

Family Law Tax Case Update

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SB1827 (9/30/06):

California Registered Domestic Partners income report – state taxes

1. Effective 1/1/07, for California income tax purposes, Registered Domestic Partners (RDPs) in California file as married couples.
2. All RDPs must file either jointly or as married filing separately.
 - a. Single filing status is no longer available.
 - b. Head of household may still be available if the party qualifies as an “abandoned spouse”?
3. Since RDPs must continue to file as single or head of household for federal purposes, this will require some interesting computations.
4. It is unclear whether California returns will require the RDPs to combine the report adjusted gross incomes from their federal returns or to prepare ‘phantom’ federal joint returns.
 - a. Combining AGIs may eliminate some benefits available to married couples.
 - b. Phantom federal returns will increase the amount of work for tax preparers and the expense for RDPs.
5. The Franchise Tax Board is holding public sessions to work out the details of the forms and systems changes necessary to accommodate this new law.
 - a. The FTB believes a number of issues are going to need to be resolved through litigation.
6. Meanwhile, the Lacerte and Pro-System tax programmers are ready to throw themselves off the Golden Gate Bridge.

Private Letter Ruling 200646003 (11/17/06):

Stock Options

1. Wife receives a portion of Husband’s vested non-statutory stock options in the MSA.
2. The options themselves, however, will not be transferred.
 - a. Husband will continue to exercise them on Wife’s behalf.
 - b. The transaction(s) will be reported on Husband’s W-2.
3. The IRS ruled the following:
 - a. Wife will report the income from the exercise of her shares.
 - b. Wife will receive credit for the income taxes withheld from the sale of her shares.
 - c. Wife will not receive credit for nor will be entitled to deduct the FICA taxes withheld from the sale of her shares.
4. This is consistent with Rev. Rul. 2002-22 and Rev. Rul. 2004-60.
5. It should be noted that Rev. Rul. 2002-22 allows an employer to actually divide non-statutory options but does not require them to do so.

Chief Counsel Advice 200646014 (11/17/06):

Dependency Exemption

1. The non-custodial parent claimed the dependency exemption but did not attach Form 8832 signed by the custodial parent releasing the exemption.
2. The IRS should consider a Form 8832 (presumably signed by the custodial parent) submitted during an examination of the non-custodial parent's return.

Notice 2006-86 (2006 -41 IRB 680 – 9/20/06):

Dependency Exemption

1. If both parents are entitled to claim a child as a “qualifying child” because of equal time share, the taxpayer with the higher adjusted gross income claims the child under IRC §152(c)(4)(B) (“tie breaker”).
 - a. This could reduce the “overall” benefit of the “qualifying child”.
 - b. In reality, if the parents keep good records, one parent can probably prove physical custody for a larger portion of the year and the tie-breaker will not apply.
2. The “qualifying child” rules apply uniformly for claiming the dependency exemption, head of household status, the child and dependent care credit, the child tax credit and the earned income credit.
3. Under IRC §152(e), the custodial parent who is entitled to claim a “qualifying child” may release the exemption claim to the non-custodial parent.
 - a. This allows the non-custodial parent to claim the dependency exemption and the child tax credit only.
 - b. The custodial parent continues to receive the head of household status, child and dependent care credit and earned income credit.

Tax Relief and Health Care Act of 2006 (12/20/06):

Tax Court jurisdiction – innocent spouse claim

Code §6015(e)(1) was changed to include Tax Court jurisdiction over equitable relief elections under §6015(f).

Tipton v. Commissioner (127 TC No 15 – 12/18/06):

Innocent spouse

IRS properly dismissed Husband from further involvement in Wife's innocent spouse claim after he failed to appear at trial to intervene.