Marital Dissolution & Taxation

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Directed Study

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ABSTRACT

Taxation and divorce have a long history in the United States. The ever-changing relationship between taxation and divorce continues to evolve at the intersection of the Internal Revenue Code, state divorce laws, and societal beliefs. The tax implications of divorce are fact specific and spill over into the arenas of alimony, child custody, and property distribution. Often these implications have disproportionate consequences that manifest in gender and economic terms. However, the goal of tax policy is equity, ensuring that similarly situated taxpayers are treated the same. Furthermore, the tax code is intended to be gender-neutral. Nevertheless, taxation outcomes have gendered implications in regards to divorce. Over time, the laws relating to taxation and divorce have undergone many changes. This paper discusses alimony, property settlements, and child support as it pertains to divorce and taxation. By examining the gendered outcomes of divorce and taxation, this paper will provide recommendations for reform.

I. INTRODUCTION

Divorce, like marriage, is under state jurisdiction in the United States. Thus, divorce laws vary from state to state. However, all states now allow no fault divorce.[1] Divorce, also referred to as the dissolution of marriage, a judicial severance of the tie of matrimony.[2] The process of divorce generally involves issues of spousal support, child support and custody, as well as distribution of property.

The decision to divorce, while inherently private, is profoundly social and economic. The economic aspects of divorce are deeply entrenched in the tax code. In the United States, the tax system plays a significant part in dictating the behaviors of taxpayers, married and divorced taxpayers alike. Unlike divorce law, taxation exists under both state and federal jurisdiction (as well as local jurisdiction in many instances). Nevertheless, state and local tax laws are generally consistent with federal taxation. However, marital status is one topic that has occupied a grey area and created controversy on numerous historical occasions, especially when it comes to defining marriage. Moreover, the tax code does not classify individuals as divorced.[3] Instead, the tax code only classifies individuals as married or single for tax purposes.[4] Code Section 7703(a)(1) of the Internal Revenue Code determines marital status for tax purposes.[5] Typically, marital status is determined on the last day of the year. [6]

In the United States, the income tax is a direct tax levied on the net income of taxpayers.[7]

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[1] Jana B. Singer, *Divorce Reform and Gender Justice*, 67 N.C. L. Rev. 1103, 1105 (1989).
[2] Divorce, THE LAW DICTIONARY (2002).
[3] See I.R.C. § 7703(a)(1).
[4] *Id*.
[5] *See* I.R.C. § 7703(a)(1).
[6] *See, e.g.,* TJAGSA PRACTICE NOTE: Legal Assistance Items, 1994 Army Law. 56, 57.
[7] Joanne Ross Wilder, *Divorce and Taxes: Fifty Years of Changes*, 24 J. Am. Acad. Matrim. Law. 489, 489 (2012).

The tax system in the United States has experienced substantial modifications in response to changing circumstances.[8] The modifications have varied in substance and form as well as affected the revenue collected, the proportions of tax, and the type of taxes collected. Certain changes were in response to events such as war, economic conditions, and the passage of the 16th Amendment.[9] The 16th Amendment of the Constitution grants Congress the power to levy taxes, specifically a federal income tax.[10] Other changes were gradual responses to the economy, society, politics, and societal welfare. In 1948, there was the adoption of full income splitting for married taxpayers.[11] However, in 1969 marital joint filing was adopted, which reestablished major marriage penalties.[12] Nevertheless, in 1986, tax rates were cut, which reduced many marriage penalties.[13] Therefore, there is no single provision of the Internal Revenue Code that produces the disproportionate tax consequences that can occur at divorce. Instead, there are numerous tax provisions, incidental causes, and code complexities that create various disparities.

Tax equity principles of progressivity, horizontal equity, and neutrality, while desired within the tax system, are conflicting.[14] Neutrality demands that taxes should not favor one group or sector over another, nor influence individual decision-making.[15] Horizontal equity necessitates that those taxpayers with the same income pay the same tax.[16] Progressivity is when a tax system imposes not only a greater tax liability for those with higher incomes, but a greater tax rate for

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[8] *Id*. at 489-90.
[9] *Id*.
[10] Robert S. McIntyre & Michael J. McIntyre, *Fixing the "Marriage Penalty" Problem*, 33 VAL. U. L. REV. 907, 908-09 (1999).
[11] *Id*.
[12] *Id*.
[13] *Id*.
[14] *Id*.
[15] *Id*.
[16] McIntyre & McIntyre, *supra* note 10, at 908-09.

those with higher incomes.[17] As such, the actual rate must increase as income increases.[18] The three principles are mutually exclusive and cannot exist in one tax system. Currently, the joint filing system in the United States promotes progressivity and horizontal equity.[19]

A. Overview

This paper discusses the tax consequences of divorce and the factors that contribute to varying tax outcomes as a result of divorce. Furthermore, this paper examines the disparities and gender implications of the tax consequences of divorce. By examining these discriminatory outcomes, this paper will provide recommendations for reform and examine past reform efforts. The first section of this paper discusses tax and divorce law in the United States. The second section of this paper examines the American Tax Relief Act of 2012 and its marriage relief provisions. The third section of this paper examines reform efforts. Finally, this paper concludes by tying all of the information together and expanding the discussion surrounding the tax consequences of divorce.

B. Tax & Divorce in the United States

1. Alimony

Alimony is payment made to support a former spouse after divorce or separation.[20] There are many different types of alimony such as rehabilitative, temporary, permanent, and other forms.[21] Today, alimony is generally based on need, but states consider a variety of factors for alimony calculations.[22] Alimony is modifiable when there is a change in circumstances.[23]

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[17] *Id*.
[18] *Id*.
[19] Eissa, N. and H. Hoynes. 2000b. TAX AND TRANSFER POLICY, AND FAMILY FORMATION: MARRIAGE AND COHABITATION, 4, Unpublished paper.
[20] Margaret Ryznar, *Alimony's Job Lock,* 49 Akron L. Rev. 91, 97 (2016).
[21] *Id*. at 100.
[22] *Id*. at 99.
[23] *Id*. at 101.

However, alimony typically terminates upon remarriage and even upon cohabitation of the payee.[24] Alimony is viewed as running counter to the clean break theory associated with no fault.[25] Generally, the vast majority of alimony recipients are women, but alimony is not often rewarded and is unpopular.[26] Furthermore, in many cases alimony is temporary, and permanent alimony has even been eliminated in some states.[27]

Alimony is deductible by the payor and includible in the income of the payee.[28] For federal income tax purposes, IRS Form 1040 is used to report alimony income and alimony deduction.[29] Alimony is deductible whether or not the payor itemizes deductions because alimony is an above the line deduction, which means it is subtracted from the taxpayers gross income before the adjusted gross income is calculated.[30] The payor is not required to withhold income taxes from alimony payments, except in cases of alimony payments to a nonresident alien, because such payments are deemed United States source income.[31] Alimony is taxable income for the payee, therefore, the payee must include alimony received in the tax calculation for purposes of determining liability for estimated taxes.[32] The payor is required to indicate the name and social security number of the payee on the tax return on which the payor claims an income tax deduction for alimony payments.[33] There are seven criteria for a finding that a payment constitutes alimony: (1) the payment is made in cash; (2) the payment is to or for a spouse or a former spouse made

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[24] *Id*.
[25] *Id*. at 104
[26] Singer, *supra* note 1 at 1106.
[27] Ryznar, *supra* note 20 at 91.
[28] *See* I.R.C. § 71(a) and 215(a).
[29] The Department of Treasury, U.S. Individual Income Tax Return Form 1040, irs.gov (Sept. 2, 2015, 12:28 a.m.), http://www.irs.gov/pub/irs-pdf/f1040.pdf
[30] *See* I.R.C. § 62(a)(10); 67(a).
[31] *See* I.R.C. § 1441(a); Rev. Rul. 69-108, 1969-1 C.B. 192.
[32] *See* I.R.C. § 6654.
[33] *See* I.R.C. § 215(c); Treas. Reg.1.215-1T, Q&A 1.

under a divorce or separation instrument; (3) the spouses do not file a joint tax return with each other; (4) there is no liability to make the payment after the death of the recipient spouse; (5) the payment is not treated as child support or a property settlement; (6) the divorce or separation instrument does not designate the payment as not alimony; and (7) spouses must reside in separate households when the payment is made.[34]

First, the payment must be made in cash.[35] Second, the payment must be received by or on behalf of a former spouse pursuant to a qualifying instrument such as divorce or separate maintenance decree or written separation agreement.[36] Third, the divorce or separate maintenance decree or written separation agreement does not designate that the payment is not alimony.[37] Fourth, the divorced or legally separated spouses must not be members of the same household.[38] Fifth, the payor cannot be liable to make payments, in cash or property, after the death of the payee.[39] Sixth, the parties must file separate income tax returns.[40] Seventh, the payment must not be for child support or a property settlement.[41]

Recapture[42] applies in the third year if the alimony paid in the third year decreases by more than $15,000 from the second year or if the alimony paid in the second and third years decreases significantly from the alimony paid in the first year.[43] Alimony recapture occurs when alimony

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[34] Stephen P. Comeau, *An Overview of the Federal Income Tax Provisions Related to Alimony Payments*, 38 Fam. L.Q. 111, 113 (2004).
[35] *See* I.R.C. § 71(b)(1); 215(b).
[36] *See* I.R.C. § 71(b)(1)(A), (b)(2).
[37] *See* I.R.C. § 71(b).
[38] *See* I.R.C. § 71(b)(1)(C).
[39] *See* I.R.C. § 71(b)(1)(D).
[40] *See* I.R.C. § 71(e).
[41] *See* I.R.C. § 71(c).
[42] When alimony payments decrease or end during the first 3 calendar years, the payor may be subject to the recapture rule. The recapture rule requires the inclusion of part of the alimony payments in the third-year part that were previously deducted.
[43] Kathleen A. Hogan, *Alimony Recapture*, Fam. Advocate, 28 (2014).

payments decrease or end during the first 3 calendar years.[44] Alimony recapture requires the payor to include in income in the third year part of the alimony payments previously deducted and the payee can deduct in the third year part of the alimony payments previously included in income.[45] The three year period starts with the first calendar year a qualifying alimony payment is made under a decree of divorce or separate maintenance or a written separation agreement.[46] No recapture is required if either spouse dies or remarries before the end of the third post-separation year.[47] The recapture rules do not apply to support payments made pursuant to a court order for temporary or pendente lite support.[48] Thus, recapture aims to discourage divorcing spouses from improperly characterizing property settlement payments as alimony.

2. Property Division

Property distribution upon dissolution of marriage depends upon how marital property is classified.[49] Division of marital property is a civil judgment at dissolution and is a one-time division of exiting rights that is not modifiable or taxable.[50] The classification of martial property depends on whether the jurisdiction follows a common law property system or a community property system.[51] In a common law state divorce, all property acquired by either spouse during the marriage is presumptively martial property at divorce unless acquired by gift or inheritance.[52] Thus, each spouse owns an undivided half interest in the property during marriage.[53] Property classification affects rights of ownership, rights to income from property, rights and duties of

[44] *Id*.
[45] *Id*.
[46] *Id*.
[47] *See* I.R.C. § 71(f)(5)(A)(i), (ii).
[48] *See* I.R.C. § 71(b)(2)(C).
[49] Allison Anna Tait, *Divorce Equality*, 90 Wash. L. Rev. 12, 1293-98 (2015).
[50] *Id.* at 1255.
[51] *Id.*
[52] *Id*.
[53] *Id*.

management and control, rights to make lifetime gifts, property rights in the event of divorce, and rights to dispose of property at death.[54] Generally, equitable distribution is used to divide property between former spouses, which usually means a 50/50 division. Nevertheless, most marital estates do not contain many assets, and often the principal residence is the largest or only asset.[55]

Code Section 1041(a) discusses whether property transfers between divorcing spouses are a "sale or exchange," which would require recognition of gain or loss under Code Section 1001.[56] Code Section 1041(a) states that no gain or loss is recognized on the transfer of property between spouses, or between former spouses, provided the transfer is "incident to divorce."[57] Code Section 1041(c) requires that the transfer must occur "within 1 year after the date on which the marriage ceases," or be "related to the cessation of the marriage" to be considered an incident to divorce.[58]

When property is subject to Code Section 1041(a), the property is treated as if it had been acquired by gift.[59] The transferee's basis in the transferred property carries over from the transferor.[60] Thus, the transfers are subject to a gift tax unless the transferee provides adequate consideration, and the donee spouse will take a transferred basis in the property.[61] This is the case even when the property's adjusted basis is less than, equal to, or greater than the property's value at the time of the transfer regardless of the consideration paid.[62] Because the tax code does not distinguish married spouses from divorcing spouses, if the divorcing spouses are still married in the taxable year of the transfer, the gift will qualify for the unlimited marital deduction.[63] This is

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[54] *Id*.
[55] *Id*.
[56] *See* I.R.C. § 1041(a).
[57] *Id*.
[58] *See* I.R.C. § 1041(c).
[59] *See* I.R.C. § 1041(a).
[60] *See* I.R.C. § 1041(b)(2).
[61] *See* I.R.C. § 1015.
[62] Treas. Reg. 1.1041-1T(d), Q&A 11.
[63] *See* I.R.C. § 2523(a).

not the case for divorced spouses as the marital deduction will not be available. However, transfers made within one year of the marriage's conclusion are protected by the safe harbor in Code Section 1041(c)(1).[64]

Generally, there is no recognized gain or loss on the transfer of property between former spouses if the transfer is incident to divorce, even if the transfer was in exchange for cash, the release of marital rights, the assumption of liabilities, or other consideration.[65] The basis in property received from a former spouse incident to divorce is the same as the former spouse's adjusted basis.[66] There are instances where the transferor will be required to recognize the gain. When this occurs, the transferee's basis will be adjusted to take into account the gain recognized by the transferor.[67] If the gain is required to be recognized, the amount of such recognized gain is added to the transferee's carryover basis in the asset received.[68]

Regulation 1.1041-2(a)(1) prohibits Code Section 1041 from applying to the spouse whose interest is redeemed.[69] This provision applies when the other spouse does not have a primary and unconditional obligation to purchase the stock.[70] In these cases, the redeeming spouse will be subject to Code Section 302 used for distributions in redemption of stock. The rule of Reg. 1.1041-2(a)(2) applies the no recognition rules of Code Section 1041 to the redeeming spouse, but applies constructive distribution rules to the other spouse.[71] However, if the other spouse has a primary and unconditional obligation to purchase the redeeming spouse's interest, the other spouse will be deemed to have received the distribution from the corporation and then to have transferred the

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[64] *See* I.R.C. § 1041(c)(1).
[65] *Id*.
[66] *See* I.R.C. § 1041(b)(2).
[67] *See* I.R.C. § 1041(e).
[68] *Id*.
[69] Treas. Reg. 1.1041-2(a)(1).
[70] *Id*.
[71] Treas. Reg. 1.1041-2(a)(2).

distribution to the redeeming spouse.[72] Thus, the redeeming spouse is not subject to income tax on the redemption; however, Code Sections 301 and 302 will apply to the other spouse.

During a divorce, if S corporation stock is transferred, suspended losses incurred by the transferor spouse are transferred to the transferee spouse.[73] In terms of life insurance policies, transfers pursuant to divorce do not trigger the transfer value rule regardless of whether there was consideration.[74] In terms of passive activity, transfers of interest pursuant to divorce will not trigger a deduction for suspended losses by the transferor spouse.[75] However, in instances of a disposition of interest in a passive activity by gift, the basis of interest immediately before the transfer is to be increased by the amount of any passive activity losses allocable to the interest with respect to deductions that have not been allowed. This allows the transferee spouse to use the losses as a result of an increase in basis.[76]

Transfers of interests in an IRA to a former spouse are nontaxable transfers, as long as the transfer is pursuant to a decree of divorce or separate maintenance.[77] The interest in the IRA is treated as owned and taxable to the transferee spouse once the transfer occurs under a divorce or separation agreement.[78] However, when a former spouse takes an IRA distribution directly and pays the proceeds the other spouse, the tax burden remains with the owner of IRA because in such instances no interest is transferred; the tax burden is shifted with a transfer of interest, not proceeds.[79]

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[72] *Id*.
[73] *See* I.R.C. § 1366(d)(2)(B).
[74] *See* I.R.C. § 101(a)(2).
[75] *See* I.R.C. § 1041.
[76] *See* I.R.C. § 469(j)(6).
[77] *See* I.R.C. § 71(b)(2)(A).
[78] *See* I.R.C. § 408(d)(6); Treas. Reg. 1.408-4(g)(1).
[79] *Czepiel v. Comm'r*, No. 2826-98, 1999 Tax Ct. Memo LEXIS 327 (U.S. T.C. Aug. 30, 1999).

Generally, the Employee Retirement Income Security Act (ERISA) prohibits the alienation of qualified retirement plans.[80] However, a Qualified Domestic Relations Order (QDRO) allows transfers of interest of qualified retirement plans in instances of divorce.[81] A QDRO can allow payment of plan benefits, typically payable to the plan participant, to be paid to an alternate payee at any time if the plan's term allows it.[82] A QDRO can direct payments to an alternate payee prior to the time that the plan could make payments to a participant or at the earliest retirement age permitted.[83] The tax burden shifts to the alternate payee only when the payee is a former spouse or spouse.[84] If an order is not a qualifying QDRO, the distribution is taxable to the participant.[85]

3. Child Support

Payments that are specifically designated as child support under a divorce or separation instrument are not deductible by the payor, and are not taxable income to either the payee or to the child.[86] Code Section 71(c) excludes these payments from the definition of alimony cash payments, which constitute child support.[87] A payment is treated as specifically fixed for child support if the divorce or separation instrument specifically designates an amount or percentage as being made for the child of the payor.[88] However, the presumption for an unallocated award is that it is not child support.[89] Therefore, it is vital that the divorce instrument clearly and unambiguously identify child support.

[80] *See* I.R.C. § 401(a)(13)(A).
[81] *See* I.R.C. § 401(a)(13)(A) and 414(p).
[82] *See* I.R.C. § 401(a)(13)(B).
[83] Treas. Reg. 1.401(a)-13(g)(3); *See* I.R.C. § 414(p)(4).
[84] *See* I.R.C. § 402(e)(1)(A).
[85] *See* I.R.C. § 414(p)(1)(A)(i) and (ii) and 414(p)(2)(A)-(C); *Hawkins v. Comm'r*, 86 F. 3d 982 (10th Cir. 1996).
[86] *See* I.R.C. § 71(c)(1).
[87] *See* I.R.C. § 71(c).
[88] *See* I.R.C. § 71(c)(1).
[89] *Simpson v. Comm'r*, 16789-97, 1999 Tax Ct. Memo LEXIS 288 (U.S. T.C. July 29, 1999).

A fixed payment is a clearly determinable payment for child support, but does not have to be a specific amount.[90] Thus, the actual amount can vary from year to year without losing its qualification as a child support payment.[91] A payment will be considered to be a child support payment if the payment, even if initially characterized by the payor as alimony, is reduced due to a contingency relating to the child specified in the divorce instrument.[92] The reduction amount will be treated as child support.[93] Under Code Section 71(c)(2)(B), contingencies relating to a child are as follows: dying, becoming employed, leaving school, leaving the household of the custodial parent, marriage, and attaining a specified age or level of income.[94]

When a payor is required to pay both alimony and child support, but pays less than the full-required amount, the payment is first allocated as child support until that requirement is fulfilled.[95] When a payment is recharacterized from alimony to child support, both the payor and payee will likely be required to amend a number of their income tax returns.[96] Payments of unallocated support may still be taxable to the payee as alimony if the child support is not fixed with specificity.[97]

II. THE PROBLEM

A. Illustration One

Husband proposed a division of assets that amounted to a nearly even split at face value. Husband would keep 4 million in an after-tax investment account and give Wife 4 million in tax deferred retirement accounts.

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[90] Treas. Reg. 1.71-1T(c).
[91] *Id*.
[92] *See* I.R.C. § 71(c).
[93] *Id*.
[94] *See* I.R.C. § 71(c)(2)(B).
[95] *See* I.R.C. § 71(c)(3).
[96] *Supra* note 43, at 28.
[97] *Comm'r v. Lester*, 366 U.S. 299, 304 (1961).

In this instance, Wife would be exposed to substantial tax liability. The deferred retirement accounts require Wife to pay tax on the interest income, dividend income, and capital gain earned in order to withdraw the funds. Thus, all investment income is taxed as ordinary income upon withdrawal. However, while the deferred retirement accounts were in the possession of husband he could avoid paying tax as long as he did not withdraw the funds. Conversely, Husband's after-tax investment account would only require Husband to pay tax on any investment gain above his original cost basis. Furthermore, Husband would be able to offset his tax liability with any capital loss carryovers. Additionally, if Husband uses after-tax money to purchase investments that deliver gains in the form of qualified dividends and long-term capital gains, he may pay less taxes overall because these types of investment gains are subject to a lower tax rate. Also, in some instances, long term capital gains are not taxed at all.

B. Illustration Two

Husband volunteered a split that would give wife investments worth $500,000 that had cost $200,000 to purchase, and to keep $520,000 in investments that had cost $480,000.

In this instance, Wife would have a tax bill on $300,000 in capital gains, while Husband would only be taxed on $40,000 in capital gains. Despite the fairly even distribution of value, the wife's assets are accompanied by higher future tax liability than are the husband's assets. In the United States, individuals pay capital gains tax on the annual net capital gains. Capital gains are the profits realized when a capital asset is sold for a price above the purchase price.[98] However, capital gains taxes are only triggered when an asset is realized and sold, but not while the investor holds the asset.[99] Thus, an investor can own stock that appreciates annually, but the investor would

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[98] Norman Kronstadt, *Income Tax Aspects of Capital Gains and Losses: A Primer for the Family Law* Practitioner, 37 Fam. Adv. 42, 43 (2014).
[99] *Id.*

not be subject to the capital gain tax until the stock is sold. Furthermore, since the tax is an annual net capital gain tax, long and short-term capital gains are combined, but can be offset by capital losses. A short-term capital gain is a capital asset held for one year or less; a long-term capital gain is held for more than one year.[100] A capital loss occurs when there is a decrease in the capital asset's value compared to the asset's purchase price.[101]

C. Illustration Three

Husband agrees that Wife can keep the house after the divorce. Husband also agrees to pay Wife $70,000 in alimony, part of which will be satisfied by him continuing to pay the mortgage, property taxes, repairs, and insurance after the divorce. The cost of the mortgage, property taxes, repairs, and insurance are $50,000 annually.

In this instance, Husband will be able to deduct $70,000, while Wife will have to include $70,000 to her income for tax purposes but will only receive $20,000 cash annually. Additionally, Wife only worked part-time during the marriage earning approximately $20,000. Thus, Wife moves from the 15% tax bracket to the 25% tax bracket based on the 2016 Tax Bracket Rates. According to Reg. 1.71-1T(b), when the divorce agreement requires that the payor pay the payee's mortgage, property taxes, or insurance policy and the payee is the owner, these payments will qualify as alimony or maintenance payments.[102] This will enable the payor to deduct the payments as alimony and requires the payee spouse to include the payments in income. Rev. Rule 62-39, 1962-1 CB 17 states that the payee can deduct the mortgage interest and real estate taxes paid, but only if the payee itemizes deductions, and provided that the interest constitutes qualified residential interest.[103]

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[100] *Id.*
[101] *Id.*
[102] Treas. Reg. 1.71-1T(b).
[103] Rev. Rule 62-39, 1962-1 CB 17.

D. Illustration Four

Husband must pay Wife $10,000 in cash each year for 10 years ending upon Wife's death. Husband must also pay Wife's estate $20,000 in cash each year for 10 years, but Wife's death does not end these payments. The $10,000 annual payments may qualify as alimony.

In this case, the $20,000 annual payments that do not end upon your former spouse's death are not alimony. Alimony payments must end when the payee dies. An agreement requiring alimony payments to continue after the payee's death will taint all such payments. This includes a required payment to the payee's estate, because the payment is considered a payment after death according to Reg. 1.71-1T(b) Q&A 13.[104] However, a divorce agreement can require payments to continue to the payee after the death of the payor.[105] Nevertheless, payor's estate would not be entitled to an alimony income tax deduction for those payments. Additionally, under Code Section 682(b), the post-death payments from the payor's estate are considered distributions to an estate beneficiary subject to the estate income tax distribution rules.[106] As such, if the payor's estate distributes net income the estate can deduct the distribution and the payee would be required to include the payment as income for tax purposes.

E. Illustration Five

Husband and Wife agree that Husband will make alimony payments to Wife until their only child's the couple's only child's eighteenth birthday. Husband complies and makes all of the payments pursuant to the agreement until the child's eighteenth birthday. The Husband makes the payments for five years, under the belief that the payments were alimony. The Husband deducts the payments for tax reporting purposes and Wife reported the payments as income.

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[104] Treas. Reg. 1.71-1T(b) Q&A 13.
[105] *Id*.
[106] *See* I.R.C. § 682(b).

In this instance, a payment designated as "alimony," but which terminates upon the eighteenth birthday of a child, will be viewed as child support. Under *Hammond v. Commissioner*, despite the designation, the payment will not be treated as an alimony payment; instead it will be treated as a child support payment.[107] If the payment is reduced on the occurrence of a contingency relating to the child specified in the divorce instrument, then the payment is considered a child support payment. The couple's child turning eighteen is a contingency that relates to the child because it depends on an event relating to the couple's child.[108] It is irrelevant whether the event is certain or likely to occur. Therefore, the amount equal to the reduction will be treated as child support. The spouses will have to file amended tax returns for the years in which they treated the payments as alimony. Additionally, under the amended tax returns, the Husband will not be permitted to deduct it and the Wife will not have to include it as income.

F. Implications

Gender bias is prevalent in divorce and manifests in many ways; the disparities that individuals face after divorce are very much colored by the gender roles and social norms that are perpetuated during marriage. As a result, divorced women and men have vastly different experiences. Men and women occupy disparate positions after divorce.[109] Generally, women handle family responsibilities and these responsibilities are more likely to affect the working lives of women than working men.[110] Often women participate in the secondary job market, which provides low wages and limited opportunities.[111] This is especially so when the woman is the

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[107] *Hammond v. Comm'r*, Tax Ct. Dkt. No. 5822-97, 1998 Tax Ct. Memo LEXIS 55 (U.S. T.C. Feb. 10, 1998).
[108] *See* I.R.C. § 71(c)(2)(A).
[109] Cynthia L. Starnes, *Reflections on Betty Crocker, Soccer Mom, and Divorce: A Message From Detergent Manufacturers*, 1997 Wis. L. REV. 285, 286-93 (1997).
[110] *Id.*
[111] *Id.*

primary caretaker or has spent a significant amount of time out of the labor market.[112] The time invested in handling family responsibilities does not have the same societal value that is equated to time invested in the labor market (typically a benefit gained by the husband).[113] Therefore, generally, a woman earns less at divorce than her husband who has invested a continuous and concentrated effort in the labor market.[114] The disparity in income among spouses is often a consequence of the spousal division of labor, which aligns career choices with gender norms.[115] The reality of divorce is even bleaker where children are involved.[116] Mothers typically receive custody.[117] While child support may likely provide minimal financial assistance, the time spent caring for a child/children after a divorce usually falls on the custodial parent.[118] Thus, career choices will still be shaped by caretaking responsibilities and will often lead to the mother compromising her career investment.[119]

Divorce is a key factor in the impoverishment of women.[120] The number of divorced women in poverty is related to the consequences and process of divorce.[121] In some instances, as the standard of living for men rises; it declines for women.[122] Generally, women do not economically recover from divorce unless they remarry. As such, after divorce, the former wife's vulnerable position materializes as her investments in the domestic sphere have come at a sacrifice for investments in the public/economic sphere. [123] According to Terry Arendell, "[d]ivorce is a

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112 *Id*.
113 *Id*.
114 *Id*.
115 Cynthia L. Starnes, *supra* note 109, at 286-93.
116 *Id*.
117 *Id*.
118 *Id*.
119 *Id*.
120 Terry Arendell, *Mothers and Divorce: Legal, Economic, and Social Dilemmas*, 154 (1986).
121 *Id*.
122 *Id*. at 157.
123 *Id*. at 153.

socially structured experience that reflects the gender-based organization of our society, with all its relate inequities."[124]

After divorce, women suffer a severe drop in their standard of living and income the first year after the divorce.[125] Compared to their spouse, women of all social classes are likely to face economic hardship after divorce.[126] Conversely, after divorce, men have more disposable income prior to divorce even if required to make alimony or child support payments.[127] However, many divorced women do not receive alimony or child support.[128] Even in instances where alimony or child support is granted, typically, the payments barely provide for half of basic needs.[129] Divorced women are more likely to become poor and remain poor over a period of years than women who remain married.[130] Divorced women who work generally do not make enough to stay out of poverty.[131]

Both family law and tax law ignore the reality that spouses occupy disparate positions.[132] In today's tax code, there are no longer any sections referring to "husband and wife." Instead, such language is replaced with references to "payor and payee."[133] Gender bias in the tax code manifests in many ways.[134] Many of the disparities that materialize at divorce are byproducts of the inequalities that are perpetuated during marriage.

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[124] *Id.* at 157.
[125] Richard R. Peterson, Women, Work, and Divorce, 5-8 (1989).
[126] *Id.*
[127] *Id.*
[128] *Id.*
[129] *Id.*
[130] *Id.*
[131] Peterson *supra* note 125, at 5-8.
[132] Beverly I. Moran, *From Urinal to Manicure: Challenges to the Scholarship of Tax and Gender*, 15 Wis. Women's L.J. 221, 223-25 (2000).
[133] *Id.*
[134] *Id.*

The social security system is one example of inequality within marriage.[135] For two-earner couples, the higher earner sets the social security benefits.[136] As such, the lower earner's benefits are based on the higher-earning spouse.[137] Therefore, the working married woman, who is usually the lower earner, receives the same benefit as she would if she stayed at home and contributed nothing into the social security system.[138]

Another example is the marriage penalty and bonus.[139] The marriage penalty or bonus is the change in a couple's income tax liability as a result of marital status.[140] While the language is phrased in gender-neutral terms, the concept is far from gender neutral.[141] Generally, the rates benefit married couples where one spouse does not work or makes substantially less, usually working part-time.[142] Typically, the wife is the spouse who stays home or works part-time.[143] Moran observed,

> [i]f you have a married couple in which the wife doesn't work, that couple will pay lower taxes by virtue of being married. On the other hand, once the wife starts to work, there comes a point where the couple pays more in taxes than they would if they were both single.[144]

Not all married couples are affected by the penalty.[145] The marriage penalty affects married two wage earners who make nearly the same amount.[146] Thus, the rate structure penalizes women who are often the second wage earner.[147]

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[135] *Id*. at 223.
[136] *Id*.
[137] *Id*.
[138] *Id.* at 224.
[139] *Id*.
[140] *Id*.
[141] *Id*.
[142] *Id*.
[143] *Id.* at 224.
[144] *Id.*
[145] *Id.*
[146] *Id.*
[147] *Id.*

The tax code disproportionately encourages married women to leave the labor market.[148] Tax policies reinforce the gendered division of household labor.[149] Tax policy continues to have devastating consequences at divorce. The federal income tax code appears to be gender-neutral as there are no gender-specific provisions.[150] However, the tax code does not exist in a vacuum; it shapes behaviors and incentivizes economic choices and social norms.[151] One example where gender disparities manifest involves the notion of the secondary earner.[152] The tax structure incentivizes the secondary earner to remain home through a variety of tax policies that produce concepts.[153] In most cases, the secondary earner is the wife, which furthers cultural and social norms regarding the gender division of labor.[154] Furthermore, "[t]he tax code, operating in the context of such predominant gender-defined roles, reinforces and perpetuates these roles by creating incentives that reward behavior in conformity with the cultural norm and discourages behavior that would contravene the norm."[155] Thus, the tax code perpetuates the gendered division of labor within the household.[156] Many of the gender biases of the income tax system manifest in individual outcomes.[157] The tax structure disincentives' married women's participation in the labor force with the presence of components such as joint filing for married couples, the progressive rate system, the nontaxability of imputed income, and the structure of the social security tax.[158]

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[148] Michael A. Johnson, *A Gap in the Analysis: Income Tax and Gender-Based Wage Differentials*, 85 Geo. L.J. 2287, 2302-03 (1997).
[149] *Id*.
[150] *Id*. at 2294-95.
[151] *Id*.
[152] *Id*.
[153] *Id*.
[154] *Id*.
[155] *Id*. at 2294.
[156] *Id*.
[157] *Id*.
[158] *Id*.

Furthermore, tax and divorce law manifest gender bias by not recognizing and valuing work that takes place in the domestic sphere.[159] Typically, the labor that occurs in the home is devalued and categorized as imputed income.[160] Generally, during divorce, housework is assigned a lower economic value than wages earned in the labor market.[161] Steiner wrote "[a]nd if the woman works both in the marketplace and in the home, she is disadvantaged because usually only one of those contributions is considered at divorce."[162] Ultimately, women are hindered by the fact that they devote more time to housework and child rearing because this labor is not recognized by the law.[163]

III. REFORM

A. Past Reforms

Both divorce and tax law have undergone numerous reforms and modifications.[164] The most recent wave of divorce reform was the no-fault movement.[165] Prior to the implementation of no-fault divorce, a divorce could only be obtained through a showing of fault.[166] This was typically defined in terms of adultery, desertion, or extreme cruelty.[167] Under fault-based divorce, spouses had a number of defenses that could be pled, such as provocation.[168] Ultimately, a judge could hold both parties at fault or that the alleged act had not been proven, which meant the couple would remain married.[169]

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[159] Elizabeth Steiner, *Why Are Divorced Mothers Economically Disadvantaged? And What Can Be Done About It?,* 17 Tex. J. Women & L. 131, 138 (2007).
[160] Nancy Staudt*, Taxing Housework*, 84 Geo. L.J. 1571, 1624 (1996).
[161] Steiner, *supra* note 161, at 138.
[162] *Id.*
[163] *Id.*
[164] June R. Carbone and Margaret F. Brinig, *Rethinking Marriage: Feminist Ideology, Economic Change, and Divorce Reform*, 65 Tul. L. Rev. 953, 975-76 (1991).
[165] *Id*. at 976.
[166] *Id*.
[167] *Id*. at 975.
[168] Reva B. Siegel, *The Rule of Love: Wife Beating as Prerogative and Privacy*, 105 Yale L.J. 2117, 2133-34 (1996).
[169] *Id*.

California adopted the first no-fault divorce with the Family Law Act of 1969.[170] The Act allowed a proceeding for dissolution of marriage on the grounds of irreconcilable differences, which could be based on the declaration of one of the spouses.[171] However, as the concept of no-fault divorce spread, the idea was modified in several important respects from the California Family Law Act of 1969 and the Uniform Marriage and Divorce ("UMDA") Act, which abolished all fault-based grounds for divorce and installed pure no-fault law based on marriage breakdown.[172] Fourteen states and the District of Columbia use an incompatibility standard for no-fault ground.[173] Additionally, twenty-one states include a no-fault provision based either on California's Act or the Uniform Act, but do not replace fault.[174] Fifteen states permit pure no-fault divorce.[175]

Moreover, the provisions governing the financial aspects of divorce varied among states.[176] Eight states are community property states; forty-two states are common law states.[177] To resolve this difference, the final version of the 1973 UMDA called for an equitable distribution of all property.[178] The UMDA altered legal standards governing alimony to eliminate marital fault as a bar.[179] Again, states differed in their elimination of fault from financial considerations.[180] The no-fault divorce laws did not change the legal standards regarding child custody in any major way, as the best interests of the child standard was used by the UMDA and California.[181]

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[170] Herma Hill Kay, *Equality and Difference: A Perspective on No-Fault Divorce and Its Aftermath*, 56 U. Cin. L. Rev. 1, 4-14 (1987).
[171] *Id.*
[172] *Id.* at 5.
[173] *Id.*
[174] *Id.*
[175] *Id.*
[176] *Id.* at 5.
[177] *Id.* at 7-8.
[178] *Id.* at 9-10.
[179] *Id.* at 10-11.
[180] *Id.* at 11-12.
[181] *Id.* at 13.

Similar to divorce law, tax law has undergone many reforms. The consequences of reform are not always clear at the time of enactment because, in some instances, reform outcomes have unintended affects. This notion can be seen in the concept of the marriage penalty, as a number of marriage neutral reform provisions in the Tax Code led to devastating ramifications for certain married taxpayers. As such, identifying reforms that affect divorced taxpayers can be difficult. However, one such area is the treatment of alimony. "The treatment of alimony. . . ." demonstrates "how basic areas important to the computation of both gross income for the payee and taxable income for the payer" have changed.[182] Under the Revenue Act of 1942, alimony was included in the payee's income and deductible to the payer.[183] Prior to this, alimony was not deductible to the payor or included in the payee's income.[184] The change was to provide uniformity of treatment for taxpayers, despite varying state laws, and to shift the tax burden to the payee spouse in order to relieve the hardship created for payor spouses.[185]

Alternatively, tax law does not permit a deduction for child support payments or require child support payments to be included as income.[186] Moreover, there is no right to a deduction or requirement to include the amount as income when child support payments are not paid.[187] This notion is complicated further, as mothers are overwhelming awarded custody in the majority of custodial proceedings.[188] Deductibility and inclusion rules for unpaid child support would be plausible considering the general principles of basis in taxation.[189] If the tax code gave the custodial

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[182] Marjorie E. Kornhauser, *A Legislator Named Sue: Re-Imagining the Income Tax*, 5 J. Gender Race & Just. 289, 311 (2002).
[183] *Id.*
[184] *Id.*
[185] *Id.*
[186] William A. Klein, *Tax Effects of Nonpayment of Child Support*, 45 Tax L. Rev. 259, 278-79 (1990).
[187] *Id.* at 274.
[188] *Id.* at 275.
[189] *Id.*

parent a basis in the claim equal to the amount of the child support, then it would operate similar to rules for discharge of indebtedness for the non-custodial parent and a bad debt deduction for the custodial parent.[190]

Prior to 1984, tax law did not distinguish sales and exchanges between divorced taxpayers.[191] As such, the basic rule governing sales and exchanges of property dictated the transfer of property between divorced taxpayers as well.[192] Thus, a transfer of property, due to divorce, was a taxable event due to the relinquishment of a valuable marital property right.[193] Therefore, the transferor had to recognize gain or loss based on the difference between the basis and the fair market price of the property.[194]

However, in 1984, the Internal Revenue Code was amended and Code Section 1041 was introduced.[195] Code Section 1041 provides "no gain or loss shall be recognized on a transfer of property" outright or in trust between former spouses as an incident of divorce.[196] Accordingly, the transfer is not a taxable event.[197] The basis of the property at the time of the transfer is the transferor's adjusted basis, which carries over to the transferee and thus becomes the transferee's basis.[198] Therefore, the transferee does not pay income tax on the value of the property.[199] Even if the transfer was in exchange for the release of marital rights, assumption of liabilities, an arm's length transaction, or other consideration, no gain or loss is recognized.[200] This rule applies

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[190] *Id.*
[191] *See United States v. Davis*, 370 U.S. 65, 69 (1962).
[192] *Id.*
[193] *Id.*
[194] *Id.* at 72.
[195] *See* I.R.C. § 1041.
[196] *Id.* at (a)(2).
[197] *Id.* at (b).
[198] 26 C.F.R. § 1.1041-1T(d)A-11. Treas. Reg. § 1.1041-1T(d)A-11
[199] *Id.*
[200] 26 C.F.R. § 1.1031-IT, Q-10 1.1041-1T(a), Q&A 2; 1.1041-1T(d), Q&A 11. Treas. Reg. § 1.1031 (d) 1-(a). Treas. Reg. 1.1041-1T(a), Q&A 2; Treas. Reg. 1.1041-1T(d), Q&A 11.

regardless of whether the transfer is of property separately owned or a division of community property.[201]

B. Recommendations

Women, and in most instances children, have been the victims of the financial aspects of marital dissolution regarding divorce and tax laws. These disparities are a part of the larger discussion of equality between divorced women and men. Accordingly, I present the following two recommendations as reform options.

First, I recommend amending the tax code to allow alimony and child support payments to receive the same treatment for tax purposes. As such, alimony payments would no longer be deductible for the payor and included in the income of the payee. Because of this, alimony and child support payments would receive similar treatment under the tax code, which promotes uniformity and simplicity. However, the amendment would include a provision that would make unpaid child support and alimony payments includable in the income of the payor and deductible from the payee.

Although alimony and child support are not often awarded when payments are required, it is usually the wife who receives the payments. As such, when payments are not made women suffer financially and are forced to use other sources of income to account for the unpaid payments. Furthermore, this is compounded by the fact women and children are disproportionately at risk of being impoverished post-divorce. Thus, the deduction would at least provide a tax deduction that is a closer reflection of the financial reality when child support and alimony are unpaid. Under the current tax code, divorced men who fail to make payments benefit from the increased disposable income.

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[201] Treas. Reg. 1.1041-1T(d), Q&A 11.

Second, the tax code should recognize housework as imputed income by taxing it. Imputed income is the value that is obtained from owner-supplied resources, goods, services, or labor.[202] Generally, imputed income is difficult to measure because it constitutes an entire class of items that never materialize into a visible cash stream.[203] Thus, taxing imputed income would likely be complicated. Nevertheless, this would likely be a costly process and administrative nuisance. Imputed income is not taxed by the current taxation system in the United States, which is likely an administrative benefit due to the complexity of calculating the value of imputed income.[204] However, not taxing imputed income disincentivizes the second wage earners participation in the work force.[205]

In terms of divorced couples, when one spouse stays home and does not participate in the labor market, the services that the spouse provides equal an untaxed benefit in the form of imputed income.[206] Traditionally, the spouse who stays home or contributes domestic labor is most often the wife. As such, during divorce, the domestic investment of the wife is rarely acknowledged and often undervalued. Accordingly, the husband receives a substantial tax benefit in the divorce because the tax benefit bestowed by imputed income is essentially similar to receiving a discount of the taxpayers marginal tax rate.[207] During divorce, the wife is forced to compare after-tax labor market income with before-tax imputed earnings.[208] The effect of imputed income favors marriages with one wage earner.[209] This often leads to a division of labor based on gender.[210] Note

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[202] *See* Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983, 1002 (1993).
[203] *Id.*
[204] *Id.* at 1003.
[205] *Id.* at 1001-02.
[206] *Id.* at 1025-26
[207] *Id.*
[208] *Id.* at 1016.
[209] *Id.* at 1025.
[210] *Id.* at 1029.

the irony: the more the husband is taxed, the more we "pay" the wife to stay home and, perhaps, the more the man works to compensate for the loss due to taxes.[211]

IV. CONCLUSION

These recommendations demonstrate that tax and divorce law may not be the best mechanisms for addressing the tax consequences of divorce. Ultimately, the disparities that exist are due to the gender roles that men and women occupy in society. Undoubtedly, tax and divorce law do not create these unequal positions, however, the laws perpetuate the gender division of labor. Accordingly, to truly eliminate gender injustice, normative gender roles must be challenged, and societal norms must undergo a massive overhaul. Otherwise, reform recommendations will continue to be the lesser of two evils.

Divorce proceedings are stressful and time consuming. This is further compounded by the tax implications that can accompany a divorce. The existence of federal and state laws affecting divorce and taxation present a challenge for practitioners, former spouses, and reformers. Leaving the current laws in place intensifies disparities and furthers gender discrimination. There are class dimensions as well. Lower income couples are more likely to get divorced.[212] Conversely, divorce rate of couples in higher income brackets has been progressively decreasing.[213] Furthermore, taxpayers in the lower income brackets are less likely to be able to afford quality representation in divorce proceedings. Ultimately, the combination of gender and class bias can lead to many women living in difficult conditions after divorce.

[211] *Id.* at 1034.
[212] *See* Simon Burgess, Carol Propper, and Arnstein Aassve, *The role of income in marriage and divorce transitions among young Americans*, Journal of Population Economics, 455-75 (2003).
[213] *Id.*

In the United States, women initiate most divorce proceedings.[214] In the United States, a couple marrying for the first time has a 40 percent risk of divorce.[215] The tax consequences of divorce are still a reality for many. Gender discrimination is prevalent within this context, as the second or lower wage earner in a marriage disproportionally tends to be women.[216] Additionally, divorce taxation reinforces existing wage discrimination against women. Often, the consequences of divorce are considered separately from the tax code. The economic reality and societal conditions faced by couples are often influenced by gender norms. The current solutions are unable to fully resolve the issues that arise at the intersection of taxation and divorce because a viable resolution requires the inclusion of both tax and divorce consideration. To reconcile the unjust and discriminatory effects that divorce taxation can have, the considerations must include not only the tax code and divorce law, but public policy, feminism, civil rights, sociology, and normative theory. A methodological challenge in the conceptualization of taxation and divorce is necessary. The complexity of the issue must be examined with regard to the societal institutions and normative messages in addition to the jurisdictional and economic principles that exist.

I have presented two recommendations to resolve the tax consequences of divorce. However, the recommendations only partially alleviate the injustice because the resulting change does not combat the societal factors that have been fundamental in creating the underlying problem that leads to the gendered consequences of divorce taxation. While the gendered implications of divorce taxation may be a consequence of the tax code and current divorce law, neither will be enough to provide a truly equitable and just solution.

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[214] Brinig, Margaret and Douglas W. Allen, *These Boots Are Made for Walking: Why Most Divorce Filers are Women*, American Law and Economics Review 2 (1), 126-129 (2000).
[215] Divorce Source, *U.S. Divorce Rates and Statistics*, (Apr. 7, 2016, 11:26 AM) http://www.divorcesource.com/ds/main/u-s-divorce-rates-and-statistics-1037.shtml.
[216] Karine Moe, *Women, Family, and Work: Writings on the Economics of Gender*, 36 (2008).

More literature discussing the tax consequences of divorce is still needed. While the materials that exist cover the topics of alimony, child support, property distribution, exemptions and deductions, and other significant concepts, the majority of the narrative fails to acknowledge the disparities that exist among divorced men and women. Although injustices concerning the tax code as well as family law and divorce do exist, often these narratives exist separately. A critical analysis of both divorce and tax law through the lens of gender and privilege is needed.