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# Child Support: Tax Planning

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## Child Support: Tax Planning

### What is child support and who is responsible for paying it?

Every parent is obligated to financially support his or her children, providing such necessities as food, clothing, shelter, etc. Divorce doesn't cause this obligation to cease. When a divorce occurs, the noncustodial parent is usually ordered to pay some child support to the custodial parent; the rest of the child's expenses are paid by the custodial parent.

Child support may end at the child's 18th birthday, although some states set a cutoff at 21 years of age if the child is principally dependent on one parent (absent an agreement between the parties for a higher age). Also, some courts may order that child support continue until the child has graduated from college.

**Tip:** Some courts may also order child support to continue if the child has significant special needs.

### How do you determine the amount of child support?

The amount of child support that the noncustodial parent pays to the custodial parent can be simply a matter of agreement between the parents or it can be ordered by a judge. All states now have child support guidelines that help the court decide the amount of child support to be paid. However, there can exist considerable variation among states regarding the precise formula used to determine child support. Judges will carefully review agreements by the parents to ensure that the best interests of the child (or children) are kept in mind.

Often, the support obligation of each parent is based on the ratio of each parent's income, the percentage of time the child spends with each parent, the number of children, and the amount of alimony paid (if any). A child support worksheet is provided by the court to determine the amount. To complete a typical worksheet, each parent must determine his or her weekly (or monthly) available income (gross income minus taxes, Social Security, and other mandatory deductions). Optional deductions (like contributions to a 401(k) plan) aren't deducted.

When both parents are working, one method of determining support assigns a percentage of child-rearing costs to each parent based on his or her proportionate contribution to household income. When only one parent is employed, the amount of child support is assigned after determining the basic living expenses necessary for that parent.

**Example(s):** Assume Mary and John have two children and are seeking a divorce. Mary will have custody of the kids. Mary grosses \$900 per month and John grosses \$4,300, for a combined total of \$5,200. Thus, John earns 83 percent and Mary earns 17 percent of the total. Their particular state mandates that a household with two children should provide \$983 per month to maintain two children. Since 83 percent of \$983 is \$813, John owes Mary \$813 per month in child support.

Because there are a number of methods for determining the amount of child support to be paid, it is necessary for you to consult with the child support guidelines and worksheets provided by your own state. You should be able to obtain a worksheet at the probate court for your county.

### Can you modify a child support order?

Child support orders can be modified by a court even after a divorce has been finalized. The basis for modifying a child support order is that there has been a substantial change in circumstances for one or both parties. For example, perhaps the father lost his job after the divorce or the mother got a big raise or won the lottery. In general, a substantial change in circumstances may be defined as any change that significantly increases living expenses or increases (decreases) the income of a parent. Of course, a modification can also be sought if one parent fraudulently failed to disclose all of his assets and income when the child support worksheet was completed.

Your request for modification of child support will be either contested or uncontested. Courts often provide a standard form for modifying child support--you fill in all relevant information (including how circumstances have changed) and check off a box to indicate whether the matter is contested. In an uncontested case, the parents will voluntarily agree so there will be no opposition motion or pleading filed. In a contested matter, you will have to take your dispute to court. Keep in mind that once a court sets a support order, only a court can modify it. If you make an informal modification and your ex-spouse changes his or her mind, you won't have any protection regarding an arrearage.

## Who pays for the child's medical expenses, education, and other incidentals?

The provisions of your child support agreement must be specific and free of ambiguities in order to prevent disagreement at a later date. Try to anticipate future expenses. For example, dental bills can normally be expensive for children since braces are often needed. Medical insurance is also vital. In some families, a college education is expected and viewed as a necessity. Finally, paying for day care or other forms of child care when both parents work is also a significant expense and should be considered in any agreement.

If one parent is working and the other stays at home to care for the children, it's probably advisable to provide in the child support agreement that the working parent maintain health and dental insurance for the children on his employer plan. For high-net-worth families, the agreement might provide that the party with the higher income completely subsidize college education for the child (or children). On the other hand, perhaps each party will agree to pay a percentage of the college costs. Other questions you might want to consider include:

- Who will be responsible for repaying student loans
- Who will be responsible for subsidizing graduate school (if any)
- Who will pay for SAT preparation courses

Naturally, if the parents can't reach an agreement on these incidentals, it will be up to the judge to decide. Few, if any, states require payment for graduate school.

Finally, you should consider the issue of insurance--both life and disability insurance. A child support agreement will do you little good if the noncustodial parent dies or becomes severely disabled and unable to work. The settlement agreement can require the parent paying child support to purchase life and disability insurance to protect the income stream. If you suspect that the premiums won't be paid, you (the spouse receiving support) can own the policies and pay the premiums.

## How is unpaid child support collected?

Unfortunately, an award of child support doesn't guarantee the actual receipt of support. There are a number of methods for enforcing child support orders, including garnishment of wages, interception of tax refunds, commencement of contempt of court proceedings, public humiliation, the placement of liens on property, and the denial of state licenses.

### *Wage garnishment*

The most common method of collecting a judgment for child support is a wage garnishment. Here, a portion of the noncustodial parent's wages is removed from his or her paycheck at the source and delivered to you; with unpaid child support, up to 50 percent of net wages can be taken. To garnish wages, the custodial parent obtains authorization from the court to seize a percentage of the noncustodial parent's wages. Typically, a sheriff notifies that parent and his or her employer of the garnishment. Once the employer has been told to garnish wages, the employee will be informed.

Of course, the noncustodial parent can request a court hearing to oppose the garnishment and present a number of objections. For example, he or she can assert that you incorrectly computed the amount owed or that the amount to be taken will leave him or her with an insufficient amount to live on.

### ***Intercepted tax refunds***

Federal and state income tax refunds may be intercepted by the IRS and state departments of revenue and forwarded to your district attorney's office (or other state office charged with overseeing child support enforcement). The appropriate office will see that you get the money.

Before a refund is intercepted, the debtor will receive a written intercept notice, notifying him or her of a chance to request a hearing to object to the intercept. Relevant grounds for an objection include that the amount of the back support has already been paid or that the notice requests more than what is owed.

If the payer spouse is remarried and files a joint tax return, and that spouse's refund is intercepted, his or her new spouse's share of the federal refund can generally be returned. The new spouse should file IRS Form 8379 (Injured Spouse Claim and Allocation) and attach it to the tax return.

### ***Contempt of court***

If a judge orders a parent to pay a particular amount of periodic child support and the parent doesn't pay, the parent who's owed the child support can file an action before the court to ask that the other party be held in contempt. A hearing will be scheduled, and if the delinquent spouse fails to attend, a warrant may be issued for his or her arrest. The delinquent party can be jailed, or the judge may order him or her to make future payments in a timely manner and to pay the arrearage as well according to a set schedule. The judge can also order the delinquent spouse's wages withheld, place a lien on his or her property, or order him or her to post a bond. In addition, the judge can order the delinquent spouse to pay the opposing party's legal fees.

### ***Public humiliation***

In recent years, states have come up with more creative ways to obtain back child support. For example, most state child-support enforcement agencies now publish a "Most Wanted" list of parents who owe substantial child support, posting photographs and amounts owed.

### ***Property liens***

In some states, a custodial parent who is owed child support money can ask the court to grant a lien on the payer spouse's real or personal property. A real estate attachment, for example, may prevent him or her from refinancing or selling the house until the lien has been paid off. Sometimes the custodial parent can force a sale of the payer spouse's property to satisfy the lien.

### ***Denial of state license***

In a number of states, the debtor-parent's professional license (e.g., doctor's license, attorney's license, etc.) will not be renewed by the state if substantial back child support is owed. Some states will even fail to renew driver's licenses.

## **Can relocation and/or remarriage affect a child support order?**

Relocation of the parties and/or remarriage don't affect child support orders. The natural parents of a child continue to be responsible for support of the child, even if the custodial parent remarries. However, if the custodial parent moves out of state with the children, a noncustodial parent's increased transportation costs to visit with his or her children may constitute a substantial change in circumstances and warrant a decrease in child support.

Regarding arrearages in child support payments, even if a judgment was obtained in one state and the payer spouse has since moved to another state, state laws allow the custodial parent to file the judgment in the second state and enforce it there.

## What are the tax ramifications of child support?

Briefly put, child support is not taxable to the one who receives it, nor is it deductible to the one who pays it.

### *Is it child support?*

For payments to be classified as child support, the divorce decree or separation agreement must:

- Fix a sum that is payable for the support of a child (this can be either a dollar amount or a specific fraction of a payment). For example: Husband will pay \$500 per month child support to Wife.
- Provide that the amount payable by the payer spouse to the receiving spouse will be reduced in the event of some contingency relating to a child (such as the child's marrying, dying, leaving school or reaching a designated age). For example, Husband will pay \$500 per month child support to Wife until child reaches age 18.

OR

- Provide that the amount payable by the payer spouse to the receiving spouse will be reduced at a time that can clearly be "associated with" a contingency relating to a child.

**Example(s):** Husband agrees to pay Wife \$2,500 per month until she dies. (The words "child support" are not specifically mentioned.) Wife has custody of the couple's child, Justin, who was born on October 20, 1991. The divorce agreement states that on January 1, 2010, Husband's required payment to Wife will decrease to \$1,700 per month. Because Justin will turn 18 years old within six months of the date on which the payment is scheduled to decrease, the payment reduction is assumed to relate to Justin's reaching 18 years old. Therefore, the \$800 per month reduction is treated as child support unless the parties can rebut this presumption.

In this example, part of the husband's payment is characterized as alimony and part as child support.

### *Who can claim an exemption for the child as a dependent on the federal income tax return?*

The general rule is that unless otherwise specified, the dependency exemption usually goes to the parent who has physical custody of the child for the greater part of the calendar year (i.e., the custodial parent), regardless of how much support was provided by each parent.

**Example(s):** Frank and Liz separated in May. Their daughter, Carol, lived with Liz for the rest of the year, and Frank provided all the support for Liz and Carol that year. Because Carol lived with Liz longer than she lived with Frank, Liz may claim the dependency exemption, even though she made no actual financial contribution toward Carol's support.

However, there are circumstances when the noncustodial parent can claim the dependency exemption instead of the custodial parent. To do so, the noncustodial parent must meet one of the following conditions:

- The custodial parent must sign a written declaration that he or she will not claim the exemption for the child for the tax year, and the noncustodial parent must attach this declaration (IRS Form 8332) to his or her tax return, or
- A qualified pre-1985 instrument between the parents must provide that the noncustodial parent can claim the child as a dependent (the noncustodial parent must also have provided at least \$600 for the support of the child during the year).

**Note:** Once the minor child reaches majority age under state law, the exemption goes to the parent who actually provides more than 50 percent of the child's support.

### **Child-care credit**

A custodial parent who pays child-care expenses so that he or she can work may be eligible for a tax credit for a portion of those expenses--up to 35 percent, depending on income. The qualifying expenses on which that percentage is based are limited to \$3,000 for one qualifying dependent, or \$6,000 if there is more than one dependent.

Only the custodial parent is entitled to claim both the child and the dependent care credit. This is true even if the custodial parent does not claim the dependency exemption for the child. A noncustodial parent may not claim a child-care credit for expenses incurred even if that parent is entitled to claim the exemption for the child.

**Example(s):** Assume John and Mary have a son, Benny, who lives with Mary four days a week and with John three days a week. John and Mary are both singers and work outside the home. Each parent pays half of the \$4,000 per year that it costs to keep Benny in day care during the week. Mary is entitled to claim a child-care credit for her share of the day-care expenses. She's considered the custodial parent because Benny spends a greater portion of time with her than with his father.

### **Head of household filing status**

The head of household filing status is available for those who are unmarried (or treated as unmarried for tax purposes) at the end of the calendar year, who provide more than half the cost of maintaining the household, and whose household is the principal home of at least one qualifying person for more than half of the year. (A qualifying person is their child or any other person who qualifies as their dependent.)

**Example(s):** John and Sue have an eight-year-old son, Tim. John and Sue obtained a divorce on January 1, 2009, and Sue was awarded custody of Tim. Tim lived with Sue throughout the year. When Sue files her 2009 tax return, she can claim head of household filing status.

The head of household filing status is also available to a married (separated) taxpayer under certain circumstances. The taxpayer must meet all of the following tests:

- The taxpayer's spouse did not live in the taxpayer's household at any time during the last six months of the calendar year
- The taxpayer files a separate return for the year
- The taxpayer maintains his or her home as a household that was the main home for a child stepchild, or adopted child for more than half of the year (a foster child must be a member of the household for the entire year)
- The taxpayer is entitled to claim the child as a dependent
- The taxpayer provides more than 50 percent of the cost of maintaining the household



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