

# THE TAX COURT DISALLOWS A DOUBLE DEDUCTION ON DUELING DEPENDENCY CLAIMS

**Pirrone, Maria**  
**St. John's University**

## **ABSTRACT**

*In Shenk v Commissioner, 140 T.C. 10, the Tax Court ruled that a noncustodial parent who did not attach a proper dependency exemption release to his return from the custodial parent was not entitled to claim a deduction. The Tax Court looked to the Internal Revenue Code to determine which parent was entitled to claim a dependency exemption that appeared on both parents' tax return. The noncustodial parent insisted on looking at the state court order to determine eligibility. According to the Code, a child may be treated as a qualifying child of the noncustodial parent if the custodial parent releases the claim to the exemption for the child and the noncustodial parent attaches the release to the return. The taxpayer claimed entitlement pursuant to a provision in the divorce decree. The Tax Court reasoned that the Internal Revenue Code determines the eligibility of the deduction, not the state court order.*

## **INTRODUCTION**

Divorce is an unfortunate life event that exists in more than one half of all American households. A married couple is viewed as one economic unit. Individuals involved in matrimonial actions often find themselves struggling to make sense of a myriad of state laws that affect their property rights. When there are minor children involved, the laws become even more complicated and complex. Matrimonial actions fall within the jurisdiction of state courts. The appropriate state court issues a divorce judgment that outlines the obligations and rights of the parties. Federal tax laws fall within the purview of the Internal Revenue Code of 1986, as amended (Code). At times, certain provisions of the state court judgment may conflict with the Internal Revenue Code.

*In Shenk v. Commissioner, 140 T.C. 10, the Tax Court held that a noncustodial parent who did not attach a proper dependency exemption release to his return from the custodial parent was not entitled to claim a deduction.*

## **STATUTORY OVERVIEW**

A tax is imposed on all taxable income of individuals. Code § 63 defines the term taxable income as gross income minus the deductions allowed (other than the standard deduction).

The starting point in the calculation of taxable income is the determination of gross income which is defined by Code § 61 as "all income from whatever source derived" other than certain items specifically excluded from gross income. Sources of gross income generally include, among other things, compensation for services, interest, dividends, capital gains, rents, royalties, alimony and separate maintenance payments.

An individual's adjusted gross income ("AGI") is determined by subtracting certain "above-the-line" deductions allowed under Code § 62 (a) from gross income. These deductions include, among other things, trade or business expenses, losses from the sale or exchange of property, deductions attributable to rents and royalties, contributions to pensions and other retirement plans, certain moving expenses, and alimony payments.

In order to determine taxable income, an individual reduces AGI by any personal exemption deductions and the greater of the applicable standard deduction or itemized deductions. Individuals are entitled to claim a personal exemption for themselves and any dependents they support. The personal exemption resembles a tax deduction: it reduces taxable income and the corresponding tax liability. The personal exemption amount is indexed annually for inflation. In 2013, the personal exemption amount is \$3,900. The personal exemption phase out ("PEP") will reduce a taxpayer's personal exemption by two percent for each \$2,500 by which the taxpayer's AGI exceeds a certain threshold. JCT staff estimates of the PEP thresholds in 2013 are \$172,250 (single) and \$258,350 (married filing jointly).

A taxpayer is entitled to one exemption for each person who can be claimed as a dependent. The analysis of the Tax Court began with the examination of Code § 152 (c)(1) which proffers a five-part test for a qualified child. Generally, a "qualifying child" must: (i) bear a specified relationship to the taxpayer (e.g., be a child of the taxpayer), (ii) have the same principal place of abode as the taxpayer for more than one-half of such taxable year, (iii) meet certain age requirements, (iv) not have provided over one-half of such individual's support for the taxable year at issue; and (v) not have filed a joint return for that year.

Special rules apply for children of divorced parents. A child could be the qualifying child of noncustodial parents if certain conditions are satisfied under Code § 152(e)(1) and (2), if the "child receives over one-half of the child's support during the calendar year from the child's parents \* \* \* who are divorced \* \* \* under a decree of divorce", such child was "in the custody of 1 or both of the child's parents for more than one-half of the calendar year", "the custodial parent signs a written declaration (in such manner and form as the Secretary may by regulations prescribe) that such custodial parent will not claim such child as a dependent for any taxable year beginning in such calendar year", and "the noncustodial parent attaches such written declaration to the noncustodial parent's return" for the appropriate taxable year.

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status.

Code § 1 provides different tax rates for different taxpayers, and Code § 1(b) provides relatively favorable rates for a "head of a household" Code § 2(b) in turn defines a "head of a household", and one of the criteria for that status is that the taxpayer "maintains as his home a household which constitutes for more than one-half of such taxable year the principal place of abode, as a member of such household, of \* \* \* (i) a qualifying child of the individual (as defined in Code § 152 (c) determined without regard to Code § 152 (e)". . Under Code § 152 (c)(1)(B), a "qualifying child" must have "the same principal place of abode as the taxpayer for more than one-half of such taxable year"; and by providing that the child's status is determined "without regard to Code § 152 (e)."

## **FACTS**

Mr. Shenk, the taxpayer and his wife, Julie Phillips, divorced in 2003. The family court's "Judgment of Absolute Divorce" provided that Ms. Phillips was "awarded primary residential custody" of the parties' three children; M.S., W.S., and L.S and that Mr. Shenk would be liable for child support payments. The judgment provided specifically for dependency exemptions. The judgment provided that in 2003, and in odd numbered years thereafter, provided that she is

employed and earning income, Ms. Phillips shall be entitled to claim the parties' two younger children, WS and LS, as dependency exemptions on her income tax returns. As long as he was up to date with his child support payments as of the end of the year, Mr. Shenk would be entitled in 2003, and in odd numbered years thereafter, to claim the parties' oldest son, MS, as a dependency exemption on his income tax returns. In even numbered years, the parties' entitlement to the foregoing dependency exemptions shall be reversed, with Mr. Shenk having two exemptions and Ms. Phillips having one.

In 2009 all three children resided with Ms. Phillips more than 50% of the time. As of the end of 2009 Mr. Shenk was up to date on his child support payments. Mr. Shenk contends, and we assume, that Ms. Phillips was not employed in 2009

On a joint return filed with her current husband on April 15, 2010, Ms. Phillips reported income. The return was not part of the record. Because 2009 was an odd-numbered year, she also claimed two dependency exemption deductions for W.S. and L.S. Mr. Shenk claimed two such deductions--for M.S. and L.S.--because he believed Ms. Phillips had not been employed in 2009 and therefore did not meet the conditions for claiming dependency exemptions. He also claimed the corresponding child tax credit, and he claimed head-of-household filing status.

Because L.S. was thus claimed as a dependent on two returns, the IRS became aware of the dueling claims. The IRS allowed Ms. Phillips's return to stand, leaving her with two dependency exemption deductions; and it disallowed one of the dependency exemption deductions claimed on Mr. Shenk's return. On January 18, 2012, the IRS issued to Mr. Shenk a notice of deficiency for 2009, determining additional tax attributable to denying that second dependency exemption deduction, the child tax credit, and head-of-household filing status.

On March 2, 2012, Mr. Shenk, a resident of Maryland, timely filed his petition in Tax Court for a redetermination. When the case was called for trial, Mr. Shenk asked for a continuance so that he could request the family court to revise its judgment of divorce to require Ms. Phillips to execute Form 8332 enabling him to perfect his claim for the dependency exemption deductions. His continuance request was denied. The IRS has a three-year period of limitations to assess taxes and therefore the delay would put the IRS out of time for the assessment period against the mother and therefore it would not be able to collect the necessary taxes.

#### **HOLDING AND ANALYSIS**

The Tax Court held that a noncustodial parents' dependency exemption claim would not be allowed because of the custodial parent's failure to sign Form 8332 despite a state court's divorce decree providing the dependency exemption would be divided between the parents.

A taxpayer is entitled to one exemption for each person who can be claimed as a dependent. The analysis of the Tax Court began with the examination of Code § 152 which proffers a five-part test for a qualified child. A "qualifying child" must: (i) bear a specified relationship to the taxpayer (e.g., be a child of the taxpayer), (ii) have the same principal place of abode as the taxpayer for more than one-half of such taxable year, (iii) meet certain age requirements, (iv) not have provided over one-half of such individual's support for the taxable year at issue; and (v) not have filed a joint return for that year under Code §Sec. 152(c)(1). Under those provisions, Mr. Shenk could not claim his children as dependents for 2009 because, as he admits, they did not share the same place of abode with him for more than one-half of the year.

The court pointed out and reviewed the special rules in Code § 152 (e) to determine which parent may claim a dependency exemption deduction for a child in the case of divorced parents.

The child could be the qualifying child of Mr. Sherk, under Code § 152(e)(1) and (2), if the "child receives over one-half of the child's support during the calendar year from the child's parents \* \* \* who are divorced \* \* \* under a decree of divorce", such child was "in the custody of 1 or both of the child's parents for more than one-half of the calendar year", "the custodial parent signs a written declaration (in such manner and form as the Secretary may by regulations prescribe) that such custodial parent will not claim such child as a dependent for any taxable year beginning in such calendar year", and "the noncustodial parent attaches such written declaration to the noncustodial parent's return" for the appropriate taxable year.

Ms. Phillips did not timely sign Form 8332 or an equivalent document stating that she would not claim the dependency exemption. The court also pointed out that Mr. Sherk did not attach any release to his return.

The court ruled that Mr. Sherk was not entitled to the dependency exemptions because he was unable to show compliance with the third and fourth of the statutory criteria. Specifically, Ms. Phillips did not ever sign a declaration that she "will not claim such child as a dependent", and Mr. Sherk did not "attach such written declaration to" his return. Since Mr. Sherk was entitled to the dependency exemption, he was not entitled to head-of-household filing status or the child tax credit for 2009.

Mr. Sherk argued that under the conditions set out in the State court judgment of divorce, Ms. Phillips was not entitled to the disputed dependency exemption deduction, and he implicitly argues that she should have executed a declaration disclaiming and releasing the exemption. However, Code § 152 (e) requires that a declaration be "signed". The IRS stipulates that Mr. Sherk met the condition of the judgment (i.e., he was up-to-date with his child support payments); and the court assumes that Ms. Phillips did not meet the condition imposed on her by the judgment, so that as far as the State court was concerned, Mr. Sherk was entitled to the disputed deduction. But the court reasoned that ultimately it is the Internal Revenue Code and not State court orders that determine one's eligibility to claim a deduction for Federal income tax purposes, and Mr. Sherk does not meet the criteria of the Code for claiming the dependency exemption deduction because he is the noncustodial parent, and the custodial parent did not sign the required declaration.

The court pointed out that "Congress added the written declaration requirement to Code § 152 (e) in 1984 to provide more certainty to the "often subjective and \* \* \* difficult problems of proof and substantiation" that accompanied dependency exemption deduction disputes under the prior statutory scheme". The court acknowledged the difficulty it would have had to determine if Mr. Sherk had fulfilled his support obligations (a question apparently easy to answer in this instance, though difficult and controversial in others), but also questions about whether Ms. Phillips was "employed and earning income", as the judgment required. If such questions had to be answered before one could determine the proper claimant of the dependency exemption deduction, then Code § 152 (e) would fail of its purpose."

The U.S. Tax Court ruled that "ultimately it is the Internal Revenue Code and not state court orders that determine one's eligibility to claim a deduction for federal income tax purposes, and Mr. Sherk does not meet the criteria of the code for claiming the disputed dependency exemption deduction."

Given the court's determination that Mr. Shenk is unable to claim the dependency exemptions, he was not entitled to a child tax credit for "each qualifying child" has not reached the age of 17. Further, Mr. Shenk was not entitled to head-of-household filing status. Mr. Shenk admitted that all three of his children resided with their mother for more than half of 2009 and with him for less than half of 2009. Consequently, no qualifying child lived with Mr. Shenk in his place of abode for more than half of that year, so he was not entitled to head-of-household filing status.

### **CONCLUSION**

Divorce attorneys frequently advise clients with regard to tax due to the division of a business, taxability of alimony payments and which party can claim the children for the purposes of the dependency exemption. Parties can agree on any of the terms and if they want to avoid litigation they can memorialize their agreement in a property settlement agreement. The agreement is usually incorporated in the final judgment of divorce. However, divorce cases fall within the jurisdiction of state courts and it is imperative for the judgment entered by the state court to adequately address the IRC requirements for the dependency exemption which may require the timely submission of IRS Form 8332.

### **REFERENCES**

Code §1

Code §61

Code §62

Code §63

Code §151

Code §152

*Shenk v. Commissioner*, 140 T.C. 10