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Common Questions at Tax Season

by Alan C. Eidsness and Jaime Driggs


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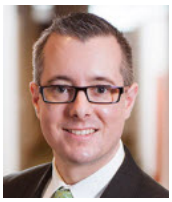
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Although family practice is often unpredictable, some things we have come to expect. Tax season is one of those times when we can count on facing some of the same issues over and over. The questions below are just a few of those we are likely to be called on to answer this time of year.

What if the dissolution is pending and one party wants to file separately? Can the family court require a party to file a certain way? What if one spouse has already filed their own separate return?

There is no law requiring parties to a marriage dissolution proceeding to file their tax returns jointly vs. separately. Whether to require parties to a marriage dissolution proceeding to file joint income tax returns or separate income tax returns for a given year falls within the broad discretion of the district court to make a just and equitable division of property. *Theroux v. Boehmler*, 410 N.W.2d 354, 356 (Minn. Ct. App. 1987). A party who insists on filing separately without a compelling reason runs the risk that any extra tax burden which results will be taken into consideration in dividing property. In *Theroux*, the court of appeals affirmed requiring joint returns where separate returns would have increased the tax burden by $5,000-$6,000. In *Ellingson v. Ellingson*, 2007 WL 1893174, at *8 (Minn. Ct. App. Jul. 3, 2007), even though there was no evidence regarding the financial implications for filing jointly vs. separately, the court of appeals held that the district court did not abuse its discretion in requiring joint returns based on the parties' history of filing jointly. If a spouse has already filed separately and filing jointly would save money, consider asking the court to order the spouse to cooperate in amending their return to file jointly, which is possible so long as it is filed within certain prescribed time periods. I.R.C. § 6013(b)(1).

What if a party refuses to sign Form 8332 even though the judgment and decree requires them to do so? Can the other party attach the judgment and decree to their tax return and file their return without Form 8332?

In a decision on consolidated appeals issued just last month, the Eighth Circuit answered these questions. The pertinent facts in both cases were the same. The husbands, who were the noncustodial parents, were granted the right to claim the dependency exemptions so long as they were current with their child support obligations. The husbands paid their child support and were current for the tax year in question but their former wives did not sign Form 8332. Since the husbands did not have Form 8332, the husbands attached the documents from the dissolution proceedings granting them the right to claim the exemptions so long as they were current in their child support obligations to their former wives, hoping that the documents would satisfy the requirements of I.R.C. § 152(e)(2) that Form 8332 is designed to fulfill. The tax court disallowed the exemptions and the husbands appealed. The Eighth Circuit affirmed, holding that the legal documents did not provide the unconditional declaration required by I.R.C. § 152(e)(2)(A), and which Form 8332 contains, since the husbands' entitlement to claim the exemptions was conditioned upon remaining current in their support obligations. The harsh result was not lost on the Eighth Circuit, but the husbands needed to seek relief in family court and not tax court: "[I]f, a violation of a state court order wrongly deprives the intended beneficiary of a federal tax advantage, the state court unquestionably retains authority to remedy that violation." *Armstrong v. Commissioner*, ___ F.3d ___, 2014 WL 961033, at *5 (8th Cir. 2014). Thus, if a party violates an obligation to sign Form 8332, the other party must seek relief in family court. One option would be to bring a motion for contempt. If the aggrieved party has already filed their return and does not want to bother amending it, another possibility is to seek reimbursement for the lost value of the exemption or to seek the right to claim the exemption the following year if not already entitled to claim it.

The judgment and decree does not address who gets to claim dependency exemptions. Who gets to claim them?

Can that issue be addressed in family court or has it been waived?

Where a judgment and decree is silent regarding dependency exemptions, the Internal Revenue Code controls. Accordingly, the party who qualifies as the custodial parent under I.R.C. § 152(e)(4)(A) is entitled to claim the exemption. However, the issue has not been waived forever and the family court retains the authority to allocate the exemptions even though it was not addressed in the judgment and decree. *Ley v. Ley*, 1990 WL 132632 at *1 (Minn. Ct. App. Sep. 18, 1990) (rejecting argument that court erred in granting noncustodial parent right to claim exemption because custodial parent did not waive her right to claim the exemptions in the judgment and decree).

How is the initial allocation of the dependency exemptions decided by the family court?

Under the Internal Revenue Code, the custodial parent, as defined by I.R.C. § 152(e)(4)(A) not by the custody label used in family court, is entitled to claim the dependency exemption. However, "[t]he code does not preclude state district courts from allocating tax dependency exemptions to a noncustodial parent incident to the determination of child support and physical custody." *Rogers v. Rogers*, 622 N.W.2d 813, 823 (Minn. 2001). The standard for allocating the dependency exemption between parents has not been clearly defined. In *Rogers*, the Supreme Court reversed the court of appeals and upheld the district court's denial of a party's motion to modify the exemption allocation in the judgment and decree because the district court had considered the parties' relative resources and there was sufficient evidence supporting the district court's conclusion that its allocation of the exemptions was in the children's best interests. *Id*. Although *Rogers* was decided in the modification context, it has been repeatedly relied upon in reviewing the district court's initial allocation of the exemptions. *See, e.g., Ludgate v. Ludgate*, 2012 WL 6652540, at *6 (Minn. Ct. App. Dec. 24, 2012); *Buzzell v. Buzzell*, 2008 WL 2344471, at *4 (Minn. Ct. App. Jun. 10, 2008); *Hall v. Hall*, 2007 WL 4394875, at *1 (Minn. Ct. App. Dec. 18, 2007).

In *Crosby v. Crosby*, 587 N.W.2d 292, 298 (Minn. Ct. App. 1999), the court of appeals focused on the "relative resources of the parties" and potential benefit to each party, and affirmed the allocation of both exemptions to the husband where the parties were granted joint physical custody and the wife could not benefit from the exemptions because her main source of income was a tax-exempt annuity. The potential benefit provided by the exemption is a key factor. *See Lopez v. Lopez*, 2011 WL 6757462, at *3 (Minn. Ct. App. Dec. 27, 2011) (affirming award of all four exemptions to noncustodial parent because he provided majority of funds for their support and awarding the exemptions to the noncustodial parent would "generate the most tax benefits for the family"); *Buzzell*, 2008 WL 2344471, at *4 (affirming award of both exemptions to noncustodial parent because custodial parent's earnings were too high to provide a benefit and because it would serve the children's best interests by helping to alleviate income disparity between parents); *Huntsman v. Huntsman*, 2002 WL 556142, at *7 (Minn. Ct. App. Apr. 16, 2002) (reversing order awarding exemption in alternating years where one parent was unemployed and would not benefit from exemption and remanding to consider awarding exemption to employed parent exclusively).

Finally, it is important to note that the allocation of the exemptions is a consideration in determining child support and is potentially a basis for deviating from the guidelines. Minn. Stat. § 518A.43, subd. 1(5) (directing consideration of "which parent receives the income tax dependency exemption and the financial benefit the parent receives from it").

Is the allocation of dependency exemptions modifiable? What is the basis for doing so?

The right to claim dependency exemptions is in the nature of child support and is modifiable if the statutory modification standard is met. *Biscoe v. Biscoe*, 443 N.W.2d 221, 224 (Minn. Ct. App. 1989); *see also Meyer v. Meyer*, 2011 WL 2437495, at *1 (Minn. Ct. App. Jun. 20, 2011) (reversing district court's modification of exemption allocation for applying de novo standard instead of Minn. Stat. § 518A.39, subd. 2). In *Botts v. Wagner*, 2008 WL 4007422, at *2 (Minn. Ct. App. Sep. 2, 2008), the court of appeals reversed a district court's denial of husband's motion to modify the allocation of the exemptions because wife admitted that she was not earning enough income to benefit from claiming the exemptions and instructed the court on remand to review whether the modification statute had been satisfied.

If one party is entitled to claim the dependency exemption under the judgment and decree for a given year, can the other party still claim any tax benefits relating to the child?

The right to claim the dependency exemption controls who can claim child tax credit, I.R.C. § 24(c)(1), but not child and dependent care credit. I.R.C. § 21(e)(5). This means that a parent who waived the exemption for a given year but paid qualifying child care expenses may still deduct those expenses under I.R.C. § 21. Additionally, a parent waiving the exemption in a given year is nonetheless eligible to file head of household so long as he or she satisfies the requirements for doing so. I.R.C. § 2(b)(1)(A)(i). Likewise, a parent who is eligible for the Earned Income Credit does not lose their right to claim the credit by having waived the exemption for the child in a given year. I.R.C. § 32(c)(3)(A).

What about the Affordable Care Act?

Under the Patient Protection and Affordable Care Act of 2010, the penalty associated with failing to maintain adequate health insurance coverage for a child is assessed against the person claiming the dependency exemption for the child. I.R.C. § 5000A. Since the party responsible for maintaining insurance coverage for the child may or may not be the party entitled to claim the dependency exemption for the child, it is possible that the party claiming the exemption may be unfairly assessed a penalty. Undoubtedly, the family court would have the authority to order the aggrieved party to be reimbursed for the penalty, but it would still be prudent to add language to stipulations to provide for such reimbursement.

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