

Tax Implications of Divorce: Spousal and Child Support

In addition to the difficult personal challenges raised in the process of divorce, careful planning is required to ensure that the divorcing parties understand the tax implications of their decisions. From the payment of alimony and child support to claiming the dependency exemption, each financial transaction typically addressed during the divorce process carries with it significant tax consequences. Unless properly addressed, these unexpected repercussions may bring even more significant challenges to the parties of a divorce,

Spousal Support. Generally, when one spouse makes spousal support payments to the other upon divorce or separation, the payments are deductible by the payor and taxable to the payee if the payments qualify under the tax rules as “alimony.” In order to qualify as alimony, the payments must: (1) be required under the divorce decree or separation agreement (voluntary or “extra” payments do not qualify); (2) be in cash only (not goods or services); (3) be required to end at the death of the recipient spouse; and (4) the parties must be living in separate households. The parties may elect to have payments that qualify as alimony be treated as not qualifying (but not vice versa). Tax planning for spousal support payments generally entails calculating the tax benefit of the alimony deduction and sharing that benefit with the payee spouse, who is often in a lower income tax bracket.

Although alimony payments are generally deductible, there are limits to what qualifies as deductible alimony under the excess alimony recapture rule. This rule, if applicable, prohibits the front-loading of alimony payments, and requires the payor spouse to recapture and include as ordinary income spousal support payments previously made, and requires the payee spouse to reduce the income previously reported as taxable alimony payments. Excess alimony recapture can be triggered by any event, even those outside the payor spouse’s control, such as an amendment to the divorce or separation instrument, failure to make timely spousal support payments, a reduction in the payor spouse’s ability to provide spousal support, or a reduction in the payee spouse’s support needs.

Child Support. Support payments for children (“child support”) are not deductible by the paying spouse and are not taxable to the recipient. These include payments specifically designated as child support in a divorce or separation agreement as well as payments which otherwise might resemble alimony but are linked to an event or date related to a child, such as attaining a specified age, marrying, or attending school, for example. Assume that a spouse is to pay “alimony” of \$3,000 a month, dropping to \$2,000 a month at a specified date. If the date coincides with a child’s 18th or 21st birthday, the “extra” \$1,000 is characterized as

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child support, not alimony. Further, if the payor spouse makes less than the entire combined spousal and child support payment for an entire year, then any amount paid is first classified as non-deductible child support, and the remainder as deductible alimony. For example, if John is to pay Martha \$24,000 per year for spousal support and \$24,000 per year for alimony (\$48,000 total), but pays only \$36,000 for the year, the first \$24,000 is characterized as child support and the remaining \$12,000 is characterized as alimony.

Dependency Exemption. To some extent, the parties may determine by agreement which of them is entitled to claim the dependency exemption for their dependent children. By default, the exemption for the child goes to the spouse who has legal custody of the child. However, the custodial spouse can waive his or her right to the exemption, thus allowing the noncustodial spouse to claim it.

The dependency exemption entitles the claiming spouse to more than just the exemption. For example, the child tax credit and the higher education (Hope and Lifetime Learning) credits are only available to the spouse who claims the child as a dependent. However, if the custodial parent waives the right to the dependency exemption, the custodial parent can still claim the child care credit for qualifying expenses.

A custodial parent can waive the right to claim the dependency exemption for a child by filing IRS Form 8332 (Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent). The waiver may be completed on an annual basis or at one time to cover all future years. If the waiving spouse will be receiving support payments, he or she often prefers the annual approach so that, if support payments are late or missed altogether, the next annual waiver may be refused.



Tax Implications of Divorce: The Division of Property (cont.)

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