TAX ISSUES FOR DOMESTIC COURT April 2019
Judge Susan R. Burch
Guilford County – 18th District
North Carolina

A NEW and IMPROVED *very basic overview of* tax issues in family law cases.

I. Deductions for Dependent Children
II. Taxable Consequences of Alimony and Spousal Support
III. Consideration of Tax Consequences in Division of Property Cases

The purpose of this manuscript is to provide a basic, very basic, overview of tax issues for judges in family law cases. The first two sections explore the Internal Revenue Code's treatment of deductions related to family law cases, and the final section explores our appellate court's guidance in considering tax consequences in division of marital property cases. As this is a basic, very basic, overview, it contains general information and explanation from IRS publications and other independent sources' review of tax law and its application. I have not cited the applicable sections of the Internal Revenue Code, as I hope I never have to submit anything professionally that requires citing the I.R.C. I have, however, tried to identify the publications used, and will be happy to send an electronic copy of them to anyone who is interested. I have also cited several North Carolina appellate cases and trust that you can find the full case on your own if you wish to read it. For anyone interested in further study of taxes and IRS regulations, I recommend their website: www.irs.gov. It is well organized and contains a tremendous amount of information. You can literally waste hours and hours there. I also recommend the Tax Policy Center from the Urban Institute and Brookings Institute https://www.taxpolicycenter.org/. In this world of partisan non-information, it provides an entry into an in depth study of the tax code and topics related to its application.

Please do not consider anything about this presentation to be legal or tax advice with regard to preparing your own taxes. I made a C in this class in law school.

I. DEPENDENTS (otherwise known as children) AND RELATED TAX MATTERS

There are 3 tax benefits related to dependent minor children:

1. Child Tax Credit
2. Tax Credit for Dependent Care
3. Exclusion from Income for Dependent Care

And two additional tax advantages available to custodial parents:

4. Head of Household Filing Status
5. Earned Income Credit

Remember the Child Tax Exemption? Child tax exemption was the ability to claim the child as a dependent when determining the number of exemptions from income. Beginning in 2018, exemptions were eliminated and the child tax credit was raised/changed.

(So what's the difference between an exemption and a credit? Good question! An exemption reduces the amount of income on which you owe taxes, lowering your ultimate tax bill. A credit is an off-set against the amount of tax that you owe, reducing the amount of tax you have to pay.)

The new child tax credit is refundable.
This means that if the filer earns at least $2,500 and the amount of the tax credit exceeds the taxes owed, the filer can get the difference of 15% of the earnings above $2,500. (The mathematical maximum for this is $1,400).

Another aside: There is also now a $500 nonrefundable tax credit for other dependents (i.e. dependent children or relatives over the age of 17).

Basic Rule:
The custodial parent claims the tax credit for the child.

If the child lived with the parents an equal number of nights (and since most years contain 365 nights, how does that work exactly? But, if this is true - then the parent with the higher AGI is considered the custodial parent).

The *IRS publication 501: Dependents, Standard Deduction, and Filing Information* is an excellent source for material on this topic.

Exceptions to the Basic Rule: The custodial parent can agree (or the court can order the custodial parent) to allow the noncustodial parent to claim the children as dependents for the Child Tax Credit under the special rules for children of divorced or separated parents.

> **Caveats**: The noncustodial parent can only claim the Child Tax Credit. He or she cannot use the child as a dependent to qualify for Head of Household filing status, Dependent Care Tax Credits, or the Earned Income Credit. The noncustodial parent would not meet the child's residency requirement to qualify for these benefits.

To qualify for this exception: the custodial parent must execute Form 8332 Written Declaration or a similar written declaration releasing the exemption to the noncustodial parent. This release can be for one year, until a time certain, or in a pattern certain, i.e. odd years.

For divorce decrees and separation agreements entered into after 1984 and before 1/1/2009, the noncustodial parent can also document this exemption by attaching certain portions of the legal document which grant the release.

The legal document must contain language that:

1. The noncustodial parent can claim the child as a dependent without regard to any condition, i.e. payment of support.
2. The custodial parent will not claim the child as a dependent during the same period.
3. Identifies the years for which the noncustodial parent can claim the child.
4. Includes the cover page of the document and the custodial parent's social security number.
5. Includes the signature page of the agreement or the order.

Also, child tax credits begin phasing out at high income levels: In 2018, at $200,000 for single filers, and $400,000 for married filing jointly.

The IRS has separate rules about the child tax credit and other child tax benefits for “Children of Divorced or Separated parents” and the key here is that the parents are divorced or legally separated under a decree of divorce or separate maintenance, written separation agreement or have lived separate and apart for the last 6 months of the year. This rule can also apply to parents who never married but have lived separate and apart at all time during the last 6 months of the year.

IF PARENTS DO NOT AGREE AND MORE THAN ONE PERSON FILES A RETURN CLAIMING THE CHILD: the IRS has a way to deal with this – the **Tie Breaker Rule**

If only one person is the child’s parent	The parent gets the deduction
If both are parents and they do not file a joint return	The parent with whom the child lived for the longer period during the year gets the deduction
If both are parents and the child lived with each for the same amount of time	The parent with the higher AGI gets the deduction
If neither is a parent	The person with the higher AGI gets the deduction

Child and Dependent Care Credit

Is a credit for expenses paid for care of a qualifying dependent that enable you (and spouse if filing jointly) to work or look for work. (Generally not available for married filing separately but there is an exception for legally separted as defined by IRS). *See IRS Publication 503: Child and Dependent Care Expenses.*

The amount of the credit is a percentage of the amount of work-related expenses you paid to a care provider for the care of a qualifying individual. The percentage depends on your adjusted gross income. And the total expenses are capped at $3,000 for one qualifying individual or $6,000 for two or more qualifying

individuals. Also, any dependent care benefits that were excluded from taxable income must be subtracted from the dollar limit.

The person claiming the credit must have earned income and the work-related expenses claimed can’t exceed your earned income (or that of your spouses if he or she earned less).

A *qualifying individual* for the child and dependent care credit is:

- Your dependent qualifying child who is under age 13 when the care is provided,
- Your spouse who is physically or mentally incapable of self-care and lived with you for more than half of the year, or
- An individual who is physically or mentally incapable of self-care, lived with you for more than half of the year, and either: (a) is your dependent; or (b) could have been your dependent except that he or she has gross income that equals or exceeds the gross income test amount, or files a joint return, or you (or your spouse, if filing jointly) could have been claimed as a dependent on another taxpayer's 2018 return.

FROM THE IRS TOPIC 602: Child and Dependent Care Credit

A noncustodial parent who is claiming a child as a dependent should review the rules under the topic *Child of divorced or separated parents or parents living apart* in Publication 503.pdf, because a child may be treated as the qualifying individual of the custodial parent for the child and dependent care credit, even if the noncustodial parent is entitled to claim the child tax credit.

Also, another **important point**, to quote the IRS *emphasis added*: “CHILD SUPPORT PAYMENTS aren't for care and don't qualify for the credit.”

BUT: The child support guidelines provide that actual receipt of tax credits for child care can be a reason to deviate from the presumptive guideline amount.

Child Care Costs

Reasonable child care costs that are, or will be, paid by a parent due to employment or job search are added to the basic child support obligation and prorated between the parents based on their respective incomes. Other reasonable child care costs, such as child care costs incurred while the custodial parent attends school, may be the basis for a deviation. The court may also consider actual child care tax credits received by a parent as a basis for deviation.

The guidelines no longer talk about the assumption that the custodial parent is claiming the child tax exemption - because child tax exemptions no longer exist. There is no language now about the court assigning those to the non-custodial parent where the custodial parent has no income or tax liability.

The guidelines also no longer take 75% of the child care costs, in consideration of the tax credits. Hence the language above about it being a reason to deviate.

Exclusion from Income of Child and Dependent Care costs.

Dependent Care Assistance Plan (or Dependent Care FSA)
- maximum contribution in 2018 is $5,000.

Rules - generally

1. Qualifying Child is 12 or under and person claiming is the **custodial parent.**
2. Parent is employed, student or looking for full-time work.
3. The expenses claimed can't exceed the earned income.
4. The expenses must be for work-related child care, including day care, before and after school care and summer camps.

The amount contributed and used as pre-tax dollars will off-set against the credit amount.

As another aside, I encourage people to go see a tax professional about this. Even for low to average income earners, this exclusion and credit can be beneficial for reduction of the total tax obligation. It's also very fact specific as to which method, exclusion or credit or combination thereof is the most beneficial.

A word about **Head of Household** filing status: you want this if you can get it. There are significant tax advantages when filing under this status. The standard deduction is higher and income is taxed at a lower rate.

To qualify, the filer must be:

1. Unmarried or "considered unmarried" on the last day of the tax year; AND
2. Paid more than half the cost of keeping up a home for the year; AND
3. A "qualifying person" lived with you in the home for more than half the year (except for temporary absences, such as school).

"Considered Unmarried" means

1. You file a separate return; AND
2. You paid more than half the cost for keeping up your home in the tax year; AND
3. Your spouse did not live in the home for the last 6 months of the year (temporary absences or absences under special circumstances do NOT qualify); AND
4. Your home was the main home for a child, step-child or foster-child for more than half the year; AND
5. You must be able to claim an exemption for the child; HOWEVER, there is an exception to this requirement if the noncustodial parent can claim the child pursuant to the rules for children of divorced or separated parents.

So, **important point**, shifting the child tax credit by order **does not** remove a parent's ability to claim Head of Household status if they otherwise meet the residency test for the child. Likewise, allowing a parent to claim the child tax credit doesn't make them eligible for this filing status. They must still meet the other residency requirements.

A word about Earned Income Credit: this is a tax credit for certain people who have earned income under $41,646 with limits on investment income ($2,950). It operates to reduce taxes owed and may also provide an additional refund. The amount of the credit depends on the number of "qualifying children".

"Qualifying Child"

1. Relationship: must be a child, stepchild, fosterchild or a descendant of one of the above (OR certain other family members);
2. Age: under the age of 19 at the end of the tax year, or under 24 and a full-time student, or permanently disabled.
3. Residency: must have lived with you for more than half the year (in the US).

Filing status: you cannot file Married filing separately and claim this credit.

(And recall, the noncustodial parent cannot claim this credit as he or she will not meet the residency requirement).

The Earned Income Credit may actually operate to refund money to qualifying custodial parents in excess of their federal tax withholdings. (As can the now refundable child tax credit).

See *IRS Publication 596: Earned Income Credit* for more information on this.

Mooney v. Mooney, 2011 N.C. App. LEXIS 2277, 216 N.C. App. 416, 716 S.E.2d 875, 2011 WL 4917015 This case addresses child support but doesn't actually deal with tax issues, HOWEVER, it contains the best quote from a trial judge EVER so I'm sharing it.

From the Appellate court: The procedural history leading to the issuance of the June 2010 Order is complex and undisputed by the parties. As such, we will not recount the entire history of the dispute, but, rather, we simply quote Judge Fox's introduction to the June 2010 Order to illustrate the magnitude of this case's history in the North Carolina Court System:

From trial judge David K. Fox:

[This court] is moved to initially note that the stacked court files in the matter of Mooney vs. Mooney are now five inches thick; thicker than the Charlotte telephone book. And that does not reflect the files separately kept by the clerk of the Court **[*2]** of Appeals. These Parties have contrived to consume vast amounts of the [c]ourt's time, unconscionable resources of the beleaguered Henderson County Clerk's Office, have tied up bailiffs, judges, courtrooms, and have cheerfully squandered thousands of their own money and the State's treasure "lawing" one the other during the past seven years. Of course, this hearing isn't the end: other issues than this instant matter have been separately heard in May, 2010 whilst additional disagreements between these contestants are scheduled for venting in court later this month. Considering the Parties have been divorced since 2004, this example of ongoing obduracy[1] makes the efforts of Sisyphus pale by comparison to the labours of the [c]ourt facing calendar after calendar listing "Mooney vs. Mooney".

[1] I had to look this word up and I love it - I use it all the time now: Obdurate- extremely determined to act in a a particular way and not to change despite what anyone else says, STUBBORN.

Even though represented by competent counsel, Plaintiff is wont to periodically complicate things by preparing and filing her own pleadings and seeking her own hearings concurrent with the progress of other issues, rather like a patient on an operating table rousing to wrest the scalpel from the surgeon and inflicting a few random incisions herself. Indeed, the record would seem to demonstrate one **[*3]** of the Parties is the chief sinner in this never ending, ever renewing domestic struggle, but the dispositive portion of this Order evidences that, in fact, both Parties have indulged in the feckless behaviour which yet again has forced the District Courts of Henderson County to revisit Mooney vs. Mooney, even as a dog returneth to its vomit.

I. **Taxable Consequences of Alimony and Spousal Support**

Alimony: defined as payment to or for a spouse or former spouse under a written divorce decree or separation instrument.

To qualify under the old rules, the order must have been entered before the end of calendar year 2018.

New rule for 2019:

No longer deductible to payors.
No longer income to recipients.

BUT: What happens to modifications of the previous orders?

General rule: modifications of 2018 and older orders do not change the tax treatment unless the order specifically states that the Tax Cuts and Jobs Act treatment now applies.
(and I can't think of when you would want to do that?)

The prior rules provided for a number of limitations and exclusions on what the IRS would consider deductible alimony. Those included:

1. Voluntary payments
2. Child Support
3. Noncash Property Settlements
4. Payments that are part of the spouse's community income
5. Payments to keep up the payer's property
6. Use of the payer's property

Example of the exclusion:

If the payor owns residential property: mortgage payments (principle and interest), taxes, insurance and upkeep on property are not considered deductible alimony. Neither is the value of the use of the home.

If the payor and payee jointly own the home as tenants in common: the ½ of the payments are deductible as alimony and ½ of the real estate taxes and interest are otherwise deductible.

If the payor and payee jointly own the home as tenants by the entirety, then payments are not deductible as alimony, however payor can claim all real estate taxes.

GOING FORWARD: mortgage interest is still deductible by the payor (up to $1,000,000 - and when you read this, say this like Mike Myers does in Austin Powers). Property taxes are limited to a $10,000 cap combined with deduction for state income taxes.

On the bright side for judges, no more mini hearings in the alimony trial about estimated tax consequences of awards.

Our state law about **Alimony** continues to include property transfers, payments of expenses and execution of debt instruments. These items were just not deductible.

Upchurch v. Upchurch, 34 N.C. App. 658 (1977)

> Defendant contends the trial court erred in concluding that plaintiff is entitled to possession of the home and in awarding possession to her. We find no merit in this contention.
>
> It is clear that HN3 the court has the power to grant the possession of real estate as a part of alimony. G.S. 50-17; 5 Strong's N.C. Index 3d, Divorce and Alimony, **[***10]** § 18.14. *Yearwood v. Yearwood*, 287 N.C. 254, 214 S.E. 2d 95 (1975). Defendant argues that the home in question is considerably larger than plaintiff needs and one that will be expensive to maintain. Here again we have a decision that was in the discretion of the trial judge and we perceive no abuse of discretion.

Whedon v. Whedon, 58 N.C. App. 524 (1982)

The Court held (*in* part) that although the alimony award and property distribution were proper, the trial court erred in ordering the husband to pay the wife's income taxes resultant upon the alimony award.

II. **Consideration of tax consequences in Division of Property Cases**

Basic Rule: Transfers of property between spouses or between former spouses incident to divorce do not have immediate taxable consequences.

"Incident to divorce" means (1) within one year after the date of divorce or is (2) related to cessation of marriage.

This generally means pursuant to a divorce or separation instrument and the transfer occurs not more than 6 years after the date of divorce.

> Lawing v. Lawing, 81 N.C. App. 159, 179, 344 S.E.2d 100, 113-114, 1986 N.C. App. LEXIS 2279, *40-41
>
> The statute clearly recognizes that the court may make the distributive award payable over an extended period. Since G.S. 50-20(e) does not limit the duration of the time period for payment, nothing else appearing, the structure and timing of payment of the award would rest with the discretion of the trial judge. *See Andrews v. Andrews, supra*.
> There are, however, other relevant statutory provisions. According to ***HN22*** G.S. 50-20(b)(3), "'Distributive award' means payments that are payable either in a lump sum or over a period of time in fixed amounts, *but shall not include payments that are treated as ordinary income to the recipient under the Internal Revenue Code*." (Emphasis added.) [***41] The emphasized language suggests, and plaintiff contends, that a North Carolina court may only make distributive awards payable over periods that will not subject the distributive payments to treatment as ordinary income under the United States Internal Revenue Code ("the Code" or "I.R.C."). We note that in enacting the equitable distribution statute, the General Assembly intended to avoid taxable events which would chill the use of equitable distribution. *See* Comment, Equitable Distribution -- The Tax Effects [**114] of North Carolina's Equitable Distribution Statute, 18 Wake Forest L. Rev. 555, 565 (1982). We therefore hold that ***HN23*** a court's authority to make distributive awards is limited and that a court may not enter a distributive award that will be treated as ordinary income under the Internal Revenue Code.

However, the time limitations are a rebuttable presumption – i.e. if the court orders distributive payments more than 6 years out, the court must make findings of fact of legal or business impediments to meeting the 6 year time frame. (for tax purposes)

Also important to note, the time period runs from the date of divorce OR the entry of the equitable division of property order.

For post 1984 transfers: the basis is equal to the transferor's adjusted basis immediately before the transfer.

However, the court has to address "tax considerations" as part of the factors in N.C.G.S. 50-20.

Before amendment in 2005: 50-20(c)(11) required the court to consider "the tax consequences to each party".

The parties have the burden of presenting evidence about tax consequences.

> **Walser v. Walser, 2002 N.C. App. LEXIS 1980 Unpublished**
> Pursuant to N.C. Gen. Stat. § **50-20(c)(11)**(1999), when considering an unequal distribution, the trial court shall consider the tax consequences to each party in its equitable distribution judgment. As the party seeking an unequal division of property, "defendant has the burden of showing that the tax consequences of the distribution were not properly considered." *Wall,* 140 N.C. App. at 312, 536 S.E.2d at 653. **"The trial court is not required to consider tax consequences unless the parties offer evidence about them."** ***Id.*** **(*emphasis added)***

Dolan v. Dolan, 148 N.C. App. 256 (2002)

[*5]** We first address defendant's contention that the trial court erred by considering speculative tax consequences as a factor in determining the distribution of the marital property. HN1 In determining whether an equal distribution of marital property is equitable to the parties, the trial court must consider all of the factors listed in N.C. Gen. Stat. § 50-20(c)(2001). These factors include "the tax consequences to each party." N.C. Gen. Stat. § **50-20(c)(11)**. Our courts have construed this provision "as requiring the court to consider tax consequences that will result from the distribution of property that the court actually orders." *Weaver v.*

Weaver, 72 N.C. App. 409, 416, 324 S.E.2d 915, 920 (1985). HN2 It is error for a trial court to consider "hypothetical tax consequences as a distributive factor." *Wilkins v. Wilkins*, 111 N.C. App. 541, 553, 432 S.E.2d 891, 897 (1993).

JUDGE WYNN'S DISSENT:

WYNN, Judge dissenting.

N.C. Gen. Stat. § **50-20(c)(11)** (1999) requires the trial court in determining whether "an equal division is not equitable" to consider as a factor: "The tax consequences to each party." I dissent from the majority holding and *certify* to our Supreme Court under **[***8]** N.C. Gen. Stat. § 7A-30 (1999) the issue of whether the plain language of N.C. Gen. Stat. § **50-20(c)(11)** should be judicially 67limited to apply only **[*260]** where such taxes are incurred as a direct result of the distributional award. *See* *Wilkins v. Wilkins*, 111 N.C. App. 541, 432 S.E.2d 891 (1993); *Weaver v. Weaver*, 72 N.C. App. 409, 324 S.E.2d 915 (1985).

"The law has long been that where the plain language of a statute . . . is unambiguous on its face, the court is bound by the clear meaning." *Hamby v. Hamby*, 143 N.C. App. 635, 645, 547 S.E.2d 110, 117, *disc. review denied*, 354 N.C. 69, 553 S.E.2d 39 (2001). "When language used in [a] statute is clear and unambiguous, [the Court] must refrain from judicial construction and accord words undefined in the statute their plain and definite meaning." *Hieb v. Lowery*, 344 N.C. 403, 409, 474 S.E.2d 323, 327 (1996), (quoting *Poole v. Miller*, 342 N.C. 349, 351, 464 S.E.2d 409, 410 (1995)). "Where the Legislature has made no exception to the positive terms of a statute, the presumption is that it **[***9]** intended to make none, and it is a general rule of construction that the courts have no authority to create, and will not create, exceptions to the provisions of a statute not made by the act itself." *Upchurch v. Funeral Home*, 263 N.C. 560, 565, 140 S.E.2d 17, 21(1965) (quoting 50 Am. Jur. Statutes § 432, p. 453 (1944)). Here, the language of the statute is clear and it is not necessary for us to resolve an ambiguity.

Under N.C. Gen. Stat. § **50-20(c)(11)** the legislature imposed no limitation on the trial court's consideration of the tax consequences as a factor in the distribution of

marital property. N.C. Gen. Stat. § 50-20(c) provides in pertinent part that:

> There shall be an equal division by using net value of marital property and net value of divisible property unless the court determines that an equal division is not equitable, the court shall divide the marital property and divisible property equitably. Factors the court shall consider under this subsection are as follows:
>
> . . .
>
> (11) The tax consequences to each party.

Moreover, other jurisdictions have not been restrictive in determining when a trial court **[***10]** may consider tax consequences. *See, e.g.*, *In re Bookout*, 833 P.2d 800, 806 (Colo. App. 1991), *cert. denied*, 846 P.2d 189 (Colo. 1993); *Hogan v. Hogan*, 796 S.W.2d 400, 408 (Mo. App. 1990); *White v. White*, 105 N.M. 600, 734 P.2d 1283, 1286 (1987); *Barnes v. Barnes*, 16 Va. App. 98, 428 S.E.2d 294, 300 (1993); *see also* Tracy A. Bateman, Annotation, Divorce and Separation: **[*261]** Consideration of Tax Consequences in Distribution of Marital Property, 9 A.L.R. 5th 568, 592, § 2[a] (1993).

Since the plain language of the statute provides no such limitation on the consideration of tax consequences in determining whether an equal division is not equitable, I *certify* to our Supreme Court the holdings of this Court to the contrary. N.C. Gen. Stat. § 7A-30.

Dolan AFFIRMED 355 N.C. 484 (2002)

Because of:

Weaver v. Weaver, 72 N.C.App. 409 (1985) *disapproved on other grounds in* Armstrong v. Armstrong, 322 N.C. 396 (1988).

The defendant argues similarly that the trial court failed to consider taxes that defendant might have to pay on the interest in his partnership if he were to withdraw, or to consider the lower taxes his wife will pay on the house the trial judge awarded her. Again, the defendant asks the court to engage in mere speculation. HN4 The trial court is

not required to consider possible **[***16]** taxes when determining the *value* of property in the absence of proof that a taxable event has occurred during the marriage or *will* occur with the division of the marital property. *In re Marriage of Fonstein*, 131 Cal. Rptr. 873, 552 P. 2d 1169 (1976); *accord Stern v. Stern*, 66 N.J. 340, 331 A. 2d 257 (1975). We construe HN5 Section 50-20(c)(11) of the General Statutes as requiring the court to consider tax consequences that will result from the distribution of property that the court actually orders.

Harvey v. Harvey, 112 N.C. App. 788 (1993)
In *Weaver*, we held that HN4 "[t]he trial court is not required to consider possible taxes when determining the value of property in the absence of proof that a taxable event has occurred during the marriage or will occur with the division of the marital property." ***Weaver***, 72 N.C. App. at 416, 324 S.E.2d at 920. In *Wilkins v. Wilkins*, 111 N.C. App. 541, 432 S.E.2d 891 (1993), we held that it was improper to value the plaintiff's retirement benefits on an after tax basis. We reasoned that calculating the value of the assets based on "hypothetical tax consequences arising from speculative early withdrawals" violated the provision of G.S. § 50-20(b)(1) that vested retirement or pension funds are to be valued as of the date of separation. *Wilkins*, 111 N.C. App. at 549, 432 S.E.2d at 895. These cases stand for the principle that evidence of circumstances not in existence on the date of separation is not competent evidence for the purpose of **[***9]** valuing a marital asset. *Christenson v. Christenson*, **[*793]** 101 N.C. App. 47, 398 S.E.2d 634 (1990). Similarly, in *Weaver* and *Wilkins* we held that it is improper to consider possible tax consequences as a distributive factor under G.S. § 50-20(c)(11) in the absence of evidence that some taxable event has already occurred or that the distribution ordered by the court will itself create some immediate tax consequence to either of the parties. *See*, *Smith v. Smith*, 104 N.C. App. 788, 411 S.E.2d 197 (1991).

So, the legislature **amended 50-20 (c)(11) in 2005** to read:

> **Chp 50-20 (c)** (11) The tax consequences to each party, including those federal and State tax

> consequences that would have been incurred if the marital and divisible property had been sold or liquidated on the date of valuation. The trial court may, however, in its discretion, consider whether or when such tax consequences are reasonably likely to occur in determining the equitable value deemed appropriate for this factor.

Pellom v. Pellom, 669 S.E.2d 323 (2008)

Pursuant to statute, a trial judge shall consider in an equitable distribution matter:
The tax consequences to each party, including those federal and State tax consequences that would have been incurred if the marital and divisible property had been sold or liquidated on the date of valuation. The trial court may, however, in its discretion, consider whether or when such tax consequences are reasonably likely to occur in determining the equitable value deemed appropriate for this factor.
N.C. Gen. Stat. § 50-20(c)(11) (2007).

In applying the above statute, this Court has held:
[*328] The trial court is not required to consider possible taxes when determining the *value* of property in the absence of proof that a taxable event has occurred during the marriage or *will* occur with the division of the marital property. **We construe Section 50-20(c)(11) of the General Statutes as requiring the court to consider tax consequences that will result from the distribution of property that the court actually orders.**
Weaver v. Weaver, 72 N.C. App. 409, 416, 324 S.E.2d 915, 920 (1985) **[**11]** (internal citations omitted), *disapproved on other grounds by Armstrong v. Armstrong,* 322 N.C. 396, 403-04, 368 S.E.2d 595, 599 (1988).

Amir v. Amir, 2018 N.C. App. LEXIS 246, 810 S.E.2d 416, 2018 WL 1162813

However, our Court has held that the trial court is only required to consider tax consequences that will result from the distribution of the property that the court actually orders.

Additional Point:

- The use of tax considerations in Pellom centered around the valuation method of a business and whether the personal income taxes of the Defendant had been used in the Plaintiff's expert's valuation. The trial court made extensive findings and they included a determination that Plaintiff's expert also considered the "entity-level tax consequences in his valuation of DAA by using Ibbotson Build-Up Method to determine the appropriate capitalization rate". So the court concluded that the trial court had considered tax consequences.

- 50-20 (c) (11) is a factor for the court to consider when determining if an equal division is equitable and if not, how the property should be equitably divided. So it seems that this provision doesn't address the use of possible tax consequences in determining the value of marital property, except such that it might constitute a factor to consider in determining the division of the property.

Sufficiency of Evidence on Tax Consequences:

Smith v. Smith, 2018 N.C. App. LEXIS 972, 818 S.E.2d 647, 2018 WL 4702228

Unpublished.

Findings of fact from the order:

34. Two-thirds of Defendant/wife's paternal inheritance ($872,064.00) was in the form of retirement accounts.

35. In order to reduce the enormous disparity in the parties' earned incomes at the time the **division** becomes **[*7]** effective, Defendant/wife would have to liquidate both retirement accounts

and pay a combined state and federal **tax**rate of 40%, based upon a hypothetical question put to Defendant/wife by her attorney (T. p. 69)

36. It is unreasonable for the court to impute income to

Defendant/wife that requires her to liquidate her separate inheritance and to pay a **tax** bill of approximately $348,000 in doing so.

Analysis from the appellate opinion:

On 22 December 2011, Defendant testified concerning possible liquidation and **tax** consequences of her assets:

> [Defendant's Counsel:] Well, let's say that you've already taken that money out and using it to pay attorney fees and child support, the fact that it's in a qualified retirement account, you would have to pay **taxes** on that money, would you not?
>
> [Defendant:] Yes, I would.
>
> [Defendant's Counsel:] And the effective **tax** rate would be approximately what?
>
> [Defendant:] If I took all those funds out at one time, the effective **tax** rate, federal and state, it would put in a 40 percent **tax** bracket.
>
> [Defendant's Counsel:] Okay. So $871,000.00 point 40, appears **[*18]** that the — my math calculation, the **tax** would be $348,400.00 and I think if we

> deduct that amount from the $871,000.00, you're welcome to do this calculation, but to save time, it looks like that the net after **tax** would be $522,600.00 —
>
> [Defendant:] Yes, that's the number I get also.
>
> [Defendant's Counsel:] Okay. Well let's say if you took the $522,600.00, after you've withdrawn the money from the only retirement accounts that you apparently currently own, if you took the $522,600.00 out and you added roughly the balances of the accounts Mr. Kornegay established through your earlier testimony, those other accounts would total approximately how much, in round numbers?
>
> [Defendant:] They'd probably total up another $500,000.00 —
>
> [Defendant's Counsel:] Okay.

The trial court used Defendant's testimony as evidence for Findings of Fact 32-36. Finding of Fact 35 states, "Defendant/wife would have to liquidate both retirement accounts and pay a combined state and federal **tax** rate of 40%, based upon a hypothetical question put to Defendant/wife by her attorney." This finding improperly relies on, *inter alia*, "the occurrence of certain events, none of which had occurred on or before the date of separation **[*19]** or the date of the hearing" and seeks to "predict variables . . . requir[ing] the trial court to

engage in impermissible speculation." *Wilkins v. Wilkins*, 111 N.C. App. 541, 553, 432 S.E.2d 891, 897 (1993); *see Plummer*, 198 N.C. App. at 547, 680 S.E.2d at 752-53; *Harvey v. Harvey*, 112 N.C. App. 788, 793, 437 S.E.2d 397, 400 (1993). Findings of Fact 32-34 and 36 all rely on Defendant's testimony about hypothetical **tax** consequences and speculation, and go beyond the permissible consideration allowed under Section 50-20(c)(11). The trial court's order did not *actually order* liquidation or any action resulting in **tax** consequences for Defendant's separate **property**. Therefore, the trial court's consideration of the **tax** consequences was speculative and hypothetical. *See Plummer*, 198 N.C. App. at 547, 680 S.E.2d at 752-53; *Harvey*, 112 N.C. App. at 793, 437 S.E.2d at 400; *Wilkins*, 111 N.C. App. at 553, 432 S.E.2d at 897.

CONCLUSION

If you actually read all of this, thank you. I hope it helps in some way. There are so many substantive areas of law to keep up with for the district court work, adding the tax code to that list seems overwhelming. Keep up the good work.