

# **Bad Situations:**

## ***Divorce, Bad Debt and Tax Implications***

### **Course Description**

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This course covers tax implications of bad situations like divorce, bad debt, foreclosures, and more. It will teach participants how to apply, implement, and evaluate the strategic tax aspects of marital dissolutions and living together arrangements. Current perspectives on property transfers, asset divisions, alimony, filing status, exemptions, and child support are examined with an emphasis on planning considerations. The cancellation of indebtedness income inclusion rules are examined in the context of debt forgiveness and property foreclosure. Emphasis is given to the exceptions from income inclusion contained in §108. The tax treatment of property repossession under §1038 is explored with detail given to the calculation of gain and received property basis. Finally, bad debt treatment under §166 is reviewed and critical distinctions made between business and non-business debts.

**Completion Deadline & Exam:** This course, including the examination, must be completed within one year of the date of purchase. In addition, unless otherwise indicated, no correct or incorrect feedback for any exam question will be provided.

**Course Level:** Overview. This program is appropriate for professionals at all organizational levels.

**CPE Credits:** 15 (CPA, EA)

**Category:** Taxation

**Prerequisite:** General understanding of federal income taxation.

**Advanced Preparation:** None

### **Course Learning Objectives**

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#### **Chapter 1: Basic Marital Tax Matters**

1. Specify multiple tax implications to consider when going through a divorce, and recognize the requirements and effects of filing as married or unmarried.
2. Identify the requirements of filing a joint return noting how to avoid being penalized.
3. Determine the key elements of filing separate returns including what items to report and identify whether or not married taxpayers should file separate returns.

4. Recall the requirements for filing as head of household and the tax advantages and disadvantages of this filing status.
5. Recognize the phaseout of exemptions noting its effects on taxpayers, identify when exemptions can be taken for spouses, and determine reporting requirements for dependent exemptions, and specify the requirements for pre-2005 dependency particularly relationship, married person, citizen or resident and income.
6. Identify the former regular and special method for determining support noting complications from back child support, determine the current “qualified child” standard using residency, relationship, age, and joint return prohibition, and recall the requirements that must be met for parents to treat a child as a qualifying child of a non-custodial parent.
7. Identify deductible and nondeductible divorce expenditures noting which spouse is subject to tax imposed upon withheld wages, and recognize the effects of making separate estimated tax payments or joint declarations of estimated tax.
8. Determine community property and community property states, and identify the effects of conversion and commingling of property and how to avoid such marital property issues.
9. Identify community income earned by married couples for reporting purposes by:
  - a. Specifying reporting guidelines, recognizing the allocation of income earned and received into community property and separate property and selecting what income and property belongs to which spouse when they have different residency statuses;
  - b. Recalling the requirements for the special community income allocation rules of §66(a), determining what constitutes community property termination and specifying the treatment of alimony payments; and
  - c. Recognizing the use of statements and records to provide estimates of a former spouse’s income and identifying conditions for greater tax relief.
10. Identify the effect of living together on filing statuses and dependency, determine differences between the married tax rate and other tax rates, recognize the tax consequences of having a living together contract to avoid tax traps, and specify the results of *Marvin v. Marvin*.

## **Chapter 2: Transfers Incident to Divorce**

1. Identify types of marital property and their likely division in marital property settlements and specify the legal principles used in dividing assets and providing support on divorce or separation.
2. Determine the benefits of premarital agreements and the requirements and permissible provisions for a valid and comprehensive agreement under the Uniform Premarital Act.
3. Specify the position of *U.S. v. Davis* on interspousal transfers noting the changes made by §1041, and identify the requirements of §1041 and the scope of its application.
4. Select the factors that determine whether a property transfer is incident to divorce and identify how to meet these factors or avoid §1041 altogether when desired.

5. Determine the application of §1041 to transfers in trust under §1041(e) and to third party transfers on behalf of a spouse or former spouse.
6. Recognize deferred tax liability by identifying property basis for the transferor spouse and transferee spouse under §1041 after a property settlement.
7. Specify the application of §1041 to property transfers where the transferee assumes liabilities encumbering the property, and choose the holding period for an asset transferred between spouses or former spouses incident to divorce.
8. Recall the dangers of purchasing a former spouse's interest in property particularly a marital residence and its tendency to create deferred tax liability.
9. Determine the tax effects of purchasing an interest in personal or real property used in a business or held for investment, recognize potential recapture and identify the use of an exchange to dispose of low-basis property received in a §1041 transfer.
10. Specify the common disposition alternatives available on divorce, recall the home sale exclusion requirements, and identify the tax treatment and use of installment obligations under §453 in divorce.
11. Recognize sale, redemption, recapitalization, liquidation and third-party transfers as methods of dividing a business in a marital settlement citing unique provisions under §302, §736 and §754.
12. Identify whether gain or loss on a sale of real or personal property is capital or ordinary, recognize the tax treatment of such gain or loss and recall the role and tax treatment of life insurance in property settlements.
13. Specify popular methods of dividing retirement benefits in a divorce or separation action identifying the requirements and tax consequences of a "qualified domestic relations order (QDRO).
14. Choose an overall tax and economic strategy for the division of pension benefits in a marital settlement by:
  - a. Specifying the pros and cons of deferred, present, and alternate property division arguments;
  - b. Determining the treatment of IRAs at divorce considering the IRA deduction limit and rollovers;
  - c. Identifying strategies for retirement planning after divorce;
  - d. Recognizing the Social Security benefits, military pensions, civil service pensions, or railroad pensions that may be available to a former spouse; and
  - e. Selecting which debts incurred during a divorce are dischargeable in bankruptcy.

### **Chapter 3: Alimony & Child Support**

1. Determine "alimony" and "separate maintenance payments" under §71 noting their deduction or income treatment under §215, specify the types of §71 "divorce or separation instruments" and determine how having an invalid decree, an amended instrument, or a premarital agreement impacts such an instrument.
2. Identify variables that impact whether a payment is alimony since 1984 and determine whether a cash payment is deemed made to or on behalf of a former spouse in order to characterize it as alimony.

3. Recall the tax treatment of housing costs for the family residence noting the impact of ownership by contrasting when the nonoccupying spouse owns the home with when the occupying spouse owns the home.
4. Identify the tax treatment of life insurance premium payments, voluntary payments and payments to a remarried spouse, and specify the conditions that could recharacterize otherwise deductible alimony payments as nondeductible.
5. Determine the differences between child support and alimony noting their tax treatment to avoid reporting errors.
6. Identify the alimony and child support tax provisions that currently apply from those that applied to instruments executed prior to 1985 by:
  - a. Specifying the pre-1985 alimony requirements, and determining periodic payments and whether certain payments would have qualified under these rules; and
  - b. Recognizing the marital or familial relationship and recalling the similarities and differences in the treatment of child support under current law and previous law.
7. Identify the deduction of alimony paid and the reporting of alimony received on the proper forms noting required information.
8. Specify the alimony recapture rule for various marital agreements and its impact on the tax treatment of past payments.
9. Recognize the use of alimony trusts to realize tax advantage and security, determine the use of annuity contracts, and specify the proper tax treatment of alimony paid by an estate to a former spouse of a decedent.
10. Recall the tax treatment of child support, identify two circumstances where a payment will be fixed as child support, specify events that determine whether a contingency is clearly child-related noting how to rebut this presumption of child support, and recall the COBRA and qualified medical child support order rules by:
  - a. Identifying whether COBRA rules apply to different plans including notice & deadline requirements and specifying situations that may result in a termination of continuing coverage; and
  - b. Determining what constitutes “qualified medical child support orders” noting differences with other similar orders and identifying the procedures, requirements and jurisdiction of QMCSOs.

## **Chapter 4: Avoiding Tax on Debt Cancellation & Foreclosure**

1. Recognize the effect that debt cancellation has on net worth and potential income inclusion from cancellation of indebtedness income, and specify exceptions to the general income inclusion rule noting their tax impact.
2. Identify tax attribute reductions noting their application when reducing canceled debt, cite the special basis reduction rules, recognize the depreciable property election in reducing the basis

of depreciable property before reducing any other tax attributes, determine what constitutes individual, partnership and S corporation bankruptcy, and specify the variables used in determining whether shares of stock issued to a creditor are nominal or token.

3. Determine gain or loss resulting from foreclosure or repossession noting reporting and filing requirements, specify the timing and character of the gain or loss, and cite the hidden income tax danger of directly or indirectly acquiring one's own debt at a discount.

## **Chapter 5: Repossession**

1. Identify the variables that determine which §1038 rules for repossessions apply, and specify basis and gain or loss resulting from repossession of personal property using installment and non-installment method sales.
2. Determine the distinctions between the rules, calculations and effects of repossessions of personal and real property, and identify when a §166 bad debt deduction may be taken if the seller repossesses real property.

## **Chapter 6: Bad Debts**

1. Identify bad debt categories noting their tax treatment and effect on accounting and reporting by:
  - a. Determining the concepts of worthlessness and true debt including the unique characteristics of deductible nonbusiness bad debt;
  - b. Recalling the treatment of bad debts related to political debts, mechanics' liens and secondary liabilities on home mortgages; and
  - c. Specifying the forms used to report bad debts and specifying the tax treatment of recovered amounts.
2. Determine the §166 tax treatment of business bad debts by:
  - a. Identifying the tax treatment of business credit transactions, loan guarantees, accounts receivable or notes receivable particularly the tax treatment of accounts receivable in a business sale and specifying the various forms on which a bad debt deduction should be taken depending on the entity type;
  - b. Recalling the tests that must be met by an accrual method business taxpayer to be able to take a bad debt deduction for a political debt and identifying the tax consequences of the insolvency of a partner when a business partnership terminates and debts are owed; and
  - c. Specifying methods that can be used by businesses to treat uncollectible amounts noting the rules that apply to each.

## **Appendix: Legal Aspects of California Foreclosure**