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Should Divorce Be More Taxing?: Structuring Tax Reduction to Reduce Inequality

Stephanie Hunter McMahon*

Introduction

When Barbie and Ken divorce, they probably think about who gets their dream home, how they will share custody of their children, and how they will move forward with their lives. They may not have the time, energy, or knowledge for tax planning. Despite this reality, Congress has created a tax system that expects couples to engage in tax planning as they divorce. Congress encourages tax planning because it decided that divorce is a time when taxpayers should be given flexibility to determine who owes tax on the dissolved couple's income.[1] If divorcing couples engage in this planning, some couples may minimize their collective taxes. But this opportunity is only available for couples with children or an unequal division of assets and earnings. And those couples must make tax efficient property transfers and support payments.[2] Thus, divorce as a tax-planning event is a targeted tax reduction that, through its operation, creates tax winners and losers.

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1. *See infra* Part I.
2. Divorce mitigates the marriage penalty that spouses with relatively equal earnings paid when married, which is certainly a financial benefit, but not the same as the extension of tax benefits discussed in this Article.

Despite the fact that some couples may enjoy significant tax savings following divorce, federal taxation has little to do with what most people think of when they think of divorce. Attitudes towards big-picture questions, such as why do so many marriages end in divorce or whether spouses owe each other anything after marriage, often color our views of what is an unrelated question: How should the government tax payments following divorce? Family law objectives differ from tax law principles and should be recognized as different. The question with respect to taxation is whether Congress should reduce the taxes of divorcing couples and, if so, how should the reduction be distributed between spouses? It is the latter question that is the focus of this Article.

Reframing the question as a comparison of divorcing couples against other taxpayers, and not simply as between spouses, produces a more equitable tax system. To justify a targeted tax reduction upon divorce, there must be a reason this group receives special government aid. Consequently, the aid should be targeted to accomplishing that objective. Divorce is a difficult time financially for many couples, so it may be appropriate to extend tax relief to at least some divorcing couples.[3] As a form of tax relief, and not an essential component of the tax system, any tax reduction upon divorce must be equitable both between spouses and among taxpayers generally.

Existing tax relief for some, but not all, divorcing couples is problematic. If there is something special about divorce that deserves a tax break, every couple, or at least couples in financial need, should enjoy tax reduction upon divorce. That does not currently happen. Under current law, tax reduction is not tied to need but to the tax planning and relative tax positions of the divorcing spouses.

Additionally, current law's tax reduction (as compared to prior law) is of the couple's *collective* taxes. Through shifting the taxation of income from the payer of property and support to the recipient, the payer owes less in tax while the recipient owes more. If the recipient is in a lower tax bracket than the payer, this can result in lower collective taxes. Importantly, the structure of the savings is that the payer enjoys all of the tax reduction unless the recipient negotiates for a larger pre-tax amount. The wealthier spouse may capture the tax reduction under existing law, leaving the recipient worse off under the existing form of tax reduction.

Because of who are generally payers and recipients of divorce-related payments, divorce-related taxation carries with it issues of class and gender. Existing law increases the tax on recipient spouses and gives tax reduction to the payer spouse with a goal of leaving more for the spouses to negotiate over. This backhand way of helping couples in divorce does nothing for those spouses who are truly poor and leaving poor marriages. In the conflict between class and gender, relatively well-off women recipients may benefit from existing law, but low-income wives from low-income marriages do not. This Article argues that this class-based result is a bad form of the intended tax benefit.

3. *See infra* note 95.

In other contexts, scholars debate whether Congress should address nonrevenue objectives through the tax code.[4] When the focus of the tax provision appears evident, such as healthcare penalties and green energy credits, one can question whether the objective is good, whether the IRS should administer the program, or whether the provision promotes the desired change in behavior. This Article furthers this research agenda by examining a case in which interested groups misinterpret Congress's limited objectives for targeted tax reduction.[5] In this case of limited congressional objectives (tax reduction) but broader societal objectives (helping divorcing spouses and children of divorce), this Article questions whether these other nonrevenue objectives are furthered by the targeted tax reduction.

Part II of this Article examines three sets of complex tax rules for divorcing couples: (1) on transfers between former spouses; (2) on payments of child support; and (3) with tax rates, deductions, and credits associated with divorcing couples' children. Part III examines the premises of existing divorce-related tax provisions. Divorce-related tax provisions shift the tax burden for income from payer spouses to recipient spouses. This shifting of tax burdens may—or may not—reduce a couple's collective taxes depending upon their relative tax positions, but it can also produce higher collective tax burdens. And in an era when the law is recognizing a growing number of relationships and the percentage of the population that is legally married is declining, the existence of a tax preference for this group is less justifiable. Although other relationships may end, only with divorce can its members enjoy this targeted tax reduction.

To the extent Congress continues to recognize divorce as a time-deserving tax reduction (not necessarily the best result, as discussed in Part III), an improved form of aid for divorcing couples can be created. This Article proposes targeted tax reduction to lower-income divorced spouses, instead of the existing regime benefiting the wealthier spouse. In place of existing tax-shifting, nonrecognition of appreciation on property transfers, and transferability of child-based benefits, tax reduction should be focused on the spouse in financial need relative to other

4. This debate is almost as old as the tax system. *See* Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 Duke L.J. 1155 (1988); Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 Yale L.J. 1165 (1993). *Compare* Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 Harv. L. Rev. 705 (1970) (arguing "that the tax incentive is generally inferior to the direct subsidy as a means of achieving social goals"), *with* Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 Harv. L. Rev. 925 (1967) (contending "that neutral, scientific measure of taxable income is a mirage").

5. *E.g.*, Walter Wadlington & Raymond C. O'Brien, Family Law in Perspective 107 (2001); Stacia Gawronski, *Spousal Support Under the Internal Revenue Code*, 20 J. Contemp. Legal Issues 63 (2012); Carole Gould, *Simplifying the Nation's Divorce Laws*, N.Y. Times (May 19, 1985), http://www.nytimes.com/1985/05/19/business/personal-finance-simplifying-the-nation-s-divorce-laws.html.

taxpayers. Therefore, for a period of time following divorce, low-income divorcing spouses should receive a tax credit to help them transition to their non-marital status. Transferors of property, which the transferors owned and controlled before the divorce, should owe tax on any appreciation of that property as of the divorce, but payable over a period of time. This prevents the recipient spouse from owing tax on appreciation the payer enjoyed. Finally, child-based tax benefits should no longer be viewed as property, but as a means to aid the child, and should therefore be tied to custody of the child. Treating divorced spouses as separate taxpayers as this proposal does, rather than extending favorable marriage treatment to them, creates simpler rules that are more likely to help lower-income spouses and the children of divorce.

This examination of divorce-related taxation emphasizes the importance of narrowly tailoring tax policies to broader, nonrevenue goals as opposed to viewing tax reduction as an end in itself. If we want to reduce social and economic inequality, as is the focus of this Symposium, this Article concludes that tax reduction is not a valid substitute for measuring whether the law accomplishes these nonrevenue policy objectives.

I. Current Law

Divorce-related tax provisions are currently scattered throughout the Internal Revenue Code ("the Code") because divorce produces many different types of taxable transactions. These transactions have been taxed in many different ways in the past. Currently, Congress mitigates most taxes upon divorce. In fact, Congress has structured many of the tax provisions so that divorcing couples can minimize their collective taxes. By allowing couples to have the lower-income spouse pay tax on income or to transfer tax benefits to the higher-income spouse, more income stays in the higher-income spouse's hands as opposed to going to the government. Nothing in the Code ensures a redistribution of any of the tax savings to the lower-income spouse.

There are three main types of divorce-related tax provisions. First, divorcing couples may divide accumulated property, make future payments to divide marital property, compensate a spouse for unpaid work performed during the marriage, or provide for a financially vulnerable spouse. With different tax consequences depending upon the type of transfer, there is flexibility to structure payments to minimize tax. Second, divorcing couples with children may (but do not always) owe child support. Payment for the care of children is only taxed as child support in limited circumstances. Finally, divorcing parents are given opportunities to designate who claims children for some tax benefits. For example, a child's personal tax exemption, and with it the child tax credit, can be transferred between parents, but the child cannot be transferred for purposes of qualifying for the earned income tax credit (EITC) and head-of-household status. With respect to each set of rules, for couples to maximize their collective tax reduction, divorcing spouses must make rational decisions, sometimes years in advance, regarding their financial positions and the law that will apply at that future date.

A. *Transfers Between Former Spouses*

Divorce may trigger two types of transfers between spouses to settle property and any ongoing support obligation.[6] First, a spouse may transfer to the other spouse some amount of the property accumulated during the marriage that is either held in one spouse's name or jointly owned. Equal divisions of accumulated property are endorsed, at least in theory, in all the states, but debates remain over what should be considered accumulated property to be divided, particularly whether increased earning capacity is property that should be split.[7] Second, one spouse may be obligated to make payments going forward to help support the other spouse, generally based on the recipient's need and the payer's ability to pay. State family law may require these payments of alimony, but the requirement has fallen out of favor.[8] These two different types of payments have different tax consequences under current law, although it is relatively easy for wealthier couples to color payments as one or the other if divorcing spouses choose to do so.

Currently, the federal government taxes property settlements between divorcing spouses the same way it taxes tax-free gifts, hence no current taxation.[9] Neither the payer nor the recipient owes tax on the transfer; however, the recipient takes the payer's basis in the property and, generally, that basis is used to calculate the recipient's tax gain or loss when the recipient disposes of the property.[10] In other words, federal law defers taxation on property settlements, but any built-in tax gain or loss as of the transfer may be taxed later to the recipient when the recipient sells or otherwise disposes of the transferred property. This provision's greatest impact is on transfers of appreciated property (for example, the family's investment portfolio) because of the tax benefit of deferral. This provision has no effect on transfers of cash or property that has neither appreciated nor depreciated; the payer spouse (or the couple) has already been taxed on that cash or property.[11]

This favorable tax deferral was not always available. Before 1984, the Code had no rules for this circumstance. The Supreme Court, in *United States v. Davis*,

6. These transfers have different theoretical justifications, which are beyond the purview of federal income taxation.

7. Carolyn J. Frantz & Hanoch Dagan, *Properties of Marriage*, 104 COLUM. L. REV. 75, 100–01, 106–12 (2004). This is made more complicated nationally because nine states are community property and the other states are common law.

8. *Id.* at 119.

9. I.R.C. § 1041(a)–(b) (2012).

10. I.R.C. § 1001(e)(1) (2012).

11. The recipient spouse could be taxed as receiving income. *See infra* Part III.

ruled that transfers of property as a result of divorce were realization events that required the payer to recognize any appreciation in the transferred property.[12] The recipient spouse owed no tax on the transfer on the theory she traded a right to marital support for the transferred property. As a result of *Davis*, if a recipient spouse did not have a state property interest in transferred appreciated property, the transfer was a taxable event to the payer, generally the wealthier spouse.[13] One potential side effect of the *Davis* rule was a liquidity problem for payers who transferred significant amounts of appreciated property. On the other hand, recipient spouses often had a larger basis in transferred property so that they would owe less tax if they later disposed of their new assets.[14]

The American Bar Association (ABA) called for the legislative repeal of *Davis*, arguing that divorce should not be a taxable event, specifically, not to a husband as payer or to a wife who marries a wealthy spouse and earns "valuable support rights." By labeling the *Davis* result a taxable event, the ABA obscured the issue—it was not an additional tax, but timing of the tax.[15] Only gain would be taxable, and that gain, if not taxable to the payer at divorce, would likely be taxable later to the recipient.[16]

Without floor debate and after only one hearing, Congress reversed *Davis* in 1984 as part of major changes to divorce-related taxation.[17] Focusing on the payer, Congress mandated deferral and then taxation to the recipient in order to prevent "harsh consequences, often placing a tax burden on top of heavy alimony

12. 370 U.S. 65 (1962).
13. Rev. Rul. 81-292, 1981-2 C.B. 158; Rev. Rul. 76-83, 1976-1 C.B. 213; Rev. Rul. 74-347, 1974-2 C.B. 26.
14. Rev. Rul. 67-221, 1967-2 C.B. 63.
15. Valentine Brookes, *Report of the Committee on Domestic Relations Tax Problems*, SEC. TAX'N BULL., July 1996, at 62, 63–66 (1966). The Report noted that overruling *Davis* means a wife is taxed on her husband's appreciation because she receives her husband's lower basis. "Why should she be made to pay tax on the husband's profit?" *Id.* at 66. No answer has yet been given.
16. Others have recognized the injustice created by taxing the recipient on appreciation generated while the property was owned by the payer. *E.g.*, Leon Gabinet, *Section 1041: The High Price of Quick Fix Reform in Taxation of Interspousal Transfers*, 5 AM. J. TAX POL'Y 13, 39 (1986) (worrying that payers will leverage property prior to transfer); C. Garrison Lepow, *Tax Policy for Lovers and Cynics: How Divorce Settlement Became the Last Tax Shelter in America*, 62 NOTRE DAME L. REV. 32, 59 (1986) (proposing equal division of tax liability). Some scholars dismiss the concern, assuming people "act rationally and take account of obvious considerations that are economically detrimental to them." Michael Asimow, *The Assault on Tax-Free Divorce: Carryover Basis and Assignment of Income*, 44 TAX L. REV. 64, 74 (1988).
17. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 421, 98 Stat. 494. For a discussion of the political process, see Barb Mattei, *1984 Deficit Reduction Act: Divorce Taxation*, 1986 WISC. L. REV. 177, 194 (1986); Marjorie A. O'Connell, *The Domestic Relations Tax Reform Act: How We Got It and What We Can Do About It*, 18 FAM. L.Q. 473, 473 (1985).

and support obligations."[18] Although the Senate initially objected to this, it accepted tax deferral as a political means of limiting further expansions of tax relief upon divorce.[19] Tax reduction for payers thus won the day.

Unlike property settlements that generally conclude at the divorce or shortly thereafter, alimony implies an ongoing obligation between former spouses. Recently, state law has limited alimony awards.[20] For example, Massachusetts abolished lifetime spousal support, and Texas limits alimony awards to a three-year maximum period and an amount capped at 20% of a payer's gross income or $2,500 per month.[21] Alimony is often further limited by actual payment. Although definitive data is lacking, research suggests that noncompliance is significantly over 50%, and thus it is common for payments not to be made at all or for less than the amount ordered by the court.[22]

Despite the reality of nonpayment, the Code only provides for payment and ignores a recipient's empty wallet by failing to grant a loss or bad debt deduction. The default is that the payer of alimony deducts the amounts actually paid, so that the payer is not taxed on these amounts, and the recipient pays tax on the income received.[23] Thus, as with appreciation in property transfers, alimony is only taxed once to the recipient, but the recipient of alimony does not enjoy transferred property's deferral.

Not every payment you might think of as alimony—and not even some labeled alimony—qualify as alimony for tax purposes. Regardless of state law definitions, six statutory requirements must be met for alimony tax treatment.[24] First, payments must be in cash. Second, payments must be made "under a divorce

18. *Tax Law Simplification and Improvement Act of 1983: Hearing on H.R. 3475 Before the H. Comm. on Ways & Means*, 98th Cong. 152 (1983) [hereinafter *Hearing on H.R. 3475*] (statement of Ronald Perlman, Deputy Assistant Secretary (Tax Policy), Department of the Treasury). The House of Representatives also worried that expecting the payer to pay the tax opened the system to abuse because the IRS may not be alerted to the transfer until after the statute of limitations as to the payer had lapsed. H.R. Rep. 98-861, at 1116 (1984); H.R. Rep. 98-432, at 191 (1984). There was no mention in the congressional record of the ABA's argument that the person who consumes the income should pay tax on it. ABA Domestic Relations Tax Simplification Task Force, The "Income Shifting" Principle in Proposals for Simplification of Domestic Relations Tax Law 1, 4 (1983) [hereinafter "Income Shifting"].

19. *See* Mattei, *supra* note 17, at 193 n.120.

20. *See* Judith G. McMullen, *Alimony: What Social Science and Popular Culture Tell Us About Women, Guilt, and Spousal Support After Divorce*, 19 Duke J. Gender L. & Pol'y 41, 47 (2011).

21. Alicia Brokars Kelly, *Actualizing Intimate Partnership Theory*, 50 Fam. Ct. Rev. 258, 265 (2012); Jennifer Levitz, *Massachusetts Sets Limits on Alimony*, Wall Street J., Sept. 27, 2011, *available at* National Newspapers Core.

22. Constance L. Shehan, Felix M. Berardo, Erica Owens & Donna H. Berardo, *Alimony: An Anomaly in Family Social Science*, 51 Fam. Rel. 308, 312 (2002).

23. I.R.C. §§ 71, 215 (2012).

24. I.R.C. § 71.

or separation instrument." Third, the payer and recipient must not be members of the same household at the time of the payment. Fourth, payments must terminate upon the death of the recipient. Fifth, the payments must not be taxed as child support, as discussed in the next Part. Finally, parties must not have opted out of alimony treatment.[25]

Determining whether a particular arrangement between divorcing spouses satisfies these requirements may require litigation. Sometimes the law is stretched to produce a common sense result and, at other times, the technicalities of the law belie common sense. For example, in one case a husband paid his wife $215,000 at their divorce agreement's signing.[26] The husband deducted the payment as alimony, and the wife excluded it as a property settlement, clearly an improper tax result with no one paying tax on the income.[27] In order to tax what looked like a property settlement as a property settlement, the Tax Court denied the husband the deduction because the legal obligation did not terminate if the wife died between the signing of the agreement and the payment, even though they happened at the same meeting. In other cases, courts have relied on the same requirement to hold that payments for the other spouse's medical bills or car repairs, which appear on their face to be support payments, are taxable as property settlements because neither the law nor the agreement stopped the payments if the recipient died.[28] If termination of a payment is not laid out in the agreement, courts defer to state law for whether the obligation survives the recipient's death, even though state legislatures were unlikely to have considered the tax ramifications when enacting these family property laws.

Alimony's last requirement permits a divorcing couple to agree that the payer owes the tax and the recipient receives payments tax-free. No one maintains records as to the frequency of this election, but based on the limited litigation and guidance issued, it does not appear this option is used often: there are only

25. *Id.*

26. Webb v. Comm'r, 60 T.C.M. (CCH) 1024 (1990).

27. Clear-cut rules are necessary to protect government revenue. The alternative is that taxpayers will game the system. *See* Cook v. Comm'r, 80 T.C. 512 (1983), *aff'd mem.*, 742 F.2d 1431 (2d Cir. 1984) (holding not taxable to husband on transfer); Cook v. United States, 904 F.2d 107 (1st Cir. 1990) (holding wife receives stepped-up basis and that the Second Circuit was incorrect).

28. Preston v. Comm'r, 209 F.3d 1281, 1285 (11th Cir. 2000); Hoover v. Comm'r, 69 T.C.M. (CCH) 2466 (1995). One alternative would be for courts to read that the expense creating the obligation must occur before the death of the recipient spouse, but precedent has likely precluded that reading.

twelve cases and four Treasury Department rulings on point.[29] Nevertheless, some recipient spouses would be wise to use this alternate treatment because more than tax on the income may be at stake. For example, tax receipt of alimony can affect whether a recipient is entitled to the child tax credit, the EITC, and other deductions and credits that are capped by the claimant's taxable income. By increasing the recipient's income, alimony might cause some recipients to lose these valuable tax benefits when they would not be lost if the payer had agreed to pay the tax.

The current default, much less its electivity, was not always the law. In *Gould v. Gould*, the Supreme Court decided the taxation of alimony in terms of property law, not tax law.[30] Based on a narrower reading of income than is used today, alimony was determined to be part of the husband's income, to which the wife had an equitable right.[31] Therefore, the husband owed tax on alimony paid but the wife did not owe tax on the alimony she received because it was, in a sense, already hers. The Revenue Act of 1942 overruled *Gould*, which made the recipient taxable on alimony and gave the payer a deduction.[32] Congress's stated objective was to relieve payers of hardship from the high World War II tax rates, when top marginal rates reached 90%.[33] Congress was concerned that "in many cases the husband would not have sufficient income left after paying alimony to meet his income tax obligations."[34] The 1942 change was to "correct this situation" and

29. Richardson v. Comm'r, 70 T.C.M. (CCH) 1390 (2012); Linzy v. Comm'r, 102 T.C.M. (CCH) 482 (2011); Proctor v. Comm'r, 129 T.C. 92 (2007); Simpson v. Comm'r, 86 T.C.M. (CCH) 470 (2003); Jaffe v. Comm'r, 77 T.C.M. (CCH) 2167 (1999); Medlin v. Comm'r, 76 T.C.M. (CCH) 707 (1998); Ambrose v. Comm'r, 71 T.C.M. (CCH) 2429 (1996); Kouskoutis v. Comm'r, No. 496–11S, T.C. Summ. Op. 2012-64 (2012) (Westlaw); Shiley v. Comm'r, No. 13418–09S, T.C. Summ. Op. 2011-11 (2011) (Westlaw); Nahhas v. Comm'r, No. 3235–05S, T.C. Summ. Op. 2007-28 (2007) (Westlaw); Vanarsdall v. Comm'r, No. 7943–04S, T.C. Summ. Op. 2005-170 (2005) (Westlaw); Tobkin v. Comm'r, No. 6646–00S, T.C. Summ. Op. 2004-42 (2004) (Westlaw); I.R.S. Priv. Ltr. Rul. 2006-38-008 (2006); I.R.S. Priv. Ltr. Rul. 2001-41-036 (2001); I.R.S. Priv. Ltr. Rul. 96-10-019 (1996); I.R.S. Non Docketed Serv. Rev. 9303 (1990).

30. 245 U.S. 151 (1917).

31. *Id.* at 153–54 (citing Audubon v. Shufeldt, 181 U.S. 575, 577 (1901)).

32. Revenue Act of 1942, Pub. L. No. 77-753, § 120(a)–(b), 56 Stat. 798, 816–17.

33. H.R. Rep. No. 77-2333, at 46 (1942). *See also Revenue Revision of 1942: Hearings on H.R. 7378 Before the H. Comm. on Ways & Means*, 77th Cong. 92 (1942) (statement of Randolph Paul, Tax Adviser to the Secretary of the Treasury). One theory posits that the 1942 shift of the taxation of alimony but not child support was because obligations to support children "might have been considered to be stronger" than obligations to support wives. Deborah A. Geier, *Simplifying and Rationalizing the Federal Income Tax Law Applicable to Transfers in Divorce*, 55 Tax Law. 363, 372 (2002). Based on Congress's concern that payers would have insufficient funds after paying alimony, I posit that Congress might have distinguished child support, which a payer would owe regardless of the divorce because the child would have demanded similar resources.

34. H.R. Rep. No. 77-2333, at 46.

was thus focused solely on the payer.[35] In 1984, alimony's tax treatment was made elective by allowing taxpayers to opt out of the 1942 arrangement.[36] With this tax reduction, the conference report concludes that divorced couples might owe less in collective taxes than before or during marriage.[37] Nothing is said about who should, or would, enjoy these savings.

Because the tax treatment of property settlements and alimony differ (either as a deferral of the tax on transferred property's appreciation, or as a current deduction for the payer and an inclusion in income by the alimony recipient), spouses are expected to work together to minimize their collective taxes, as discussed further in Part III. This expectation exists despite the ABA's assurance in 1966 that "[r]arely, if ever, are tax shifting purposes dominant in divorces."[38] Tax planning upon divorce is also not unfettered. Congress created a recapture provision that undoes the favorable alimony taxation if the couple front-loads "alimony" payments in an effort to avoid property settlement taxation.[39] Thus, Congress kept some distinction, and denied complete flexibility, between alimony and property settlements. This also means the IRS is left to police the distinction between rules created as a political compromise aimed at collective tax reduction.

B. *Child Support*

Over one-quarter of all children living in the United States live in one-parent households.[40] Almost half of these children are entitled to child support.[41] Sadly, less than half of custodial parents receive the full amount of child support they are owed, and one-quarter do not receive any of the child support to which they are legally

35. *Id.*

36. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 422, 98 Stat. 494, 795–97. *See also* H.R. Rep. No. 98-861, at 1116 (1984) (Conf. Rep.). The House wanted to allow taxpayers to decide, within certain broad limits, who would be taxable on transfers; the Senate Finance Committee advocated elimination of the alimony deduction. O'Connell, *supra* note 17, at 494–97; Mattei, *supra* note 17, at 193 n.120. The Finance Committee tried to get women's groups to support elimination of the alimony deduction, also advocated in Part IV. Marjorie O'Connell, a member of the ABA's Task Force on this issue, met with these groups to urge them that the deduction allowed payers to meet their spousal support obligation. O'Connell, *supra* note 17, at 494–97.

37. H.R. Rep. No. 98-432, at 194 (1983). The House approved that "an overall tax savings generally results because the payer is normally in a higher marginal tax bracket than the payee." *Id.*

38. Brookes, *supra* note 15, at 63.

39. I.R.C. § 22(k) (1942); H.R. Rep. No. 98-432, pt. 2, at 1496–98.

40. Timothy Grall, Census Bureau, Custodial Mothers and Fathers and Their Child Support: 2011, at 2 (2013). Child support is not contingent upon marriage. Of the 81.7% of custodial parents who are women, more than one-third have never been married. *Id.* at 2–4.

41. There are 7.3 million custodial parents who do not have formal or informal agreements regarding child support. *Id.* at 5.

entitled.[42] This poor record exists despite the median annual child support award being $4,800, or $400 per month.[43] Unlike with property settlements and alimony, the tax treatment of child support has not changed over the years. Payers of child support do not receive a deduction for payments to custodial parents, and recipients do not include child support in their income. Arguably, this creates a disincentive to pay child support as opposed to alimony, which is tax-advantaged for the payer. In part in reaction to this tax result, courts and Congress have given divorcing parents some flexibility in classifying payments as child support or as alimony.[44]

Congress has long supported the existing tax treatment of child support because of concerns with the alternative.[45] For parents who share custody of a child, there is no tax deduction for the costs incurred for the care of the child beyond the child's personal exemption, the child tax credit, and other credits discussed later in this Part.[46] To grant a privilege to child support would create an economic benefit for divorced parents compared to joint custodial parents. In order to not create a new benefit, the payer does not receive a deduction and the recipient does not include child support payments in income.[47]

Because of the differences in the tax treatment of child support and alimony (child support taxed to the payer and alimony taxed to the recipient), questions arise whether payments are alimony or child support. Periodic payments for the support of a former wife and child, as opposed to being for the child alone, are taxable as alimony and not child support.[48] Therefore, family maintenance payments are taxable to the recipient and deductible by the payer. This favorable rule for payers is often referred to as the *Lester* rule, after *Commissioner v. Lester*, in which the Supreme Court gave judicial sanction to the minimization of taxable child support because no part of the case's "family support payment" was "fixed" as child support.[49] The Court reported, "Congress was in effect giving the husband and wife the power to shift a portion of the *tax burden from the wife to the husband* by the

42. *Id.* at 1. Although mothers are more likely to be entitled to child support, mothers and fathers are equally likely to be behind on their payments. *Id.* at 9.
43. *Id.* at 11. Of the amounts actually received, the median is $2,400 annually, or about $200 per month. *Id.*
44. In 1984, Congress continued the earlier rule that if a payer is delinquent in payments, the first amounts paid is attributable to child support rather than alimony. H.R. Rep. No. 98-861, at 1117 (1984).
45. *See* H.R. Rep. No. 77-2333, at 46 (1942); H.R. Rep. No. 98-432, at 1494 (1984).
46. The tax system provides no relief in the event of non-payment of child support or alimony. Rev. Rul. 93-27, 1993-1 C.B. 32; Perry v. Comm'r, 92 T.C. 470 (1989); Swenson v. Comm'r, 43 T.C. 897 (1965). *See also* Leandra Lederman, *Statutory Speed Bumps: The Role Third Parties Play in Tax Compliance*, 60 Stan. L. Rev. 695, 714 (2007).
47. I.R.C. § 71(c)(1) (2012). This treatment presumes the recipient parent does not benefit from the funds received. If a custodial parent benefits from child support, he or she could arguably pay taxes on some amount of child support as alimony.
48. S. Rep. No. 77-1631, at 86 (1942).
49. 366 U.S. 299 (1961), *aff'g* 279 F.2d 354 (1960).

use of a simple provision in the settlement agreement."[50] Since the last round of legislative changes, the Tax Court has ruled that it will not look into unallocated family support payments to determine how much it should view as child support;[51] thus, there is no requirement that any amount be taxable as child support, despite the presence of children.

When Congress acted in 1984, it expanded the definition of taxable child support, but not to the extent to abrogate spouses' choice. In conference, Congress expanded child support to include not only payments "fixed" as child support, but also payments contingent upon events related to a child, or at a time clearly associated with such a contingency.[52] The expansion makes it more likely that income is taxed as child support because it is harder for parents to change the tax consequences without changing their economic arrangement. Whether child support exists for tax purposes depends on how parents designate and shape their obligations to each other.[53] Throughout the limited congressional discussion, there was no mention of the welfare of the child or any desire to use the tax system to improve the child's welfare.

Thus, existing rules regarding payments made for the care of children, as interpreted by the Supreme Court and the Treasury Department, place great weight on the labeling and structuring of payments. These rules provide tax-planning opportunities to divorcing couples to choose their preferred tax result without necessarily providing greater support for children or the custodial parent.[54] Despite the fact that these groups are often in financial need, Congress limited their aid with this tax reduction.

C. Tax Rates, Deductions, and Credits

All taxpayers must annually calculate the amount of taxes they owe, and divorced spouses must each file a tax return.[55] Filing is often more complicated for

50. *Id.* at 304 (emphasis added).

51. Simpson v. Comm'r, 78 T.C.M. (CCH) 191 (1999); Lawton v. Comm'r, 78 T.C.M. (CCH) 153 (1999) (mother's EITC contingent upon child support characterization).

52. I.R.C. § 71(c); H.R. Rep. No. 98-861, at 1, 117 (1984) (Conf. Rep.). During congressional debates over the tax treatment of divorce in 1984, Congress initially ignored child support to such an extent that the Chair of the ABA Tax Section stated that he presumed *Lester* to be retained. *Hearing on H.R. 3475*, *supra* note 18, at 210 (statement of M. Bernard Aidinoff, Chair, Section on Taxation, American Bar Association).

53. For examples of other planning opportunities, see Wendy S. Goffe, *Estate Planning with Trusts for Divorcing Spouses*, 38 Fam. L.Q. 157, 163–64 (2004).

54. States often do not differentiate payments. Judith McMullen & Deborah Oswald, *Why Do We Need a Lawyer?*, 12 J. L. & Family Stud. 57 (2010).

55. I.R.C. § 6012 (2012).

divorcing parents because the tax system contains child-based tax benefits.[56] First, the Code provides a personal exemption deduction for qualifying children equal in amount to an adult's exemption.[57] Whoever claims a child's personal exemption is also entitled to the child tax credit and certain other tax benefits associated with that child. Second, the Code provides a greater EITC for low-income but wage-earning custodial parents.[58] The size of the credit increases with the number of children, up to three, that the custodial parent has. Third, the Code allows an unmarried custodial parent to file as a head of household. Not only does head-of-household status provide favorable tax rate brackets as compared to individual filers, it also increases the size of the standard deduction.[59] Because some benefits may be transferred by spousal agreement, the resulting system allows divorcing parents to maximize their child's tax benefits.

Congress grants divorce-specific flexibility for some, but not all, child-based benefits, and that flexibility results in complexity for divorcing couples who try to maximize their tax reduction. The complexity does not exist for non-divorced parents. For non-divorced parents, the same person must claim all child-based benefits, so it is an all-or-nothing choice.[60] That is not required of divorced parents; instead, some benefits may be split from the rest. Regardless of divorce, a child cannot be transferred for either head-of-household status or the EITC calculation

56. In 2004, Congress standardized the definition of "qualifying child" used in each provision, although not the age requirements the provisions impose. Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, §201, 118 Stat. 1166. To be a qualifying child, the person must satisfy a five-prong test. First, the individual must be the "child of the taxpayer;" a "descendant of such child;" or "a brother, sister, stepbrother, or stepsister of the taxpayer or a descendant of the sibling." I.R.C. §§ 152(c)(1)(A), (c)(2) (2012). Legally adopted individuals are treated as children by blood. § 152(f)(1)(B). Eligible foster children are also included. §152(f)(1)(C). Brothers and sisters include siblings by half-blood. §152(f)(4). Second, the individual must have "the same principal place of abode as the taxpayer for more than one-half" of the year, although as shown *infra* this requirement is optional for some purposes. I.R.C. §152(c)(1)(B). Third, the individual must be younger than the taxpayer and either (1) not yet nineteen years old at the end of the year, or (2) be a "student" who is not yet twenty-four years old at the end of the year, although some tax provisions impose a younger age requirement. I.R.C. § 152(c)(3)(A)(i). There is an exception for individuals who are disabled. I.R.C. § 152(c)(3)(B). Fourth, the individual cannot have provided over one-half of her own support for the year. I.R.C. § 152(c)(1)(D). Finally, the individual must not have filed a joint return for that year. I.R.C. § 152(c)(1)(E).

57. I.R.C. § 152.

58. Although a discussion is beyond the scope of this Article, eligibility for the EITC is based on custodial support and not parental status. I.R.C. § 32 (2012). The EITC is available to those without children, although the credit is significantly smaller. Rev. Proc. 13-15, 2013-5 I.R.B. § 2.05.

59. I.R.C. §§ 2(a), 63(c) (2012).

60. *See* I.R.C. § 152. Until 2003, only after divorce could children's personal exemptions be transferred between parents. Section 152(e) was extended to parents who were not previously married. King v. Comm'r, 121 T.C. 245 (2003).

unless custody of the child is transferred. These tax benefits depend upon custody, as do the dependent care credit[61] and the health insurance cost credit.[62] On the other hand, in the event of a divorce the custodial parent can relinquish to the other parent the child's personal exemption, and perhaps unknown to them, the parent who claims the exemption determines who may claim other tax benefits, such as the child tax credit, a credit for qualified tuition and related expenses,[63] and a credit for coverage under a qualified health plan.[64]

Today, a child's personal exemption can be transferred between parents if the custodial parent signs a written declaration that he or she will not claim the child as a dependent.[65] Thus, a custodial parent may transfer a child's exemption to the noncustodial parent for any reason and regardless of whether support payments were made. With the election, divorce overrides the requirement that a qualifying child reside for more than half of the year with the claiming parent. Congress's expectation was that this would maximize tax reduction and increase administrative convenience.[66] The Treasury Department noted that when used, support-based tests for dependency exemptions were heavily litigated, and the House Report agreed with eliminating support-based tests because of the "subjective and present difficult problems of proof and substantiation."[67] Support was, therefore, deemed to be too much to require for a child's exemption.

As a result of its transferability, legal confusion exists as to whether a child's exemption is the parents' tradable property. The Treasury Department does not permit court orders or separation agreements alone to transfer an exemption for fear that state courts may allocate exemptions in a manner inconsistent with federal law.[68] Nevertheless, children's personal exemptions are treated as marital assets by

61. I.R.C. § 24 (2012).
62. I.R.C. § 35 (2012).
63. I.R.C. § 25A(f) (2012).
64. I.R.C. § 36B (2012).
65. I.R.C. § 152(e); Treas. Reg. § 1.152-4(e)(1)(ii) (2014).
66. *See Hearing on H.R. 3475*, *supra* note 18, at 154 (statement of Ronald Perlman, Deputy Assistant Secretary (Tax Policy), Department of the Treasury).
67. *Id.* (stating that support claims composed 20% of the low income tax court cases); H.R. Rep. No. 98-432, at 1497 (1984).
68. H.R. Rep. No. 98-432, at 1498; T.D. 9408, 2008-33 I.R.B. 3. The Treasury Department was concerned that "[d]ivorce decrees, separation agreements, and similar instruments are complex documents that may be subject to differing interpretations governed by state law. Allowing these documents to serve as a written declaration creates complexity and uncertainty." T.D. 9408, 2008-33 I.R.B. 3. The ABA agreed. Section of Taxation, ABA, Comments Concerning Proposed Regulations Under Section 152(e) of the Internal Revenue Code 5 (Sept. 19, 2007), http://www.americanbar.org/content/dam/aba/migrated/tax/pubpolicy/2007/070919proposedregsundersec152e.authcheckdam.pdf. However, one scholar suggests that the divorce agreement should be sufficient proof of an intent or obligation to shift exemptions. Robert G. Nassau, *How to Split the Tax Baby: What Would Solomon Do?*, 61 Syracuse L. Rev. 83, 114–16 (2010).

some family courts, as discussed in Part III, to be allocated between parents in the same way as other accumulated property.

Not all tax benefits relating to qualifying children are transferrable in divorce and, therefore, severable from custody. The EITC and the head-of-household status are tied to custody of the child. Despite the custody limitation, maximization of tax reduction remains a goal of these provisions. For example, with respect to the EITC, when more than one person can claim a child, the law often demands allocation of the child to maximize tax reduction.[69] If both parents meet the requirements to claim the child, the child is mandated to be the qualifying child of the parent with whom the child lived for the longer period of time during the year. If both parents lived with the child for the same amount of time, the child is mandated the qualifying child of the parent who had the higher adjusted gross income for the year.[70] Thus, the rules create a default that may require the sharing of information regarding each spouse's financial position. This default focuses on tax reduction as the goal, rather than provision for the child.

Only with the head-of-household status does the tax benefit remain with the custodial parent and with a focus on support for the child. This status provides favorable tax rates and a larger standard deduction compared to filing as a single taxpayer.[71] The wider tax brackets of head-of-household status results in more income being taxed at lower tax rates; a larger standard deduction allows more income not to be taxed.[72] To qualify for head-of-household status, a taxpayer must not be married at the end of the year and must maintain a household that constitutes the principal place of abode for a qualifying child for more than one-half of the year.[73] This latter requirement requires the taxpayer to furnish over one-half of the cost of household maintenance, and the child to reside with the person claiming the status.[74] Head-of-household status cannot be transferred without transferring the child and the burden of support for that child.

Through the child-based tax provisions, Congress mixes a concern for children with a desire to grant parents tax reductions. For divorcing parents, there

69. IRS, Publication 596: Earned Income Credit (EIC) 11–14 (Nov. 20, 2013), http://www.irs.gov/pub/irs-pdf/p596.pdf. If a parent and non-parent have lived with a child for at least six months and one day, thereby each meeting the statute's requirements, the parent can choose to claim his or her child for purposes of the EITC. *Id.* at 12.

70. *Id.* at 12.

71. *See* I.R.C. §§1, 63(c)(2)(B) (2012).

72. *See* I.R.C. § 1. Although not all taxpayers claim the standard deduction, the majority of them do. In 2011, 67.6% of taxpayers claimed the standard deduction. *See* IRS, SOI Tax Stats—Individual Income Tax Returns Publication 1304 (Complete Report) tbl.A (2011), http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax-Returns-Publication-1304-%28Complete-Report%29. The choice of standard deduction or itemized deductions is provided in I.R.C. § 63(a)–(d).

73. I.R.C. § 2(b)(1) (2012).

74. I.R.C. § 2(b)(1)(B); Treas. Reg. § 1.2-2(b)(1) (2013).

are often choices to be made to maximize the reduction. These choices are not always easy to make.[75] Congress cut the tie between a child's personal exemption and the other benefits tied to that exemption, producing a lack of consistency among these various provisions. During their divorce, former spouses should allocate the tax benefits that they can, as they remember the effects of the provisions that cannot be allocated between them. The choice may change over the years as their financial situations evolve. Without a crystal ball regarding their own (and their former spouses') economic futures, transfers of a child's tax benefits upon divorce can trap even the most wary.

II. Problematic Premises

This Part examines three premises of the existing tax treatment of divorce-related events. First, these tax rules, intended to favor taxpayers, adopt a policy of shifting the tax burden of income from the higher-income spouse to the lower-income spouse. The objective is to reduce the couple's collective taxes. Second, many of the rules permit, or require, implicit or explicit elections be made by divorcing spouses in order to minimize their collective taxes. Those who make the wisest elections owe less in tax. Third, because Congress has created these special rules for the taxation of divorce-related events, instead of allowing the general rules of taxation to apply, marriage is given special recognition denied to other relationships.

Each facet of this tax policy unjustly limits who benefits from the tax reduction. Shifting the tax burden reduces collective taxes for only some divorcing couples, and not necessarily those couples who need tax relief the most. Moreover, especially because divorcing spouses are no longer a functioning couple, the sharing of any tax benefit between former spouses is not automatically equitable. Broadening the review of divorce-related taxation to include those couples who do not benefit from the relief, plus taxpayers not entitled to use these rules, should cause us to rethink existing law.

A. *Tax Shifting*

The tax benefit of divorce is most often created because soon-to-be former spouses shift the tax burden for income from a spouse in a higher tax bracket to one in a lower tax bracket. This shifting of taxation reduces a couple's collective taxes. This can be accomplished by shifting taxation of income (as with alimony), shifting gain following the sale of property (as with some property settlements), or shifting deductions and credits that offset other income (as with children's personal exemptions and the child tax credit). This tax shifting may have politically justified

75. *See* H.R. Rep. No. 98-432, at 1499–1500 (1984). The Treasury Department allows both parents to claim a child for the health care expense deduction and a few other provisions. I.R.C. § 213(d)(5) (2012); Rev. Proc. 2008-48, 2008-36 I.R.B. 1.

objectives. Nonetheless, as this Part will show, it has practically unjustified results.

When tax shifting generates tax reduction, its mechanics are straightforward. Consider Abe and Beth who divorce. Abe is expected to have significant amounts of income taxed in the 39.6% bracket; Beth is in the 10% tax bracket. In their divorce agreement, Abe agrees to pay Beth $5,000 per month for ten years, taxable as alimony. If Beth is taxed on the $5,000 payment, she owes $500 per month in taxes, but if Abe is taxed on the income, he owes $1,980 per month. As a result of the change in taxpayer for the alimony payment, $1,480 less is going to the government each month, and that "windfall" can be divided per the spouses' negotiations. Similarly, if Beth transfers each of their three children's $3,950 personal exemption to Abe, because of their different tax brackets, a combined $3,507.60 in taxes may be saved.[76]

Through the shifting of the tax burden, more income remains with the spouses because less revenue is paid to the government. Without the tax shifting, Beth would have owed less in tax, but the government would have taken a larger slice of Abe's income, leaving less to be divided. After the application of the divorce-related provisions, Beth owes more in taxes, but there is more money left over—initially Abe's. Thus, the shifting of taxes is often portrayed as an issue of collective taxes and not who pays the tax. Calculating the tax based on the lower-income spouse's rates creates the tax savings.

For both primary-earner and relatively equal-earner couples, the results of divorce without current divorce-related tax provisions would be the same as if the spouses had never married. Nevertheless, post-divorce tax shifting is accepted, at least in part, because of the perceived hardship that is caused by increasing couples' taxes upon divorce.[77] On one hand, primary-earner couples' taxes increase following divorce as a result of the loss of the marriage bonuses: joint filing's wider tax brackets and a number of other benefits reduce this group's tax relative to their filing as individuals. These benefits are lost upon divorce for primary-earner couples: a divorce penalty. On the other hand, two relatively equal-earner couples do not enjoy the marriage bonus, but suffer higher collective taxes when they marry than if they filed as individuals: a marriage penalty. Following a divorce, the two-earner couple has a divorce bonus by eliminating the marriage penalty. It was distaste for increasing the former's taxes relative to marriage that produced a tax benefit for this group alone.

Current divorce-related taxation continues the marital tax union for some couples. Primary-earner couples' alimony payments allow the higher-income spouse to shift the associated tax burden to the lower-income spouse, extending the bonus that existed in marriage. The justification for continuing the bonus in divorce is, effectively, that once these taxpayers have a tax boon, divorce is a bad time to

76. An exemption is worth $395 (or $3,950 times 10%) to Beth but $1,564.20 ($3,950 times 39.6%) to Abe. The difference of $1,169.20 per exemption is saved in collective taxes.

77. For additional information regarding congressional history of alimony, see notes 33 through 37, *supra*.

take it away. This divorce bonus, and the alimony payments that create it, are less likely for relatively equal-earner couples, who are more likely to be in the same (or at least a closer) tax bracket.[78]

Tax shifting thus focuses not on the income per se but on the taxation of that income. "The question presented is not whether income should be shifted from one spouse or ex-spouse to the other, but whether the income that in fact is shifted between the parties by local law should or should not be taxed to the recipient."[79] Congress, at least in its published reports, missed this important point. By labeling the gains from divorce as "income shifting," one is less likely to realize the issue is shifting the tax burden associated with income transferred under family law, or shifting the ability to claim child-based benefits but without shifting the child. Thus, the focus should not be on the income or the child, but on who pays the tax.

With little theoretical justification for what is more appropriately called "tax shifting," the ABA expressed concern that, without it, taxpayers would simply find other methods to reduce their taxes.[80] This concern that taxpayers will seek other means of tax avoidance could be made any time tax reduction is targeted. Nevertheless, assigning income to be taxed from lower-bracket taxpayers is generally prohibited, even though taxpayers have repeatedly found new means to do so. For example, in *Lucas v. Earl*,[81] the Supreme Court prevented income shifting via contract from a wage earner to his lower-taxed wife. Similarly, in *Helvering v. Horst*,[82] the Supreme Court disallowed the transfer of the taxes imposed on interest payments from the owner of the debt to his lower-taxed son. And much of partnership tax law has developed in an attempt to prevent partners from shifting income and deductions among them.[83] Despite the general prohibition on tax shifting, in the divorce context, Congress not only permitted, but also legislated in favor of, this means of tax reduction.

It is impossible to determine how many couples use these provisions to reduce their taxes. With respect to transfers of appreciated property, the tax provisions are favorable to couples who lack liquidity and who understand the time value of deferring taxation; however, there is not a lot of property that is covered by

78. Among dual income spouses, the wife's income has been found to have a significant moderate negative impact on the likelihood of an alimony award. Robert Kelly & Greer Fox, *Determinants of Alimony Awards: An Empirical Test of Current Theories and a Reflection on Public Policy*, 44 SYRACUSE L. REV. 641, 702 (1993).

79. "INCOME SHIFTING", *supra* note 18, at 5.

80. In 1982, members of Congress, in conjunction with an ABA Task Force, the American Institute of Certified Public Accountants Tax Divisions, and members of the Treasury Department, considered repealing Sections 71 and 215, which permit shifting the tax burden associated with alimony. *Id.* at 1–2.

81. 281 U.S. 111 (1930).

82. 311 U.S. 112 (1940).

83. I.R.C. § 704(b) (2012). *See also* ALAN GUNN & JAMES REPETTI, PARTNERSHIP INCOME TAXATION 43–45 (2005) (examining the Congressional intent behind revisions to Rule 704).

this rule. In 2010, the median net worth of U.S. families was $77,300.[84] This caps for many the amount of unrealized appreciation that can be deferred in divorce. Moreover, 25% of Americans had a negative net worth.[85] Of course, couples may have property encumbered by liabilities, and with married couples' home ownership rate at almost 80%, it is likely that many divorcing couples have some property to transfer.[86] As for alimony, in 2011, 583,411 returns deducted $10.7 billion paid in alimony.[87] Much of the deduction benefited wealthy payers of alimony. Although taxpayers with adjusted gross income of $250,000 or greater represented only a little more than 11% of the returns claiming the alimony deduction, the amount they deducted represented more than 35% of the total alimony deductions.[88] A few taxpayers have much at stake in their tax shifting arrangements.

But, although all divorcing couples are subject to these tax provisions, only a subset of couples benefit from tax shifting, and those who may benefit are not necessarily more worthy. Not only do divorcing couples need sufficient appreciated property or the income to make alimony payments, the former spouses must be in different tax brackets or be entitled to different tax benefits so that the burden is transferred from a higher-taxed to a lower-taxed spouse. If neither spouse owes tax, there is no benefit to tax shifting. Similarly, if both spouses owe tax but are in the same tax bracket, there is no tax savings from shifting the tax burden from one spouse to the other. Hence, the benefit of tax shifting is based on the tax position of the spouses relative to each other, and not relative to other divorcing couples.[89]

There are also situations where tax shifting produces higher collective tax burdens for couples—certainly not what Congress intended. If income is taxable to a lower-income spouse, that spouse might lose tax benefits, such as the EITC or dependent care credit, because the increased income pushes the spouse above income thresholds. What the lower-income spouse suffers in higher taxes and lost benefits might be greater than what the other spouse saves in taxes.

Similarly, certain tax benefits have little value for some higher-income taxpayers. For example, personal exemptions are normally more valuable to higher-bracket taxpayers than lower-bracket taxpayers because their value is the amount

84. Jesse Bricker, Arthur B. Kennickell, Kevin B. Moore & John Sabelhaus, *Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances*, 90 FED. RES. BULL. 1, 17 (2012).
85. *Id.*
86. *Id.* at 43.
87. IRS, INDIVIDUAL INCOME TAX RETURNS 2012: PUBLICATION 1304, at 1, 2 tbl.A, http://www.irs.gov/pub/irs-soi/12inalcr.pdf.
88. IRS, ALL RETURNS: SOURCES OF INCOME, ADJUSTMENTS, AND TAX ITEMS, BY SIZE OF ADJUSTED GROSS INCOME, TAX YEAR 2012, at tbl.1.4, http://www.irs.gov/uac/SOI-Tax-Stats---Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.
89. Men are increasingly the secondary earner within married couples and, therefore, the effects of tax shifting might soon favor women. RICHARD FRY & D'VERA COHN, PEW RESEARCH CENTER, WOMEN, MEN AND THE NEW ECONOMICS OF MARRIAGE 1–2 (2010).

of the deduction multiplied by the taxpayer's top marginal tax rate; however, Congress phases out personal exemptions at higher income levels under the regular income tax and has eliminated personal exemptions for purposes of the alternative minimum tax.[90] Once exemptions are phased out, they produce no tax reduction for the taxpayer claiming them. But just because a child's personal exemption has no value to one parent does not mean it can be allocated to the other; it is simply wasted. Thus, transferring the tax benefit to the wealthier spouse might result in no tax savings or even greater taxes owed if the lower income spouse could have benefited by the exemption.

The same type of tax wastage can occur with child-based tax credits. Although tax credits reduce the amount of tax owed dollar for dollar and are generally of equal value to all taxpayers, there are two situations this would not be the case—one which suggests allocating credits to the higher-income spouse and one which suggests allocating credits to the lower-income spouse. First, if the credit is not refundable and one spouse has no tax obligation, credits do not provide any tax benefit. Consequently, if the sole goal is tax reduction, the better choice is to allocate nonrefundable credits to the higher-income spouse, who is more likely to owe some amount of tax.[91] Refundable tax credits, on the other hand, provide some benefit to qualifying recipients without a tax obligation. Certain of these credits, including the child tax credit, also phase out and, therefore, have limited or no value for high-income taxpayers. Because of these limitations with the credits themselves, if the goal is to minimize collective taxes, it may or may not be optimal for transferable credits to be transferred to a higher-income or lower-income spouse depending on their relative tax situations.

These complex tax consequences need to be considered in their entirety at the time of the divorce to engage in effective tax planning, but the consequences are not always knowable. Consider the settlement of appreciated property: Couples who transfer appreciated property as part of their property settlement should negotiate their settlements in anticipation of the taxes imposed on the sale of the property. To illustrate, a couple jointly owns an investment portfolio worth $100,000 and in which the couple had invested a principal amount of $50,000. Before the transfer, the couple has a $50,000 tax basis for determining taxable gain or loss. In the divorce, the husband transfers his half of the portfolio to the wife. Under *Davis*, the husband would be taxed on his $25,000 share of the $50,000 of appreciation when he transferred his interest in the portfolio. The wife's basis going forward for determining her tax consequences on a sale of the investment asset would be $75,000: her share of the original $25,000 investment plus a $50,000 cost basis from acquiring her husband's half of the portfolio. If the wife sold the investment portfolio for $100,000, she would owe tax only on her original $25,000 of untaxed

90. I.R.C. §§ 56(b)(1)(E), 151(d)(3) (2012).

91. The transfer to higher-income spouse would result in incomplete use of tax credits if they phase out at higher income levels or there is another income-based imitation on credits.

appreciation. Under current law, the husband recognizes no gain on the transfer, and the wife carries over their $50,000 basis.[92] If she sells the investment, she owes tax on all $50,000 of gain.

The investment portfolio is worth less to the wife under current law than under *Davis*, but how much less is often unknowable at the time of the divorce. The appropriate discount off the portfolio's fair market value is the wife's tax rate at the time of a sale of the asset multiplied by the tax gain that would have been taxed to her former husband, in this example $25,000. But this gain is not always taxed. If the wife owns the investment until she dies, any appreciation goes untaxed (at least under today's tax code). Because of the tax uncertainty, spouses make choices with potentially significant tax implications with incomplete information, even if they make tax a top priority in their divorce.

Besides the often impossible knowledge required, this example highlights another, possibly more troubling aspect of tax shifting under today's Code: Even when there is collective tax reduction or tax deferral because of tax shifting, nothing in the law requires that the higher-income spouse compensate the lower-income spouse for that spouse's increased tax burden. Tax shifting, if effective at tax reduction, reduces the taxes of the wealthier spouse and increases the taxes of the lower-income spouse. If spouses recognize this tax result, they may include in their negotiations offsetting payments from the wealthier spouse to the lower-income spouse. Some assume the "current-law bias…encourages the payer to make larger payments than he or she would otherwise make and that leaves the payee with more after-tax cash than he or she would otherwise have . . . ."[93] However, to the extent the lower-income spouse is in the weaker negotiating position, possibly with less awareness of taxes, the tax shifting might be captured by the higher-income spouse.

Studies show that wives are in weak negotiating positions,[94] and therefore are likely to bear the brunt of the tax increase. Despite divorce leaving spouses, particularly wives, vulnerable,[95] these women see their taxes increase without a structural means of demanding a share of the tax reduction. Therefore, it is incorrect to think of the existing tax benefit as helping women. It helps the collective, which may, in turn, help a strong negotiator.

92. I.R.C. § 1041 (2012).

93. Geier, *supra* note 33, at 435.

94. *See* Catherine T. Kenney, *The Power of the Purse: Allocative Systems and Inequality in Couple Households*, 20 GENDER & SOC'Y 354 (2006); Amy Kroska, *Examining Husband-Wife Differences in the Meaning of Family Financial Support*, 51 SOC. PERSP. 63 (2008); Allen M. Parkman, *Bargaining Over Housework: The Frustrating Situation of Secondary Wage Earners*, 63 AM. J. ECON. & SOC'Y 765 (2008).

95. According to the Census Bureau, in 2009, 22% of women who had divorced in the previous twelve months were in poverty. Some 27% of recently divorced women had less than $25,000 in annual household income; and 23% of women who divorced in the past twelve months were more likely to receive public assistance (15% of recently divorced men). TIMOTHY GRALL, CENSUS BUREAU, CUSTODIAL MOTHERS AND FATHERS AND THEIR CHILD SUPPORT: 2009, at 1 (2011).

This tax planning imposes economic risk on the lower-income spouse in a divorce for pennies on the dollar in tax savings. Because the benefit of tax shifting is the difference between the spouses' tax rates, the total amount that can be saved is limited. Thus, tax shifting for divorcing spouses, with its weak theoretical justification, poses significant concerns for recipient spouses and custodial parents as well as the income tax itself. Even if one hopes that it would aid couples transition to being single, tax shifting is a poor mechanism to accomplish that goal. As discussed in Part IV, there are other means to address congressional concerns that raise fewer of the problems created by tax shifting.

B. Explicit and Implicit Elections

Some, but not all, of the tax provisions that affect divorcing couples contain an election that allows spouses to choose which spouse is taxed on transferred income or receives the tax benefit provided by a child-based benefit. Some, but not all, of the elections are explicitly provided in the statute with a default in the event a couple does not make an election. Other elections are not explicitly provided in the tax code but are no less available. Instead, these implicit elections involve the structuring of payments between spouses to adopt or avoid a given classification. With explicit and implicit elections, couples can choose their preferred tax treatments as long as they properly structure their divorce or post-divorce transactions, and as long as they are willing to accept the non-tax ramifications of those choices.

Just because these tax elections exist does not mean that everyone should or will consider taxation sufficiently important to trump other considerations. Considerations other than taxation may limit divorcing couples' choices.[96] For example, a spouse might be concerned that maintenance orders (also known as alimony or support payments) may be adjusted under state family law but property settlements are unlikely to be afforded the same flexibility. The fact that spouses have to choose which to sacrifice—a preferred tax result or a preferred family law result—is troubling but intentional.

One argument given for these explicit and implicit elections is that, "[b]ecause little revenue is at stake, the parties should be given full power to decide who, between

96. Other scholars have proposed maximizing choice or expanding tax benefits to encourage payments between divorced spouses. *See* Roland L. Hjorth, *Divorce, Taxes, and the 1984 Tax Reform Act: An Inadequate Response to an Old Problem*, 61 WASH. L. REV. 151, 187 (1986); Laurie L. Malman, *Unfinished Reform: The Tax Consequences of Divorce*, 61 N.Y.U. L. REV. 363, 367 (1986); Wendy Gerzog Shaller, *On Public Policy Grounds, a Limited Tax Credit for Child Support and Alimony*, 11 AM. J. TAX POL'Y 321, 337 (1994) (proposing credit for payer); Laura Bigler, Note, *A Change is Needed: The Taxation of Alimony and Child Support*, 48 CLEV. ST. L. REV. 361, 363 (2000) (proposing to tax alimony and child support to recipient).

them, should be taxed."[97] The idea of choice is appealing, but, as discussed in Part II, the congressional purpose was not individual autonomy, it was tax reduction. Favoring choice is also more reasonable when the choice can be meaningfully made by divorcing couples and with little cost, neither of which is the case with divorce-related elections.

But first, valuing choice for its own sake assumes there is little value in the government creating a tax system based on the most accurate definition of taxpayers' ability to pay taxes. Determining who should pay taxes based on a theoretically sound standard contributes to a sense of fairness and equity in the system. By creating elections, Congress confirms that there is no right answer as to who should owe the tax and, possibly, that no person *should* owe tax.[98] For example, if alimony should be taxed to the person who controls the income, the election to tax the payer has no theoretical foundation; if alimony should be taxed to the person who earns it, there is no justification for taxing the recipient.[99] If neither person is theoretically required to pay the tax, then maybe no one should owe the tax.

For those couples that benefit by maximizing their elections, factors other than a couple's worthiness for tax reduction determine their tax benefit. Not based on their ability to pay taxes or on another equitable theory, their reduction is based on their, and their lawyers', negotiating abilities and the spouses' relative taxable incomes. Thus, the elections allow well-advised and well-situated couples to reduce their taxes in violation of general norms of equity that demand that similarly situated taxpayers be taxed similarly and that those with greater ability to pay taxes pay more in tax.[100]

97. Geier, *supra* note 33, at 432. The ABA advocated "private ordering," or for taxpayers to have the choice as to who would pay the tax. *See also* ABA DOMESTIC RELATIONS TAX SIMPLIFICATION TASK FORCE, PRELIMINARY SPECIFICATIONS FOR SIMPLIFICATION OF DOMESTIC RELATIONS TAX LAW 1, 3–4 (1982) (advocating for "private ordering" or for taxpayers to have the choice as to who would pay the tax and failing to mention that the tax burden would generally be imposed on the lower-income recipient spouse).

98. For a discussion of why elections are problematic, see Emily Cauble, *Tax Elections: How to Live With Them if We Can't Live Without Them*, 53 SANTA CLARA L. REV. 421, 445–48 (2013); Heather M. Field, *Choosing Tax: Explicit Elections as an Element of Design in the Federal Tax System*, 47 HARV. J. ON LEGIS. 21, 22–25 (2010); Heather M. Field, *Tax Elections & Private Bargaining*, 31 VA. TAX REV. 1, 4–7 (2011) [hereinafter Field, *Tax Elections*]; George K. Yin, *The Taxation of Private Business Enterprises: Some Policy Questions Stimulated by the "Check-the-Box" Regulations*, 51 SMU L. REV. 125, 129–31 (1997); Edward Yorio, *The Revocability of Federal Tax Elections*, 44 FORDHAM L. REV. 463, 463–65 (1975).

99. Because tax-shifting focuses on collective tax reduction, it disregards the fact that there might be a theoretically appropriate person to tax for alimony. *See* Cauble, *supra* note 98, at 464–65, 472 n.234. The desire to create an optimal default for taxation of alimony payments also assumes that one spouse will not owe the tax. *See, e.g.*, Field, *Tax Elections*, *supra* note 98, at 64–65.

100. James Repetti & Diane Ring, *Horizontal Equity Revisited*, 13 FLA. TAX REV. 135, 135–36 (2012).

If the only goal of elections in the divorce context is tax reduction, the elections allow revenue to leak from the revenue system without a sound basis for the leakage. Leakage of any sort from a theoretically pure tax system is tax avoidance or, if illegal, tax evasion.[101] Therefore, these provisions provide congressionally supported tax avoidance. If divorced couples are encouraged to avoid taxes, should married couples and single individuals not do the same? In other words, if choosing tax reduction is good for one group, should it not be good for another?

Moreover, that this method of tax reduction may require wise use of elections increases the tax system's complexity and means that receipt of this tax relief is often not automatic. Not only are there risks of higher costs and misallocated resources with increased complexity,[102] but divorcing spouses must understand their choices and, possibly, work together to enjoy the intended tax benefit. Poorly advised spouses are unlikely to know about the elections or plan effectively. As many divorce litigants forgo lawyers, and pro se clients, in turn, tend to get less tax advice, unrepresented couples may be unaware of these tax consequences of their divorce.[103] And not all attorneys advise regarding the tax consequences of divorce.[104] One lawyer testified before Congress that, after hiring a divorce attorney, "it is not usual for a divorcing individual to think they need a tax lawyer."[105]

Even for those divorcing spouses with knowledge of taxation, these elections may not be salient.[106] Taxes may have little salience when a couple is faced with the other hardships incurred in a divorce, as divorce is one of the more stressful events a person can face.[107] In the midst of the trauma of divorce, the impact of the

101. Although we might want couples to equalize their earnings, it is unclear why they should be given a tax benefit to encourage that objective.

102. *See* Steven A. Dean, *Attractive Complexity: Tax Deregulation, the Check-the-Box Election, and the Future of Tax Simplification*, 34 HOFSTRA L. REV. 405, 410–11 (2005).

103. McMullen & Oswald, *supra* note 54, at 63 (citing ABA STANDING COMM. ON THE DELIVERY OF LEGAL SVRVS., RESPONDING TO THE NEEDS OF THE SELF-REPRESENTED DIVORCE LITIGANT 11–12 (1994)).

104. *See infra* notes 110, 230–31 and accompanying text (addressing counsel's potentially incomplete knowledge of both tax and divorce law).

105. *Hearing on H.R. 3475*, *supra* note 18, at 272 (comments by Marjorie A. O'Connell, Esq., O'Connell & Associates).

106. For more on salience in taxation, see Brian Galle, *Hidden Taxes*, 87 WASH. U. L. REV. 59, 63 (2009); David Gamage & Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 TAX L. REV. 19, 19–20 (2011); Edward J. McCaffery & Jonathan Baron, *Isolation Effects and the Neglect of Indirect Effects of Fiscal Policies*, 19 J. BEHAV. DECISION MAKING 289, 289 (2006); Deborah H. Schenk, *Exploiting the Salience Bias in Designing Taxes*, 28 YALE J. ON REG. 253, 255 (2011); Raj Chetty, Adam Looney & Kory Kroft, *Salience and Taxation: Theory and Evidence* 1–2 (Nat'l Bureau of Econ. Research, Working Paper No. 13330, 2007).

107. *See* Paul R. Amato, *The Consequences of Divorce for Adults and Children*, 62 J. MARRIAGE & FAM. 1269, 1273 (2000); Matthijs Kalmijn & Christiaan W.S. Monden, *Are the Negative Effects of Divorce on Well-Being Dependent Upon Marital Quality*, 68 J. MARRIAGE & FAM. 1197, 1197–99 (2006).

couple's choices on their individual taxes may not be intuitive. With the explicit elections, there is nothing on the tax return that alerts spouses to their right to opt out of defaults.[108] Additionally, there is nothing on the tax return about implicit elections because they depend upon how couples structure their obligations. The fact that some elections are explicit in the statute might, nonetheless, reinforce the expectation that divorcing spouses are aware of, and understand, their choices.

Thus, spouses' knowledge of, and ability to optimally use, the explicit and implicit elections varies. As a result, divorce taxation "continues to generate an overabundance of confusion and litigation . . . an unfortunate and unnecessary cost to both the government and divorcing couples."[109] Some couples likely do not optimize their tax reduction due to lack of awareness of the rules because some taxpayers, and, more egregiously, their advisors, do not know the tax consequences of their choices.[110] On the other hand, many others understand them well enough to litigate in the hope of favorable outcomes.[111] Some couples even plan ahead and request rulings or tax opinions about the tax consequences of their divorce settlements.[112]

In the face of an information deficit by some, but not all, divorcing couples, the flexibility Congress and the ABA value may only add to the difficulty of divorce and may not produce optimal tax results for many couples. Many people do not respond well to having many choices.[113] If divorcing spouses fail to make wise use of their choices, the current system presents a risk of giving a windfall to payers (and the well-advised) and a burden to recipients (and the vulnerable).

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108. To increase salience, Congress could require a closing of the books tax return for spouses, as required for short-year businesses after terminations. *See* Treas. Reg. § 1.6012-2(a)(2) (2010).

109. Geier, *supra* note 33, at 409.

110. *See, e.g.,* Pettet v. U.S., No. 7:96-CV-55-F3, 1997 U.S. Dist. LEXIS 19127, at *18 (E.D.N.C. Nov. 4, 1997) (recounting that the taxpayer, attorney, and accountant testified they were not familiar with the tax requirements of alimony).

111. *See generally* Melvin v. Comm'r, 95 T.C.M. (CCH) 1425 (2008), *aff'd*, 303 Fed. Appx. 791 (11th Cir. 2008) (holding that the petitioner was not entitled to the claimed deduction for alimony); Burkes v. Comm'r, 75 T.C.M. (CCH) 1772 (1998) (holding that petitioner was not negligent for reasonably relying on her attorney).

112. For examples of couples requesting rulings and tax opinions in advance of their divorce, see Cunningham v. Comm'r, 68 T.C.M. (CCH) 801, 801 (1994); I.R.S. Priv. Ltr. Rul. 126246-11, at 2 (Feb. 10, 2012); I.R.S. Priv. Ltr. Rul. 135343-09, at 1 (June 18, 2010); I.R.S. Priv. Ltr. Rul. 133864-09, at 1 (Apr 23, 2010).

113. *See* President's Advisory Panel on Fed. Tax Reform, Simple, Fair, and Pro-Growth 91 (2005) (arguing taxpayers are paralyzed by savings choices). *See generally* Barry Schwartz, The Paradox of Choice: Why More is Less (2004) (arguing too much choice can be paralyzing).

And even within this rubric, not all spouses have a choice about the allocation of their tax burdens.[114] For example, children's personal exemptions are often considered a family asset.[115] Family courts use the elective nature of the exemption to transform it into tradable property. Not all states do so, but thirty-five states' courts routinely exercise their power to allocate exemptions, directing the custodial parent to execute the necessary written declarations to transfer children's exemptions.[116] One could argue that greater marital assets may smooth the way for other aspects of divorce planning. However, this use of the exemption fundamentally changes what it is by severing the exemption from the child whose existence justifies the deduction.

Whether or not judges compel certain choices, to plan properly, spouses must accurately anticipate both their relative earnings for the period in which the tax shifting will take place, and changes in the tax law that may be independent of divorce taxation. Depending on the mood of Congress, the future of people's earnings may be more predictable than the future of the tax law.

Changes in law are unpredictable in part because Congress may not even consider important tax changes' impact upon divorce agreements. For example, the phasing out of benefits may negate tax shifting's savings, but it is unlikely divorced couples' concerns will be raised in congressional debates on the topic. While the phaseout of personal exemptions for high-income taxpayers was first applied in 1988,[117] the phaseout was itself phased out beginning in 2006,[118] eliminated entirely in 2010, and the phaseout of the phaseout was repealed beginning after 2012, all

114. California uses computer software, DissoMaster, to calculate tax-minimizing allocations. This black box approach obscures allocations, further divorcing them from any broader goals than tax reduction, while still not responding to potential changes in circumstance or the tax law. *See Calculate Child Support*, CAL. DEPT. CHILD SUPPORT SERVS., http://www.childsup.ca.gov/Resources/CalculateChildSupport.aspx (May 2, 2015).

115. The National Taxpayer Advocate argues exemptions should only be allocated voluntarily. NAT'L TAXPAYER ADVOCATE,, FY 2001 ANNUAL REPORT TO CONGRESS 109 (Dec. 31, 2001), http://www.irs.gov/pub/irs-utl/2001_tas.pdf. Under regulations, if a noncustodial parent is entitled to an exemption under a divorce agreement and the custodial parent refuses to assign the exemption, the noncustodial parent can sue in state court over the divorce decree. *See, e.g.*, Bojarski v. Bojarski, 41 A.3d 544 (Me. 2012); Spencer v. Spencer, No. 30320, 2011 WL 4537845 (Haw. Ct. App. Sept. 30, 2011).

116. NAT'L TAXPAYER ADVOCATE, *supra* note 115, at 110–17.

117. Tax Reform Act of 1986, Pub. L. No. 99-514, § 103, 100 Stat. 2085.

118. Section 151(d)(3)(F) provided that the phaseout provision expired on December 31, 2009. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107–16, § 102, 115 Stat. 38. This amendment was scheduled to sunset at the end of 2010. *Id.* at § 901. However, Section 101 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended this sunset until the end of 2012. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 101, 124 Stat. 3298.

without comment on the effect on divorced couples.[119] If a divorce decree is finalized in a year when a phaseout is not in effect, its tax plan is unlikely to be optimal for wealthy primary-earner couples under the phaseout. Similarly, if a divorce decree is finalized when there is a phaseout, the plan is likely not optimal if the phaseout lapses. In the event that spouses do not accurately anticipate changes in the law, the couple may suffer higher taxes.

And though knowledge may bring power, flexibility risks generating taxpayer frustration when taxpayers and their lawyers structure transfers to achieve particular tax results, but without a willingness to bear all of the burdens of that structure. For example, for payments to be taxable as alimony, the payments must terminate at the recipient's death. The implicit election to make a property settlement qualify as alimony requires inclusion of this feature. Thus, the election requires the recipient bear the risk that, if the recipient dies, her estate will not receive the payment. If a couple fails to accept this limitation, as in *Rosenthal v. Commissioner*,[120] it is insufficient for them to claim the payments are "reportable by Wife and deductible by Husband" as their agreement provided. Incomplete private ordering may be the worst of all worlds for couples.

There are other costs associated with the elections that divorcing couples might not recognize. For instance, to elect out of the default property settlement rules (by selling the property and distributing cash) imposes current taxation on the payer. Similarly, if a couple explicitly elects out of alimony, the payer must pay the tax on transfer payments. On the other hand, if there is an implicit election out of alimony tax treatment, it might be because the couple structures the payments as child support (in which case the payer is taxed) or as property settlements (in which case the tax may be deferred). For many, the costs imposed by the choices, required by the many tradeoffs divorce demands, may be difficult to keep straight.

One cost that is often recognized with divorce-related taxation is administrative cost. The taxpayer's costs have been discussed above, but no less troubling are those imposed on the government. For example, in 2010, 47% of returns with alimony deductions did not match a recipient's return reporting the income.[121] The Treasury Inspector General for Tax Administration analyzed 567,887 returns for 2010 and found a "discrepancy of more than \$2.3 billion in deductions claimed without corresponding income reported."[122] Because of various limitations imposed by the IRS, only 10,870 of the 266,190 that were identified as having a discrepancy were examined further.[123]

119. From a review of congressional reports. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 101(b)(2), 126 Stat. 2316.
120. 70 T.C.M. (CCH) 1614, 1615 (1995).
121. Treasury Inspector Gen. for Tax Admin., Dep't of the Treasury, Significant Discrepancies Exist Between Alimony Deductions Claimed by Payers and Income Reported by Recipients 4 (Mar. 31, 2014), http://www.treasury.gov/tigta/auditreports/2014reports/201440022fr.pdf.
122. *Id.*
123. *Id.* at 5.

Addressing the discrepancy over alimony is among the easier administrative tasks for the IRS with respect to divorce-related taxation. The transfer of child-based benefits poses greater problems. Despite the requirement that noncustodial parents must attach a waiver to claim exemptions, the IRS has difficulty enforcing this requirement, at least initially. Only on audit are the benefits disallowed.[124] Audit is triggered if two people claim the same child because of the duplication of the child's Social Security number. Nonetheless, the first parent to file is likely to receive the benefits, and any ensuing tax refund, until the audit is complete, and possibly forever if the spouse who incorrectly receives a refund is judgment-proof.[125] The second parent to claim the child, even if lawfully entitled to do so, is denied proper deductions and credits until the audit is complete.

Perhaps more troubling from the administrative perspective is sorting out payments when no one is willing to pay the tax. Much of the litigation over these payments is the result of neither spouse reporting income and, therefore, neither spouse paying the taxes due.[126] Each claims that either an explicit or implicit election was made that shields the spouse from the tax obligation.[127] It is impossible to know whether the spouses plan the tax evasion together, or if instead, a single spouse simply takes the opportunity not to report the income. The results are clear, however. The IRS continues to confront numerous cases regarding who should owe tax on transfers incident to divorce.[128]

Because only some divorcing couples are in a position to effectively use these elections and they often give rise to tax abuse, the flexibility needs to be removed for all. Instead of creating a system in which well-advised taxpayers can reduce their collective taxes, and in the process hopefully share the savings in an equitable way, Congress should dole out its largess in a way that is more intentionally equitable. Flexibility for its own sake is not a virtue in taxation, and elections are not without costs. Part IV below proposes a simple tax system that provides for divorcing couples.

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124. Nassau, *supra* note 68, at 112.
125. *Id.* at 112 n.138.
126. *See supra* note 26 and accompanying text; Schutter v. Comm'r, 242 F.3d 390 (10th Cir. 2000); Richardson v. Comm'r, 125 F.3d 551 (7th Cir. 1997); Hoover v. Comm'r, 102 F.3d 842 (6th Cir. 1996); Sa'd v. Comm'r, 104 T.C.M. (CCH) 784 (2012); Murphy v. Comm'r, 71 T.C.M. (CCH) 3144 (1996).
127. Congress is aware of this problem. *Hearing on H.R. 3475*, *supra* note 18, at 264 (statement of Marjorie O'Connell, Esq., O'Connell & Associates).
128. The government often sends inconsistent notices to each spouse to protect federal revenue because one taxpayer will win in court, but this approach risks political backlash. *Richardson*, 125 F.3d at 553; *Murphy*, 71 T.C.M. (CCH) at 3144. When the IRS settled for tax on half of the alimony with the wife, a court held that settled the appropriate tax treatment for the husband. Christoph v. United States, 919 F. Supp. 1576 (S.D. Ga. 1995).

C. Family Classifications

Through the enactment of divorce-related tax provisions, Congress determined that terminating a marriage is a sufficiently unique occurrence that it deserves special tax treatment. Although ceasing to be a partner or shareholder receives special provision in the Code,[129] the termination of most relationships is not subject to special rules. What is troubling with respect to divorce is that partner and shareholder statuses are available to everyone; general availability is not the case with divorce. Only couples (and in thirteen states only heterosexual couples) who otherwise meet their state's requirements and choose to marry can divorce. The system treats these relationships differently, and for some couples, favorably. This differentiation, whether or not economically beneficial to the couples, is problematic.

Special treatment in the tax system provides the government's support for marriage by easing the burden on couples who leave marriage. As of the 2010 census, 58% of men and 55.2% of women over the age eighteen were married; however, only 48.4% lived in a husband-wife household.[130] This is an increase from the 2000 census for marital status, in which the percentage of those over fifteen was about 54.4%; however, the number of married couples living together has decreased from 51.7%.[131] Thus, the valued relationship, the one once seen as the normal relationship, is far from universal, and it is arguably less normal than it used to be.

For those who are married, there are theoretical problems with extending tax advantages to the termination of the relationship. Subject to some debate beyond the scope of this Article, the argument can be made (as I have made elsewhere) that joint taxation measures a married couple's ability to pay taxes in a way it does not for most roommates, siblings, or friends.[132] Additionally, taxing spouses as two separate individuals imposes a difficult tracking burden between them.

129. I.R.C. §§ 331, 736 (2012).

130. Daphne Lofquist, Terry Lugaila, Martin O'Connell & Sarah Feliz, U.S. Census Bureau, 2010 Census Briefs: Households and Families 5 (2012), http://www.census.gov/prod/cen2010/briefs/c2010br-14.pdf; U.S. Census Bureau, Statistical Abstract of the United States: 2012, at 53, tbl.57 (129th ed. 2012), http://www.census.gov/compendia/statab/2012/tables/12s0057.pdf.

131. Lofquist et al., *supra* note 130.

132. Stephanie Hunter McMahon, *To Have and to Hold: What Does Love (of Money) Have to Do with Federal Tax Filing?*, 11 Nev. L.J. 718 (2011). *But see* Grace Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 Buff. L. Rev. 49 (1972); Amy C. Christian, *The Joint Return Rate Structure: Identifying and Addressing the Gendered Nature of the Tax Law*, 13 J.L. & Pol. 241, 242 (1997); Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 Tex. L. Rev. 1, 4 (1980); Marjorie E. Kornhauser, *Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return*, 45 Hastings L.J. 63, 64 (1993); Shari Motro, *A New "I Do": Towards a Marriage-Neutral Income Tax*, 91 Iowa L. Rev. 1509, 1512 (2006); Bea Ann Smith, *The Partnership Theory of Marriage: A Borrowed Solution Fails*, 68 Tex. L. Rev. 689, 692 (1990); Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. Cal. L. Rev. 339, 339–40 (1994).

The information necessary to know who should be taxed on income may not be kept but for tax purposes. These justifications for the special treatment of married couples no longer apply once the marriage has been terminated.

Although one could argue that after divorce former spouses still share resources, the similarity between married and divorced couples ends there.[133] With the divorce decree, sharing and comingling of funds beyond any legal requirement presumably ends. Increases in one's wealth generally do not improve the other's standard of living, and it often requires legal intervention for declines in one's income to reduce payments.[134] Information regarding this legally mandated sharing is also available in divorce documents, significantly reducing much of the administrative concern of tracing finances within marriage. Therefore, one person's wealth may support more than one person, but after divorce, it is less persuasive to argue that two people function as an economic unit or that administrative problems prevent the tracking of transfers.

Nonetheless, making divorce trigger tax recognition is an imperfect measure for the end of economic unity or administrative complexity. However, the federal tax system's use of a bright-line rule for state-defined marriage makes divorce-related provisions more administrable, and limits the revenue lost to the federal government through the tax planning of other couples. Using marriage and divorce as a proxy, the government does not have to determine who acted like they were married; it must only consider whether they were once legally married, and that they no longer are. Moreover, the rule is generally easy to understand because the status of marriage is a broad one that exists outside of tax. Confusion does exist at the margins as to when couples are legally married, and therefore when they can divorce.[135] Additionally, not all of those who marry are currently able to divorce, as some states do not allow those legally married under foreign law to use their domestic divorce proceedings.[136]

Relationships whose terminations do not receive special tax assistance are marginalized by existing tax law that favors marriage. One scholar argues that the joint return begins with a certain family arrangement as the "*only* relevant type of family."[137] That same definition carries through when the Code recognizes the

133. Marital status is an indicator of increased economic position, at least for educated spouses. FRY & COHN, *supra* note 89, at 3.

134. *See* JOHN DEWITT GREGORY, PETER NASH SWISHER & ROBIN FRETWELL WILSON, UNDERSTANDING FAMILY LAW 374–85, 402–08 (4th ed. 2013).

135. *See id.* at 36–61; WADLINGTON & O'BRIEN, *supra* note 5, at 24–31.

136. Tracy A. Thomas, *Same-Sex Divorce*, 5 CAL. L. REV. CIRCUIT 218 (2014); *Judge: Married Women Can't Divorce in Alabama*, ASSOCIATED PRESS NEWSWIRE, Mar. 12, 2014, *available at* Factiva, Doc. No. APRS000020140312ea3c002y5; David Crary & Holbrook Mohn, *Divorce is the Latest Gay Rights Battle Facing Same-Sex Partners*, HUFFINGTON POST (Dec. 1, 2013), http://www.huffingtonpost.com/2013/12/02/in-some-states-gays-fight_n_4372851.html.

137 Anthony C. Infanti, *Decentralizing Family*, 2010 UTAH L. REV. 605, 606–07 (2010).

termination of only that type of relationship. This division between couples is not based on equitable principles of taxation, but by marital status under state family law. This benefit is limited despite concerns raised for unmarried couples, siblings, roommates, same-sex relationships in states that do not allow same-sex marriage, and more.

The group of taxpayers who are not married is significant. In 2010, single-person households composed 26.7% of the population, family households headed by a woman with no husband present were 13.1%, and family households headed by a man with no wife present were 5.0%. Unmarried-couple households were 6.6% of the population and all other multi-person households were 6.8%.[138] The existence of many different types of relationships, each of which might involve the transfer of property or support, should make us question the validity of tax reduction for some individuals in one particular type of relationship.

In particular, there are many types of romantic relationships whose termination is not governed by divorce-related taxation. For example, although thirty-seven states (plus the District of Columbia)[139] currently recognize same-sex marriage, in the other thirteen states couples are unable to use the state family law regime to referee the termination of their relationships. And eight states[140] have civil unions or domestic partnerships granting privileges similar to marriage. It is uncertain how these couples should be taxed. Couples married under common law principles must file as married,[141] but must couples who enter into civil partnerships? Should it matter if a civil partnership is the only legal relationship granted to same-sex couples in the state? Do opposite-sex couples who enter into civil partnerships receive the same tax treatment as same-sex couples? Should the termination of these other relationships be governed by divorce-related tax rules?

The complications these terminations have in non-tax respects carry over into their tax treatment. There is currently little statutory provision for post-termination obligations between same-sex couples in states that do not recognize same-sex marriage, both with respect to the obligations themselves, and to the tax treatment thereof.[142] The common law of many states requires that among unmarried couples, whether or not the parties are of the same-sex, a wealthier member provide palimony to the other following the termination of their relationship if the potential recipient can meet a high burden of proof regarding the nature of the relationship. Palimony is an extension of alimony and property division among couples who were not legally married, but who entered into a similar type of contract. Consequently,

138. Lofquist et al., *supra* note 130, at 6.

139. *Where State Laws Stand*, Freedom To Marry, http://www.freedomtomarry.org/pages/where-state-laws-stand (Feb. 11, 2015). This area of law remains in a state of flux. In 2015, the Supreme Court will review the freedom to marry in cases arising in Kentucky, Michigan, Ohio, and Tennessee. *Id.*

140. *Id.* (California, Hawaii, Illinois, Nevada, New Jersey, Oregon, Rhode Island, and Washington).

141. Rev. Proc. 2013-17, 2013-11 I.R.B. 2.

142. *See supra* note 136 and accompanying text.

lawyers can argue that their clients have rights to accumulated wealth regardless of who holds legal title to that wealth; however, this lawsuit requires proof of a private contract that the relationship would be treated with the same legal status as marriage.[143] California first recognized the equitable rights of long-term cohabitants in *Marvin v. Marvin*[144] in 1976, and most states have followed suit. If unmarried cohabitants do not prove the contract elements of the lawsuit, most states do not allow them to avail themselves of state family divorce law.[145]

For those terminations that warrant palimony, even though substantively similar to alimony and property settlements, the payments are not taxed pursuant to the divorce rules. There are three possible tax treatments for palimony, but the question of which treatment applies is not well-settled. First, transfers or payments could be characterized as gifts. In this case, the payer must pay tax when earning the income used to provide the gift, and is also subject to the gift tax; however, gifts are excluded from the recipient's income.[146] Because of the favored tax treatment of recipients, what constitutes a gift for tax purposes has been the subject of litigation. In *Commissioner v. Duberstein*, the Supreme Court largely defined gift by reference to the payer's motives.[147] The Court requires payers give the gift with "detached and disinterested generosity" in order for the transfer to be excluded from the recipient's income. A payment proceeds from "a detached and disinterested generosity" if it is made "out of affection, respect . . . or like impulses," only then it is an excludible gift.[148] Payments for services rendered, or if there is a moral or legal duty motivating the payment, are not gifts and are not, therefore, excludible from income. Thus, the determination that these payments are gifts is more likely if there is no legal obligation to provide them.[149]

143. Patricia A. Cain, *Taxing Families Fairly*, 48 SANTA CLARA L. REV. 805, 830–31 (2008); Wendy C. Gerzog, *Shapiro: Palimony and the Estate Tax*, 131 TAX NOTES 859 (2011).

144. 557 P.2d 106, 110 (Cal. 1976).

145. GREGORY ET AL., *supra* note 134, at 26–27; WADLINGTON & O'BRIEN, *supra* note 5, at 48–49.

146. I.R.C. §102 (2012). For a discussion of the taxation of gifts, see Joseph M. Dodge, *Beyond Estate and Gift Tax Reform*, 91 HARV. L. REV. 1177 (1978); Douglas A. Kahn & Jeffrey H. Kahn, *"Gifts, Gafts, and Gefts"—The Income Tax Definition and Treatment of Private and Charitable 'Gifts' and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441 (2003); William A. Klein, *An Enigma in the Federal Income Tax: The Meaning of the World 'Gift'*, 48 MINN. L. REV. 215 (1963); Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 24 CONN. L. REV. 1, 28–37 (1992).

147. 363 U.S. 278 (1960).

148. *Id.* at 285.

149. Courts often, but not always, find transfers between unmarried cohabitants were a gift and subject to the gift tax. *See, e.g.*, Merrill v. Fahs, 324 U.S. 308 (1945); Comm'r v. Wemyss, 324 U.S. 303 (1945); United States v. Harris, 942 F.2d 1125 (7th Cir. 1991); Reis v. Comm'r, 33 T.C. (CCH) 1333 (1974); Pascarelli v. Comm'r, 55 T.C. 1082 (1971). *But see, e.g.*, Green v. Comm'r, 54 T.C.M. (CCH) 764 (1987) (holding that where a woman sued for

Second, an extra-statutory notion of non-taxable support could allow the recipient of palimony to exclude any income received on the termination of the relationship.[150] Despite the lack of statutory basis, support receives special tax treatment in other contexts.[151] Similar to the treatment as a gift, support would require only a single layer of taxation; however, while the payer would owe tax when earning the income used to provide the support, the payer would not be subject to the gift tax. Although favorable, this position of excludible support is a risky one to take. The existing exclusion for support for tax purposes is narrow and, without congressional sanction, is unlikely to be expanded.

The exclusion for support is limited for numerous reasons: the costs it imposes on the government, the opportunity it provides for tax gamesmanship, the fact that the greatest benefit of exclusion goes to higher-income individuals, and the difficulty of deciding how much of any payment constitutes support.[152] One form of excluded support is child support, and it is excluded without a special code provision mandating its exclusion.[153] Additionally, the IRS has accepted that government support is excluded from the recipient's income, although Congress reacted to the exclusion by requiring the inclusion of some government benefits.[154] Enlarging the support exclusion to include palimony is to risk the problems of exclusion, not only for palimony itself, but for any newly-created support obligations. To the extent that society imposes new obligations on taxpayers for support, such as the enforced

compensation, receipt of money was compensation). The courts' focus is on state law. For example, when one member of an unmarried couple died, the estate argued homemaking services were insufficient to support a cohabitation contract. Estate of Shapiro v. United States, 634 F.3d 1055 (9th Cir. 2011). The Ninth Circuit overturned based on its reading of Nevada contract law (rather than tax theory), which permitted the provision of an estate in return for homemaking services. *Id.*

150. *See* Alice G. Abreu & Richard K. Greenstein, *Defining Income*, 11 Fla. Tax Rev. 295, 299 (2011); Patricia A. Cain, *Federal Tax Consequences of Civil Unions*, 30 Cap. U. L. Rev. 387, 402–03 (2002) (assuming support should be excluded from income).

151. Audubond v. Shufedt, 181 U.S. 575 (1901) (stating that in bankruptcy alimony is awarded special treatment and not treated as a debt because it is a general obligation of support).

152. One risk of expanded support is drawing a line around what is excludible support and what, if any, must be included in income. Rules for defining child support would not necessarily carry over to the adult context.

153. *See supra* Part I.B.

154. I.R.C. § 86 (2012); I.R.S. Notice 11-14, 2011-11 I.R.B. 544 (excluding certain homeowner aid from income); I.T. 3194, 1938-1 C.B. 114 (1938) (excluding social security from income). *See* Robert W. Wood & Richard C. Morris, *The General Welfare Exception to Gross Income*, 109 Tax Notes 203 (2005).

support of elderly parents by their children,[155] similar arguments can be made as those concerning palimony. Instead of this expansion, we should recognize these legally mandated payments as a source of income for the recipient.

Third, palimony could be taxed to both payer and recipient. Although the most legally appropriate option, this characterization is politically unlikely because of the discrepancy in treatment compared to current divorce taxation. A cornerstone of the federal income tax is that increases in wealth, clearly realized by the taxpayer, and over which the taxpayer has control, is income subject to tax unless a specific provision exempts the taxpayer from taxation.[156] In *Commissioner v. Glenshaw Glass*, the Supreme Court held that punitive treble damages awarded under antitrust laws were income to the recipient.[157] "The mere fact that the payments were extracted from the wrongdoers as punishment for unlawful conduct cannot detract from their character as taxable income to the recipients."[158] Unless Congress acts, there are "no limitations as to the source of taxable receipts, nor restrictive labels as to their nature."[159]

The broad rule of inclusion into income created by *Glenshaw Glass* applies even if the income is used to pay a debt. Except in limited circumstances, when a taxpayer earns income to pay a debt, the taxpayer is taxed on the earnings, and if a taxpayer uses appreciated property to settle a debt, the taxpayer is taxed on the appreciation.[160] Receipt of the payment is also an increase in wealth for the recipient, so the receipt is also subject to tax.[161]

If the *Glenshaw Glass* theory is adopted, the gain on appreciated property transferred between former partners would be taxable to the payer, just as a realization of the gain and receipt of the property would be taxable to the recipient as increased wealth. Similarly, payments of newly earned income for ongoing support would be taxable to both payer and recipient. The payer owes taxes on earning the income and does not receive a deduction for the payment of a personal obligation; the recipient owes taxes when receiving payment of an

155. Although rarely enforced, twenty states have laws that require adult children to provide financial support for their parents if their parents cannot afford to take care of themselves. Francine Russo, *Caring for Aging Parents*, TIME (July 22, 2013), http://healthland.time.com/2013/07/22/caring-for-aging-parents-should-there-be-a-law; *see also* Shannon Frank Edelstone, *Filial Responsibility: Can the Legal Duty to Support Our Parents Be Effectively Enforced?*, 36 FAM. L.Q. 501 (2002). These filial responsibility laws are generally limited to necessities, so the recipient would presumably be in a low tax bracket.

156. Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).

157. For a discussion of Glenshaw Glass, see Joseph M. Dodge, *The Story of Glenshaw Glass: Towards a Modern Concept of Gross Income*, *in* TAX STORIES 15 (Paul L. Caron ed., 2d ed. 2009).

158. 348 U.S. at 431.

159. *Id.* at 429–30.

160. I.R.C. § 61 (2012).

161. *Id.*

obligation owed by the payer.[162]

Thus, there are three ways that palimony could be taxed. Although the tax treatment of same-sex couples has received much attention,[163] the proper tax treatment of them as unmarried couples has yet to be resolved. As a practical matter, transfers are likely to be viewed as gifts or support, if only for political necessity because of the comparison between palimony payments and those made upon divorce. However, this extension of tax relief is problematic. In the case of palimony, tax relief is extended to harmonize the termination of non-marital relationships with divorce, but without the statutory basis that divorce-related taxation is built upon. A potential slippery slope of tax reduction may inadvertently be created when an easier (and more equitable) result is to eliminate the divorce-based means of reduction.

In addition to the relationships which either have not been formalized as marriage, or which replicate the marriage relationship outside of state law, other romantic relationships exist whose termination might warrant taxation similar to the termination of marriage. Polygamy is unique in that it is considered by its adherents, but not the law, as marriage.[164] Congress first denied recognition to polygamous marriages in the territories in 1862.[165] States have since adopted these prohibitive laws, although a federal judge decriminalized polygamy in Utah by declaring the state's law unconstitutional.[166] The termination of a polygamous marriage could, theoretically, be structured to fit under the divorce-related tax laws, but it would not be taxed as such unless family law recognized these marriages.[167] Unless and until that recognition, there is no provision for the termination of these relationships under state family or federal tax law. Therefore, as with payments between former same-sex spouses that do not qualify as gifts or as support, both the payer and the

162. The recent U.S. Supreme Court decision in *United States v. Windsor*, 133 S. Ct. 2675 (2013), provides no guidance for how the Treasury Department must interpret these issues going forward.

163. *See* Patricia A. Cain, *Heterosexual Privilege and the Internal Revenue Code*, 34 U.S.F. L. REV. 465 (2000); Catherine Martin Christopher, *Will Filing Status Be Portable? Tax Implications of Interstate Recognition of Same-Sex Marriage*, 4 PITT. TAX REV. 137 (2007); Anthony C. Infanti, *LGBT Taxpayers: A Collision of "Others"*, 13 GEO. J. GENDER & L. 1 (2012); William P. Kratzke, *The Defense of Marriage Act (DOMA) is Bad Income Tax Policy*, 35 U. MEM. L. REV. 399 (2005); James M. Plunkett, *Rethinking Tax Priorities: Marriage Neutrality, Children, and Contemporary Families*, 78 U. CIN. L. REV. 1409 (2010); Carlton Smith & Edward Stein, *Dealing with DOMA: Federal Non-recognition Complicated States Income Taxation of Same-Sex Relationships*, 24 COLUM. J. GENDER & L. 29 (2012); Thomas, *supra* note 136.

164. *See* Samuel D. Brunson, *Taxing Polygamy*, 91 WASH. U. L. REV. 113 (2013); Lynne Marie Kohm, *Why Marriage is Still the Best Default in Estate Planning Conflicts*, 117 PENN ST. L. REV. 1219 (2013).

165. Morrill Anti-Bigamy Act, ch. 126, 12 Stat. 501 (1862).

166. Brown v. Buhman, 947 F. Supp. 2d 1170 (D. Utah 2013).

167. Brunson, *supra* note 164.

recipient should be taxed on any payments associated with the termination of a polygamous relationship.

Similarly, the termination of sexual relationships that resulted in children may be as worthy of tax reduction as the termination of a marriage, even if the parents were not a long-term couple. Shari Motro proposes a requirement of "preglimony" to support mothers in these relationships.[168] As yet not adopted by any state, preglimony is financial assistance by fathers to unmarried women who conceive in order to equalize fathers' burdens with that of pregnant women.[169]

Motro proposes a tax treatment for these payments from expectant fathers to mothers that encourages, but does not require, payments from those "already predisposed to contribute" to pregnant women.[170] This is more like the traditional income shifting than the tax shifting of divorce because, although the payer is predisposed to make payments, the income might not otherwise be shifted. Because these payments would not be required, they would likely be taxed as gifts under current law, and so they would taxable to the payer but not included in the recipient's income.[171] In order to encourage these payments with a tax reduction, Motro would allow the payer to deduct the payments and the recipient to include them in income, as with alimony today. The problem with this tax reduction is the same problem as with tax shifting: It benefits only a small group of couples, and ignores that this savings to the "team" benefits the payer and not the recipient.[172] The payer ends up with a lower tax bill, and the recipient with a higher one.[173]

If preglimony develops in a way that its recipients use the legal system to impose and enforce support, required payments to the recipient would likely lose gift characterization because payments would fail the required "detached and disinterested generosity" test.[174] And, if Motro successfully makes this an

168. Shari Motro, *The Price of Pleasure*, 104 Nw. U. L. Rev. 917 (2010).
169. *Id.* at 919.
170. Shari Motro, *Preglimony*, 63 Stan. L. Rev. 647, 673 (2011). Motro assumes this "sidesteps thorny enforcement issues and encourages cooperation rather than conflict." *Id.* at 672. However, this regime shifts enforcement to the IRS to determine whether payments were made, whether there was a pregnancy, and whether the recipient reported the income. Motro omits proof for paternity. *Id.* at 694. With alimony, Social Security numbers must be included to reduce fraud. It is unlikely that many in preglimony situations would want to share this sensitive information.
171. Although I disagree with Motro's argument for treating these payments like a gift when there is a legal obligation to make payments, I agree with her when the law does not require payments. *See id.* at 680–81.
172. *Id.* at 673, 676. If you "hook" couples on income shifting, what is the political likelihood that it will not be continued post-birth?
173. Motro recognizes that it may encourage "ungenerous" payments and proposes payments be deductible/includible only over a threshold, in accordance with some measure of their circumstances, or to require equal shifting. *Id.* at 693. This does not overcome the problem that the lower-income recipient has a higher tax burden.
174. Comm'r v. Duberstein, 363 U.S. 278, 285 (1960).

obligation owed to the women themselves,[175] the payments should not be taxable as child support to only one parent. Therefore, unless there is a change in the tax law, as Motro proposes, these payments would likely be taxed to the payer when earned, and to the recipient when received. This tax treatment would not produce the intended benefits of tax shifting upon divorce.

The discrepancy between the tax treatment of the termination of marriage and the termination of other relationships highlights the problematic nature of existing tax reduction. Notwithstanding these problems, there is one potential benefit from the use of a bright-line test to determine whether couples can use the special divorce-related tax provisions. Groups that are not afforded the same recognition in the marriage-focused tax law have an obvious example of discrimination to attack: taxes.[176] Moreover, in taxation, these groups have an opponent that many other Americans love to hate,[177] which might, in turn, help these groups achieve other rights. As was the case in *United States v. Windsor*,[178] which now provides equality under federal law, it may be possible to leverage benefits gained in the tax realm to other areas of life.

As long as divorce-related taxation stands as evidence of a favored relationship, it is evidence of favoritism in the Code. That the tax reduction is only available to those within the favored group who wisely use implicit or explicit elections to maximize tax shifting makes the situation no less problematic. The tax system helps define who is worthy of recognition and who is not. In that process, these provisions marginalize those not entitled to the benefits. For all of those who are excluded from special recognition by the tax system, their relationships are deemed of so little value that their termination is not worthy of aid.

III. Proposal

This Part proposes an alternative to the existing favoritism found in divorce-related taxation that minimizes the problematic features discussed in Part II. Today, divorce-related tax reduction is only available to those who make wise use of implicit and explicit elections (or were lucky), and benefit from tax shifting. Consistent with

175. Motro, *supra* note 170, at 693. In the surrogacy context, there is debate about whether payments should be taxed as child support or as compensation. *See* Bridget Crawford, *Taxation, Pregnancy, and Privacy*, 16 Wm. & Mary J. Women & L. 327, 343–45 (2010).

176. Patricia Cain and Anthony Infanti have both argued that the tax code can be used to argue that discrimination against same-sex couples is unconstitutional. Cain, *supra* note 150, at 406; Anthony C. Infanti, *Tax Reform Discourse*, 32 Va. Tax Rev. 205 (2012).

177. *See* Scott Clement, *America's Love/Hate (But Mostly Hate) Relationship with Taxes, in 7 Charts*, Wash. Post (Apr. 15, 2014), http://www.washingtonpost.com/blogs/the-fix/wp/2014/04/15/americas-lovehate-but-mostly-hate-relationship-with-taxes-in-7-charts/.

178. 33 S. Ct. 2675 (2013). *See also* Evan Perez, *U.S. Expands Legal Benefits, Services for Same-Sex Marriages*, CNN (Feb. 10, 2014), http://edition.cnn.com/2014/02/08/politics/holder-same-sex-marriage-rights/.

this Symposium's focus,[179] I urge Congress to use any tax reduction that is granted upon divorce to decrease inequality. If aid is to be granted to divorcing spouses, it should be granted to those spouses who are in greater need as compared to other taxpayers, and not only because they are in a different tax position vis-à-vis their former spouse. In the process, this proposal revises the tax treatment of transfers upon divorce, narrows the opportunity for confusion and tax gamesmanship, and provides a tax credit to divorced spouses who are in greatest need.

With this proposal, some couples (generally wealthier ones) may find their collective taxes increased, even as the lower-income spouses' taxes decrease. Accepting this proposal therefore requires an acceptance that divorce terminates the link between spouses that the tax system currently recognizes.[180] Under existing law, marriage changes the general rule that realized gains are subject to tax: When spouses transfer property between themselves, the payer is not taxed on any appreciation in the property and the recipient is not taxed on the receipt.[181] Similarly, joint filing (with its favorable tax brackets compared to married individuals filing separately) preempts the shifting of other taxable income by giving spouses an economic incentive to file as a unit.[182] Thus, as a married couple, spouses are generally considered one unit and not two individuals. This benefit does not exist for unmarried taxpayers; unmarried individuals are almost always considered separately for tax purposes.[183] The question for divorce-related taxation is: at what point do spouses lose their tax link so that transactions between them should be considered as between any other unrelated taxpayers?[184] This proposal places that separation point at divorce.

A. *Tax Credit*

First, this proposal contains a targeted tax credit for divorcing spouses. As compared to current law, a tax credit is a better way of reducing the costs of divorce. To the extent divorce causes unique hardship that is to be addressed by the tax code, this hardship is unlikely to be limited to couples with unequal incomes.[185] Therefore, a broadly applicable tax credit could aid with the transition from marriage and

179. "Social Equality 'at Home and Abroad'" was the theme of the 2014 *Indiana Journal of Law and Social Equality* Symposium where this Article was first presented.
180. This Article does not debate whether the linkage for marriage is warranted.
181. I.R.C. § 1041 (2012).
182. I.R.C. § 1 (2012).
183. Sometimes individuals are considered together, for example with attribution rules or after forming partnerships or corporations. *See, e.g.*, I.R.C. §§ 11, 267, 318, 701 (2012).
184. Many Code provisions continue to treat former spouses as spouses. *See* I.R.C. §§ 72, 121, 163, 220, 223, 267, 302, 318, 402, 408, 453B, 1361 (2012).
185. One could argue that it adds insult to injury to remove the marriage bonus at the time of divorce. But the removal of a possibly illegitimate benefit is an inadequate justification for existing favoritism.

offset the costs of divorce. However, such a broadly applicable credit would have to be minimal in order to keep its cost down, and it is questionable whether the public would condone a credit for wealthy spouses. A more politically palatable alternative is a targeted tax credit for low-income divorcing spouses for a period of time following divorce.

This Article does not establish an optimal amount of the credit, but argues for the use of a credit to replace the current tax-shifting method of tax reduction.[186] The exact amount of the credit, its refundability, and the period of time for which it would be available, are not theoretical questions, but political ones.[187] The political discussion should focus on how much assistance is best provided to those in hardship following divorce.[188]

The amount of the credit might be calculated to accomplish various objectives. First, the amount of the credit may provide assistance to offset the hardship of divorce. Second, if the remainder of this proposal is adopted, Congress may use the credit to offset taxes owed on payments received from the other spouse in the divorce. Third, Congress should ensure the tax system as a whole does not both give and take from low-income spouses through the interaction of multiple credits. If this divorce-based credit simply replaces another credit that is lost, the credit would not reduce economic inequality or address divorce-related concerns; therefore, the amount or structure of the credit should compensate for the loss of other tax benefits.

To curb abuse of the proposed credit, Congress may limit its availability in numerous ways. However, because the goal of this proposal is to help low-income spouses transition out of marriage, both spouses should be entitled to the credit. This potentially creates a financial benefit for divorce over marriage, but one that addresses the concerns of divorce-specific hardship. To mitigate abuse, Congress might limit the credit to one per taxpayer or one per marriage so that taxpayers with

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186. Motro suggests a credit to be phased out for couples whose household income drops as a result of divorce, if the objective is to help mitigate divorce hardship. Motro, *supra* note 170, at 685.

187. A smaller change requires taxation to the payer per *Glenshaw Glass* but not to the recipient, as is currently seen in Chairman David Camp's Ways and Means Committee proposals. *See* Tax Staff, House Majority Comm. on Ways & Means, Tax Reform Act of 2014 Discussion Draft 25–26, *available at* http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf. The recipient should report the income and claim an above-the-line deduction to offset the income to help ensure that income is not "lost" between the payer and the recipient. That the deduction is above-the-line allows the recipient to qualify for other tax expenditures based on adjusted gross income.

188. As the credit is not tied to payments between spouses, a spouse might be willing to let the other spouse forego payment because the government steps in (that is, the government assumes the role of provider) or the spouse might be willing to take benefits in kind. This latter problem exists with respect to child support. Daniel L. Hatcher, *Child Support Harming Children*, 42 Wake Forest L. Rev. 1029 (2007).

multiple divorces do not benefit more than once by divorcing and remarrying.[189] Or Congress could tie the amount of the credit to the length of the marriage, so that spouses who have more reason to expect a continuation of the marriage benefit the most. This political decision should be one that recognizes the inequality currently plaguing low-income divorcing spouses.

Regardless of the chosen structure, a credit will not be without problems, but less so than current law. To ensure the proper political accountability of the credit, it is important that the value and objectives of the credit be understandable to the public and to recipients. Because taxation of divorcing couples should not be examined in isolation, but in comparison to other taxpayers, this tax expenditure must also be made obvious to Congress and the public to ensure the amount of the tax benefit is periodically reviewed.

B. *Property Divisions*

Second, this proposal removes existing tax preferences for appreciated property settlements, which would, in part, fund the credit. To this end, Section 1041 of the Code would be amended. Currently, Section 1041 permits tax deferral on transfers of property in a divorce and, when the taxation occurs, it is taxed to the recipient spouse. This produces inequitably higher taxation of lower-income spouses when appreciated property is transferred. This proposal taxes the spouse who owned and controlled appreciated property.

To properly tax spouses, this proposal first ends the nonrecognition of gain for payers on the transfer of accumulated property. Taxation of the payer on any gain, with a corresponding increase in tax basis for the recipient, prevents the recipient from paying the tax on income enjoyed by the payer. Under a *Glenshaw Glass* conception of income, as discussed in Part II, property divisions should trigger taxes for the payer because the payer realizes a change in a previously untaxed increase in wealth.[190] Thus, under this proposal, the payer would owe tax on his share of pre-transfer appreciation. To avoid this taxation, spouses could transfer property prior to divorce, which would empower the lower-income spouse before divorce. However, to prevent tax avoidance, transfers in the year prior to the signing of the divorce decree should be presumed to be the result of the divorce, and should be taxed as such.

Additionally, under this proposal, the receipt of property divisions should be partially excludible by the recipient. Under a *Glenshaw Glass* conception of income, property divisions according to spouses' state law property interests would not trigger taxes for the recipient to the extent the property division is a return of a

189. As proof of what some couples will do for tax reduction, a couple divorced and remarried repeatedly in order to file as single taxpayers. Boyter v. Comm'r, 668 F.2d 1382 (4th Cir. 1981), *rev'g* 74 T.C. 989 (1980).
190. I.R.C. § 1001 (2012).

spouse's capital.[191] In other words, if the recipient has a property interest and is just receiving that property interest in the divorce, there is no increase in wealth to be taxed. However, instead of importing state-defined property interests as the basis for exclusion, the federal government should permit the transfer of a couple's assets (whether separate or marital) to allow each spouse to own 50% of the total assets of either spouse after the divorce without taxation to the recipient.

Consider, for example, a divorce decree that provides the wife with half the family business that is the couple's (and each spouse's) only asset. If all of the entity's interests are in the husband's name, under this proposal, the receipt of half the business interests would not trigger current taxation to the wife, but the husband would owe tax on appreciation of the transferred shares.[192] This prevents the recipient spouse from owing the tax on gain that the payer earned and controlled prior to the divorce.[193]

For a recipient spouse to exclude the receipt of up to 50% of the couple's collective property, a divorcing couple must report to the IRS their total value of property as of the divorce.[194] Therefore, to implement this portion of the proposal, the IRS would require each spouse to file a form with the tax return that is due immediately after the divorce. Valuations are always problematic to some extent, but divorce is often a time when valuations are otherwise made for non-tax purposes. Couples who do not engage in property divisions can ignore this requirement, although universally mandating the reporting may be helpful to many spouses who lack financial information at the time of divorce.[195]

Because the division under this proposal is at 50% of collective property (rather than basing it on state property interests), this proposal minimizes the problems created by the different tax treatments of community property and

191. *Id.*

192. Any appreciation in the family home is unlikely to be taxed. Pursuant to Section 121, married couples can exclude $500,000 of gain on the sale of their principal residence and unmarried individuals can exclude up to $250,000 of gain. There is a two-year use and residency requirement for this exclusion and, in some cases, these requirements can be imputed between divorcing spouses. I.R.C. § 121(d)(2) (2012); Treas. Reg. § 1.121-4(b) (2003).

193. If Congress taxes payers, the recipient should receive a fair market basis in the property on a theory similar to contributions to corporations: when the shareholder pays the tax, the corporation does not owe the tax a second time. I.R.C. § 362 (2012). Because the payer pays the tax as of the transfer, the recipient takes a carryover basis plus the amount of the reported gain. This theory would need to be codified.

194. Because of administrative concerns, I considered basing property divisions on the timing of transfers but concluded that this opened the provision to abuse and has less theoretical justification than one based on a percentage of assets. Because receiving assets soon after divorce would likely benefit lower income spouses, Congress might combine a timing limit and a percentage of assets into the definition of property divisions.

195. This proposal decreases reliance on state law. A potential downside is that by ignoring state property law interests in marital property, the federal tax system may ignore real differences between spouses.

common law regimes. Under *Davis*, which recognized gain on property divisions to the payer,[196] couples of the different states received different tax treatments.[197] Couples in community property states, but not common law states, could evenly split their marital property without triggering taxation because the spouses each own an interest in marital property. Because this proposal does not tax the recipient on up to 50% of the collective (and not just the community) property that she receives, this is more generous than community property law.

Payers residing in community property states may be advantaged under this proposal because they would not be treated as transferring the half of the community property that previously belonged to the other spouse under community property law. This different tax treatment is warranted if there are real differences in property rights; however, these differences might cause states to adopt quasi-community property laws creating short-term rights for recipient spouses upon filing for divorce, as six states did before the enactment of Section 1041.[198] To prevent states from gaming the federal tax system, Congress should require that divorcing spouses maintain control over (not simply an ownership interest in) property for a significant period (hypothetically a year) prior to the divorce to permit deferral of taxation. Without the prior transfer of title and control, the payer should be taxed on any appreciation in transferred property. This would create a national standard for the federal taxation of property divisions and, in the process, may encourage married couples to divide property more equally earlier in marriage.

Eliminating Section 1041's tax deferral would revive practical complications for payers who transfer significant amounts of appreciated property. To alleviate payers' liquidity problems, they should be permitted to pay the taxes owed on an installment method if a form reporting the income is filed with the tax return following the finalization of the divorce. If the form is not properly submitted with the return, the installment method should not be available, and generally applicable penalties should apply. In this way, the government encourages the payment of taxes owed on transfers legally required to satisfy a personal obligation. However, it does so in a way that assists taxpayers in a period of transition without prioritizing the termination of marriage to the extent the government does today.[199]

196. United States v. Davis, 370 U.S. 65 (1962).

197. *See* Karen B. Brown, *The Story of* Davis*: Transfers of Property Pursuant to Divorce*, *in* TAX STORIES, *supra* note 157, at 171.

198. Anti-Davis rules were created in Oregon, Illinois, Minnesota, Kansas, Missouri, and North Carolina. Gabinet, *supra* note 16, at 14 n.10.

199. I recognize that practical elements of this plan need additional consideration but are beyond the scope of this Article. Consider savings plans. If savings plans are within 50% of the couple's property, any built-in gain would be taxable to the payer and not taxable to the recipient. If savings plans are not within the 50%, they are taxed as Section 71 payments. Savings plans that are funded with post-tax dollars (so that the appreciation is not taxed on dispersal) arguably should not be taxed in either case because the appreciation is never to be taxed. On the other hand, savings plans that are funded with pre-tax dollars and are taxed on distribution should be taxed under either case (and in the latter to both spouses) because the appreciation is taxable.

C. *Section 71 Payments*

Third, this proposal revises current Section 71 to reflect general tax principles and, as a result, raises additional funding for the tax credit. Currently Section 71 provides a default that the recipient spouse owes tax on alimony payments and the payer claims an above-the-line deduction for those payments.[200] This privileges divorce because the treatment diverges from generally accepted tax theory by taxing one party to the payments and that is the recipient. Under the theory of *Glenshaw Glass*, both parties should owe taxes on these payments, because each party enjoys an increase in wealth; clearly realized, and over which the taxpayer has control.[201] The payer uses the wealth to pay a court-mandated obligation, and the recipient receives and enjoys the wealth. This proposal adopts an approach consistent with these generally accepted principles. Coupled with the tax credit, this revised treatment of family law alimony payments benefits all low-income divorcing spouses.

For purposes of this proposal, Section 71 payments are not tied to state law definitions or purposes for payments. Instead, under this proposal, if a spouse receives more than 50% of the couple's collective property as of the divorce as a result of the divorce, the excess is taxed as a "Section 71 payment." Thus, this proposal makes it so that the tax treatment prescribed by Section 71 is no longer tied to non-tax family law objectives. [202] Consequently, all payments in excess of property divisions are taxed consistently. Section 71 payments have either not been taxed prior to the divorce (for example, future earnings) or are more than the recipient spouse's share of collective property.[203]

This treatment is consistent with generally applicable tax rules. As discussed in Part I, a cornerstone of the federal income tax is that increases in wealth—clearly realized by the taxpayer, and over which the taxpayer has control—are treated

200. I.R.C. § 71 (2012).

201. Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).

202. Although Congress is bound by state-created interests, it is not bound by state-created labels. *See, e.g.*, Helvering v. Hallock, 309 U.S. 106 (1940); Morgan v. Comm'r, 309 U.S. 79 (1940); Burnet v. Harmel, 287 U.S. 103 (1932); Tyler v. U.S., 281 U.S. 497 (1930); Burk-Waggoner Oil Ass'n v. Hopkins, 269 U.S. 110 (1925); Hecht v. Malley, 265 U.S. 144 (1924). *But see* Blair v. Comm'r, 300 U.S. 5 (1937). Congress (and subsequently the Treasury Department) use the imported term of alimony either as shorthand or because they do not value the distinctions. For example, in 1944, Congress purposefully refused to use "alimony" in the statute because of differences between states' laws. I.R.C. § 71 (1954). Congress stated in its reports that it was concerned about the uniform treatment of "amounts paid in the nature or in lieu of alimony." H.R. Rep. No. 77-2333, at 46, 71–72 (1942); S. Rep. No. 77-1631, at 83–85 (1942).

203. I considered calling these "excess payments" because they are in excess of accumulated property but was concerned that the term might discourage the award of, or negotiation for, these amounts. Malman, *supra* note 96, at 390–91 (discussing three options of taxation—both, recipient, or payer—but rejecting what she sees as "double taxation").

as income subject to tax, unless a specific provision exempts the taxpayer from taxation.[204] This is true even when the increase in wealth is used to pay a debt or satisfy an obligation. Therefore, the payer is taxed on ordinary income when earned income is paid to the recipient, or when any built-in appreciation in property is transferred to the recipient. The payer does not receive a deduction for these payments, because the payments are a personal expense that is not deductible without special congressional action, and this proposal removes the existing deduction. The recipient is also taxed on receipt of the payments because the payments represent an increase in the recipient's wealth. Recipients are currently taxed this way if the payer pays alimony while both of the former spouses continue to live in a single household, a tax arrangement which has been publicized in the news.[205]

By making the tax treatment of property divisions and Section 71 payments conditioned upon tax principles rather than state family law objectives, some current tax complications for alimony are eliminated. No longer is the form of payment critical to its tax treatment. The form of payment as either property divisions or Section 71 payments (whether as a lump sum or as periodic payments) does not matter from the tax perspective, because taxation is made dependent upon whether the amounts are representative of previously taxed amounts.[206] Form generally only has meaning in tax if (1) a tax benefit is made contingent upon the form of payment or (2) it is necessary for the administration of the tax system.[207] Neither of these need apply in the divorce context.

It is important to note that because Section 71 payments are taxed to both parties, additional government revenue is raised during a time of distress for the taxpayers involved. Under this proposal, the increase in taxation is offset by a tax credit for low-income, but not all, divorcing taxpayers. This eliminates one benefit of marriage that only exists for some married couples. Same-sex couples who cannot marry, and others who are not in the favored marital group, have long been paying this second layer of tax, unless their transfers are recognized as gifts.[208]

204. *Glenshaw Glass*, 348 U.S. at 431.

205. *See, e.g.*, Kerry Hannon, *Taxes and Divorce: 6 Tips for Women*, FORBES (Mar. 7, 2013), http://www.forbes.com/sites/nextavenue/2013/03/07/taxes-and-divorce-6-tips-for-women/.; *Alimony: Tax Planning*, DIVORCE EDUC. CENTER N.J. (Nov. 19, 2012, 4:36 AM), https://web.archive.org/web/20121119043605/http://www.decnj.org/articles/Alimony_Tax.html (accessed using the Internet Archive index).

206. It is beyond the scope of this Article to determine whether there should be tracing requirements or whether it is sufficient for property divisions to be of an equal value.

207. *Gregory v. Helvering* established the doctrine of substance over form, which requires that taxpayers are bound by the substance of a transaction rather than its legal form. 293 U.S. 465 (1935).

208. Transfers between married spouses and between divorcing spouses are excluded from the gift tax. I.R.C. §§ 2523, 2516 (2012).

D. Child-Based Benefits

Fourth, this proposal imposes few changes to existing child-related tax benefits. Current law only taxes payers of child support, and allows children to be "transferred" for purposes of claiming some, but not all, child-based benefits without transferring physical custody. This proposal retains the former taxation scheme but removes the latter elective feature. The goal is to eliminate the transferability that exists for some child-related tax benefits, while encouraging the payment of child support, as compared to other forms of support. The result would be significantly more administrable child support and child-based benefits for both taxpayers and the government.

As is the law today, this proposal taxes child support to the payer because the payments are for the benefit of his or her own child. This provides certainty for child support, but payments are likely taxed to the higher-income, support-paying parent and not the lower-income, support-receiving parent. Although there are arguments that *Glenshaw Glass* should require the recipient parent also report the income when the recipient has the ability to determine how the money is spent, there is a counterargument that the income does not increase the recipient's income, but instead increases the income of the child. The more convincing argument is that any alternative would work to increase the economic inequality of low-income children due child support.

The treatment of child support is more favorable under this proposal (as compared to Section 71 payments) because child support is only taxed to the payer, producing a collective tax reduction that is enjoyed by the recipient.[209] Unlike under existing law, the reduction is in the hands of the recipient, care-giving spouse (generally the less wealthy spouse, although not necessarily). This beneficial treatment creates a potential inequity between those with children and those without, because only the former enjoy the implicit election to frame payments as child support rather than as Section 71 payments.

Through its relatively favorable tax treatment, this proposal incentivizes the expansion of child support, in spite of the pressure today to minimize taxable child support.[210] Moreover, deemphasizing the importance of labels as to tax consequences, payments should be taxable as child support to the greater of (1) state minimum guidelines for child support or (2) amounts labeled as child support, and the termination of which is tied to an event related to the child. The former assists ill-advised couples who frame payments as family support without differentiating payments between those for a former spouse and those for a child. To the extent

209. Although there is a benefit for child support as compared to other forms of transfers, the tax benefit is not as great as simply not paying. This proposal creates no incentive to pay consistent with current law because it would privilege child support over payment for custodial children.

210. A non-tax preference for child support (rather than alimony) already occurs in family law.

payments would qualify as child support under state law, payments should be taxed as such. The latter provision encourages payments to be labeled as child support, and therefore (hopefully) viewed as such.[211]

This proposal also advocates for the provision of child-based benefits to the custodial parent, regardless of which parent provides the child the greatest amount of financial support.[212] In other words, to increase the likelihood that child-based tax benefits provide for the child, if either parent provides half of the child's financial support, the custodial parent is entitled to all of the child's tax benefits.[213] Thus, even if the noncustodial parent provided all of the child's financial assistance, that parent would not be entitled to child-based tax benefits. Through this revision, Congress provides tax aid to the direct benefit of the child, rather than reducing the economic cost of financial expenditures for the child. Removing current law's choice as to who receives some child-based benefits may harm parents to the extent that tax reduction is the goal. Nevertheless, linking child-based tax benefits more directly to the child furthers the goal of providing for the child.

Complications may exist in the operation of this rule due to shared custody. If parents are awarded shared physical custody, the tax benefits should be divided between parents according to the ratio of their custody, as long as the parents, collectively, would be eligible for these tax benefits. This default eliminates the need for allocations based on financial support or calculations of actual parenting time.

Prior attempts to allocate children's personal exemptions and related tax benefits based on financial support were not administrable.[214] At different times, the statute required that a parent contribute a specified amount to a child's care, or at least relatively more than the other spouse contributed, in order to receive the tax benefits associated with the child.[215] Information deficits pervaded both systems. As noted by Congress, tests based on the amount of support created problems for parents and the IRS alike, especially when each parent believed he or she met the

211. The collective tax reduction creates a tax incentive for payment of child support over Section 71 payments, but only if spouses understand the tax savings. It also creates an incentive for the payer to negotiate to capture some of the savings. That payments must terminate on an event related to the child imposes a cost on the implicit election to frame payments as child support rather than as Section 71 payments.

212. If parents debate custody solely to seek a child's tax advantages (for example, exemption and certain credits), there is a much larger problem in society.

213. If it is now acceptable to sever tax relief from both financial and custodial care of children, why should Congress limit the ability to transfer to those who are the parents of the child?

214. H.R. Rep. No. 98-861, at 1118 (1984) (Conf. Rep.); H.R. Rep. No. 98=432, pt. 2, at 1494 (1984); H.R. Rep. No. 77-2333, at 46 (1942).

215. For example, in 1966 a taxpayer could claim a dependent if half of the person's support was provided by the taxpayer and the person was under nineteen, had less than $600 of gross income, was the child of the taxpayer, and was a student. I.R.C. §§ 152(a), (e)(1)(B) (1964).

requirements.[216] Angry former spouses often made it difficult to prove who satisfied the test.[217] Similar problems of proof would exist if parents had to provide records of how many days each retained custody of the child. Therefore, basing entitlement to benefits on the terms of the divorce agreement is preferred, even if this approach is not perfect.

Some may object to basing tax consequences on custody agreements, especially if the agreement does not reflect how custody actually plays out. However, similar inequity may result from the existing policy of trading benefits, as discussed in Part II. Moreover, these complaints are more appropriately directed at a couple's divorce agreement rather than at the tax system. For example, an ex-spouse may complain that, despite having technically entered into a joint-custody arrangement, she alone provides all of the financial assistance for a child, and she actually maintains sole physical custody. The problem for this spouse is not the tax consequences of the divorce decree's arrangement—it is the fact that the legal arrangement does not reflect the reality of her situation. Just because her divorce agreement is inaccurate does not mean the tax system for everyone should be changed in a way that would create an equitable result in her case. If anything, the tax results should encourage family law to create agreements that are accurate.

A proposal that minimizes choice while focusing on custody of the child reduces tax gamesmanship and centers the tax benefits on the most important beneficiary—the child. In a world of low child support payment rates,[218] this proposal severs the tax benefit from the collective tax reduction of the parents, and gives the benefit to the custodial parent. To the extent the system errs, it errs in favor of the child. The fact that more revenue might go to the government (and increased government revenue only occurs if the couple would have benefited from tax shifting) should not prevent Congress from re-focusing the benefit on the person for whom the system was created.

E. Not a Divorce Penalty

This proposal is premised on the theory that when spouses break the bonds of marriage, the tax benefits associated with marriage that are enjoyed by some (but not all) couples should also terminate. If one accepts this theory, this proposal is not a tax increase for any newly divorcing couple. Instead, for some couples, divorce is the removal of a tax benefit favoring marriage; for others it is the removal of a marriage penalty. Regardless, divorce is the termination of special recognition of the marital relationship, and it puts former spouses on the same terms as if they

216. S. Rep. No. 90-488, at 2 (1967).

217. *See id.* at 2–3. *See also* Nassau, *supra* note 68, at 97.

218. *See supra* note 42.

had not married.[219] Nevertheless, despite the fact that divorce is an event that intentionally breaks the links of marriage, there may be social, economic, and political reasons to mitigate any tax imposed at the time of the divorce. Under this theory, any mitigation of tax in the event of a divorce is a tax expenditure and not required of the tax system.

Despite some current political support for eliminating the deduction for the payer of alimony,[220] taxation of both payer and recipient is likely to be unpopular. Some critics may claim that it creates unacceptable double taxation, particularly because the obligation arises from a former marital unit. However, once the marital bond is broken and former spouses are treated as separate taxpayers, this application of the tax is the logical result. This harmonizes the tax consequences of Section 71 payments with the payment of any other debt. Additionally, this increased taxation may work to decrease inequality within marriage. The possibility of taxation to both spouses upon divorce may motivate some couples to divide property before the relationship's termination, and therefore empower the lower-earning spouse.

Not everyone will agree with the interpretation of *Glenshaw Glass* as often requiring taxation to both spouses.[221] Although there is unlikely to be debate as to the taxation of the payer, there is likely to be some reluctance to accept taxation of the recipient. In a different context, one scholar has argued that all noncommercial activities should be exempt from tax.[222] By extension, the recipient of transfers from former spouses would not be taxed because the activity is not commercial. Another argument against taxing the recipient can be made on general public policy grounds. The difficulty with this exclusion is similar to those discussed in Part II: exclusion is a large tax benefit, not tied to need or ability to pay, that advantages divorce and therefore marriage.

Certain characterizations of a transfer resulting from divorce, either as a detached-and-disinterested gift or as support, would provide a narrower basis for exclusion. To the extent payments' tax treatment is dependent upon their characterization, the system invites litigation and gamesmanship because, without a

219. One could argue we should adopt a standard that relates the tax treatment of divorce-related payments back to the original cause of the payments—marriage. However, while that standard might determine the character of income, it should not also affect the timing of the income. To allow the prior relationship to defer taxation shifts the taxpayer in addition to changing the amount and possibly character of that tax.

220. *See* TAX STAFF, *supra* note 187. Unlike this Article's proposal, however, the proposal by the Chair of the House Ways and Means Committee would allow the recipient to exclude the payments from reported income. *Id.*

221. For example, Marjorie Kornhauser suggests that based on the theory that marriage is a partnership, divorce should be taxed as the liquidation of that partnership. Marjorie E. Kornhauser, *Theory Versus Reality: The Partnership Model of Marriage in Family and Income Tax Law*, 69 TEMP. L. REV. 1413, 1422–23 (1996).

222. Douglas A. Kahn, *Exclusion from Income of Compensation for Services and Pooling of Labor Occurring in a Noncommercial Setting*, 11 FLA. TAX REV. 683 (2011).

specific basis for exclusion, the default is inclusion as gross income to the recipient. However, fitting payments within these rigid classifications is difficult, due to the lack of a 'perfect fit.' Payments received by a recipient are unlikely to be labeled as compensation because of the unsavoriness of deciding exactly what services spouses perform. If payments are a gift, they are excludible under Section 102; however, as discussed in Part II, to the extent there is a court order requiring payment, these payments do not appear to have the requisite "detached and disinterested generosity." If payments are legally required support, they might be excluded on other public policy grounds, as are child support and welfare payments; however, without a statutory basis, this expansion of support could prove to be a dangerous slippery slope.

Common justifications for other exclusions from taxable income do not apply in the divorce context. Many tax provisions defer or eliminate taxation because taxpayers have a continuity of investment that is not broken in the transaction.[223] Divorce, however, intentionally breaks the continuity of a marriage. In divorce, the purpose of the transfer is to permit spouses to change to a new, different status. Thus, the rights enjoyed in marriage are not of the same kind as the property received on divorce.[224] Similarly, Congress is not attempting to encourage a particular behavior. Divorce is unlike the largely untaxed sale of a principal residence because, in the latter case, Congress desires to encourage the status of home ownership.[225] With property settlements, the tax is not eliminated, but is instead deferred and shifted between taxpayers to preserve taxation in order to not encourage divorce.

Despite the lack of a theoretical alternative, taxing the recipient of some portion of property settlements may be disconcerting to some.[226] If a recipient does not previously have a property interest in what she receives in the divorce, the divorce payment increases her income and that increase in wealth is generally taxable. Consider a couple, Wilma and Hank, whose only accumulated asset is a business worth $100,000, in which they are equal owners. Wilma is awarded the business in the divorce. Wilma had a property interest in one-half of the business before the divorce. Receipt of that one-half of the business is not taxable to Wilma or Hank. For the remaining half of the business transferred to Wilma, under this proposal not only is Hank taxed on any appreciation on its disposition, Wilma is also taxed on receiving the second half of the business. Wilma is taxed because she is made better off by the half of the business that she was not otherwise entitled to.[227]

223. I.R.C. §§ 351, 721, 1031, 1033 (2012).
224. *See e.g.*, I.R.C. § 1031.
225. I.R.C. § 121 (2012).
226. Congress should require a tax filing at divorce estimating property valuation that might bring tax consequences to divorcing spouses' minds.
227. Although deferral may mitigate the couple's tax pain by decreasing taxes on the payer, in doing so it puts couples with appreciated assets in a better situation than those with liquid savings and puts divorcing couples in a better position than other taxpayers.

This taxation of payer and recipient currently applies if the couple had not been married. Two friends, Fran and Filip, jointly own a business and, after a fight, they sue each other. A court requires them to terminate joint ownership in their business, which has appreciated in value. If Fran sells her interest to Filip, Fran has income equal to any appreciation in her half of the business transferred to Filip. Moreover, Filip was taxed when he earned the income that he uses to buy Fran's half of the business. If Fran "gives" her interest to Filip after the lawsuit, she is still taxed on the appreciation, and Filip has income equal to the value of that half because the transfer is not a gift per *Duberstein*.[228]

Therefore, looking at the recipient as part of a larger group of all taxpayers in need, this proposal's baseline taxation is necessary to guarantee equal treatment of all taxpayers. In divorce, spouses with little earning potential may be given more than 50% of the couple's collective property. The fact that the allocation is made with the hopes of aiding a spouse in an unfortunate situation does not mean the tax results should be more beneficial than those extended to other taxpayers. If the recipient spouse stole the money, won it in a lottery, or found it in a piano, the money would be income and subject to tax as gross income.[229] If the recipient spouse were given a skill at the divorce settlement to earn money, the earnings would be taxed. The fact that the income is generated via divorce cannot change the result without unfairly privileging divorced spouses over other taxpayers. We might wish that there was more marital property so that poor spouses are relieved of hardship, but providing divorcing spouses greater aid than that provided to other poor individuals is an inequitable targeting of tax relief.

Underlying this proposal is the premise that tax should not drive the framing of divorce payments, and that tax policy should not be sacrificed simply because there is a divorce. Following this premise, the tax treatment of divorce-related events should be evaluated independently of the family law results. It might be "absurd to think" that we can separate taxation from the social and psychological issues;[230] however, the difficulty of the endeavor makes it no less worthy. The alternative is that valuable tax principles might be lost in favor of state law, without fully appreciating the sacrifice.[231]

228. Comm'r v. Duberstein, 363 U.S. 278 (1960).

229. Paul v. Comm'r, 64 T.C.M. (CCH) 955 (1992); Treas. Reg. § 1.61-14 (as amended in 1993). *See also* Cesarini v. United States, 296 F. Supp. 3 (N.D. Ohio 1969).

230. Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1421 (1975).

231. For example, focusing on taxation may cause a divorce agreement, which does not produce the largest collective tax reduction, to be perceived as a miscarriage of the tax system. That incorrectly suggests taxation should follow the dictates of state family law. If the tax rules are created according to fairly applied principles, divorce agreement A produces tax result A instead of result B because agreement A is not substantively the same as agreement B. If a couple or a family court judge chooses agreement A instead of agreement B, tax consequences should follow. It is tax-centric or tax-phobic to argue that if tax result A is better for the couple than tax result B, the court and the couple should choose A instead of B or that B should be taxed as A because there is greater tax reduction.

This proposal eliminates the existing benefit for tax shifting and the elections often necessary to produce it. Moreover, it simplifies tax law both for divorcing couples and the government. In the process, it ensures that those with the greatest need receive the largest tax reduction. The use of a tax credit strengthens, and makes obvious, the link between the tax benefit and its intended object. Of course, not all complexity is eliminated but, with adoption of this proposal, the structure of choices would work to the benefit of the least advantaged.

Conclusion

For much of the history of the income tax, Congress has designated divorce as an event that deserves tax reduction, and Congress is likely to continue targeted tax reduction programs for some (but not all) couples in divorce. Because the current law's tax savings is captured by a relatively small group of divorcing couples, the benefiting couples and their representatives have an economic incentive to resist changes to the law. In addition, a widespread sensitivity to the economic need of many divorced spouses makes it difficult to adopt a system without special recognition for divorce.

Nevertheless, divorce-related tax provisions that deviate from general tax policies are a tax expenditure, which can or cannot be targeted to accomplish its objective. When shaping this tax expenditure, Congress should focus any tax reduction for divorcing couples on those in need, rather than seeing these provisions as just another grant of tax reduction, often to wealthy couples. Recasting the issue highlights the underlying question of whether Congress has created divorce-related tax rules that address the potential hardships of divorce.

With existing provisions, Congress assumes that divorcing spouses will, and should, engage in effective tax planning. Existing divorce-related tax provisions form a complicated set of rules that often require spouses to have knowledge of tax, work together, and anticipate future income and future changes in the law. These rules are "difficult for lawyers to apply . . . intelligently and even more difficult for their clients to understand . . . ."[232] Divorcing couples are advised not to do the tax planning themselves. It was reported in *Forbes* that even "your divorce lawyer may not be competent to address [the relevant] tax rules so you may need a tax advisor."[233] While some couples can use divorce as a tax reduction tool, many couples may be harmed by rules that are not intended for their individual circumstances, and some that could benefit may not have the tools to plan properly.

232. *See* Hjorth, *supra* note 96, at 187 (arguing for choice regarding support and nonrealization).
233. Robert W. Wood, *How to Make Divorce Less Taxing*, Forbes (June 11, 2010, 4:22 PM), http://www.forbes.com/2010/06/11/divorce-taxes-alimony-child-support-personal-finance-robert-wood.html.

This complexity exists because academics and Congress have been too cute in structuring existing relief. They have assumed that all couples benefit by the existing regime, and that divorce attorneys understand the tax law and can effectively explain it to divorcing couples in the midst of their divorce. Focusing on economic need rather than tax reduction demands that tax shifting and elections not be the basis of divorce-related taxation. Congress creates little benefit for the poor by giving them flexibility when they do not owe taxes or when they cannot benefit from a difference in tax rates.

This Article's proposal eliminates underlying flaws of the present system and, in its place, creates a default recognizable as congressional aid to those in need. The proposed tax relief targets low-income spouses with a tax credit at the time of the divorce, and generally applicable law still applies in the divorce context. Reducing choice and planning opportunities focuses the tax reduction, instead of allowing it to be grabbed by those who successfully use their choices. Thus, tax relief is given based on need and not greed.[234]

234. As a final note, there is nothing mandating that any tax preference be granted upon divorce. Congress could apply traditional tax policies to all of these payments and provide any assistance to divorcing couples through more direct means. Not everything has to be done through the tax code.