Tax Implications of Divorce and Separation

The course begins by addressing the complex tax issues faced by individuals who are divorced or separated. It acknowledges the potential for conflicts of interest that tax professionals may encounter when dealing with clients in these situations.

The course discusses the various filing statuses available to divorced or separated individuals and how to properly handle dependents on their tax returns. These decisions can significantly impact their tax liability.

The course delves into payments like alimony and property transfers that often occur during divorces. It explains how these financial transactions should be treated on tax returns, as the tax treatment of alimony, for example, has changed due to the Tax Cuts and Jobs Act of 2017.

The course includes practical examples of different scenarios that divorced or separated individuals may encounter, such as alimony, child support, court-ordered payments, property settlements, and transfers of individual retirement arrangements. These examples help learners understand the application of tax rules in real-life situations.

It discusses the concepts of injured spouse and innocent spouse relief, which can be important for individuals who are dealing with the tax implications of a divorce or separation.

The course explains special rules that apply to individuals residing in community property states. Community property states have unique tax considerations for married couples who are divorcing.

Overall, this course aims to equip tax professionals to assist individuals going through divorce or separation with a comprehensive understanding of the tax implications and strategies related to their situations, taking into account both the Tax Law for 2018 and the changes introduced by the Tax Cuts and Jobs Act of 2017.

This course was based on the Internal Revenue Code (referenced throughout)

CPE 2 Federal

IRS Course XYCW6-T-00061-23 S   CTEC 6203-CE-1254

Updated 2023

Introduction: The course begins by addressing the complex tax issues faced by individuals who are divorced or separated. It acknowledges the potential for conflicts of interest that tax professionals may encounter when dealing with clients in these situations.

Filing Status and Dependents: Part one of the course discusses the various filing statuses available to divorced or separated individuals and how to properly handle dependents on their tax returns. These decisions can significantly impact their tax liability.

Alimony and Property Transfers: The course delves into payments like alimony and property transfers that often occur during divorces. It explains how these financial transactions should be treated on tax returns, as the tax treatment of alimony, for example, has changed due to the Tax Cuts and Jobs Act of 2017.

Scenarios and Examples: The course includes practical examples of different scenarios that divorced or separated individuals may encounter, such as alimony, child support, court-ordered payments, property settlements, and transfers of individual retirement arrangements. These examples help learners understand the application of tax rules in real-life situations.

Deductions and Tax Withholding: The course covers deductions that may be allowed for certain costs associated with obtaining a divorce. It also provides guidance on how to handle tax withholding and estimated tax payments to ensure compliance with tax laws.

Injured Spouse and Innocent Spouse Relief: It discusses the concepts of injured spouse and innocent spouse relief, which can be important for individuals who are dealing with the tax implications of a divorce or separation.

Community Property States: The course explains special rules that apply to individuals residing in community property states. Community property states have unique tax considerations for married couples who are divorcing.

Quiz and Final Exam: The course includes a quiz to test the learners' understanding of the material covered. After successfully completing the quiz, learners proceed to a final exam, which likely assesses their overall knowledge of the course content.

Overall, this course aims to equip tax professionals to assist individuals going through divorce or separation with a comprehensive understanding of the tax implications and strategies related to their situations, considering both the Tax Law for 2018 and the changes introduced by the Tax Cuts and Jobs Act of 2017.

Tax Implications of Divorce and Separation

Conflict of Interest Circular 230 section 10.29

We need to consider the possibility of a conflict of interest that may arise when our current clients undergo separation or divorce during the year. We must determine whether there is a potential conflict that necessitates a decision to represent only one client or to inform them that we can no longer represent either party.

If the client or clients have been our clients in the past, we should assess whether a conflict of interest currently exists or might arise in the future. Here are some key questions to consider:

1. Does preparing the tax return for one client compromise our ability to maintain objectivity and fairness to both clients?

2. Does preparing the tax return materially restrict our responsibilities to the other client?

3. Would a neutral third party agree that a conflict is likely?

When there is a potential for a conflict, it is essential to have all parties involved sign a written waiver acknowledging the potential conflict. This waiver should be retained for a minimum of 36 months.

For example, if we have been preparing tax returns for a couple like Zach and Carrie for several years, and they have no children, rent their home, and have no joint assets, it may be possible to continue representing both clients. However, we must disclose to both clients the potential for a conflict of interest and assure them that it won't impact our ability to prepare their separate returns. Both clients should sign a conflict of interest waiver, which we will keep in our records for 36 months. Additionally, we should inform them that if an unforeseen conflict arises, we will promptly notify each of them and may have to terminate our relationship with one or both clients."

Let's consider a scenario where you are a tax professional, and you have two clients, Paul and Bev. Paul and Bev are a married couple with three children. They are purchasing their new home and also own a rental property. Both Paul and Bev have contacted you individually, requesting that you prepare their separate tax returns.

In this situation, the safest course of action may be to refrain from preparing either of their tax returns. The reason for this caution is that by preparing only Bev's tax return without considering Paul's financial information, you could potentially encounter a conflict of interest.

If you decide to represent Bev exclusively, it's essential to take certain steps to address this potential conflict. One crucial step is to obtain written consent from both Paul and Bev. This consent form should clearly state that you intend to represent Bev in the tax preparation process and should be kept on record for a minimum of 36 months.

By obtaining written consent from both parties, you can demonstrate transparency and professionalism in managing this potential conflict of interest while ensuring compliance with ethical and legal guidelines in the tax preparation industry."

Spousal Conflict Waiver(Sample)

Client Names: ____ ____ ________________

(Hereinafter referred to as "Client")

Tax Practitioner:____ ____ ________________

(Hereinafter referred to as "Tax Office name")

Potential Conflict of Interest

In the past, "Tax Office Name" has been engaged by both spouses to prepare your individual tax returns as well as advise and consult on other tax-related matters. You have both requested that "Tax Office name" continues to provide these services to both of you, despite the fact that the two of you are in the process of divorcing or are divorced.

A potential conflict of interest inherently exists due to the (pending) dissolution of your marriage. In preparing the tax returns for each of you, there may be situations in which one party will be benefited and the other will be negatively affected. If All Seasons becomes aware of such, situations, "Tax Office name" will disclose the consequences of such tax strategies to both of you and it will be up to you both to agree in writing how to proceed. If no agreement can be reached between, then All Seasons can no longer provide services to both parties and will have to disengage.

Privacy and Privilege

In compliance with the provisions of the Gramm-Leach-Bliley Act of 1999, Client is hereby informed that "Tax Office Name" does not disclose any nonpublic personal information about current or former clients to anyone, except as instructed to do so by such Client. "Tax office name" restricts access to nonpublic personal information to those professionals who may assist in the preparation of Client's return or provide tax advisory and bookkeeping services. "Tax Office Name" maintains physical, electronic and procedural safeguards to protect Client's nonpublic personal information.

"Tax Office Name" is generally not authorized to disclose tax return information for purposes other than the preparation and filing of the tax return, however "Tax Office Name" may disclose tax return information to third parties with Client consent, "Tax Office Name" has no control over what that third party does with the information. If the third party uses or discloses the information for purposes other than the purpose for which Client authorized the disclosure, "Tax Office Name" is not responsible for that subsequent use or disclosure under federal tax law and Client may not be protected from that disclosure.

Clients have been informed that privilege – however limited – may be waived when communicating with the "Tax Office Name" in the presence of third parties.

Client Acknowledgement

Clients' signatures below are acknowledgement that you both understand and waive any conflict of interest as described above, feel free to review this issue with your legal counsel before signing this waiver.

Client Signature: ____ Date: ________________________

Print Clients Name: ____ Date: ________________________

(EX)-Spouse Signature: ____ Date: ________________________

Print Clients Name: ____ Date: ________________________

Understanding Tax Filing Status 26 IRC § 7703(a)

Filing status is a critical factor in determining the need to file a tax return, the standard deduction you're eligible for, and the precise amount of tax you owe. It also influences your eligibility for specific tax deductions and credits. Your choice of filing status is influenced by your marital status on the last day of the tax year, among other factors such as dependents and widow(er) status. In cases of marital separation, making the right choice regarding filing status becomes paramount.

Key Concepts Covered:

1. Determining Marital Status:

- Marital status for tax purposes is determined as of the end of the taxable year.
- In the unfortunate event of a spouse's passing, the determination is based on the time of their death.

2. Legal Separation:

- Individuals who are legally separated from their spouses through divorce or separate maintenance are not considered married for tax purposes.

3. Impact of Filing Status:

- Filing status affects whether you must file a tax return.
- It influences the standard deduction you can claim.
- Your filing status determines your tax liability.
- Certain deductions and credits are dependent on your chosen filing status.

4. Special Consideration: Head of Household:

- Taxpayers with qualifying dependents may be eligible to use the Head of Household filing status.

5. Marital Changes During the Year:

- In cases where couples separate during the year, it's crucial to ask the right questions to determine the most advantageous filing status.

Learning Objectives: Upon completing this module, you will:

- Understand the significance of tax filing status in relation to your tax return.

- Be able to determine your correct filing status based on your marital and living situation.
- Comprehend the impact of filing status on tax obligations, deductions, and credits.
- Recognize the special considerations for taxpayers with dependents.

Marital status: According to Federal tax law, individuals are considered married if they were lawfully married in a state or foreign country whose laws authorize the marriage of the two individuals. Federal law does not recognize registered domestic partners, civil unions or any other similar relationship that is not considered a legal marriage. In 2013, The US Department of Treasury and The Internal Revenue Service ruled that same-sex legally married couples will be treated as married couples for federal tax purposes. They did not apply this ruling to registered domestic partners, civil unions or any other formal relationship recognized under state law. Same sex legally married couples must follow the same rules given to opposite sex legally married couples. If unmarried, the default filing status is single, if certain requirements are met, filing status may be head of household or qualifying widower. If married, filing status is either married filing a joint return or married filing a separate return. If conditions are met a married person may be able claim the head of household filing status.

Marital Status and Federal Tax Law

Definition of Marital Status: According to Federal tax law in the United States, an individual's marital status is determined by their legal marriage in a state or foreign country that authorizes such marriages. Federal law does not recognize registered domestic partnerships, civil unions, or similar relationships as equivalent to legal marriage.

Same-Sex Marriage Recognition: In a significant development in 2013, the US Department of Treasury and the Internal Revenue Service (IRS) established that legally married same-sex couples would be treated as married couples for federal tax purposes. However, this recognition was not extended to registered domestic partnerships, civil unions, or other formal relationships recognized under state law. This ruling meant that same-sex legally married couples would follow the same tax rules as opposite-sex legally married couples.

Filing Status Options:

1. **Single:** If an individual is not legally married, their default filing status is "single" for federal tax purposes.
2. **Head of Household:** Under certain circumstances and if specific requirements are met, an individual who is unmarried may qualify for the "head of household" filing status. This status typically applies to individuals who are the primary financial providers for their household and meet certain criteria, such as having a dependent.
3. **Qualifying Widow(er):** If a taxpayer's spouse passes away during the tax year, they may be eligible to use the "qualifying widow(er)" filing status for the two years following the spouse's death, provided they meet certain conditions.
4. **Married Filing Jointly:** If an individual is legally married and wishes to file their federal tax return jointly with their spouse, they can choose the "married filing jointly" status. This status often provides certain tax benefits.
5. **Married Filing Separately:** Alternatively, if married individuals choose not to file jointly, they can opt for the "married filing separately" status. This filing status has its own tax implications and may be chosen based on individual circumstances.

Head of Household for Married Individuals: In some cases, even if an individual is legally married, they may meet specific requirements that allow them to claim the "head of household" filing status. These requirements typically involve living apart from their spouse for a significant portion of the tax year and providing financial support for a dependent.

Understanding marital status and choosing the appropriate filing status is crucial when preparing a federal tax return. It can significantly impact tax liability and any potential eligible tax credits or deductions.

Unmarried persons

A person is unmarried if either of the following applies:

1. There is a final decree of divorce or separate maintenance by the last date of the tax year. The laws of each state are used to determine if divorced or legally separated.
2. A decree of annulment If obtained, a decree of annulment holds that no valid marriage ever existed. When there is an annulment, we must file amended tax returns for all years affected by the annulment that are not closed by the statute of limitations (Usually 3 years from the due date of the return). On the amended tax return you change the filing status to single or head of household, whichever status applies.

Exception: A divorce that is obtained for the sole purpose of filing tax returns as unmarried individuals and at the time of the divorce, they intend to remarry and do so in the next year must file as married individuals.

> The court case of Boyter v Commissioner of Internal Revenue Service in 1981 is an example of getting divorced and remarried. The couple traveled to Haiti in December 1975 got a legal divorce, and then remarried early in 1976. They did the same thing in 1976. They filed their tax returns as single taxpayers for both years. The Internal Revenue applied the sham transaction doctrine. The sham transaction doctrine can invalidate a supposedly legal transaction if the transaction has no economic substance other than tax purposes.

The filing status available to unmarried taxpayers is qualifying widower, single, and head of household.

Married persons

For tax purposes, an individual is considered married for the entire tax year, even if they are living separately without a final decree of divorce or separate maintenance by the last day of the tax year. It's important to note that an interlocutory decree, which is a temporary court order pending the final decree, does not count as a final decree for tax purposes.

Exception to Marital Status Rule

There is an exception to the standard marital status rule. If a taxpayer has lived apart from their spouse for the last six months of the tax year and meets certain qualifications, they may be eligible to file as the head of household.

Illustration with an Example

To illustrate this exception, consider the case of Ally and Ben. They were married but separated on July 3rd, and they had two children. Following the separation, the children primarily resided with Ally, while Ben had weekend visitations. In terms of their tax filing options, they could choose to file jointly as a married couple or separately. However, it's important to note that neither of them would qualify for the head of household status in this scenario because they continued to live together for the last six months of the year.

Now, had their separation occurred before the end of June, the situation would have been different. In such a case, Ally would have met the criteria for the head of household filing status, while Ben would have filed separately as a married individual. This would have been possible because Ally had physical custody of the children for more than six months during the year.

Married Filing Jointly under IRC 26 §601

The status of "Married Filing Jointly" (MFJ) is an election made on a tax return. A married taxpayer chooses this status by indicating "MFJ" on the tax return. Once this election is made, it cannot be changed to "Married Filing Separately" (MFS) after the due date of the return. When you file a joint return, you must include all income, exemptions, deductions, and credits for both spouses on that return. It's important to note that a joint return can be filed even if only one spouse has income or deductions.

In cases where both spouses have income, it may be beneficial to calculate the tax for both joint and separate returns to determine which option results in a lower combined tax liability.

Furthermore, if a divorce is pending, it's our responsibility to conduct due diligence and inform our clients that they will be jointly and individually liable for any tax, interest, and penalties associated with a joint return.

Filing a Joint Return with a Nonresident Alien

To file a joint tax return, it is necessary for at least one taxpayer to be a U.S. citizen or a resident alien as of the end of the tax year. If either the taxpayer or their spouse was a nonresident alien at any point during the tax year, a joint return can still be filed if the nonresident spouse is treated as a resident of the United States for tax purposes.

For a taxpayer who wishes to file a joint return with a nonresident alien spouse, they must obtain an ITIN (Individual Taxpayer Identification Number) for the nonresident spouse. The application for an ITIN can be submitted using Form W-7.

It's important to note that filing a joint return with a nonresident alien spouse means that the combined worldwide income of both individuals becomes subject to U.S. taxation. However, if a taxpayer chooses not to file jointly with a nonresident spouse, they have the option to file separately as "Married Filing Separately," or if they meet certain qualifications, they may be eligible to file as "Head of Household."

.

Tax Liability for Divorced Taxpayers

Divorced taxpayers who have previously filed a joint tax return share both joint and individual responsibility for any taxes owed, penalties, and accrued interest on that specific return. This responsibility persists even if the divorce decree stipulates that only one of the former spouses will be accountable for the tax liabilities associated with previously filed returns. It's important to note that federal law governs tax returns, while state law dictates divorce settlements.

The IRS possesses the authority to capture any tax refunds and pursue collections from both ex-spouses until the outstanding tax debt is fully settled. If a spouse who was released from tax responsibility in the divorce ends up having their funds utilized by the IRS to pay off the joint tax debt, their recourse typically involves revisiting state court proceedings, unless they meet the qualifications for one of the relief provisions outlined below.

Section 6015 of the Internal Revenue Code (IRC) - Relief from Joint and Several Tax Liability on Joint Returns

Under certain circumstances, a spouse may be granted relief from the tax liability, associated penalties, and interest on a joint tax return. This relief is accessible regardless of the size of the tax owed.

There are three types of relief available:

1. Innocent Spouse Relief: To seek innocent spouse relief, a taxpayer should submit Form 8857, accompanied by a statement explaining the grounds for requesting innocent spouse relief. To qualify for innocent spouse relief, the following conditions must be met:
a. A joint tax return must have been filed.

b. The joint return must contain an understatement of tax owed, which could result from factors like underreported income, overstated deductions, incorrect basis, or any other element leading to an inaccurate tax return.

c. The taxpayer seeking relief must demonstrate that they neither knew nor had any reason to know about the inaccuracies when they signed the return. Providing evidence of their lack of knowledge is essential.

d. After considering all relevant facts and circumstances, it must be deemed unfair to hold the taxpayer liable for the tax liability.

This process allows eligible taxpayers to request relief when they were unaware of errors or inaccuracies on a joint return that they signed, ensuring a fair assessment of their tax liability.

2. Separation of Liability The concept of separation of liability pertains to joint filers who fall into categories such as divorce, widowhood, legal separation, or those who have not resided together for a continuous 12-month period ending on the date they file for this relief. To apply for separation of liability relief, individuals should submit Form 8857. This relief divides the underpayment of tax between each spouse separately. To qualify for separation of liability relief, the following conditions must be met:

1. **Taxpayer Status:** The taxpayer is either unmarried or legally separated.
2. **Residence Separation:** The taxpayer and their spouse did not reside in the same household at any point during the twelve-month period leading up to the application for relief.

This relief option allows taxpayers in these specific situations to allocate the underpayment of tax individually, ensuring a fair distribution of tax responsibilities.

3. Equitable Relief

Unlike innocent spouse relief, individuals can apply for equitable relief to address either an understatement of tax or an underpayment of tax. To initiate a request for equitable relief, one should complete Form 8857. In 2014, the IRS announced the removal of the two-year time limit for equitable relief requests. Prior to this change, taxpayers had to apply for relief within two years from the time the IRS first attempted to collect the tax. If an individual's equitable relief request was previously denied solely because of the two-year limit, they have the option to re-apply.

To qualify for equitable relief, the taxpayer must meet the following criteria:

1. Tax Deficiency: There must be an understatement of tax or unpaid tax.

2. Fairness Consideration: Considering all the relevant facts and circumstances, it must be deemed unfair to hold the individual liable for the tax.

It's important to note that equitable relief is the only available option for addressing unpaid taxes.

When seeking innocent spouse relief, it's crucial to request the correct type of relief initially. If innocent spouse relief is denied, it's unlikely that a request for those years will be reconsidered.

Married individuals residing in community property states who do not file joint returns may also be eligible for relief from liability related to community property laws. Tax refunds can be applied to a spouse's outstanding debts, including federal tax, state income tax, child support, or spousal support. Federal tax refunds may also be used to offset non-tax debt, such as student loans. In cases where one spouse on a joint return qualifies as an injured spouse, they can apply for an allocation of the refund, and the IRS will assess whether any portion of the refund should be directed to the injured spouse.

Injured Spouse

An injured spouse is a spouse who is filing a joint tax return and whose portion or the entire share of their tax overpayment has already been applied to or is anticipated to be applied to the outstanding debt of the other spouse.

To qualify as an injured spouse, the individual must meet the following criteria:

- **Tax Payments:** The injured spouse must have made and reported tax payments, such as federal income tax withheld from their wages or estimated tax payments. Additionally, they may have claimed refundable tax credits, like the earned income credit or additional child tax credit, on a joint return.
- **Not Legally Obligated:** Importantly, the injured spouse must not be legally obligated to pay the past-due amount of the other spouse's debt.

Being recognized as an injured spouse helps protect the taxpayer's share of the overpayment from being used to offset their spouse's past-due debts

Married Filing Separately

When a taxpayer and their spouse opt to file separate tax returns, each individual must report their own income, exemptions, deductions, and credits on their respective tax returns. It's important to note that a married taxpayer can choose to file a separate return even if they are the only spouse with income.

Taxpayers who reside in community property states and decide to file separate returns are required to allocate income between separate income and community income in accordance with the laws of their state of residence. In the case of married taxpayers filing separately, each spouse is solely responsible for the tax on their individual returns.

When married taxpayers file separate returns and one spouse itemizes deductions, the other spouse is also required to itemize deductions. When dividing itemized deductions, certain deductions that were paid from a joint checking account can be claimed on either return, regardless of which spouse made the payment. For instance:

- Medical Expenses: Each spouse can claim half of the total medical expenses paid from a joint account, in addition to any expenses paid separately.

  This approach ensures that married individuals who choose to file separately account for their own financial circumstances while adhering to applicable tax laws and regulations.

State Income Tax

1. You can claim all the state income tax paid from a separately filed return.

2. You can also claim all the state income tax paid separately from a jointly-filed return.

3. When dividing state income tax payments, claim the smaller of the state income tax paid separately or the total state tax paid. Then, divide this amount by each taxpayer's percentage of gross income.

Please note that for the tax year 2018, the Tax Cuts and Jobs Act (TCJA) of 2017 imposes a limit of $10,000 on the total amount of taxes that can be deducted. All the rules mentioned above still apply, but they must be within the new limits set by the TCJA.

Property Tax

1. Claim any property tax paid separately.

2. Divide the property tax paid from a joint bank account in any manner, as long as it does not exceed the total amount paid.

It's important to note that for tax years 2018 through 2025, property tax and state income tax are combined for the $10,000 limit.

Mortgage Interest

1. Claim the mortgage interest paid separately.

2. Divide the mortgage interest paid from a joint bank account in any way, as long as it does not exceed the total amount paid.

These guidelines help individuals manage deductions for state income tax, property tax, and mortgage interest, ensuring compliance with tax laws and the TCJA limits where applicable.

Disadvantages of Married Filing Separately (MFS) Tax Returns

Married couples who choose to file separate tax returns (MFS) should be aware of several disadvantages associated with this filing status:

1. Higher Tax Rates: Generally, the tax rates for MFS are higher. Starting in 2018, the first five tax brackets for singles are half the size of those for married individuals.

2. Dependent Care Credit: The dependent care credit is not available to MFS filers.

3. Higher Education Credits: MFS filers cannot claim higher education credits.

4. Earned Income Credit: The earned income credit, often beneficial for lower-income individuals, is not available to MFS filers.

5. Exclusion for Savings Bond Interest: MFS filers cannot exclude or claim a credit for the interest earned from qualified savings bonds used for higher education.

6. Adoption Expenses Deduction or Credit: Typically, the deduction or credit for adoption expenses is not available to MFS filers.

7. Alternative Minimum Tax (AMT): The exemption amount for AMT is half of what is allowed on a joint return, potentially subjecting more income to the AMT.

8. Income Limitations: Income limits for various tax benefits such as the child tax credit, retirement savings credit, itemized deductions, and personal exemptions are reduced by half compared to what is allowed on a joint return.

9. Capital Loss Deduction Limit: MFS filers can only deduct up to $1,500 in capital losses.

10. Standard Deduction: The standard deduction for MFS is half of what is allowed on a joint return.

Additional Disadvantages for Married Couples Living Together During the Year

If a married couple chooses to live together during the tax year while filing separately, they should also consider the following additional disadvantages:

1. Loss of Credit for the Elderly and Disabled: The credit for the elderly and disabled is not available to MFS couples.

2. Social Security and Retirement Benefits Inclusion: Up to 85% of Social Security or railroad retirement benefits may be included in income for MFS couples, potentially increasing their taxable income.

Changing from Separate Returns to a Joint Return (26 IRC § 6013(b)(1))

If an individual has previously filed a separate tax return for a specific tax year when they could have instead filed a joint return, they typically have the option to amend and file a joint return within a window of three years from the due date of the original return, excluding any extensions. This option is available regardless of whether the original return was filed under the status of married filing separately, single, or head of household.

Filing Separate Returns After a Joint Return (Exception Included)

Once the due date of the return has passed, taxpayers and their spouses are generally not allowed to file separate returns if they had previously filed a joint return together. However, there is an exception:

- Exception: In cases where a joint return was originally elected by the surviving spouse for a decedent, a personal representative for the decedent has the authority to change the return from a joint return to a separate return for the decedent. This change can be made within one year from the due date of the return, including extensions.

Head of Household Filing Status (26 IRC § 7703(b))

Filing as the head of household offers several advantages compared to filing as married filing separately (MFS):

- A taxpayer can claim the standard deduction even if their spouse files a separate return and itemizes deductions.
- The standard deduction is higher for the head of household filing status.
- Generally, the tax rate for the head of household is lower than that for married filing separately.
- Head of household status allows access to certain tax credits like the dependent care credit and the earned income credit, which are not available on a married filing separate return. Additionally, income limits for credits such as the child tax credit and retirement savings contributions credit are higher for head-of-household filers.

To qualify as head of household, a taxpayer must meet the following requirements:

- The taxpayer is unmarried or considered unmarried on the last day of the year.
- The taxpayer has paid more than half the cost of maintaining their home for the year.
- The taxpayer has a qualifying person who lived with them in the home for more than half the year. If the qualifying person is a dependent parent, they do not necessarily have to live with the taxpayer.

Even though the Tax Cuts and Jobs Act (TCJA) of 2017 eliminated the exemption for dependents, the same criteria will still be used moving forward to determine filing status, child care credit, child tax credit, and other related tax benefits.

Considered Unmarried (26 IRC §7703(b))

A taxpayer may be deemed as "considered unmarried" for tax purposes if, on the final day of the tax year, they meet all of the following criteria:

1. Filing a Separate Return: The taxpayer must file a separate return. This encompasses various filing statuses, such as married filing separately, single, or head of household.

2. Cost of Maintaining the Home: The taxpayer should have covered more than half of the expenses associated with maintaining their home for the entire tax year.

3. Spouse's Residence: During the last six months of the tax year, the taxpayer's spouse must not have resided in the home. It's important to note that a spouse is considered to have lived in the home if their absence was only temporary.

4. Child's Main Home: The taxpayer's home must have been the primary residence of their child, stepchild, or foster child for over half of the year.

Special rules apply when calculating income and expenses if the taxpayer is living in a community property state. In such cases, it's necessary to adhere to the state's community property rules for determining the division of income and expenses.

Nonresident Alien Spouse (26 IRC § 2(b)(2)(B))

If one spouse was classified as a nonresident alien at any point during the tax year, and the taxpayer has decided not to classify the spouse as a resident alien, they are treated as "unmarried" for the purposes of filing as head of household.

In this scenario, the nonresident alien spouse does not qualify as a qualifying person for head of household filing status. To file as head of household, there must be another qualifying person, and all other requirements for this filing status must be met.

Maintaining a Home

To qualify for certain tax benefits, including the head of household filing status, it's crucial for the taxpayer to cover at least half the cost of maintaining their home throughout the year. This encompasses various expenses such as rent, mortgage interest, real estate taxes, insurance, repairs, utilities, and the cost of food consumed within the home. However, expenses related to clothing, education, medical care, vacations, life insurance, or transportation are not considered when calculating the cost of maintaining a home.

With careful planning, it is possible for two individuals, each with children and sharing the same residence, to each qualify as head of household. However, specific conditions must be met:

- **Separate Living Areas:** The house must have distinct adult living areas along with shared common areas for all household members.
- **Principal Home:** The house must serve as the principal home for one or more qualifying individuals, and each person must demonstrate that they have covered over half the cost of their respective portion of the residence. There's no requirement to prove payment for more than half the cost of the entire home.
- **Independence in Non-Household Matters:** Each family living in the shared residence must operate independently in non-household matters, including maintaining separate items like phones and car insurance.

The key to allowing two individuals to each file as head of household when residing in a single residence is substantiating the existence of two distinct families. This scenario typically does not apply to unmarried couples, even if they have children together.

It's important to note that Chief Counsel Memorandum SCA 198-041 provides further support for these rules and guidelines.

Qualifying Person (26 IRC §2(b)(1), 26 IRC §152(c), 26 IRC §152(e))

For tax purposes, an individual is considered a qualifying person if they meet the following criteria:

1. Qualifying Child: If the person is the taxpayer's qualifying child, such as a son, daughter, or grandchild, and they lived with the taxpayer for more than half of the year, and they are single, then they qualify as a qualifying person.

2. Qualifying Child Who Is Married: If the person is the taxpayer's qualifying child, such as a son, daughter, or grandchild, and they are married but still qualify as a dependent, a parent can use them to qualify for the head of household filing status. The parent doesn't need to live with the taxpayer, but the taxpayer must pay more than half the cost of maintaining the home that was the main home for the parent.

3. Qualifying Relative (Other Than Mother or Father): If the person is the taxpayer's qualifying relative, such as a brother, sister, or grandparent, and they lived with the taxpayer for more than half of the year, they qualify as a qualifying person.

4. Qualifying Relative Who Did Not Live with the Taxpayer: If the person is the taxpayer's qualifying relative but did not live with the taxpayer for more than half of the year, they do not qualify as a qualifying person.

5. Non-Related Qualifying Relative: If the person is the taxpayer's qualifying relative, is not related to the taxpayer, and only qualifies as a qualifying relative because they lived with the taxpayer throughout the entire year as a member of the taxpayer's household, they are not considered a qualifying person.

Additionally,a taxpayer can still qualify for the head of household filing status if the individual who qualifies them is born or dies during the year. The taxpayer must have paid more than half the cost of maintaining the home during the period in which the individual lived.

For example: If Sam is unmarried and his mother, June, lived in her own apartment until her death on August 17, and Sam paid more than half of the cost of maintaining her apartment until her death, then Sam can file as head of household for that tax year.

Temporary Absences

A taxpayer can still claim head of household status even if a qualifying person has temporarily left the household due to special circumstances, such as illness, education, business travel, vacation, or military service. These temporary absences do not disqualify the taxpayer from claiming head of household status.

Kidnapped Child and Head of Household Filing Status

A taxpayer can still claim head of household filing status if they have a kidnapped child, provided that the following conditions are met:

1. The child must be legally presumed to have been kidnapped by someone who is not a member of the child's family, as determined by law enforcement.

2. In the year of the kidnapping, the child must have lived with the taxpayer for more than half of the year.

3. The taxpayer would have qualified for head of household filing status had the child not been kidnapped.

This special treatment applies for all years until the child is returned. The last year in which the taxpayer can file as head of household for this child is the year in which the child would have turned 18, or if there is a determination that the child is deceased.

Quiz 1. Divorced or Separated Individuals

1. Taxpayer is not married on the last day of the year. Which of the following filing statuses is NOT available for the taxpayer to use?

a. Qualifying widower

b. Single

c. Married filing separate

d. Head of household

2. The taxpayer has gone through a divorce. Which if the following statements is accurate regarding their tax responsibilities?

a. The taxpayer is jointly and individually responsible for any tax, interest, and penalties due on a previously filed joint return.

b. Taxpayer is relieved from responsibility if the divorce Decree states that the former spouse will be responsible for any amounts due on previously filed returns.

c. Taxpayer can amend a previously filed return to married filing separately to avoid responsibility.

d. None of the above.

3. Disadvantages of filing married filing separate returns include all of the following except:

a. Capital loss deduction is limited to $1500 instead of 3000.

b. Earned income tax credit is not available.

c. Child and dependent care credit is not available.

d. The child tax credit is not allowed

4. Married taxpayers may qualify to file as head of household if they meet which of the following requirements:

a. A joint return was not filed.

b. Taxpayer paid more than half the cost of keeping up a home all year.

c. The qualifying person lived in the home for more than half the year or a qualifying person was a parent.

d. All of the above.

5. To qualify as "considered unmarried" for tax purposes, a taxpayer must meet specific criteria. Which of the following is NOT one of those criteria?

a. Filing a separate return

b. Paying more than half of the expenses associated with maintaining the home for the entire year

c. Their spouse must not have resided in the home during the last six months of the tax year

d. Having a qualifying child living in the home for the full year.

Dependents Exemptions (26 IRC §151 and 26 IRC §152)

Section 11041 of the Tax Cuts and Jobs Act (TCJA) of 2017 introduced significant changes to the rules regarding exemptions for taxable years 2018 through 2025. Specifically, it amended Subsection (d) of section 151 as follows:

SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025: In the case of a taxable year that begins after December 31, 2017, and before January 1, 2026, the term "exemption amount" is redefined to mean zero.

For the tax year 2017, taxpayers were allowed to deduct $4,050 for each exemption they claimed.

Traditionally, there were two types of exemptions: personal exemptions and exemptions for dependents. However, starting in 2018 and continuing through 2025, there is no longer an exemption amount as per the Tax Cuts and Jobs Act of 2017. This legislative change brought about the elimination of personal exemptions and dependent exemptions during this period.

The qualification for dependents is still applicable for claiming various credits, for example, child tax credit, child and dependent care credit, EIC

Post-2008 divorce decree or separation agreement. If a divorce decree or separation agreement was established post-2008, a noncustodial parent cannot substitute Form 8332 with pages from the decree or agreement when claiming a child as a dependent. Instead, the custodial parent must sign either Form 8332 or a similar statement expressly releasing their claim to the exemption. This statement must be solely for the purpose of releasing the custodial parent's claim, with no contingent conditions, such as payment of support. The noncustodial parent must attach a copy to their tax return, even if previously filed in an earlier year.

Revocation of release of claim to an exemption. The custodial parent can revoke a release of claim to an exemption that he or she previously released to the noncustodial parent. For the revocation to be effective for 2022, the custodial parent must have given (or made reasonable efforts to give) written notice of the revocation to the noncustodial parent in 2021 or earlier. The custodial parent can use Part III of Form 8332 for this purpose and must attach a copy of the revocation to his or her return for each tax year he or she claims the child as a dependent as a result of the revocation.

Form 8332

Form 8332 serves as a written declaration by the custodial parent to release the child exemption to the non-custodial parent. The non-custodial parent must attach a copy of form 8332 or a similar statement to their tax return.

The custodial parent can release the exemption for one year or multiple years.

The custodial parent can revoke a release that he or she previously released to the non-custodial parent on Form 8332. For the revocation to be effective for the current year, the custodial parent must have given the non-custodial parent written notice of the revocation in the prior year.

The custodial parent can use part three of Form 8832 for this purpose and must attach a copy of the revocation to his or her tax return for the year that she claims the child due to the revocation.

Alimony paid

Alimony is gross income to the spouse who receives it for pre-2019 divorce agreements.

New Law

Section 11051 of TCJA 2017 repealed the deduction for alimony payments for tax years beginning after December 31, 2017, and before January 1,2026.

The deduction for alimony remains the same for divorce decrees finalized before these dates.

Alimony or separate maintenance payments IRC § 71

Alimony is a payment to or for a spouse or former spouse under a divorce or separation agreement. Alimony does not include voluntary payments that are not made under a divorce or separation agreement.

Alimony is deductible by the payer and is income to the person receiving it for divorces finalized through 2018. To be alimony, the payment must meet certain requirements. There are different requirements that apply to payments on instruments executed after 1984.

Divorce or separation instrument means:

- A decree of divorce or separate maintenance or written instrument incident to that decree,
- A written separation agreement or, the decree or any type of court order requiring a spouse to make payments for maintenance of the other spouse. This includes a

temporary decree, an interlocutory decree, and a decree of alimony pending the final decree. Payments under divorce decree can be alimony even if the decree's validity is in question. For tax purposes, a divorce decree is valid until a court having proper jurisdiction holds it invalid.

An amendment to a divorce decree may change the nature of the payments. Amendments are not usually retroactive for Federal tax purposes. If a retroactive amendment is just to correct a clerical error to reflect the original intent of the court it may be retroactive for Federal tax purposes.

Example: A court order that corrected a mathematical error retroactively to spread payments over more than 10 years would also be effective retroactively for Federal tax purposes.

Example: If an original divorce decree did not fix any part of the payment as child support and to reflect the true intention of the court, the court order retroactively corrected the error by designating a part of the payment as child support, the amended order is effective retroactively for Federal tax purposes. The person receiving alimony must give the person who paid the alimony their social security number if they do not, they may have to pay a $50.00 penalty.

The following payments are not alimony.

• Child support

•Noncash property settlements,

• Payments that are your spouse's part of community income, payments to keep up the payer's property, Use of the payer's property

Child Support

Child support payments made by the payer are never deductible. In cases where a divorce decree or separation agreement mandates both child support and alimony payments, and the total amount paid is less than the combined amount owed, the payments are applied in a specific manner.

First and foremost, any payments made are allocated to cover the child support obligation. Only after satisfying the child support obligation are any remaining payments applied to fulfill the alimony requirement. This order of allocation ensures that child support obligations are prioritized and cannot be offset by alimony payments.

Noncash Property Settlements

Section 1041 of the Internal Revenue Code provides for the nonrecognition of gain or loss on transfers between spouses that occur as part of a divorce. Such transfers are treated as if they were gifts, and the basis of the property transferred from the spouse making the transfer (transferor) to the spouse receiving the property (transferee) is carried over. This means that the transferee assumes the same basis as the transferor.

To qualify for this nonrecognition treatment, the transfer must be "incident to divorce," as defined by Section 1041(c). An incident to divorce transfer is one that occurs within one year of the date of marriage or is directly related to the end of the marriage. This provision ensures that property transfers between spouses during the divorce process do not trigger immediate tax consequences.

Payments That Are Your Spouse's Share of Community Income

When payments that would otherwise qualify as alimony are made as part of community income, the deductibility rules change. In such cases, these payments are not deductible by the payer to the extent that they represent the recipient spouse's share of community income. However, they can still be deductible by the payer to the extent that they exceed the spouse's portion of the community income.

Here's an example to illustrate this concept:

Let's say Chris resides in a community property state and lived with his spouse for part of the year. According to their divorce decree, Chris is required to pay his spouse $14,000. However, the total community income for the year was $24,000.

In this scenario, Chris will report $12,000 as his share of the community income, which is not deductible. The remaining $2,000, which exceeds his spouse's portion of the community income, is treated as alimony and is deductible. This ensures that only the portion of payments that goes beyond the spouse's community income share is subject to deduction.

Use of the Payer's Property

When a divorce or separation instrument specifies that a taxpayer is responsible for paying expenses related to a home owned jointly with their spouse or former spouse, certain rules come into play.

1. Mortgage Payments (Principal and Interest) on a Jointly-Owned Home: In the case of a jointly-owned home, half of the total mortgage payments (comprising both principal and interest) can be deducted as alimony.

2. Real Estate Taxes and Home Insurance Held as Tenants in Common: If real estate taxes and home insurance are held as tenants in common, half of the total payments can be deducted as alimony.

3. Payments for Utilities: Payments made for utilities, on the other hand, are not excluded from alimony payments. These payments are treated differently, and any payments made to a third party on behalf of the spouse or former spouse are considered as part of the alimony.

These rules help distinguish which payments related to the jointly-owned property can be claimed as alimony deductions and which are treated differently in tax calculations.

Definition of Alimony (IRC §71(b)(1)

Alimony is defined as a payment made to or for a spouse, as stipulated under a decree of divorce or separation. To qualify as alimony, the following conditions must be met:

1. Payments in Cash: Alimony includes payments made in the form of cash.

2. Designation in the Decree or Agreement: The divorce decree or separation agreement should not designate the payment as non-alimony. Additionally, it's crucial that the spouses are not members of the same household at the time these payments are made. This requirement becomes relevant only if the spouses are legally separated under a decree of divorce or separate maintenance.

3. No Liability After Recipient Spouse's Death: Alimony payments must not impose any obligation to continue payments after the death of the recipient spouse.

4. Not Treated as Child Support: The payment should not be classified or treated as child support.

Meeting these criteria helps determine whether a payment qualifies as alimony for tax purposes.

Payments in Cash

Alimony payments can take the form of cash, checks, or money orders and still qualify as alimony for tax purposes.

Payments to Third Parties

Payments made to a third party, as specified in a divorce or separation instrument, can also be considered as cash payments made to the spouse and therefore qualify as alimony. Furthermore, third-party cash payments made at the written request of one's spouse may be eligible for alimony treatment, provided the following requirements are met:

1. In Lieu of Direct Payments: The payments to the third party are intended to substitute for direct alimony payments to the spouse.

2. Written Request: Both spouses have a clear intention, as stated in a written request, for these payments to be treated as alimony. This written request must be received from the spouse before filing the tax return for the year in which the payments are made.

Meeting these conditions allows for payments to third parties, made at the request of one's spouse, to qualify as deductible alimony payments.

Payments Designated as Not Alimony

If a taxpayer and their spouse mutually agree to designate otherwise qualifying payments as not constituting alimony, then those payments do not fall under the category of alimony for tax purposes. This designation is typically accomplished by including a provision in the divorce decree or separation instrument explicitly stating that the payments are neither deductible as alimony by the payer nor includable in the recipient spouse's income. Crucially, this written statement must bear the signatures of both spouses.

Moreover, for the recipient spouse to exclude these payments from their income, they must attach a copy of the instrument that designates the payments as not being alimony to their tax return. This copy must be attached each year in which the designation applies to ensure proper tax treatment.

Spouses Cannot Reside in the Same Household

Payments made to a spouse while residing in the same household are not considered alimony, even if there's a legal separation under a divorce or separate maintenance decree. This holds true even if the spouses occupy the same physical residence but are physically separated within that home.

However, there's an exception: If the spouses are not legally separated under a decree of divorce or separate maintenance, a payment made under a written separation agreement, support decree, or court order might still qualify as alimony even if the spouses share the same household during the payment period.

Liability for Payments After Recipient Spouse's Death

Payments that are required to continue after the death of the recipient spouse are not considered alimony. This applies whether the payments were made before or after the recipient spouse's death. If all payments are designed to continue after the spouse's death, none of them are considered alimony; instead, they are typically viewed as property settlements.

Examples

1. Ben's Payments: Ben is obligated to pay his former spouse $30,000 annually. The divorce decree specifies that $10,000 of these payments will cease upon his former spouse's death, while the remaining $20,000 will continue for 10 years. If the $20,000 payments persist even after his former spouse's death, they are not considered alimony.

2. Sara's Payments: Sara is required to pay Tom, her former spouse, $30,000 per year for six years or until Tom's death. If any of their children are still minors when Tom passes away, Sara must pay $10,000 annually to a trust until the youngest child reaches the age of majority. The $10,000 portion appears to be child support, and therefore, it is not deductible as alimony.

3. Adam's Payments: Adam's divorce decree mandates that he pays his former spouse Mary $30,000 per year for 15 years. Additionally, the decree states that if Mary dies before the 15-year period ends, Adam must pay her estate the difference between $450,000 (15 years of $30,000 each) and the total amount already paid. In the event of Mary's death at the end of the 10th year, Adam would have to pay her estate $150,000. In this scenario, none of the annual payments are considered alimony; instead, they are viewed as a property settlement.

Meeting these criteria and understanding the circumstances surrounding such payments helps determine whether they qualify as alimony for tax purposes.

Recapture of Alimony - IRC §71(f)

Recapture of alimony may be necessary if alimony payments decrease or end during the first three calendar years. When this rule applies, you must include in your income in the third year the portion of alimony payments that you previously deducted. Conversely, the recipient spouse can deduct in the third year the portion of alimony payments that they had previously included in their income.

The three-year period begins with the first calendar year in which a payment that qualifies as alimony is made. However, any period during which payments were made under temporary support orders should not be included in this calculation. The second and third years are the subsequent two calendar years, whether or not payments are made during those years.

Recapture might be triggered by any of the following events:

- A change in the divorce or separation agreement.
- Failure to make timely payments.
- A reduction in the payer's ability to provide support.
- A reduction in the recipient spouse's support needs.

Recapture applies in the third year if the alimony paid in that year decreases by more than $15,000 compared to the second year, or if the alimony paid in the second and third years significantly decreases compared to the amount paid in the first year.

When calculating the decrease in alimony, exclude the following amounts:

- Payments made under temporary support orders.
- Payments required over at least three calendar years that vary because they are a fixed part of income from business or property, or from compensation from employment or self-employment.
- Payments that decrease due to the death of either spouse or the remarriage of the spouse receiving the payments before the end of the third year.

Both the taxpayer and the spouse can use a worksheet to refigure the amount of alimony subject to recapture.

TCJA Impact on Alimony Deductions - Sec. 11051

Starting with divorce or separation agreements executed after December 31, 2018, the Tax Cuts and Jobs Act (TCJA) eliminates the deduction for alimony payments. This change also affects pre-2019 agreements that are modified after December 31, 2018, and it has been made permanent.

Under this new rule, recipients will not include alimony payments in their income, and payors will no longer be able to deduct these payments. However, there is no change to the tax treatment of divorce or separation agreements established before 2019.

This change in tax law necessitates asking clients about their divorce details, including when it was finalized and whether it was modified after December 31, 2018, during interviews for tax planning or preparation

Individual Retirement Arrangements (IRAs)

Spousal IRA:

If a final decree of divorce or separate maintenance is in place by the end of the tax year, no deduction is permitted for contributions made to a former spouse's traditional IRA.

Transferred IRA Resulting from Divorce:

A transfer of all or part of an interest in a traditional IRA to a spouse or former spouse under a decree of divorce or separate maintenance or a written instrument related to such a decree is not considered a taxable transfer. The traditional IRA that is transferred is treated as the spouse's or former spouse's traditional IRA, starting from the date of the transfer. This transfer is not subject to taxation.

IRA Contribution and Deduction Limits:

For divorce decrees finalized through December 31, 2018, all taxable alimony received under a decree of divorce or separate maintenance is considered compensation for the contribution and deduction limits applicable to traditional IRAs. However, beginning after December 31, 2018, alimony will no longer be treated as taxable income to the recipient and, therefore, will not qualify as compensation for making contributions to an IRA.

Costs Associated with Divorce:

Generally, legal fees and court costs incurred for divorce proceedings are not eligible for deduction. However, there are exceptions:

- Legal fees paid for tax advice related to the divorce.
- Legal fees paid to secure alimony.

Additionally, you may be able to deduct fees paid to appraisers, actuaries, and accountants for their services in determining the correct tax or assisting in obtaining alimony. To be eligible for deduction, these fees must be itemized separately. Deductible fees are claimed as miscellaneous itemized deductions on Schedule A, subject to the 2% of Adjusted Gross Income (AGI) income limit.

Fees associated with securing alimony are deductible because alimony is considered part of the recipient's gross income. You can also deduct fees incurred for the collection of alimony.

New Law Impacting Divorce-Related Deductions:

Effective December 31, 2017, the Tax Cuts and Jobs Act (TCAJ) of 2017, specifically under Section 11045, suspended all miscellaneous itemized deductions, including certain costs associated with getting a divorce, until the tax year 2025.

Joint Estimated Tax Payments:

When a taxpayer and their spouse have jointly made estimated tax payments but subsequently file separate tax returns, they have options for allocating these payments:

- Either spouse can claim all of the payments.
- They can mutually agree on how to divide the payments.
- If no mutual agreement is reached, each can claim an amount equivalent to the

total estimated tax paid, multiplied by the tax amount shown on their respective separate returns, and then divided by the total tax amount shown on both returns.

For clarity, it may be helpful to provide an explanation of how the payments were divided. If you choose to claim any of these payments on your tax return, make sure to enter the former spouse's social security number in the designated space on Form 1040. In cases where you have divorced and subsequently remarried, enter your current spouse's social security number in that space and the former spouse's social security number, followed by "DIV," to the left of the estimated tax payments line on the tax return.

Treatment of Community Income in Community Property States (IRC §66):

In the United States, taxpayers who are married and are domiciled in one of the community property states are subject to special income rules. The community property states include:

- Arizona
- California
- Idaho
- Louisiana
- Nevada
- New Mexico
- Texas
- Washington
- Wisconsin

For taxpayers residing in a community property state during any part of the tax year, there are specific guidelines to determine whether income is considered separate or community property. It's important to note that state law plays a pivotal role in making this determination. When taxpayers and their spouses file separate tax returns, they are generally required to report half of any community income on their respective separate returns.

IRC §66(b) - Exception to Individual Responsibility for Community Income Tax:

However, there is an exception to the general rule under IRC §66(b) where an individual is not held responsible for the tax owed on a particular item of community income. To qualify for this exception, all five of the following conditions must be met:

1. The taxpayer did not file a joint return for any taxable year.

2. The taxpayer did not include the specific item of community income in their gross income on a separate return.

3. The item of community income does not fall under any of the following categories:

- Wages, salaries, and other compensation received by the spouse or former spouse for services performed as an employee.
- Income generated from a trade or business operated as a sole proprietor by the spouse or former spouse.
- Income derived from the separate property of the spouse or former spouse (excluding the income types mentioned above).
- Any other income that legally belongs to the spouse under community property law.

4. The taxpayer can demonstrate that they neither knew about nor had any reason to know about the existence of that community income.

5. Considering all the relevant facts and circumstances, it would be deemed unfair to include that particular item of community income in the taxpayer's gross income.

These criteria must all be met for a taxpayer to be exempted from the responsibility of reporting a specific item of community income.

Spousal Agreements and Community Income Reporting (IRC §66):

In certain states, spouses may enter into agreements that have implications for the classification of property or income as either community or separate property. These agreements can significantly affect the tax treatment of various financial matters.

Special Rules for Married Individuals Living Apart Throughout the Year (IRC §66(a)):

If you were married at any point during the calendar year but lived apart from your spouse for the entire year, specific rules come into play for reporting community income. To qualify for these special rules, you must meet all of the following conditions:

1. Both you and your spouse lived apart from each other for the entire calendar year.

2. You and your spouse did not file a joint tax return for any tax year that began or ended within the calendar year.

3. You and your spouse earned income during the calendar year that is categorized as community income.

4. Neither you nor your spouse directly or indirectly transferred any portion of the earned income between you before the year's end. This excludes transfers made for child support obligations.

If all of these conditions are met, both you and your spouse are required to report the community income as explained in the following discussions.

Treatment of Earned Income (IRC §66(a)):

For tax purposes, it's important to categorize earned income that is not considered trade or business income or partnership income. This income should be attributed to the spouse who performed the services to earn it. Earned income generally encompasses wages, salaries, professional fees, and other compensation for personal services.

It's worth noting that distributions of profits paid by a corporation are not classified as earned income and are subject to different tax treatment.

Income Reporting Based on Source and Community Property Laws (IRC §66):

For taxpayers living in community property states, the treatment of income can differ based on its source and the applicable community property laws. Here's how various types of income are typically handled:

Trade or Business Income (IRC §66):

Income and associated deductions from a trade or business that is not structured as a partnership should be attributed to the spouse who operates the business.

Partnership Income or Loss (IRC §66):

Income or losses generated from a trade or business conducted within a partnership should be assigned to the spouse who is a partner in that particular partnership.

Social Security and Equivalent Railroad Retirement Benefits (IRC §66):

Social security and equivalent railroad retirement benefits are considered the income of the spouse who receives these benefits.

Other Community Income (IRC §66):release

All other types of community income, such as dividends, interest, rents, royalties, or other gains, should be handled in accordance with the community property laws of your specific state. It's important to note that some states treat income from separate property as separate income, so it's advisable to check your state's laws to ensure accurate reporting.

Illustrative Example (IRC §66):

Let's consider an example involving George and Sharon, a married couple residing in a community property state. Although they were married throughout the year, they did not live together during that time. Furthermore, they did not file a joint return and did not transfer any earned income between each other. Here's a breakdown of their respective incomes:

- George's Wages: $20,000
- Sharon's Wages: $22,000
- George's Consulting Business: $5,000
- Partnership Income: $10,000
- Dividends from Separate Property:
    - George: $1,000
    - Sharon: $2,000
- Interest from Community Property:
    - George: $500
    - Sharon: $500

Under their state's community property law, all of this income is classified as community income. However, some states treat income from separate property differently, so it's essential to consider your specific state's regulations.

Notably, Sharon was not involved in George's consulting business.

Ordinarily, if they were to file separate returns, they would each report $30,500 (which is half of the community property income, totaling $61,000 - $26,500 for George plus $34,500 for Sharon). However, since they satisfy the four conditions specified for spouses living apart throughout the year, they must disregard the community property law's provisions for reporting their income from community property (with the exception of interest income). As a result, they each report only their own individual income on their respective tax returns. Consequently, George will report $26,500, and Sharon will report $34,500.

Separated Spouses - Income Treatment:

When spouses are separated but do not meet the four conditions discussed earlier (related to living apart all year and not filing a joint return), the treatment of income can vary based on the laws of the state where they reside. In some states, income earned after separation but before a divorce decree may continue to be considered community income, while in other states, it may be categorized as separate income.

Typically, each spouse is taxed on half of the community income for the portion of the year before the divorce becomes final. Income received after the divorce or separation becomes final is generally treated as separate income.

It's important to note that a decree of legal separation or separate maintenance issued by the court may or may not terminate the marital community. The court may choose to dissolve the marital community and distribute property between the spouses. To determine community property status, it's advisable for clients to provide a copy of the decree of legal separation or separate maintenance.

Affordable Care Act - Tax Family and Tax Household:

With the Affordable Care Act (ACA), there are specific terms that taxpayers need to be aware of: tax family and tax household.

For the purpose of calculating the Premium Tax Credit (PTC) using Form 8962, the tax family includes all individuals for whom the taxpayer claims an exemption on their tax return. This encompasses dependents who are properly claimed with Form 8332.

It's important to note that until there is a change, the noncustodial parent is entitled to claim the Premium Tax Credit for a child who did not live with them but is claimed on their tax return. This is the case even if they are not required to provide Minimum Essential Coverage (MEC) for the dependent.

Illustrative Example - Premium Tax Credit (PTC):

Let's consider an example involving Pat and Linda, who are divorced and have two children, Alex and June. According to their divorce decree issued in 2015, Pat is entitled to claim Alex on his tax return every year. Per IRS standards, Linda is the custodial parent. Linda provided Pat with Form 8332, releasing the dependency exemption for Alex. If Pat qualifies for the Premium Tax Credit, he includes Alex as part of his tax family.

For the purpose of Health Coverage Exemptions and the Shared Responsibility Payment, tax household plays a significant role. The tax household generally includes all members of the household who can be claimed on the tax return, whether or not they are actually claimed. Even a dependent released on Form 8332 is not claimed on the taxpayer's tax return but is included in the tax household for calculating the shared responsibility payment.

Illustrative Example - Shared Responsibility Payment (Form 8965):

Using the previous example with Pat and Linda, when calculating the shared responsibility payment, Linda includes Alex as part of her tax household on Form 8965. This ensures that the tax household is accurately considered for health coverage exemptions and shared responsibility payments for months when they did not have health care coverage or an exemption.

Quiz 2 Divorced or Separated Individuals

1. How did the Tax Cuts and Jobs Act of 2017 impact exemptions for taxable years 2018 through 2025?

a. It increased the exemption amount for taxpayers for those years.

b. It introduced a new type of exemption known as the "family exemption."

c. It redefined the exemption amount to zero for those years.

d. It allowed taxpayers to deduct twice the usual exemption amount.

2. Which of the following statements is TRUE regarding the payments for alimony finalized through 2018?

a. Alimony is not deductible by the payer.
b. Alimony is considered income to the person receiving it.
c. Alimony payments are retroactively amended for Federal tax purposes.
d. Alimony payments can include voluntary payments not made under a divorce or separation agreement.

3. Which of the following conditions is NOT required for a payment to qualify as alimony for tax purposes under IRC §71(b)(1)?

a. Payments must be made in cash

b. The divorce decree or separation agreement should not designate the payment as non-alimony

c. Alimony payments must impose an obligation to continue after the death of the recipient spouse

d. The payment should not be classified ad child support

4. Under what circumstances might the recapture of alimony be triggered for taxpayers?

a. A change in the divorce or separation agreement.

b. Making timely payments.

c. An increase in the payers' ability to provide support.

d. An increase in the recipient spouse's support needs

5. Which of the following statements regarding IRAs and divorce is TRUE?

a. Contributions to a former spouse's traditional IRA are deductible even after a final decree of divorce or separate maintenance.

b. Transferring a traditional IRA to a spouse or former spouse under a divorce decree is subject to tax.

c. Alimony received under a divorce decree and always be used as compensation for IRA contributions.

d. Beginning after December 31, 2018, alimony is no longer considered taxable income for the recipient and, therefore, cannot be used as compensation for making IRA contributions.

Quiz 1 Answers Divorced or Separated Individuals

1. Taxpayer is not married on the last day of the year. Which of the following filing statuses is NOT available for the taxpayer to use?

a. Qualifying widower

b. Single

c. Married filing separate

d. Head of household

Answer c: Married filing separate: you cannot use married filing separate if you are unmarried on the last day of the year (page 7)

2. Taxpayer has gone through a divorce. Which if the following statements is accurate regarding their tax responsibilities?

a. Taxpayer is jointly and individually responsible for any tax, interest, and penalties due on a previously filed joint return.

b. Taxpayer is relieved from responsibility if the divorce Decree states that the former spouse will be responsible for any amounts due on previously filed returns.

c. Taxpayer can amend a previously filed return to married filing separately to avoid responsibility.

d. None of the above.

Answer a: A taxpayer is jointly and individually responsible for any tax, interest, and penalties due on a prior filed joint return. Once the due date is, amending from joint to a married filing separate status is not possible. A divorce decree will not relieve the tax liability on a federal return. (page 9)

3. Disadvantages of filing married filing separate returns include all of the following except:

a. Capital loss deduction is limited to $1500 instead of 3000.

b. Earned income tax credit is not available.

c. Child and dependent care credit is not available.

d. The child tax credit is not allowed

Answer d: The child tax credit is available on a MFS return. (page 13)

4. Married taxpayers may qualify to file as head of household if they meet which of

the following requirements:

a. A joint return was not filed.

b. Taxpayer paid more than half the cost of keeping up a home all year.

c. The qualifying person lived in the home for more than half the year or a qualifying person was a parent.

d. All of the above.

Answer d: All of the above. All 4 answers are correct (page15)

5. To qualify as "considered unmarried" for tax purposes, a taxpayer must meet specific criteria. Which of the following is NOT one of those criteria?

a. Filing a separate return

b. Paying more than half of the expenses associated with maintaining the home for the entire year

c. Their spouse must not have resided in the home during the last six months of the tax year

d. Having a qualifying child living in the home for the full year.

Answer d: A qualifying child must only live in the home for half the year (page 16)

Quiz 2 Answers

1. How did the Tax Cuts and Jobs Act of 2017 impact exemptions for taxable years 2018 through 2025?

a. It increased the exemption amount for taxpayers for those years.

b. It introduced a new type of exemption known as the "family exemption."

c. It redefined the exemption amount to zero for those years.

d. It allowed taxpayers to deduct twice the usual exemption amount.

Answer c: Sec 11045 of the TCJA 2017 suspended both personal and dependent exemptions. Eliminating both exemptions during this period. (page 21)

2. Which of the following statements is TRUE regarding the payments for alimony finalized through 2018?

a. Alimony is not deductible by the payer.
b. Alimony is considered income to the person receiving it.
c. Alimony payments are retroactively amended for Federal tax purposes.
d. Alimony payments can include voluntary payments not made under a divorce or separation agreement.

Answer: c Alimony is deductible by the payer and is considered income to the person receiving it for divorces finalized through 2018. Sec 11051 of the TCJA 2017 repealed the deduction for alimony on all divorce or separate maintenance agreements finalized after December 31, 2018. (page 22)

3. Which of the following conditions is NOT required for a payment to qualify as alimony for tax purposes under IRC §71(b)(1)?

a. Payments must be made in cash

b. The divorce decree or separation agreement should not designate the payment as non-alimony

c. Alimony payments must impose an obligation to continue after the death of the recipient spouse

d. The payment should not be classified as child support

Answer c: Alimony payments must NOT impose any obligation to continue after the death of the recipient spouse for it to qualify as alimony for tax purposes. (page 24)

4. Under what circumstances might the recapture of alimony be triggered for taxpayers?

a. A change in the divorce or separation agreement.

b. Making timely payments.

c. An increase in the payers' ability to provide support.

d. An increase in the recipient spouse's support needs

Answer a: The recapture of alimony might be triggered by a change in the divorce or separation agreement. (page 26)

5. Which of the following statements regarding IRAs and divorce is TRUE?

a. Contributions to a former spouse's traditional IRA are deductible even after a final decree of divorce or separate maintenance.

b. Transferring a traditional IRA to a spouse or former spouse under a divorce decree is subject to tax.

c. Alimony received under a divorce decree and always be used as compensation for IRA contributions.

d. Beginning after December 31, 2018, alimony is no longer considered taxable income for the recipient and, therefore, cannot be used as compensation for making IRA contributions.

Answer d: Beginning after December 31, 2018, alimony is no longer considered taxable income for the recipient and, therefore, does not qualify as compensation for making contributions to an IRA. (page 27)

You have now completed the study materials. Go back to MY Courses and take the test. It is suggested that you write your answers down when you take the test in case you need to go back and correct any. We do not store your answers.

You may also print the test. We do not release the correct answers after completion of the test. Once you pass the test your certificate will be available. We will submit completed courses to CTEC and IRS on Mondays. Based on the license information you have provided us your completed courses will be submitted the Monday following your completion date.

Below is Office of Chief Counsel advice where two individuals claim the

same address for Head of Household

ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

SCA 1998-041 Released 12/04/98

Office of Chief Counsel Internal Revenue Service Memorandum TL-N-6671-97

Date: APR 3 1998

To: District Counsel, New England

From: Assistant Chief Counsel (Income Tax & Accounting) CC:DOM:IT&A

Subject: Significant Service Center Advice

This responds to your request for Significant Advice dated November 21, 1997, in connection with a question posed by the Andover Service Center.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May Be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in CCDM (35)2(13)3:(4)(d) and (35)2(13)4:(1)(e). This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

Issue

(1) Whether two unmarried individuals, each living with their own dependent children in a shared dwelling, can each claim head of household filing status?

(2) What expenses should be considered in determining whether each taxpayer furnished more than one-half the cost of maintaining a household?

(3) What constitutes acceptable verification of expenses for the cost of maintaining a household?

Conclusion

(1)The determination of whether two unmarried individuals, each living with their own dependent children in a shared dwelling, may each claim head of household filing status is not a matter simply determined by physical boundaries, but by all the facts of a case.

(2) 1.2-2(d) of the Income Tax Regulations details the expenses that should be considered in determining whether a taxpayer has furnished more than one-half the cost of maintaining a household. Such expenses include property taxes, mortgage

interest, rent, utility charges, upkeep and repairs, property insurance and food consumed on the premises. The cost of maintaining a household under $ 2 of the Internal Revenue Code does not include the cost of clothing, education, medical treatment, vacations, life insurance, and transportation, or any amount which represents the value of services rendered in the household by the taxpayer or by a person qualifying the taxpayer as a head of household.

(3)Acceptable verification of expenses for the cost of maintaining a household includes cancelled checks and receipts for the expenses such as taxes, interest, rent, utilities, repairs, insurance, and food consumed on the premises, records to show who paid or contributed toward the payment of the expenses and the amount contributed by each person involved, and amounts received from governmental agencies such as rent subsidies.

Facts Taxpayers X and Y are single parents, each with their own dependent children, who share a dwelling. Neither X nor Y is a surviving spouse or a nonresident alien. The kitchen, and other living areas are common areas, but the adults have their own bedrooms. X and Y each claimed head of household filing status, relying on the case of Estate of Fleming v. Commissioner, 33 T.C.M. 619 (1974), acq., 1974 AOD LEXIS 65. X itemized his deductions, while Y took the standard deduction for herself. X and Y maintain joint accounts from which they paid household bills. As in the Fleming case, X paid over one-half of the expenses attributable to himself and his dependent children. Y also paid over one-half the expenses attributable to herself and her dependent children.

Discussion

Background

Section 1(b) of the Internal Revenue Code provides for slightly lower tax rates for heads of households than the rates for single individuals or married individuals filing separately. A taxpayer who qualifies as a head of household may use the $ 1(b) tax rate schedule which contains rates that fall between the rates payable by single individuals and those payable by married individuals filing joint returns.

Section 2(b) generally provides that an individual shall be considered a "head of household" if the individual: (1) is not married at the close of the taxable year'; (2) is not a "surviving spouse" (as defined in § 2(a)); (3) maintains as his or her home a household which constitutes for more than one-half of the taxable year the principal place of abode, as a member of such household, of a qualified dependent (as defined in $ 2(b)(1)(A), or maintains a household which constitutes for the taxable year the principal place of abode of the individual's father or mother, if the individual is entitled to a § 151 dependency exemption for the parent; (4) furnishes more than one-half the cost of maintaining the household during the taxable year; and (5) is not a nonresident alien.

Under the facts at issue, we will assume that taxpayers X and Y each clearly fulfill the above-mentioned first, second and fifth requirements of $ 2(b). Therefore, this guidance will focus on the third and fourth requirements of 8 2(b) to determine whether taxpayers X and Y can each be considered as maintaining and furnishing more than one-half the costs of a separate household.

Section 2(b)(1)(A) () of the Code, in pertinent part, provides, that a taxpayer who is not married at the close of the taxable year can qualify for head of household filing status by maintaining as his home a household which is, for more than half of the taxable year, the principal place of abode of a child.

Section 1.2-2(c)(1) of the regulations, provides, in pertinent part, the following parameters for what constitutes "maintaining a household:"

In order for a taxpayer to be considered as maintaining a household by reason of an individual described in (a)(1) or (b)(3) of this section (e.g., taxpayer X and Y's children), the household must actually constitute the home of the taxpayer for the taxable year. A physical change in the location of such home will not prevent a taxpayer from qualifying as a head of household. Such home must also constitute the principal place of abode of at least one of the persons specified in such paragraph (a)(1) or (b)(3) of this section.

Section 1.2-2(d) details the expenses that should be considered in determining whether a taxpayer has furnished more than one-half the cost of maintaining a household as follows:

A taxpayer shall be considered as maintaining a household only if he pays more than one-half the cost thereof for his taxable year. The cost of maintaining a household shall be the expenses incurred for the mutual benefit of the occupants thereof by reason of its operation as the principal place of abode of such occupants for such taxable year. The cost of maintaining a household shall not include expenses otherwise incurred. The expenses of maintaining a household include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance and food consumed on the premises. Such expenses do not include the cost of clothing, education, medical treatment, vacations, life insurance, and transportation.

1 However, $ 2(c) provides that certain married individuals living apart from their spouses may qualify for head of household status if they satisfy certain conditions under $ 7703(b).

In addition, the cost of maintaining a household shall not include any amount which represents the value of services rendered in the household by the taxpayer or by a person qualifying the taxpayer as a head of household or as a surviving spouse.

In the Estate of Fleming case, the Tax Court specifically addressed the issue of whether two individuals, each with their own children, who share a dwelling can each be considered to maintain a separate household for tax purposes. Estate of Fleming, 33 T.C.M. at 619. During the years involved, a residence constituted the principal place of

petitioner-decedent (hereinafter "decedent"), Jean Foster Fleming, decedent's unmarried daughter, Jean F. Fleming (Jean), decedent's married daughter, Louise Fleming Mercke, decedent's son-in-law, Evans Mercke, and three of decedent's grandchildren, the three Mercke children. The Merckes contributed two-thirds of the total cost for food consumed on the premises, utilities and servant hire used by both the Merckes and the Flemings, and the Flemings contributed one-third. The Merckes and Flemings each contributed fifty percent of the total cost for residence maintenance expenses consisting of mortgage interest, property taxes, upkeep and repairs, property insurance, replacement costs and yard care. Although decedent contributed more than fifty percent of the household expenses jointly contributed by her and Jean, she did not contribute more than fifty percent of the expenses relating to the residence. Id. at 620.

The family residence occupied by the Merckes and Flemings contained four levels. The first level consisted of a game room, recreation room, two garages for four cars, kitchenette, storage room, utility room, workshop and patio. The second level consisted of a bedroom, sitting room, office, bath and one-half, storage rooms, laundry, servants' living room, servants' bath, and servants' bedroom. Decedent and Jean were the principal occupiers of the second level bedroom, sitting room, office and bath. The third level consisted of an entrance hall, living room, family room, sunroom, dining room, kitchen, pantry and bar. The fourth level consisted of four bedrooms, office, three baths and storage rooms. This fourth level was principally occupied by the Merckes. The first level, a portion of the second level and the third level were common areas shared by all seven family members. In addition, all seven family members had free access to all portions of all four levels. The Merckes and Flemings also shared a common dinner table and took their meals together as one family. Id.

The Service contended that the house constituted only one household, and being only one household the petitioner had failed to prove that she furnished more than one-half the cost of maintaining such household. However, petitioner successfully argued th the house contained two households, one of which consisted of the decedent and Jean. Id. at 621-622.

The Tax Court stated that the extent of a household is not determined solely by physical or tangible boundaries, but by all the facts of the case. Id. See also, Robinson v. Commissioner, 51 T.C.520 (1968), aff'd. 422 F.2d 873 (9th Cir. 1970), acq. 1970-1 C.B. XVI; Reardon v. United States, 158 F.Supp. 745 (D.S.D. 1958). The Tax Court also found that "it would be an elevation of form over substance to say only one household existed simply because only one building was involved and certain areas were used in common." Id. at 621. The Court found that separate households were intended and resulted. Accordingly, the Court held that decedent qualified as a head of household. Id.2

In Jackson v. Commissioner, 71 T.C.M. 2022 (1996), the Tax Court also considered the issue of whether petitioner, who during the year at issue, was unmarried and resided in a two-bedroom apartment with Jewel M. Cleckley, two of Ms. Cleckley's children, and petitioner's daughter, Fatimah, born to Ms. Cleckley and petitioner was entitled to claim head of household filing status. Id. at 2023.

In Jackson, petitioner testified that he paid $175 per month in cash to Ms. Cleckley pursuant to an oral leasing agreement between petitioner and Ms. Cleckley for himself and Fatimah for the exclusive use of one room of an apartment owned by Ms. Cleckely. In addition to the $175 per month, petitioner testified he paid everything towards his daughter's clothing, food, and medical insurance. However, other than petitioner's testimony, petitioner presented no evidence of the amounts expended. Id.

Petitioner contended that the room he rented in Ms. Cleckley's apartment constituted a household. He also stated that he could not use the telephone or kitchen without permission. Id. at 2024. Other than the $175 per month allegedly paid, petitioner incurred no additional expenditures for utilities, repairs or any other household expenses. Id. The Service contended that petitioner failed to satisfy the head of household filing requirements.

The Tax Court found that (1) petitioner bears the burden of proving that respondent's determination is incorrect; (2) the Court is not bound to accept the unverified, undocumented testimony of petitioner; and (3) a taxpayer is required to substantiate the amounts claimed as deductions, credits, etc., by maintaining the records needed to establish such entitlement. Id. at 2024-2025. Specifically, The Tax Court found that petitioner failed to prove that he paid $175 a month or, if paid, that it constituted more than half the cost of maintaining a household as his home. The Tax Court was unconvinced that petitioner provided more than half of the cost of maintaining a principal place of abode for his daughter given that Ms. Cleckley apparently paid all expenses of maintaining the household to which petitioner allegedly contributed only $175 per month.

2 The Service acquiesced with the decision as "the Court's findings are not without support in the record and cannot be considered clearly erroneous." 1974 AOD LEXIS 65.

The Tax Court found that the one room allegedly lived in by petitioner and Fatimah in the two-bedroom apartment owned by Fatimah's mother, without use of a kitchen or telephone, does not constitute a separate household. Id.3

Taxpayers X and Y's Head of Household Status

As the above two cases demonstrate, the determination of whether taxpayers X and Y may each claim head of household filing status is not a matter simply determined by physical boundaries, but by all the facts of the case. Given the fact specific nature of this determination, and that neither X nor Y is married, a surviving spouse or a nonresident alien, the first issue to determine is whether each X and Y is maintaining a household by reason of his/her children. Under the facts presented, the shared dwelling constitutes the home of X and Y for the taxable year and the principal place of abode of X and Y's children. The kitchen and other living areas are common areas, but the adults have their own bedrooms. X and Y's children share a room. However, other facts are necessary to establish whether X and Y conduct themselves as separate households or one household.

Pursuant to $ 1.2-2(c)(1), in order for X and Y to be considered as maintaining a household by reason of their children, the household must actually constitute the home of X and Y for the taxable year. A physical change in the location of such home will not prevent X and Y from qualifying as a head of household. Such home must also constitute the principal place of abode of at least one of X's children and one of Y's children. In addition, as in Estate of Fleming, the Service may consider whether each family acts independently of each other in matters not related to the house. For example, in Estate of Fleming, the Tax Court considered the following facts to determine that separate households existed: each family maintained and paid for a separate telephone, each family gave Christmas presents, Christmas cards, wedding gifts, and charitable contributions independently of the other. Estate of Fleming, 33 T.C.M. at 621. The Tax Court found that while the use of shared areas is a factor, it is not determinative. Id.

3 See also, Lyddan v. United States, 721 F.2d 873, 876 (2d Cir. 1983), cert. denied, 467 U.S. 1214 (1984)(denying head of household status to husband living with estranged spouse pursuant to a written separation agreement providing for mutual exclusivity of room use).

Taxpayers may argue that, in the case of multi-family dwellings, the standard set forth in $ 1.44A-1(d)(2) that separate families are treated as separate households should also be used for purposes of head of household filing status under $ 2(b). Under $ 44A (re-designated as 8 21 for tax years beginning after December 31, 1983), a credit for certain child care expenses is allowed for individuals who maintain a household that includes one or more qualifying individuals. With respect to multifamily dwellings, $1.44A-1(d)(2) provides that "if two or more families occupy living quarters in common,

e families is treated as constituting a separate household...." While the term "household" is used in both $$ 2(b) and 44A in similar contexts, the standard set forth in $ 1.44A-1(d)(2) does not control the determination of whether two or more families should be treated as separate households under $ 2(b). First, $ 1.44-1(d)(2) specifically provides that the separate family/separate household rule applies "solely for purposes of section 44A and [8 1.44A-1 of the regulations]." Further, it is clear from the cases discussed above that contrary to the standard set forth in $ 1.44A-1(d)(2), all of the relevant facts and circumstances must be considered in determining whether, for purposes of using head of household filing status under section 2(b), two or more families occupying common living quarters maintain separate households.

Assuming that the facts show that two separate households are intended to occupy the shared dwelling, then X needs to show that X contributed over one-half the household expenses jointly contributed by X and X's children, and Y has to show that Y contributed

e household expenses jointly contributed by Y and Y's children. X does not need to show that X contributed over one-half of the total expenses of maintaining the shared dwelling, and Y does not need to show that Y contributed over one-half of the total expenses of maintaining the shared dwelling.

4 Section 1.44A-1(d) (Expenses for household and dependent care services necessary for gainful employment) provides, in pertinent part, as follows:

(2) Two or more families. Solely for purposes of section 44A and this section, if two or more families occupy living quarters in common, each of the families is treated as constituting a separate household, and the taxpayer who provides more than one-half of the costs of maintaining such a separate household is treated as maintaining that household. Thus, for example, if two unrelated taxpayers each with children occupy living quarters in common and each taxpayer pays more than one-half of the household costs incurred by each respective family, each taxpayer will be treated as maintaining a separate household

The cost of maintaining a household is the expenses incurred for the mutual benefit of the occupants thereof by reason of its operation as the principal place of abode of such occupants for such taxable year. $ 1.2-2(d). The expenses of maintaining a household for X and Y include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance and food consumed on the premises. Such expenses do not include the cost of clothing, education, medical treatment, vacations, life insurance, and transportation. In addition, the cost of maintaining a household does not include any amount which represents the value of services rendered in the household by the taxpayer or by a person qualifying the taxpayer as a head of household or as a surviving spouse.

Acceptable verification of expenses for the cost of maintaining a household includes cancelled checks and receipts for the expenses such as taxes, interest, rent, utilities, repairs, insurance, and food consumed on the premises, records to show who paid or contributed toward the payment of the expenses and the amount contributed by each person involved, and amounts received from governmental agencies such as rent subsidies. See, e.g., IRM 5300, Exhibit 5300-43; IRM 41(12)(O), Exhibit 900-2.

If you have any questions regarding this memorandum, please contact John Moran at (202)622-4940.

JODY J. BREWSTER Assistant Chief Counsel (Income Tax & Accounting)

By:

/s/ STEPHEN TOOMEY Acting Assistant to Chief, Branch 4