Commercial/Bankruptcy/Tax Law

Love and Marriage...and Taxes

As the end of the year rapidly approaches, unmarried couples contemplating taking their relationships to the next level may find themselves increasingly incentivized to get hitched. For federal income tax purposes, marital status is determined as of the last date of the taxable year.[1] Thus, if the taxpayers get married by December 31, they are considered married for the entire year. Married taxpayers may elect to file a joint federal income tax return.[2] Taxpayers filing jointly generally owe less tax than those who file married filing separately due to more favorable tax brackets, credits and deductions. Consequently, the default choice among many return preparers is to prepare a joint federal income tax return. According to IRS statistical data, 95% of married individuals file joint returns.[3] Despite the benefits, taxpayers should keep in mind that by filing a joint return, each spouse is jointly and severally liable for the entire tax due.[4]

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Relief from Joint and Several Liability Under IRC Section 6015

Acknowledging the potentially draconian nature of the joint and several liability standard, Congress carved out several provisions for relief from liability.[5] These provisions include: (i) section 6015(b) relief for understatements of tax attributable to erroneous items on a return; (ii) section 6015(c) relief for a portion of an understatement of tax for taxpayers who are separated or divorced; and (iii) Commissioner discretion under section 6015(f) to grant equitable relief to taxpayers who do not qualify under section 6015(b) or (c).[6] To the extent that any tax, interest and penalties do not qualify under section 6015 for relief, the liability will remain joint and several.

The requesting spouse bears the burden of proof when invoking relief under section 6015.[7] Pursuant to federal tax regulations,[8] the reasonably prudent person standard is applied to determine whether the requesting spouse had reason to know an understatement existed. Factors used to analyze whether a taxpayer had reason to know include: (i) education; (ii) involvement in business and financial affairs; (iii) lavish or unusual expenditures compared to past spending patterns, levels of income and standard of living; and (iv) whether the culpable spouse was deceitful or evasive with finances.[9] Factors most often considered when determining whether it would be unfair to hold the requesting spouse liable for the deficiency include, "whether there has been a significant benefit to the spouse claiming relief and whether the failure to report the correct tax liability on the joint return resulted from concealment, overreaching, or any other wrongdoing on the part of the other spouse."[10]

Section 6015(b) Relief

To qualify for section 6015(b) relief, all of the following conditions must be met: (i) the taxpayers must have filed a joint return; (ii) there must be an understated tax on the return that was due to erroneous items of the non-requesting spouse; (iii) the requesting spouse must not have known and had no reason to know that the understated tax existed; (iv) it must be unfair to hold the requesting spouse liable for the understated tax; and (v) the requesting spouse must have invoked subsection (b) within two years after the date the Commissioner began collection action with respect to the requesting spouse.

Section 6105(c) Relief

To qualify for section 6105(c) relief, allocating liability to the requesting spouse's respective liability, one of the following conditions must be met: (i) the electing spouse must no longer be married to or must be legally separated from the individual with whom the joint return was filed; or (ii) the taxpayers who filed the joint return must not have been members of the same household at anytime during the 12 months prior to the requesting spouse making the election. Significantly, taxpayers who make an election under subsection (c) are not eligible for refunds of amounts paid.[11]

Section 6105(f) Relief

Relief under subsection (f) is available if the following conditions are met: (i) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency; and (ii) relief is not available to such individual under subsection (b) or (c).[12] Facts and circumstances may include economic hardship,[13] the non-requesting spouse's legal obligation to pay the liability, knowledge or reason to know that the understatement would not be paid, whether the requesting spouse received a significant benefit, tax compliance history, history of abuse and the requesting spouse's mental or physical health.[14]

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ON ETHICS

Faxing to Chambers While Mailing to Adversary: Ex Parte?

Kevin Kearon

The NCBA Ethics Committee welcomes ethics inquiries. It responds to the majority received informally. The Committee does not provide legal advice or answer questions of law or establish attorney-client relationships. The facts may have been modified to respect the sensitivity of inquires. The Committee's hotline number rotates and can be learned by calling (516)747-4070. The Committee's chair, Kevin Kearon, can be reached at kkearon@barketmarion.com or at (516)745-1500.

The formal opinions of the NCBA Ethics Committee can be read at nassaubar.org. Go to the Members' section and choose Ethics Opinions.

Facts

An attorney faxes a letter, purportedly copying adversary counsel, to chambers of assigned judge on a PI case on a Friday morning complaining about her adversary's disputed delinquency and asking for immediate relief on a point of discovery. She snail mails the same letter to her adversary by dropping it in her law office outgoing mailbox knowing it won't be picked up by Postal Service until Monday and received by her adversary for a couple of additional days. Court clerk calls adversary attorney on Tuesday admonishing him on the merits and wondering why he has not responded to the request for relief received by the court several days earlier. Attorney responds honestly that he had no idea of the existence of the letter request until the call from the court.

Questions

Must an attorney's communication with an adversary be by the same means or otherwise take place contemporaneously with her communication with the court--e.g., if an attorney faxes a letter to the court, but snail mails same letter to attorney adversary, has an impermissible ex parte communication or other violation of the Rules of Professional Conduct occurred?

Rules of Professional Conduct Implicated

Rules 3.4(c), 8.4(c) and (d).

Discussion

Absent a specific rule of court to the contrary (e.g., communications in connection with the presentation of request for certain types of so-ordered subpoenas in criminal cases), attorneys are generally prohibited from engaging in ex parte communications about a pending matter with the court.[1] This is typically accomplished by detailed rules about how communications with the court are permitted. For example, many local court rules provide that the "court shall not accept ex parte telephone communications on substantive issues."[2] . Nevertheless, most of us have experienced the unsettling observation of arriving in chambers and joining a conversation already begun about the merits of our case.

Consider the variety of ways and circumstances under which attorneys can interact and communicate with an assigned judge. Depending upon the rules of a particular court and adherence to those rules, communications can range in form from discussions in open court or chambers with all parties represented to traditional mailings of motions and letter requests, emails, faxes, and electronic filings. Occasionally, even conversations away from the courthouse will occur, e.g., at cocktail parties, fundraisers, golf outings, etc.

New York Professional Rules of Conduct Rule 3.4(c) provides that "[a] lawyer shall not disregard . . . a standing rule of a tribunal . . . ." Rule 8.4(c) provides that "[a] lawyer . . . shall not engage in conduct involving dishonesty, fraud, deceit or misrepresentation." Similarly, Rule 8.4(d) states that "[a] lawyer . . . shall not engage in conduct that is prejudicial to the administration of justice."

In this case, the court admonished the faxing attorney for falsely giving it the impression that adversary counsel was aware of the court's receipt of the application and for violating the courts rules on types of permissible communications with the court which required contemporaneous and like kind communications with counsel. It seems clear that the artifice engaged in here violates Rule 3.4 (c) by disregarding the rule of the court regarding permissible communications and further violates both Rule 8.4 (c) and (d) for being dishonest, fraudulent, deceitful and misrepresentative on the issue of notice to her adversary, and for being prejudicial to the administration of justice, respectively.

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1. 22 NYCRR § 100.3(B)(6).
2. IAS Part 10, *Part Rules & Procedures*, Hon. Randy Sue Marber, *available at* https://www.nycourts.gov/courts/10jd/nassau/partrules/Marberpartrules1.pdf.

TAXES ...

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Taxable Payments Incident to Divorce

Very often, the multiple controversies related to one spouse seeking innocent spouse relief as against the other leads to divorce court (if the parties aren't there already), which can create a multitude of additional tax issues.

Monetary payments incident to a divorce usually fall into one of three categories: property settlements, child support and alimony. Property settlements are non-taxable.[15] Likewise, child support is non-taxable.[16] Alimony, on the other hand, is a deduction to the payor and income to the payee.[17] This is because alimony is generally considered a division of income.[18]

Alimony Requirements Under Section 71

Cash payments[19] are considered alimony if they satisfy four requirements:

> (A) the payment is received by (or on behalf of) a spouse under a divorce or separation instrument, (B) the divorce or separation instrument does not designate the payment as one that is not includible in gross income of the payee and not allowable as a deduction to the payor, (C) the payor and the payee spouses are not members of the same household at the time the payments are made, and (D) the payments or substitutes end after the payee spouse's death.[20]

In addition, a cash payment cannot be considered alimony if the spouses file a joint income tax return.[21]

Divorce or Separation Agreement

With respect to the first requirement, "divorce or separation instrument" is defined as "(A) a decree of divorce or separate maintenance or a written instrument incident to such a decree, (B) a written separation agreement, or (C) a decree … requiring a spouse to make payments for the support or maintenance of the other spouse."[22] Parties should be wary of making payments in anticipation of entering into a formal "divorce or separation instrument" as any "payments made before the existence of a written divorce or separation instrument are not deductible as alimony."[23]

Instrument Language Designating Payment as Non-Deductible

As for the second requirement, parties should be careful to use explicit language and avoid any inconsistencies in their agreements, especially since last minute revisions are often made at the time of settlement. In *Quintal v. Commr*,[24] separate exhibits to the separation agreement labeled the payments differently. One exhibit denominated the payments as alimony and specified that the parties acknowledge that the payor anticipated that the payments would be deductible to him.[25] Another exhibit, however, stated that the parties agreed that all payments were excludable and non-deductible.[26] In determining that the payments were not deductible alimony, the court noted that "Congress eliminated any consideration of intent ... in favor of a more straightforward, objective test."[27]

Separate Households

Temporary regulations provide guidance on the third requirement.[28] Pursuant to the third requirement, the parties must reside in two separate households. Parties who physically separate themselves within a home, such as by living on separate floors, are still considered to be living in the same household.[29] However, if one spouse is preparing to depart from the home at the time the payment is made and does in fact depart the home within one month of the payment, the parties will not be considered living in the same household.[30]

Payment After Death

With respect to the fourth requirement, it is important to include specific language in the instrument that the payments will cease at the payee spouse's death. Failure to include such language will result in none of the payments, either before or after the payee spouse's death, being deductible as alimony.[31]

Finally, former spouses paying alimony should remember to include their former spouse's social security number on the Form 1040 every year or they may still face penalties.[32]

Both marriage and divorce have a myriad of tax consequences. While spouses rarely consider these when entering into a marriage, careful drafting and planning can help avoid many of the potential tax pitfalls of divorce.

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1. 26 USC § 7703(a)(1).
2. 26 USC § 6013(a).
3. Internal Revenue Service, Statistics 2014, Individual Income Tax Returns, Publication 1304, at 47 (2014), available at https://www.irs.gov/pub/irs-soi/14inalcr.pdf.
4. 26 USC § 6013(d)(3); *see also* 26 CFR § 1.6013-4(b).
5. *See,* 26 USC § 6015.
6. *See also,* 26 USC § 6015(e).
7. *See,* Tax Court Rule 142; *see also*, *Alt v. Commr,* 119 T.C. 306, 311 (2002), *affirmed,* 101 F. App'x 34 (6th Cir. 2004).
8. 26 CFR § 1.6015-2 (c).
9. *See*, *Price v. Commr*, 887 F.2d at 965.
10. *Taft v. Commr*, T.C. Memo. 2017-66 * 9; *Alt v. Commr*, 119 T.C. at 314*; Jonson v. Commr*, 118 T.C. 106, 119 (2002), aff'd, 353 F.3d 1181 (10th Cir. 2003).
11. 26 USC § 6105(g)(3).
12. 26 USC § 6015(f).
13. Tres. Regs. Sec. 301.6343-1(b)(4).
14. See IRS publication *Three Types of Relief at a Glance*, available at https://www.irs.gov/businesses/small-businesses-self-employed/three-types-of-relief-at-a-glance.
15. *See, e.g., McIntee v. Comm*'r, T.C. Summary Opinion 2017-48.
16. 26 USC § 71(c).
17. 26 USC § 71; 26 USC § 215; *see also*, *McIntee*, T.C. Summary Opinion 2017-48.
18. *See, e.g., McIntee*, T.C. Summary Opinion 2017-48.
19. 26 CFR § 1.71-1T (b) A-5 ("Only cash payments qualify as alimony…").
20. *McIntee*, T.C. Summary Opinion 2017-48; 26 USC § 71(b)(1).
21. 26 USC § 71(e).
22. 26 USC § 71(b)(2).
23. *Mudrich v. Comm'r*, T.C.Memo 2017-101 (holding that payment which predated support order was not deductible as alimony).
24. T.C. Summary Opinion 2017-3.
25. *Id.*
26. *Id.*
27. *Id.*
28. 26 CFR § 1.71-1T.
29. *Id.* at A-9.
30. *Id.*
31. 26 CFR § 1.71-1T A-11.
32. 26 USC § 215(c); 26 CFR § 1.215-1T; 26 USC § 6676.