxpayer aged 24 or older.

c. Subject to restrictions, bond interest used to pay for educational expenses will be excluded from federally taxable income. (Savings bonds are already state tax free.)

d. Valid for Series EE or Series I bonds.

e. See also III. C. below.

8. Earned Income Credit - No apparent changes from tax reform

a. Having a child or children is not required, but it is easier to obtain the EIC with a child or children in the house.

b. Children must be Qualifying Child.

c. Can claim even if other parent gets dependency exemption with Form 8332.

d. The maximum credit is determined with respect to having 0, 1, or 2 or more children in the house. However, the phase

out ranges include brackets for 0, 1, 2, or 3 or more children. A very confusing tax benefit!

e. The EIC can result in a refund even if no taxes were withheld or otherwise paid in by the taxpayer. New anti-fraud rules implemented in 2011 require the preparer to include a qualification checklist with the tax return claiming EIC benefits.

9. Wisconsin Homestead Credit

a. A refundable credit over and above any income tax refund.

b. Calculated based on household income and rent/property tax amounts.

c. Household income includes taxable maintenance and non-taxable child support received.

d. Each dependent who lived in the household for more than six months during the year AND is a dependency exemption is a $500 offset against household income.

e. See Schedule H and its instructions for further rules regarding spouses not living together or changing marital status during the year.

II. Filing Status - Mostly unaltered by tax reform.

A. Based on the marital status of the taxpayer as of December 31 of the year in question.

B. Single filing status is available for unmarried individuals as of the end of the year. See II.E. below regarding Head of Household status for certain Single taxpayers.

C. Married Filing Joint status

1. Available for spouses (opposite sex or same sex) who are not legally separated pursuant to a divorce or separate maintenance decree as of the end of the year.

2. Spouses do not need to reside in the same residence on December 31.

D. Married Filing Separately status

1. Also available for husbands and wives who are not legally separated pursuant to a divorce or separate maintenance decree as of the end of the year regardless of place of residence.

2. Beware of community property reporting issues and the need to coordinate income and deduction allocations. See Form 8958.

E. Head of Household filing status

1. Generally for unmarried taxpayers who provide the principal place of abode for more than one-half of the year for a Qualifying Child or other person for whom a dependency exemption is claimed.

2. Also available for legally married taxpayers whose spouse was not a member of the household for the last six months of the year, provided that the taxpayer provided the principal place of abode for a child.

3. Dependency exemption allocated by Form 8332 does not prevent Head of Household status as long as the child lives in the house.

4. Head of Household status is based on the facts and circumstances of whether the taxpayer provided the primary abode of a child for more than one-half of the year. Form 8332, court orders, judgments of divorce, marital settlement agreements and other documents can not assign filing status to a taxpayer.

5. Head of Household taxpayer must have provided more than one-half the cost of maintaining the household during the year. Thus, two unmarried individuals sharing a residence (post-divorce or otherwise) cannot both be considered a Head of Household.

6. Divorce or paternity documents can structure custody issues to maximize eligibility for Head of Household filing status.

7. Tax reform adds a Preparer's Due Diligence Requirement.

    a. Begins with 2018 tax returns.

    b. A paid preparer must make sure the client qualifies for claiming Head of Household status.

c. $500 penalty (indexed for inflation) for each incorrect return claiming HOH status.

d. Similar to existing rules for CTC, EIC, Educational credits.

e. See revised Form 8867.

III. Educational Savings - Mostly unaltered by tax reform.

A. Parents save the money themselves.

1. Funds available to creditors and spouses.

2. Complete control over expenditures.

3. Is exempt from gift tax if paid directly for school tuition. (I.R.C. sec. 2503(e))

4. Other expenses may be subject to the $15,000 per year per donee (parent) federal gift tax exemption amount. No tax is actually paid unless lifetime gifts exceed $11,200,000 per donee (parent) (2018 limits).

5. Payments are eligible for the American Opportunity and Lifetime Learning Credits.

B. Establish a trust arrangement.

1. Uniform Gift to Minors Account

a. Asset is the child's, not parents'. Do not allow parents to tap into this money for non-child needs. Should not be subject to property division.

b. Possibly taxed at higher tax rates if subject to the revised "Kiddie Tax" discussed at VI. below.

c. Gift tax rules apply to transfers made to child, but growth is gift tax consequence free.

d. Parental (or other custodian's) control ends at age 18 or 21.

e. Can still qualify for Educational Tax Credits.

2. “Formal” Trust

   a. Document can dictate control beyond high school years as well as restrictions on use of the money.

   b. Again is outside of parent’s net worth.

   c. Higher tax rates may apply to undistributed earnings of the trust.

   d. Distributions to the student may or may not be taxable.

   e. Distributions used for tuition are again eligible for the Educational Credits.

C. Exclusion for interest on U.S. Savings Bonds

   1. Available for either Series EE or Series I bonds.

   2. Unlimited state tax exemption.

   3. Federal tax is deferred until redeemed and will be federally tax free if three conditions are met:

      a. Issued after 1989.

      b. Purchased by someone age 24 or older.

      c. Proceeds (interest and principal) from cashed in bonds used to pay for higher educational expenses of the purchaser or his/her dependent.

   4. Limitations on tax free use for education include:

      a. 2018 phase out ranges begin at $79,550 for single or head of household taxpayers and $119,300 for joint returns.

      b. The use of non-taxable scholarships, grants, etc. limits the eligible expenses.

      c. American Opportunity and Lifetime Learning Credits also will reduce the excludible amount of bond interest.

   5. See Form 8815.

D. Coverdell Education Savings Account

1. Originally known as Educational IRAs, but have nothing to do with retirement planning or other issues.

2. Putting money into account:

   a. Non-deductible maximum contribution is $2,000 per beneficiary.

   b. Beneficiary must be under age 18 or a special needs individual at time of contribution.

   c. Contribution phases out as “contributors” income exceeds $190,000 on a joint return or $95,000 on single or Head of Household return.

3. Taking money out of account:

   a. Tax free withdrawals provided funds pay for school expenses.

   b. Can include tuition, fees, books, supplies, and equipment.

   c. Can also include grade school tuition, tutors, boarding school costs, uniforms, and transportation.

4. Consider investment timeline before using for elementary school.

5. Money must be withdrawn and spent on schooling by the beneficiary’s 30th birthday or be subject to income taxes on the final distribution and a 10% penalty for improper use if not used on schooling. (There is a 30 day grace period after Age 30 or beneficiary’s death, if earlier.)

6. Can roll account over to other family members to avoid age 30 trap.

7. May affect eligibility for the American Opportunity and Lifetime Learning Credits.

E. Section 529 Plans

1. State sponsored investment plans.

   a. Purchase tuition credits, or

   b. Accumulate cash and equity balances

2. Many states have multiple plans; thus, there are more than 50 plans available from which to choose. See www.collegesavings.org for a comprehensive comparison of all such plans. There is no requirement to use Wisconsin's EdVest plan or any particular other state's plan.

3. The tax code restricts the totally self-directed management found in IRAs, etc.

4. Rollovers between various plans are permissible.

5. Putting money into plan:

   a. Can contribute to both a CESA and a Section 529 plan in the same year.

   b. Gift tax rules do apply.

   c. Can used up to five years' annual exclusion at once to jump start investment plan.

   d. Wisconsin allows a 2018 deduction for up to $3,200 ($1,600 on married filing separate returns) per child into the EdVest and Tomorrow's Scholar plans. The dependency exemption is no longer required for the Wisconsin deduction. Former spouses can only deduct up to $1,600 per child unless their divorce decree provides for a different allocation of the $3,200 per child limit. See Wisconsin Subtraction Code 14 and Schedule CS.

   e. Excess contributions are carried forward to subsequent years in which the contribution limits was not reached.

6. Taking money out of plan

   a. Tax free when used for qualified higher education expenses: tuition, fees, books, supplies, and equipment required for attendance at an eligible educational institution. Equipment includes computers and Internet access for the student's use. This includes expenses related to special needs services as well.

   b. Room and board expenses are only covered if enrolled for at least half time.

c. Can be rolled over to other family members' plans to avoid excess money at the end of school career. There is no age 30 deadline to zero out the account.

d. May also limited other tax credit eligibility.

e. Beginning in 2018, up to $10,000 per year can be used from 529 accounts for elementary and secondary school (public, private, or religious) tuition per student.

f. Until 2025, amounts can be rolled from a 529 account to an ABLE account, subject to the ABLE account funding limits.

IV. Adoption Tax Benefits and Foster Care Payments - No apparent changes from federal tax reform; Wisconsin rules eased up.

A. Adoption Expenses and Wisconsin tax returns

1. Subtraction adjustment of up to $5,000 per adopted child allowed.

2. Includes adoption fees, court costs, and legal fees paid in the current year or prior two years as long as processed finalized during the current year.

3. Adoption is no longer limited to having been finalized in a Wisconsin court, but the parents must be full-year residents of Wisconsin.

4. See Wisconsin Subtraction Code 8.

5. Wisconsin incorporates federal adoption income exclusion benefits as well. (See below.) Can't double dip on benefits.

B. Federal tax programs for Adoptive Parents

1. Adoption assistance is a two prong approach- a tax credit and an income exclusion fringe benefit.

2. Tax Credit under I.R.C. sec. 23

a. I.R.S. Form 8839 determines the correct amount to claim as a nonrefundable credit.

b. The credit is equal to qualified adoption expenses, up to $13,810 per child for 2018.

1. The credit is claimed in the year the adoption becomes final (or fails) for expenses paid that year or the preceding year or in subsequent years for late expenses. (See foreign child rule, below.)

2. Cannot exceed the maximum amount over multiple tax years, but unused credits due to phaseouts/ limitations can be carried forward.

c. Qualified adoption expenses have a federal definition which is broader than Wisconsin's definition and includes adoption and attorney fees, court costs, travel expenses (including meals and lodging).

d. Qualified adoption expenses do not include expenses that are reimbursed by a government program, that violate state or federal law, that are for surrogate parenting arrangements, or that are for step-child adoptions.

e. Can not be claimed for same dollars excluded under Income Exclusion benefit below.

f. When adopted, the child must be under age 18 or otherwise unable to care for himself or herself. Special rules apply to special needs and foreign children adoptions regarding timing and amount of the credit.

1. "Special needs" indicates a non-foreign child that the State determines can not or should not be returned to the parent(s) or who has conditions (ethnicity, minority, physical or mental handicap, etc.) that would otherwise impair placement opportunities.

2. "Foreign child" is one who is not a citizen or resident of the U.S. prior to adoption process; adoption must be finalized to claim credit for any expenses.

g. Credit eligibility will be phased out for high income taxpayers (starting at $207,140 for 2018 for all filing statuses).

h. Married adoptive parents claiming the credit must generally file a joint tax return.

4. Income Exclusion fringe benefit under I.R.C. sec. 137

    a. Employer can pay directly or reimburse the employee for qualified adoption expenses.

    b. Must be a formal, written employee assistance program similar to other fringe benefit plans and available to all employees of the business. (Fringe benefit discrimination testing rules do apply.)

    c. As a tax free fringe benefit, amounts paid are not subject to federal or state income taxes, but are subject to state and federal unemployment, Social Security, and Medicare taxes.

    d. Most other criteria, including the maximum 2018 benefit of $13,810, are exactly the same as for the Tax Credit discussed above.

    e. With enough separate expenses, can benefit under both the income exclusion benefit and the adoption expense credit.

    f. Employer reimbursements in excess of incurred expenses will be added back to taxable income.

5. Documentation is now required to be attached to the tax return claiming adoption benefits. See instructions for Form 8839. This may disqualify adoptive parents from e-filing.

6. Identification Numbers

    a. Adoptive children continue to use the Social Security Number (SSN) they were issued at birth or naturalization.

    b. Citizen or resident alien children without a known SSN can obtain an Adoption Taxpayer Identification Number (ATIN) to use during the pendency of the adoption process with I.R.S. Form W-7A. ATINs are for most tax reporting purposes only, but can not be used to claim the Earned Income Credit (EIC). To claim the EIC, the parents must file amended tax returns after the child receives his or her SSN.

    c. If ineligible for an ATIN, I.R.S. Form W-7 applies for an Individual Taxpayer Identification Number (ITIN).

d. Upon finalization of the adoption, a Social Security Number is obtained with Form SS-5 from the Social Security Administration.

C. Foster Care Payments

1. I.R.C. sec. 131 excludes from taxable income all payments received by a foster care provider as long as the payments are qualified foster care payments. This also makes the payments state tax free.

2. Qualified foster care payments are paid to the foster care provider directly by the state or county or other qualified foster care agency licensed by and working with the state or county for a placement established by the state, county or other agency.

3. Qualified payments generally are made to the foster provider to care for a qualified foster individual in the provider's home. (A 2012 U.S. Tax Court case (*Stromme*, 138 TC No. 9) clarified that it must be the provider's principal residence, not a second or vacation home.)

4. Payments can include "difficulty of care" payments which are essentially additional compensation for those situations (physical, mental, or emotional handicaps) where the State determines such a "bonus" is warranted.

V-19. Requirements for Alimony and Child Support Payments – Earth shattering changes due to tax reform.

A. Effective for tax years after 2018, Internal Revenue Code sections 71 and 215 have been totally stricken from the tax code.

1. This applies to all divorce or separation instruments executed on or after 1/1/2019, regardless of language used therein.

2. Due to lack of guidance, it is unknown whether a partial MSA executed today for a Judgment of Divorce approved by the Court in January meets the old rules or new rules for deductibility.

3. Also applies to any preexisting instrument modified on or after 1/1/2019 when the modification expressly provides to apply the new rules.

a. There is no apparent requirement that both parties agree to such a modification; presumably the Court could impose such a change on its own, over the objection of one or both parties.

b. There is no guidance as of yet as to how this provision is to be described/drafted in a modified instrument.

4. Humorously, the striking language references the now deleted Section 71 language so we know to what it does or doesn't apply. Also note from the earlier discussion re Dependents that portions of the stricken language were shifted around as the language serves as the basis for other rules not changed by tax reform.

5. For a recipient with no other income, alimony income will no longer be considered wage income for the purposes of contributing to an IRA account.

6. The Wisconsin "term of art" called "Section 71 Payments" is meaningless after 12/31/2018.

7. Since there is no tax difference, trying to formulate Family Support vs. separate alimony and child support components will be meaningless.

B. Former strategy of having a January 2nd or 3rd final hearing in order to allow one last joint tax return goes out the window for 2018/2019 if the parties are attempting to have deductible alimony. Will there be a run on Family Court calendars the last part of December, 2018 as parties try to avoid the new rule?

C. For all existing divorce and separation instruments, the long-settled rules continue to be effective for as long as the documents are not modified.

D. With the loss of deductible support payments, the child support rules noted below will not be a major factor/stumbling block when structuring spousal vs. child support schedules.

E. American Bar Association Family Law Section approved a resolution in August, 2018 urging Congress to restore former alimony rules in light of several concerns raised by the ABA's analysis.

1. Results in less net total income for the “fractured” family to spend to now support two households.

2. Impacts implementation of prenuptial agreements previously executed under old rules and assumption that old rules would be in force down the road. (Is a Prenupt considered a “divorce or separation instrument” if the parties’ marriage is still intact?)

3. Appears to have been based on Congressional intent to follow the 1917 U.S. Supreme Court decision in Gould v. Gould (245 U.S. 151) interpreting the 1913 income tax act. (Taxability/deductibility appears to have first been codified in the 1942 IRC.)

4. Stated concerns about Section 682 alimony trusts is partially addressed by IRS Notice 2018-37 announcing clarification via Treasury Regulation, not legislative action.

V-18. Requirements for Alimony and Child Support Payments – Applicability of the old rules eventually will fade away, but still need to be followed for the rest of 2018 and any post-2018 modifications of pre-2019 instruments.

A. Deductibility by payor is pursuant to I.R.C. sec. 215 which allows the deduction to the extent the recipient must include such payments in income pursuant to I.R.C. sec. 71.

B. Requirements for Section 71 inclusion:

1. Must be a cash payment.

2. Received by or on behalf of the former spouse under a divorce or separation instrument.

3. The instrument does not designate the payment as one that is not includible as income to the recipient or deductible by the payor.

4. For persons legally separated, they must not reside in the same household when the payments are being made.

5. There is no liability to make any payment or other type of substitute payment upon the death of the payee.

6. The divorce or separation instrument must be a decree of divorce or separate maintenance or other written instrument incident to such a decree or other type of written separation instrument or

other type of decree requiring the payor spouse to make payments to support the recipient spouse.

C. Post Death Payments

1. Payments do not need to stop upon the death of the payor; payor's estate can continue to make Section 71 payments.

2. The tax code (I.R.C. section 71(b)(1)(D)) does not expressly require the divorce instrument to specifically state that payments cease upon the death of the recipient if applicable state law mandates such termination. Related Treasury Regulations (Temp. Reg. section 1. 71-1T Q&A 11 & 12) were written with respect to prior code language and do require specificity.

3. Johanson, et al v. Commissioner, T.C. Memo 2006-105, sides with the code language. "This case is another chapter in the long saga of cases … involving failure of parties … to specify what happens to payments should the payee-spouse die."

4. Does Wisconsin law have such a mandate?

    1. Yes. The first attempt was 2011 Assembly Bill 134, but it failed to get to the floor for a vote in that legislative session.

    2. Second time was the charm. 2013 Senate Bill 68 was enacted as 2013 Wisconsin Act 209. This created Wis. Stat. sec. 767.56(2c): *Unless already terminated for another reason, maintenance granted under this section terminates upon the death of the payee or the payer, whichever occurs first.*

    3. How does this now impact older decrees; does this make a challenge to case law more or less likely by the tax authorities?

d. Is "ancient" case law not specifically overturned still valid?

    1. The general principle is well established, also, that alimony continues only during the joint lives of the parties. It ends when the husband dies. *Campbell v. Campbell*, 37 Wis. 206 as cited in *Maxwell v. Sawyer*, 90 Wis. 352 (1895)

2. In a 2002 Wisconsin Tax Appeals Commission decision, the Opinion cited *Kuether v. State*, 174 Wis. 538, 540 (1921) (Alimony ceases upon the death of the payee spouse) and further commented that "[n]otwithstanding the fact that *Kuether* is more than 80 years old, it appears to be good law. Nothing in the statutes or subsequent case law suggests otherwise. *Kuether* was most recently cited for a related holding in 1963. *Estate of Rooney,* 19 Wis. 2d 89, 93 (1963). Moreover, [the taxpayer arguing against the Opinion] does not argue otherwise."

7. See also: *Yates v. Yates*, 165 Wis. 250, 253 (1917), and *Rauser v. Rauser*, 47 Wis. 2d 295 (1970).

e. Local IRS Counsel appears to concede the issue for now, but that is not a guarantee that a revenue hungry tax agency wouldn't implement a policy change down the road.

5. Better Safe Than Sorry- Specify in the Marital Settlement Agreement that the Section 71 payments terminate upon the death of the recipient.

D. Child Support – No apparent changes from tax reform.

1. Not reportable as income under Section 71 or deductible under Section 215.

2. Payments intended to be deductible under Section 71 should not be reduced or terminated upon the occurrence of any contingency involving the child or within six months before/after such an event.

3. If two or more children are involved, multiple "step downs" have a more complicated formula to consider. Best way to avoid problems is to amortize total stream of payments into one static amount for a given period of time.

4. Child support "contingencies" are a rebutable presumption; it is possible to prove non-child-related reason for diminished payments.

5. In the event of payment arrearages, payments are applied first to non-deductible child support and then to taxable payments.

6. Can not be discharged in bankruptcy.

E. Front End Loading Rules

1. Within the first three tax years after divorce (starting with the year of divorce), alimony reductions of more than $15,000 are deemed disguised non-deductible property settlements.

2. Disguised payments previously deducted must be “recaptured” and taxed to payor spouse/deducted by recipient spouse.

3. Alimony fluctuations due to percentage orders when payor’s income drops are not considered improper front-end loading situations.

4. I.R.S. Pub. 504 has an excellent worksheet to determine amount, if any, of recapture income.

5. Would a “Post-2018” decree modification altering taxability trigger recapture?

F. Temporary Support Orders

1. In the absence of a marital property reclassification agreement, temporary spousal support:

    a. Is not deductible by the payor or income to the recipient unless more than 50% of total income is transferred between the spouses. (See WDR Pub. 109.)

    b. Is a non-issue when filing a joint tax return.

2. Filing separate returns will still require marital income allocation, so again, no tax benefits available.

3. If marital property income reporting rules are terminated by an opt-out agreement or by a spouse moving out of state, you can have deductible payments as long as the general requirements of Section 71 are met, until the new rules kick in on 1/1/2019.

G. Property Settlement/Division – No apparent changes from tax reform.

1. Tax free pursuant to Internal Revenue Code Section 1041.

2. Requirements:

a. Property must be transferred between spouses (whether or not divorce ever occurs) or former spouses incident to divorce.

b. Transfer must occur within one year of cessation of marriage or at a later time if such transfer was related to the cessation of the marriage.

c. Transfer must be specified in divorce instrument (as originally executed or subsequently modified) and occurs within six years of divorce.

d. Six year time frame can be exceeded by showing that the transfer was made to effect the division of property owned by the former spouses at the time of the cessation of the marriage.

e. Transfer can be made to third party on behalf of recipient. Will be deemed a tax free transfer between former spouses and potentially taxable with respect to second step transfer.

f. Wisconsin Real Estate Transfer Tax exception for transfers between spouses applies as long as pursuant to original or amended divorce decree.

3. Basis of assets transferred equals transferor's basis. Make sure information is exchanged between the spouses and their investment firms for the proper data needed for any eventual sales of transferred assets and ensuing gain/loss determinations (and IRS basis reporting needs).

VI. "Kiddie Tax" – Significant changes from tax reform.

A. During the period of 2018 through 2025, the Kiddie Tax has been simplified as follows:

1) The child's earned income is taxed in accordance with the single taxpayer's rates and brackets.

2) The child's unearned income is taxed in accordance with the rates and brackets applicable to trusts and estates.

3) Thus, two separate calculations are involved; revised Form 8615 is still used to determine tax on unearned income, but no longer incorporates information from parents or siblings.

B. Still applies to children under age 19 or children who are full-time students under age 24, provided that the child's earned income does not exceed 50% of individual's support for the year. (This is similar to the dependency exemption rules.)

C. This no long subjects the child's unearned income to the parent(s)'s marginal tax rate, but the trust and estate tax brackets are far more taxing (no pun intended).

D. The alternate election to include the child's dividend and interest income on the parent(s)'s tax return by using I.R.S. Form 8814 is still available. This is not allowed if the child has other types of income as well. There is no such Wisconsin election, so may still need to file a separate state tax return anyway.

E. This eliminates the problem when the Form 8815 calculation needed Parent A's information, but Parent B was the one managing the child's income and tax matters.

VII. Practitioners' Concerns

A. Wisconsin Department of Revenue Publication 113

1. At least two reminders that marital property income reclassifications cannot be entered into retroactively.

2. Divorce decrees are also not allowed to retroactively change the nature of marital income.

3. Fairly strong words of warning to taxpayers and attorneys involved in divorce decrees that attempt to reclassify income. Why create ethical and malpractice issues for the counsel advocating such language or the judges asked to approve such improper language or the tax preparers trying to reconcile preparing a return the right way versus the way called for in the MSA?

4. All reclassification agreements should be filed with both tax agencies to ensure subsequent protection from tax situations involving income classification matters. Ignore the conventional wisdom that neither agency does anything with these documents.

The rules say to file them and it's not the client's fault if the agencies ignore them.

B. Wisconsin Statute 71.10(6m)

1. Wisconsin's innocent spouse statute.

2. Paragraph (b) states that the WDR cannot use marital property rules to collect from a former spouse if the judgment of divorce allocates the liability to the incurring spouse and the judgment is attached to the tax return for which the former spouse is seeking shielding.

3. This code section has been misused as a means to avoid marital property reporting as an after-the-fact opt out agreement.

4. A plain reading of this statutory language doesn't discuss filing and reporting requirements, just collection of an outstanding liability.

5. In any event, a Wisconsin tax statute has no effect against proper federal reporting rules.

C. Treasury Department Circular 230

1. Long established, but recently rewritten, revised, and reinvigorated, rules of conduct for "practice" before the Internal Revenue Service.

2. Administered by the Office of Professional Responsibility with recent staff build-up.

3. "Practice" includes actual representation before the I.R.S. as well as the provision of tax advice or the preparation of documents or other papers "related to" I. R. S. matters that are communicated to clients, either verbally or in writing.

4. Family law practitioners seem to give at least some tax advice relative to filing status, dependency exemptions, taxable alimony or non-taxable child support, QDRO-related tax planning, etc.

5. The O.P.R. considers Circular 230 stronger guidance than Publication 947 and also considers state professional conduct regulations to be applicable.

6. Consider adding the "Circular 230 Disclaimer" to written materials discussing tax matters.

D. The “It’s Not Likely To Be Audited” exception to proper marital tax reporting is not in compliance with any set of known tax rules.

E. Preparer Tax Identification Numbers

1. All tax preparers must have an I.R.S. PTIN number if preparing or assisting in the preparation of federal tax returns for at least one paying client.

2. See the I.R.S.’ website for information regarding the application process and requirements. (Paper Form W-12 or online process.)

3. Litigation has partially suspended some of the enforcement of PTIN rules and the prerequisites for obtaining a PTIN, including the registration and renewal fee, but not the requirement itself.

VIII. Other topics

A.Interest on property settlements

1. Imputed interest rules do not apply to any tax-free transfer of property between spouses or pursuant to a divorce. Treas. Reg. Sec. 1.483-1(c)(3)(i).

2. Actual interest payments are taxable to the recipient and non-deductible personal interest expense of the payor.

3. Debt incurred to acquire the interest of a spouse or former spouse in a residence, incident to a divorce or legal separation will be eligible to be treated as debt incurred in acquiring a residence for purposes of I.R.C. section 163, subject to limits below.

B. Former “spouses” who have their marriage annulled

1. Were never, and are not, married as far as taxation rules are concerned.

2. Marital property rules can not be applied. This might possibly be the only allowable way for a retroactive reclassification of income.

3. Must amend at least the prior three years’ tax returns federally and four years for Wisconsin if they filed any joint returns prior to annulment.

4. See Barr v. Commissioner, 10 TC 1288 (1948) and Rev. Rul. 76-255, 1976-2 CB 40.

C. Deductibility of mortgage interest is modified for the 2018 through 2025 window

1. Interest incurred for home acquisition debt for the primary residence or a second home is deductible on up to a total of $750,000 of purchase money (acquisition) debt for most taxpayers ($375,000 for married filing separate) for debt incurred after 12/15/2017. Refinancing existing debt up to $1,000,000 ($500,000) is still allowed for deducting interest under the prior limits. (Wisconsin only permits interest deduction on residences located in Wisconsin.)

2. Interest incurred for home equity debt secured by the primary residence is no longer deductible during 2018 through 2025, regardless of when incurred. IRS issued clarification that HEL debt used to purchase or improve a residence will qualify as acquisition debt for the purposes of the deduction.

3. Using home #1 to secure debt used to purchase home #2 has never been classified as home acquisition debt; it is home equity debt and the interest is no longer deductible.

4. The deduction for qualified mortgage insurance premiums (treated as additional mortgage interest) expired after 2017.

D. First Time Homebuyer Credit (Form 5405)

1. The 2008 Credit must be repaid over 15 years. The spouse receiving the house through a divorce settlement is responsible for repaying the entire credit amount shown on 2008 Form 5405. (But, had a spouse died, the widow(er) would only have to repay half.)

2. A Form 5405 must be filed if the house was disposed during 2018.

3. The 2009 and later years' Credit must be repaid only if home is disposed within 36 months of purchase. The spouse receiving the house through a divorce settlement is responsible for repaying the entire credit amount. Disposition is still measured from date of original purchase.

4. Since mid-2010, this benefit is no longer available to new purchasers.

E. Wisconsin's Domestic Partnership Law (Wis. Stats. Ch. 770)

1. Does not impact tax filings.

2. Does not extend marital property concepts to domestic partnerships like California's law does.

3. Has been upheld by the Wisconsin Court of Appeals.

IX. Final Notes

A. www.irs.gov and www.revenue.wi.gov are the official websites for additional reference needs and all tax forms, instructions and publications.

B. At the time this outline went to press, many draft and/or final versions of state and federal income tax forms for 2018 were not yet available. The IRS will continue to issue (we hope) (a lot of) guidance regarding the many law changes that affect 2018 and future tax returns.

C. 2017 Wisconsin Act 231 (adopted in April, 2018) conformed most state tax rules to the federal rules. The IRC sec. 199A QBI deduction was not picked up by Wisconsin.

D. Additional tax legislation may continue to alter present tax laws; consult with a knowledgeable tax professional before filing any income tax returns or advising others on rapidly changing areas of concern.

Pursuant to Treasury Circular 230, we are required to inform you that unless we have specifically stated to the contrary, the advice we provide in this presentation concerning federal tax issues or submissions is not intended or written to be used, and can not be used, to avoid federal tax penalties.

The information provided in this outline is current through October 29, 2018.

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Scott has frequently authored articles on a wide range of legal and accounting issues for various professional publications, including the Wisconsin Institute of Certified Public Accountants' monthly periodical, the *Wisconsin Lawyer* publication of the State Bar of Wisconsin, and national family law magazines. He has also been interviewed by

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