DEDUCTIBILITY OF LEGAL FEES

Legal fees paid in connection with obtaining a divorce are not deductible. Fees paid for obtaining and/or maintaining alimony or income-producing property and for tax advice are deductible. To qualify as deductible legal fees, the attorney must stipulate, on the bill, the amount or percentage of the fee which is attributable to tax matters. Legal fees are miscellaneous itemized deductions subject to the 2% of AGI limitation.

INNOCENT SPOUSE PROVISIONS

The IRS Restructuring and Reform Act of 1998 made the benefits of Innocent Spouse status easier to obtain. The Act expands the benefits to all understatements of tax attributable to erroneous items of the other spouse, regardless of the dollar amount.

The Act offers three types of potential relief based on factors such as how much the innocent spouse was aware of the understatement; for taxpayers no longer married to or legally separated from the person with whom they originally filed a joint return; and for taxpayers for whom the IRS may grant equitable relief. Consult your Enrolled Agent for details.

COMMUNITY PROPERTY STATES

If you live in a community property state (AZ, CA, ID, LA, NV, NM, TX, WA, or WI), the tax rules for filing the tax return for the year of the divorce or legal separation are different from the instructions in the tax booklet you receive from the IRS. These special rules may also apply to any returns filed "Married Filing Separate" prior to the divorce or legal separation.

Enrolled Agents (EAs) are federally-authorized tax practitioners who have technical expertise in the field of taxation and are licensed to represent taxpayers before the Internal Revenue Service at all administrative levels for audits, collections, and appeals. In addition, Enrolled Agents are the only tax practitioners required by federal law to maintain their expertise through continuing professional education. When you need up-to-date tax assistance, see an Enrolled Agent.

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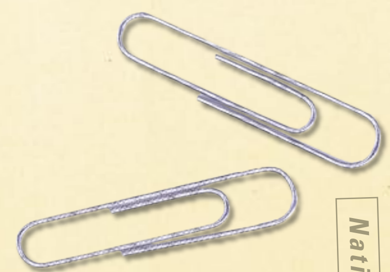
Avoiding Tax Traps *in a Divorce*



National Association of Enrolled Agents

Avoiding Tax Traps *in a Divorce*

Over the past several years, numerous changes have been made to the tax treatment of dependents, alimony, child support, property settlements, and other divorce-related issues. These changes can produce unintended results for divorced individuals. Failure to understand these rules can be very costly.

CHILD DEPENDENCY EXEMPTION

Generally, the dependency exemption for children of divorced taxpayers will go to the parent who has custody of the child for the greater part of the calendar year. This rule applies only if the child receives over one-half of his or her support from parents who are divorced, legally separated, or have lived apart for the last six months of the calendar year. In addition, the child must have been in the custody of one or both parents for more than one-half of the calendar year.

There are three exceptions to the rule which allow the non-custodial parent to claim the exemption for the child:

1. The exception arises when there is a multiple support agreement that allows the child to be claimed as a dependent by a taxpayer other than the custodial parent.
2. The custodial parent releases the exemption of the child(ren) to the non-custodial spouse. This release must be executed in writing (IRS Form 8332) and attached to the noncustodial parents' tax return.
3. When a pre-1985 divorce or separation agreement between the parents grants the exemption to the non-custodial parent and the non-custodial parent provides at least $600 for the support of the child for the year in question.

CHILD CREDIT

Eligible taxpayers may claim a child tax credit of $1,000 for each qualifying child (under the age of 17) starting in 2004. The child credit reverts to $500 in taxable years after 12/31/2010.

The child credit is partially refundable for some low-income taxpayers and for low-income taxpayers with three or more children. Please check with your Enrolled Agent for details.

CHILD CARE TAX CREDIT

If, under the terms of the divorce or separation agreement, you may not claim your child as a dependent, you may nevertheless be entitled to the child care tax credit. To claim the credit certain criteria must be met:

1. You must file a separate return.
2. Provide your home as the home of the qualifying child for more than half the year.
3. Pay more than half the cost of keeping up your home for the year.
4. Your spouse may not live in your house for the last 6 months of the year.

ALIMONY

Alimony and separate maintenance payments made under a decree of divorce or separation are deductible by the payor and taxable to the recipient if certain requirements are met. To qualify as alimony, the payment must be in cash and cannot be a transfer of property or assets. The payments must be a definite amount for an indefinite period of time, or an indefinite amount for a definite period of time. If the individuals are either divorced or separated, they must not be living together when the cash payments are made.

Single payments of cash may qualify as alimony if the amount is $15,000 or less. Payments exceeding $15,000 per year are subject to a recapture rule if they do not continue for 3 years or more unless ended because of the death of either spouse or the remarriage of the payee.

Any cash payments made to a third party, if required by the agreement on behalf of the payee spouse, will still qualify as alimony payments. Thus, payments made for rent, mortgage, tuition, or living expenses of the payee spouse under the terms of the divorce or separation instrument can qualify as alimony payments.

The agreement may also call for property settlement payments to be made from pension or retirement funds under a Qualified Domestic Relations Order (QDRO). Transfers made under a QDRO are exempt from the 10% penalty on premature distributions from qualified retirement plans.

DISPOSITION OF PRINCIPAL RESIDENCE

What happens to a jointly-owned principal residence is usually a key item in a divorce agreement.

The three most frequent provisions chosen are:

1. Sell the house and divide the proceeds with each spouse reporting his or her share of the sale on separate returns.
2. Transfer the house to one spouse or the other.
3. Retain joint ownership allowing the custodial parent to reside therein but delay the sale of the house until the occurrence of a specific event (remarriage of the custodial parent, children reaching specific ages, etc.).

CHILD SUPPORT

Child support is neither taxable to the recipient nor deductible by the payor. Under current law, if part of an alimony payment is based on a child's situation (such as coming of age, marriage, college), that portion of the payment is presumed to be child support and is not deductible by the payor or taxable to the recipient.

IRA DEDUCTION

Alimony payments received by a payee are considered to be "earned income" for the purpose of allowing alimony recipients to contribute to an Individual Retirement Account. This is true even if the alimony recipient is not employed.