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Change Is Needed: The Taxation of Alimony and Child Support

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A CHANGE IS NEEDED: THE TAXATION OF ALIMONY AND CHILD SUPPORT

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I. INTRODUCTION

When a marriage dissolves there are tax consequences for everything from distribution of property to custody of the couple's children. An already emotionally devastating time can easily become financially devastating as well. The current tax system for alimony and child support strengthens the possibility of financial

devastation. Under the present system, alimony and child support have opposite tax treatment. Alimony is included in the recipient's gross income¹ and deductible by the payor,² while child support is neither deductible nor includable.³ The separate tax treatment for alimony and child support unnecessarily complicates the tax consequences of divorce and leads to traps for the unwary. It is also inconsistent with traditional income-shifting theory, where the payee, rather than the payor, should be taxed on the payment since both control and enjoyment are lodged in the payee. Thus, change is needed.

Changes in the tax treatment of divorce have been made several times over the past century, beginning in 1917 when the Supreme Court ruled that alimony should not be included in the recipient's gross income.⁴ Further change occurred in 1942, when the precursors to the current Sections 71 and 215 of the Internal Revenue Code were enacted.⁵ Under the current system, section 71 requires that payments of alimony be included in the gross income of the recipient.⁶ Section 215 provides for a corresponding deduction to the payor for the alimony paid during his or her taxable year.⁷ However, there are no parallel provisions for child support, so it remains taxable to the payor and tax-free to the recipient. Indeed, Internal Revenue Code Section 71(c) specifically provides that payments made for the support of children of the payor spouse are ineligible for the inclusion/deduction pattern.⁸ Thus, these provisions reveal that the issue here is *who* should be taxed on income earned by one former spouse but paid to the other spouse to spend as he or she wishes. The basic structure of inclusion/deduction for alimony and no inclusion/no deduction for child support has remained unchanged to the present day.⁹ However, many complicated rules have been added to distinguish between alimony and child support, which will be discussed later in this paper.

Multiple cases have been litigated in an attempt to clarify the intricate provisions of the applicable code sections.¹⁰ It is nearly impossible for the average taxpayer to

¹I.R.C. § 71(a) (1999-2000). All citations to the Internal Revenue Code are to this code (which is technically the Internal Revenue Code of 1986, as amended) unless otherwise specified.

²See I.R.C. § 215(a) (2000).

³See *id.* §§ 71(c), 215.

⁴*Gould v. Gould*, 245 U.S. 151 (1917).

⁵Martin J. McMahon, Jr., *Tax Aspects of Divorce and Separation*, 32 FAM. L.Q. 221, 222 (1998) (citing S. Rep. No. 77-1631, 77th Cong., 2d Sess. (1942), reprinted in 1942-2 C.B. 504; see also H.R. Rep. No. 77-2333, 77th Cong., 2d Sess. (1942), reprinted in 1942-2 C.B. 372).

⁶I.R.C. § 71(a).

⁷See *id.* § 215(a).

⁸See *id.* § 71(c).

⁹See *id.* §§ 71, 215.

¹⁰See e.g., *Marten v. Commissioner*, 78 T.C.M. (CCH) 584 (1999); *Simpson v. Commissioner*, 78 T.C.M. (CCH) 191 (1999); *Lawton v. Commissioner*, 78 T.C.M. (CCH) 153 (1999); *Preston v. Commissioner*, 77 T.C.M. (CCH) 1437 (1999); Priv. Ltr. Rul. 92-510, 1992 C.B. 33 (discussed *infra* note 97).

understand the system with all of its confusing provisions. This leads to traps for the unwary and unexpected consequences from divorce settlements.¹¹ It is easy for more sophisticated taxpayers to manipulate the system to disguise one type of payment as the other for more desirable tax treatment.¹² Furthermore, these complexities are not necessary to maintain a functioning system of divorce taxation.

The taxation of child support and alimony has also been popular in law review articles and other scholarly journals.¹³ Solutions such as tax credits for ex-spouses who meet their support obligations¹⁴ and private ordering of payments by the ex-spouses¹⁵ have been proposed. However, none have been implemented, and none are sufficient to solve the problems of the current system. There must be a simplification of the present law so that the average divorced taxpayer will be able to understand and implement the rules with or without sophisticated tax counsel or an amicable relationship with his or her ex-spouse.

This goal can be achieved by treating alimony and child support the same for tax purposes. This leaves only two possible situations. The first is that both alimony and child support should be taxed to the payor (through the denial of a deduction) and not included in the recipient's gross income. The opposite conclusion is that both alimony and child support should be deductible by the payor and taxed to the recipient by including the payments in her gross income. This paper will argue that the best solution is for both alimony and child support to be taxed to the recipient. This will be accomplished by providing a deduction to the payor and including both payments in the recipient's gross income.¹⁶

There are several benefits from treating both types of support in a like manner. It will provide the simplicity that is needed for both the average taxpayer and the

¹¹Roland L. Hjorth, *Divorce, Taxes, and the 1984 Tax Reform Act: An Inadequate Response to an Old Problem*, 61 WASH. L. REV. 151, 173 (1986).

¹²Marci Kelly, *Calling a Spade a Club: The Failure of Matrimonial Tax Reform*, 44 TAX LAW. 787 (1991).

¹³See e.g., Hjorth, *supra* note 11; Wendy Gerzog Shaller, *On Public Policy Grounds, A Limited Tax Credit for Child Support and Alimony*, 11 AM. J. TAX POL'Y 321 (1994); Beverly I. Moran, *Welcome to the Fun House: The Incredible Maze of Modern Divorce Taxation*, 26 HARV. J. ON LEGIS. 117 (1989).

¹⁴Shaller, *supra* note 13, at 337. This author proposes a limited tax credit for child support and alimony payments. The credit would be computed at the 15 percent rate on the sum of alimony and child support up to \$15,000. Thus, the maximum credit under this approach would be \$2250. The goal of this reform is to allow "all taxpayers [to] . . . benefit at the same rate regardless of their particular tax brackets." See Shaller, *supra* note 13, at 338.

¹⁵Kelly, *supra* note 12, at 811-12. The article's author advocates using private ordering as the method of determining the tax consequences of divorce payments. Under her approach, the parties themselves would determine the tax consequences of payments on a contractual basis. In the current system, alimony may selectively be designated as nonalimony. This system would allow the reverse as well. Nonalimony could be designated as alimony.

¹⁶For simplicity, this paper will assume that the payor spouse is the husband and the recipient is the wife. Obviously, in reality there are often recipients who are male and payors who are female.

courts.¹⁷ Thus, the complicated provisions distinguishing between alimony and child support will be unnecessary, and the amount of court time spent on the topic will decrease. It will also eliminate the need for taxpayer manipulation since it treats both types of payment the same.¹⁸ From a tax policy standpoint, the person who will control and enjoy the money, who in this case is the recipient, will be taxed. Furthermore, the presence of a tax deduction could function as an incentive for ex-spouses to pay their alimony and child support obligations.¹⁹ Finally, such treatment reduces the overall tax burden and leaves more after-tax money for support.

This viewpoint has its critics as well. However, this paper will show that many of the reasons advocated by those who disfavor this type of tax treatment are outdated and unpersuasive. For example, the argument that taxing the recipient is unfair because it intensifies the economic hardship of women after divorce is based upon empirical evidence that has recently been disproved.²⁰ Moreover, the after-tax amount can always be held constant, whether the payment is tax neutral or results in inclusion for the payee and deduction for the payor. Indeed, as I will show, the inclusion/deduction system can actually increase the after-tax payment received by most payees over what they would receive in a tax neutral system.²¹ Finally, the argument that such a system creates preferential treatment for divorced couples over non-divorced couples is incorrect.²² In fact, the economic unit of “husband and wife” is taxed consistently before and after divorce.²³

Although no system of taxation is without flaws, taxing both alimony and child support to the recipient will create the best possible method of divorce taxation. It will achieve the much-needed goals of simplicity, fairness and support of children that are needed from the tax system as it relates to divorce. This paper will advocate this method of taxation by first examining the history of the tax effects of divorce, then stating the problems with the current system, and finally discussing in depth the benefits and consequences of taxing the recipient on both alimony and child support.

¹⁷See Deborah H. Schenk, *Simplification for Individual Taxpayers: Problems and Proposals*, 45 TAX L. REV. 121, 164 (1989).

¹⁸See Kelly, *supra* note 12, at 808.

¹⁹See Shaller, *supra* note 13, at 341.

²⁰See Sanford L. Braver, *The Gender Gap in Standard of Living After Divorce: Vanishing Small?*, 33 FAM L.Q. 111, 115-16 (1999).

²¹See *infra* Part IV. 7 for a discussion of this concept.

²²See Lisa Ann Coe, Comment, *Changing Child Support Taxation in Canada: Great Step or Sidestep?*, 19 LOY. L.A. INT'L & COMP. L.J. 969, 983 (1997); see also Schenk, *supra* note 17, at 164.

²³See Schenk, *supra* note 17, at 164.

II. HISTORY OF THE TAX TREATMENT OF ALIMONY AND CHILD SUPPORT

A. Pre-1942 and *Gould v. Gould*

The roots of the controversy of divorce taxation can be traced back to the 1917 Supreme Court decision, *Gould v. Gould*.²⁴ This case was one of the first to examine how income should be defined for purposes of the income tax.²⁵ The issue before the Court was whether an ex-wife's alimony payments received from her ex-husband should be taxed to her.²⁶ The Court held that alimony payments were not income to the recipient, and thus were not taxable to the recipient.²⁷ The taxation of alimony was treated as nondeductible and excludable following this decision. This treatment matched the attitude of early 20th century America that divorce should be an uncommon event and when it does occur, husbands owe a constant duty of support.²⁸ Therefore, under this view, husbands should also bear the tax burden of their obligation.²⁹ Since there was no income inclusion by the wife during marriage and the duty of support continues after divorce, the Court determined that she should not have an income inclusion for support payments after divorce.³⁰

In an effort to escape the tax treatment of *Gould*, ex-husbands developed other methods of fulfilling their obligations of alimony.³¹ One such device was the alimony trust.³² Husbands relied on the principle that income from property is taxed to that property's owner.³³ Thus, if an ex-husband placed stock in trust, with his ex-wife as beneficiary, the dividends would be taxed to her, as owner of the trust

²⁴*Gould*, 245 U.S. 151 (1917). Interestingly, Mr. Gould sought the advice of the Commissioner of the Internal Revenue Service on how to treat alimony for tax purposes. The Commissioner believed that income should be income to the recipient, but also that it should not be deducted by the payor. Thus, Mr. Gould withheld taxes from his wife's monthly payments. It was this withholding of funds that prompted Mrs. Gould to sue Mr. Gould for alimony arrears. See *supra* note 13, at 119-20.

²⁵See Moran, *supra* note 13, at 119. This article proposes that the current divorce tax laws should be amended to return to the *Gould* approach. The author believes the most equitable approach would be to place the entire tax burden on the payor, by denial of a deduction.

²⁶*Gould*, 245 U.S. at 152.

²⁷*Id.* at 154.

²⁸Deborah E. Behr, *Tax Planning in Divorce: Both Spouses Benefit from the Tax Reform Act of 1984*, 21 WILLAMETTE L. REV. 767, 772 (1985).

²⁹See Kelly, *supra* note 12, at 789.

³⁰See Moran, *supra* note 13, at 120-21.

³¹See Moran, *supra* note 13, at 121.

³²See Moran, *supra* note 13.

³³*Poe v. Seaborn*, 282 U.S. 101, 113 (1930). This decision dealt with husband and wife taxpayers who lived in a community property state. Thus, all property owned by either party was considered joint property. The Court ruled that income from property is to be taxed to the owner of the property, which in this case was the marital unit. Thus, the Court held that all income earned by the husband was property attributable to the marital community.

property.³⁴ The alimony trust allowed men to meet their alimony obligation while escaping payment of the tax on alimony that *Gould* required.³⁵ The Supreme Court caught on to this scheme and eliminated this option by ruling that husbands should be taxed on income generated from a trust that is used to pay alimony.³⁶ Therefore, the outcome in *Gould* was retained, and the case remained controlling precedent for the next 25 years.³⁷

B. The Enactment of Sections 71 and 215

As the number of divorces in America increased, society's attitude regarding divorce and alimony changed.³⁸ It was seen as unfair to require an ex-husband to be taxed on income used for alimony from which he received no direct benefit.³⁹ Taxing ex-husbands on income enjoyed by their ex-wives was now seen as unduly burdensome.⁴⁰ Congress reacted to the change in times and increase in divorce by enacting the statutory precursors of §§ 71 and 215 in 1942.⁴¹ These sections made alimony payments deductible to the payor and includable in the recipient's gross income.⁴² Such a shift in the tax burden on alimony reflected the view that the prior system was unfair to the ex-husband.⁴³

The new tax treatment brought about constitutional challenges in the courts.⁴⁴ There was concern on the part of ex-wives, who now bore the tax burden of alimony, that such payments were not actually income.⁴⁵ If alimony payments are not income,

³⁴See Moran, *supra* note 13, at 121 n.17.

³⁵Moran, *supra* note 13, at 121.

³⁶*Douglas v. Willcuts*, 296 U.S. 1 (1935). In this case an ex-husband created a trust, with proceeds going to his ex-wife, to fulfill his alimony obligation. He argued that the income should be taxed to his ex-wife, the beneficiary of the trust. However, the court reasoned that creating a trust to pay alimony is no different than receiving the income personally and making the payment directly. Since the latter scenario, under *Gould*, requires the husband to pay the tax on the payment, so should the former situation. Therefore, the husband had to pay taxes on the income from the trust.

³⁷See Moran, *supra* note 13, at 122.

³⁸See Behr, *supra* note 28, at 772.

³⁹Behr, *supra* note 28, at 772. Congressman Disney stated that "[t]he amount of [a] husband's income which goes . . . as alimony . . . is in reality no income to him at all since he has no control over it . . ." Behr, *supra* note 28, at 772 (citing 88 CONG. REC. 6377 (1942)).

⁴⁰See Moran, *supra* note 13, at 122-26. The impetus for these changing attitudes was World War II. The main goal of the Revenue Act of 1942 was to increase taxes to raise money for the war effort. Many Congressmen thought it unfair to require ex-husbands to pay the high war-time taxes on income enjoyed by their ex-wives.

⁴¹Revenue Act of 1942 § 421 (codified as amended at I.R.C. §71).

⁴²*Id.*

⁴³See Moran, *supra* note 13, at 125.

⁴⁴See, e.g., *Mahana v. United States*, 88 F. Supp. 285 (Ct. Cl.), *cert. denied* 339 U.S. 978, *reh'g denied*, 340 U.S. 847 (1950).

⁴⁵*Id.* at 288.

they reasoned, then such payments are not taxable under the 16th Amendment.⁴⁶ The issue was finally resolved in 1950 when it was held that alimony payments are income that Congress may tax under the Constitution.⁴⁷ Thus, alimony remained deductible by the ex-husband and included in the gross income of the ex-wife.

The law made under the 1942 act was retained when the Internal Revenue Code was enacted in 1954, with a few amendments.⁴⁸ Under the 1954 Code, § 71 made alimony payments gross income for the recipient, and § 215 provided a deduction to the payor.⁴⁹ Child support, however, was still governed by *Gould* and was not deductible or includable.⁵⁰ In fact, § 71(b) specifically removed child support from the inclusion/deduction scheme.⁵¹ This basic structure remains in the current, Internal Revenue Code of 1986.⁵²

However, from the enactment of these provisions in 1942 to 1984, several problems developed in implementing these laws.⁵³ For example, since alimony was the only type of support payment that was deductible, it had to be determined whether a certain type of payment should properly be classified as alimony, as opposed to child support or a property settlement. There were four basic requirements for a payment to be considered alimony.⁵⁴ First, the payment had to be

⁴⁶*Id.*; see also U.S. CONST. amend. XVI (stating, “The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration”).

⁴⁷*Mahana*, 88 F. Supp. at 288. An ex-wife brought suit to recover taxes she had paid on alimony received from her ex-husband. She argued that the legislation allowing alimony to be treated as income to the recipient was unconstitutional. She said alimony is not income, so the Sixteenth Amendment does not authorize its taxation. The court disagreed and said that “income” should take its plain meaning, and in this case money received by a woman from her ex-husband should be income to her; see also *Shomaker v. Commissioner*, 38 T.C. 192, 198-200 (1962); *Cooper v. Commissioner*, 21 T.C.M. (CCH) 1190, 1190 (1962) (holding that taxing alimony to the recipient also does not violate the Fifth or Fourteenth Amendments).

⁴⁸I.R.C. §§ 71, 215 (1954) (current version at I.R.C. §§ 71, 215).

⁴⁹*Id.* at § 71 (a)(1), which provides: “If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife’s gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.” Section 215 allows a deduction to the payor for payments meeting the requirements of § 71.

⁵⁰*Id.* at § 71(b). This section provided that: “Subsection (a) shall not apply to that part of any payment which the terms of the decree, instrument, or agreement fix, in terms of an amount of money or a part of the payment, as a sum which is payable for the support of minor children of the husband. For purposes of the preceding sentence, if any payment is less than the amount specified in the decree, instrument, or agreement, then so much of such payment as does not exceed the sum payable for support shall be considered a payment for such support.”

⁵¹*Id.*

⁵²I.R.C. §§ 71, 215.

⁵³See Behr, *supra* note 28, at 772-73.

⁵⁴See Behr, *supra* note 28, at 773.

periodic.⁵⁵ This meant the payment had to be for an uncertain amount, continue for an indefinite time, or continue for longer than ten years from the date of decree or agreement.⁵⁶ Second, the payment had to be made because of the marital or family relationship, meaning the payment was one of support.⁵⁷ Next, the payment was required to be made pursuant to the decree or under a written instrument relating to the divorce.⁵⁸ Finally, the payment had to be made in discharge of a legal obligation.⁵⁹ If, and only if, these requirements were met could the payor spouse deduct payments. The complexity of these rules led to confusion and dissatisfaction among taxpayers.⁶⁰ Furthermore, even if a divorcing couple labeled a payment as alimony, the courts would not always honor their agreement.⁶¹

Similar confusion arose regarding child support payments.⁶² The code required child support payments to be “fixed” as child support by the decree, instrument or agreement.⁶³ Thus, a slight variation in drafting divorce agreements could cause nontaxable child support to be treated as alimony.⁶⁴ Therefore, much litigation ensued to interpret the rules and distinguish between alimony and child support.⁶⁵

An important decision came down from the Supreme Court in 1961, which further regulated the classification of child support payments.⁶⁶ In *Commissioner v. Lester*, the Supreme Court held that a divorce agreement reducing the amount payable on a contingent relating to the child (such as death or marriage) did not “fix with requisite clarity” the amount for child support.⁶⁷ Thus, the payments were

⁵⁵I.R.C. § 71(a)(1) (1954) (current version at I.R.C. § 71(b) (1999-2000)).

⁵⁶See Behr, *supra* note 28, at 773.

⁵⁷I.R.C. § 71(a)(1) (1954) (current version at I.R.C. § 71(b) (1999-2000)).

⁵⁸*Id.*

⁵⁹*Id.*

⁶⁰See Behr, *supra* note 28, at 773.

⁶¹*Casey v. Commissioner*, 12 T.C.M (CCH) 224, 227 (1949). Petitioner labeled his alimony payments as ‘periodic’ in the divorce decree in order to qualify for an alimony deduction. However, the court ruled that the payments were installment payments, not ‘periodic,’ and Casey was not entitled to a deduction. In a key passage the court stated, characterization of payments is “a determination to be made by this Court.”

⁶²See Behr, *supra* note 28, at 773-74.

⁶³I.R.C. § 71(b) (1954) (current version at I.R.C. § 71(c) (1999-2000)).

⁶⁴See Behr, *supra* note 28, at 773.

⁶⁵See Behr, *supra* note 28, at 773.

⁶⁶*Commissioner v. Lester*, 366 U.S. 299 (1961).

⁶⁷*Lester*, 366 U.S. at 299. The taxpayer and his wife made a written agreement pursuant to divorce which stated that payments made would be reduced by one-sixth if any of their three children married, became emancipated, or died. The court ruled that this agreement did not ‘specifically designate’ these payments as child support. In order to be considered child support, payments must be so ‘specifically designated’ and not left to inference by the court. Therefore, all of the payments under the agreement were treated as alimony and were deductible from the taxpayer’s gross income.

treated as alimony and were deductible by the payor and taxed to the recipient. This rule—that child support payments had to be expressly designated as child support in the decree or agreement to qualify as child support—is known as the Lester Rule.⁶⁸ After *Lester*, courts refused to infer from the facts of a specific case that payments were child support.⁶⁹ The only way to be absolutely certain payments would be considered child support by the courts was to specifically label them as such in the divorce instrument.

The specific rules for determining the nature of a support payment caused much litigation.⁷⁰ Taxpayers could never be certain of the tax consequences of divorce payments, which made divorce negotiation difficult. The rules were confusing, difficult to apply and often served as traps for unwary taxpayers.⁷¹ After over 40 years of such confusion, Congress finally took action.

C. The Tax Reform Act of 1984 and The Current System

Congress attempted to simplify the rules governing the tax consequences of divorce in the Tax Reform Act of 1984.⁷² The goals of the reform were: (1) encouraging ex-spouses to engage in tax planning together, and (2) restricting taxpayers from going too far in making their own decisions.⁷³ The changes were consistent with divorce law reform which shifted from a fault-based to a no-fault-based divorce system.⁷⁴ Gone were the attitudes from the *Gould* era that divorce should never occur and husbands owe a continuing duty of support. Instead, a more cooperative divorce was envisioned. However, many commentators do not believe the reform has truly accomplished these goals.⁷⁵ One legal scholar called the reform “a travesty imposed on the general public and on lawyers in general practice by specialists.”⁷⁶

⁶⁸See John Y. Taggart, *Economic Consequences of Emotional Choices: Divorce and Separation Under TRA 84*, 15 CUMB. L. REV. 341, 355 (1985).

⁶⁹See Taggart, *supra* note 68, at 355.

⁷⁰See Behr, *supra* note 28, at 773.

⁷¹See Behr, *supra* note 28, at 773.

⁷²Tax Reform Act of 1984 § 422, Division A of the Deficit Reduction Act of 1984 (codified as amended at I.R.C. § 71 and *hereinafter* referred to by citation to current Internal Revenue Code).

⁷³See Moran, *supra* note 13, at 148.

⁷⁴See Moran, *supra* note 13, at 147. In 1971, the Uniform Marriage and Divorce Act was amended to eliminate the fault grounds for divorce. In 1972, California became the first state to recognize irreconcilable differences as legitimate grounds for divorce. By 1984, all states had some form of no-fault divorce available. See Moran, *supra* note 13, at 147.

⁷⁵See *e.g.*, Hjorth, *supra* note 11; Moran, *supra* note 13; Taggart, *supra* note 68 (advocating that the 1984 reform did not achieve its goals and the tax system is still in need of improvement).

⁷⁶Hjorth, *supra* note 11, at 187. This article recommends that all cash payments made pursuant to divorce should be income to the recipient if they meet the requirements of § 71(b). However, the author states that the payor should only be able to deduct these payments if he can show that they are in the nature of support payments. Hjorth, *supra* note 11, at 155. The

The details of the reform are beyond the scope of this paper; however, some of the basic changes are necessary to mention at this point. Section 215 was not substantively changed and still provides a deduction for payments that qualify as alimony under § 71.⁷⁷ Some of the previous requirements under § 71 did not change. For example, payments must still be made under a divorce or separation instrument to be deductible.⁷⁸ However, the definition of § 71 alimony underwent some major changes.⁷⁹ First, the requirement that to be considered alimony, payments must be in cash was added.⁸⁰ Also, the payor and payee may not be members of the same household at the time payments are made.⁸¹ Another change in the revised provisions is that the requirement that payments be for support in order to classify as alimony was eliminated.⁸² However, several provisions were added so the basic element of support was retained.⁸³ For example, payments must terminate at the death of the recipient, and the instrument must specifically state this, unless payments terminate by state law.⁸⁴

Under the 1984 system, the periodic requirement was also eliminated.⁸⁵ Thus, all cash payments otherwise satisfying the criteria above are alimony unless the couple designates that the payments are not alimony.⁸⁶ This change gives ex-spouses more freedom to choose how their payments will be taxed, though parties cannot “opt into” the alimony inclusion/deduction system without satisfying all of the requirements specified in the § 71 definition of alimony.⁸⁷

Another important change was made regarding child support. Under previous law (the Lester Rule), payments were not treated as child support unless they were

author also advocates reinstatement of the Lester Rule to permit parties to determine which parties should pay the income on child support. Hjorth, *supra* note 11, at 189.

⁷⁷See Taggart, *supra* note 68, at 347.

⁷⁸See Taggart, *supra* note 68, at 347.

⁷⁹I.R.C. § 71(b), which provides: “The term ‘alimony or separate maintenance payment’ means any payment in cash if- (A) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument, (B) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under this section and not allowable as a deduction under section 215, (C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and (D) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse.”

⁸⁰I.R.C. § 71(b)(1).

⁸¹I.R.C. § 71(b)(1)(C).

⁸²See Hjorth, *supra* note 11, at 154.

⁸³See Hjorth, *supra* note 11, at 154.

⁸⁴I.R.C. § 71(b)(1)(D).

⁸⁵See Taggart, *supra* note 68, at 350.

⁸⁶See Moran, *supra* note 13, at 148.

⁸⁷I.R.C. § 71(b)(1)(B).

specifically designated as such.⁸⁸ The 1984 revision repealed the Lester Rule.⁸⁹ Under the present system, child support payments cannot be deducted, even if not specifically designated as child support.⁹⁰ Child support payments are identified as payments that terminate or decrease upon the occurrence of a contingency relating to a child.⁹¹ For example, if the divorce instrument provides that the payments will be reduced by \$100 per month when a child reaches the age of 18, then \$100 of each monthly payment will be treated as fixed for child support.⁹²

These changes, among others, were meant to simplify the system and make the tax rules easier to apply. Unfortunately, while the reform did solve some of the intended problems, there is still much confusion regarding divorce taxation. Furthermore, the 1984 Act brought new problems to the surface, such as the repeal of the Lester Rule⁹³ that further complicate the system.

III. PROBLEMS WITH THE CURRENT SYSTEM

Although several attempts at reform have been made, the current tax treatment of child support and alimony remains insufficient. There are four main problems that plague the current system. First, notwithstanding the 1984 effort to simplify the system, it is too complex for the average, unrepresented participant in divorce.⁹⁴ Next, it is easy for a more sophisticated taxpayer to manipulate the system and disguise one type of payment as another type.⁹⁵ Third, this complicated system leads to traps for the unwary taxpayer.⁹⁶ Finally, under the assignment-of-income doctrine, the person who has control of the money should bear the tax burden on that item of income. The current system is inconsistent with this doctrine because child support is taxed to the payor spouse, who has no control of the payments made. Each of these problems contributes to the need to change the current taxation of alimony and child support.

⁸⁸I.R.C. § 71(b) (1954) (current version at I.R.C. § 71(c)); *see also Lester*, 366 U.S. at 299.

⁸⁹*See Hjorth, supra* note 11, at 155; Tax Reform Act of 1984 § 422

⁹⁰I.R.C. § 71(c)(1), which provides: “Subsection (a) shall not apply to that part of any payment which the terms of the divorce or separation instrument fix (in terms of an amount of money or a part of the payment) as a sum which is payable for the support of children of the payor spouse.”

⁹¹I.R.C. § 71(c)(2). Examples of contingencies relating to the child are attaining a specified age, marrying, dying, and leaving school.

⁹²JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 715 (1984).

⁹³*See Taggart, supra* note 68, at 356.

⁹⁴*See Moran, supra* note 13, at 165.

⁹⁵*See Kelly, supra* note 12, at 803.

⁹⁶*See Hjorth, supra* note 11, at 187.

A. Complexity

Since the Tax Reform Act of 1984, there has continued to be much litigation involving the payment of child support and alimony.⁹⁷ This litigation is due in large part to the complexity of the system and the inability of the typical taxpayer to understand it.⁹⁸ According to one scholar, “[c]omplexity in some areas may be justified because the underlying transactions themselves are complex and the transactions are likely to be supervised by experts. That is not [the case with] divorce.”⁹⁹ Divorce is an occasion that often involves unsophisticated taxpayers, so it is necessary to simplify the system.¹⁰⁰ Furthermore, attorneys in general practice, not typically tax specialists, represent divorcing clients.¹⁰¹ The current system is difficult for general practice lawyers to apply intelligently, which leads to the clients’ failure to understand the laws and general distrust in the equity of the system.¹⁰²

The main cause of the confusion is the separate tax treatment of alimony and child support.¹⁰³ This disparate treatment forces the taxpayer to attempt to determine whether a payment is alimony or child support, which involves interpretation of complex rules.¹⁰⁴ Because spouses often disagree as to the proper tax treatment of a payment or simply do not understand the laws, it leads to litigation. Such litigation bogs down the courts and costs taxpayers additional money in an already financially difficult time. However, “the need for administrative or judicial determination continues as long as substantive inquiry is necessary.”¹⁰⁵

B. Taxpayer Manipulation

Since there are different tax consequences for child support and alimony, there is also an incentive for taxpayers to manipulate the system.¹⁰⁶ A somewhat sophisticated taxpayer could disguise child support or a property settlement as

⁹⁷See *e.g.*, *Marten v. Commissioner*, 78 T.C.M. (CCH) 584 (1999); *Simpson v. Commissioner*, 78 T.C.M. (CCH) 191 (1999); *Lawton v. Commissioner*, 78 T.C.M. (CCH) 153 (1999); *Preston v. Commissioner*, 77 T.C.M. (CCH) 1437 (1999); *Priv. Ltr. Rul.* 92-510, 1992 C.B. 33. All of these cases deal with whether payments should be classified as alimony or child support. The cases had mixed results with some labeling the payments as alimony (deductible to the payor/includible to the recipient) and others labeling the payments as child support (nondeductible/not includible). These cases and Private Letter Rulings are just a few of the many examples of court and Internal Revenue Service time that has been devoted to distinguishing between alimony and child support for the purposes of taxation.

⁹⁸See *Moran*, *supra* note 13, at 165.

⁹⁹See *Hjorth*, *supra* note 11, at 187.

¹⁰⁰See *Moran*, *supra* note 13, at 165.

¹⁰¹See *Hjorth*, *supra* note 11, at 187.

¹⁰²See *Hjorth*, *supra* note 11, at 187.

¹⁰³See *Moran*, *supra* note 13, at 165.

¹⁰⁴See *Moran*, *supra* note 13, at 165.

¹⁰⁵*Kelly*, *supra* note 12, at 803.

¹⁰⁶*Kelly*, *supra* note 12, at 802-03.

alimony to get the corresponding deduction.¹⁰⁷ These attempts to circumvent the system will lead to even more litigation.¹⁰⁸ The incentive to manipulate the system will persist as long as there remain different tax consequences for alimony and child support.¹⁰⁹

C. Traps for the Unwary

Another problem resulting from the opposite treatment of alimony and child support is that it creates traps for the unsophisticated taxpayer.¹¹⁰ Where some taxpayers will attempt to disguise payments, other less sophisticated taxpayers who have no intention of disguising a payment will be trapped into mistreating one payment as another.¹¹¹ If payments do not meet the specific requirements of § 71, they do not qualify as alimony. For example, temporary support paid pursuant to a decree that does not specifically state payments terminate upon the death of the payee are not deductible as alimony unless the payments would stop by operation of a state statute.¹¹² Thus, taxpayers must be careful that their payments meet all of the stated requirements, or they could inadvertently mislabel one type of support as the other.

In another example, suppose there is a divorcing couple with two children.¹¹³ The husband is ordered to pay the wife \$800 per month for three years (at which point one child will be 18 years, 3 months old).¹¹⁴ Under the current system, there is an assumption that this money is child support because it occurs within six months of a child's eighteenth birthday.¹¹⁵ However, the payor might be able to rebut the presumption and deduct the payments.¹¹⁶ The payee, on the other hand, would assume the payments are child support and exclude them from her gross income.¹¹⁷ Therefore, inadvertently, one party is deducting payments that the other party does

¹⁰⁷See Taggart, *supra* note 68, at 356; See also Hjorth, *supra* note 11, at 187. The author describes a situation where the divorcing couple could attempt to “whipsaw” the Commissioner. The payee could fail to report periodic payments, claiming that they were somehow contingent to an event relating to the child. The payor, on the other hand, would deduct the same payments claiming they met the objective tests of I.R.C. Section 71 and were not child support. If the Commissioner did not detect such treatment, the couple could completely avoid taxation on the item of income. Since she did not report the payments, the amount did not go into her gross income, and she did not pay taxes on it. He took a deduction on the same payments, which means he escaped taxation as well.

¹⁰⁸See Taggart, *supra* note 68, at 356.

¹⁰⁹See Kelly, *supra* note 12, at 802-03.

¹¹⁰See Hjorth, *supra* note 11, at 187.

¹¹¹See Hjorth, *supra* note 11, at 173.

¹¹²See Hjorth, *supra* note 11, at 173.

¹¹³See Hjorth, *supra* note 11, at 173.

¹¹⁴See Hjorth, *supra* note 11, at 173.

¹¹⁵I.R.C. § 71(c)(2)(A), (B).

¹¹⁶See Hjorth, *supra* note 11, at 173.

¹¹⁷See Hjorth, *supra* note 11, at 173.

not report.¹¹⁸ The present system encourages such inconsistent reporting. The only way to determine which party is correct is to litigate.¹¹⁹ Such traps are likely to persist as long as the current tax system is retained and child support and alimony are taxed to different spouses.

D. Inconsistent with Assignment-of-Income Doctrine

The current tax structure for alimony and child support creates another problem in that it is inconsistent with the underlying theory in income-shifting contexts where control usually dictates who is taxed on a payment. A common variable used by courts, outside of the alimony and child support context, when deciding who should be taxed, as between payor and payee, is dominion or control over the money.¹²⁰

The assignment-of-income doctrine is a common law doctrine that has developed over many decades.¹²¹ It has been used to determine which of several possible taxpayers should pay the tax on a particular item of income.¹²² Beginning in 1930, the Supreme Court ruled on several non-alimony or child support cases concerning who the proper taxpayer is for an item of income.¹²³ The principles developed in these cases can be used to allocate the tax burden for child support and alimony payments as well.

The assignment-of-income doctrine began with *Lucas v. Earl*, in 1930.¹²⁴ This case involved an attempt by a husband to shift some of his income to his wife for tax purposes.¹²⁵ The Court declared control as the essential element in deciding the proper taxpayer for an item of income.¹²⁶ Therefore, it refused to allow the husband to shift his income, since he retained ultimate control over the funds.¹²⁷

¹¹⁸See Hjorth, *supra* note 11, at 173.

¹¹⁹See Hjorth, *supra* note 11, at 173.

¹²⁰See, e.g., *Lucas v. Earl*, 281 U.S. 111 (1930); *Helvering v. Clifford*, 309 U.S. 331 (1940).

¹²¹See Michael Asimow, *The Assault on Tax-Free Divorce: Carryover Basis and Assignment of Income*, 44 TAX L. REV. 65, 84 (1988).

¹²²See Asimow, *supra* note 121, at 84.

¹²³See, e.g., *Lucas*, 281 U.S. at 111; *Helvering v. Horst*, 311 U.S. 112 (1940).

¹²⁴*Lucas*, 281 U.S. at 111. The respondent, Earl, made a contract with his wife in an attempt to share all of his income with her as joint property. Such sharing of property would also share the tax burden, which would consequently lower the tax burden attributable to the income. The issue was whether Earl could be taxed for the whole of his income, or should be taxed for only half in view of the contract with his wife. The Court disallowed his attempt at shifting a portion of the tax burden, requiring that whoever earned the income should be taxed on it.

¹²⁵*Id.*

¹²⁶See Ayla A. Lari, *Sharing Alike: French Family Taxation as a Model for Reform*, 37 DUQ. L. REV. 207, 247 (1999) (interpreting *Lucas v. Earl*, 291 U.S. 111 (1930)).

¹²⁷*Lucas*, 281 U.S. at 114; *but see Poe v. Seaburn*, 282 U.S. 101 (1930) (where it held that in community property states, income and property are attributed to the marital unit, and each spouse is deemed the owner of one half of the marital income and property and is taxed accordingly).

The assignment-of-income doctrine continued to develop with cases that dealt with intrafamily gifts and trusts.¹²⁸ In *Blair v. Commissioner*,¹²⁹ a father assigned income from a trust to his children. The Court attributed the tax on this income to the children because the father successfully transferred his complete interest.¹³⁰ This can be contrasted with situations in which the income-earner attempts to decrease his tax burden while surrendering little or no control over the income by keeping it in the family.¹³¹ The Court refused to allow these latter attempts at escaping taxation when the income-earner retained control over the income.¹³² *Helvering v. Clifford* dealt with a grantor of a trust assigning the income of the trust to his wife.¹³³ In a key passage, the Court indicated the importance of control as determining the proper individual to pay taxes on an item of income:

Since the income remains in the family and since the husband retains control over the investment, he has rather complete assurance that the trust will not effect any substantial change in his economic position. It is hard to imagine that respondent felt himself the poorer after this trust had been executed, for as a result of the terms of the trust and the intimacy of the familial relationship respondent retained the substance of full enjoyment of all the rights which previously he had in the property.¹³⁴

¹²⁸See Asimow, *supra* note 121, at 84.

¹²⁹300 U.S. 5 (1937).

¹³⁰*Id.* at 13-14. The specific facts of the case are as follows: A beneficiary of a trust assigned the income of the trust to his children. The issue was whether the assignor was still taxable on the income. The Government argued that the assignments were only “a right to receive the income” and “no attempt was made to assign any equitable right, title, or interest in the trust itself.” The Court disagreed. It ruled that the petitioner was the owner of an equitable interest in the property. He assigned this complete interest and the assignees thereby became the owners of the beneficial interests. Therefore, these assignees, and not the petitioner, should be taxed on the income.

¹³¹See, e.g., *Helvering v. Horst*, 311 U.S. 112 (1940); *Helvering v. Clifford*, 309 U.S. 331 (1940).

¹³²See *Horst*, 311 U.S. at 118. That case involved a taxpayer who owned a coupon bond. He retained ownership of the bond but transferred the interest coupons shortly before their due date to his son. The Court held that the father should be taxed on the interest collected by the son. It considered the interest coupons a gift, which would be tax free to the recipient. The Court stated, “the power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it.” See *Horst*, 311 U.S. at 118.

¹³³309 U.S. at 331.

¹³⁴*Clifford*, 309 U.S. at 335-36. In that case, the husband declared himself trustee over certain securities. He distributed income from this trust to his wife, at his “absolute discretion.” The issue was whether the husband, as grantor of the trust, may still be treated as owner of the corpus, and thus subject to taxation on the income generated from it. The Court held that the benefits directly or indirectly retained by the grantor of the trust left him with enough dominion and control over the corpus to be taxed on income generated by it. Another key passage from that decision is: “So far as his dominion and control were concerned it seems clear that the trust did not effect any substantial change. In substance his control over

Thus, the court ruled that the husband was responsible for paying the income tax on the trust income.¹³⁵

Therefore, as the history of the assignment-of-income doctrine shows, control is a major factor in deciding who to tax on a particular item of income. In fact, the control principle serves as a check to preserve the integrity of the taxation system.¹³⁶ The present treatment of alimony is consistent with this theory. Since the ex-wife receives money that she has complete control over, she must pay the taxes on it. However, by requiring the payor to bear the tax burden for child support, the current taxation of child support is inconsistent with the assignment-of-income doctrine. A non-custodial father should not be required to pay taxes on money over which he retains no control.

Despite all of the reforms made to the tax treatment of alimony and child support, the current system is inadequate. It does not satisfy the goals of simplicity or administrative feasibility. Furthermore, it traps the unwary taxpayer and allows a more sophisticated taxpayer to manipulate the system. Its placement of the tax burden on the payor of child support is inconsistent with the assignment-of-income doctrine and its underlying value that whoever controls the payments should pay the corresponding tax. Thus, it is necessary to change the current system and tax child support and alimony in a like manner.

IV. PROPOSAL: BOTH ALIMONY AND CHILD SUPPORT SHOULD BE TAXED TO THE RECIPIENT

If child support and alimony are to be taxed in the same manner, there are only two possible approaches. The first approach is to tax both forms of payment to the payor.¹³⁷ This would mean the payor does not get a deduction, and the recipient does not include the payments in her gross income. The alternative approach is to tax both alimony and child support to the recipient. Under this approach, the payee would include the payments in gross income, and the payor would get to deduct the payments. In sum, both forms of payment can be taxed to the payor, or both can be taxed to the recipient. The resulting system must be administratively feasible, straightforward and consistent with assignment-of-income tax policy.¹³⁸ For the reasons set forth below, the best way to reform the system is to require the recipient to pay taxes on both forms of payment and to provide a corresponding deduction to the payor.

the corpus was in all essential respects the same after the trust was created, as before. The wide powers which he retained included for all practical purposes most of the control which he as an individual would have." *Id.* at 335.

¹³⁵*Id.* at 336.

¹³⁶*See* Lari, *supra* note 126, at 247.

¹³⁷This is the approach advocated by Moran, *supra* note 13.

¹³⁸*See* Moran, *supra* note 13, at 166.

A. Arguments in Support of Proposal

1. Simplification

A very obvious benefit of taxing both alimony and child support to the recipient is that it simplifies the system.¹³⁹ It is the distinction between alimony and child support that is responsible for the complexity infiltrating the current taxation of divorce.¹⁴⁰ This opposite treatment necessitates the complex rules currently in force and requires extensive court interpretation.¹⁴¹ Treating alimony and child support the same for tax purposes eliminates this complexity.¹⁴² Because the tax burden is assigned solely to one person, there is no longer the need to distinguish between payments.¹⁴³ The complex definitional rules of section 71 can be completely discarded. This simplification of the system will benefit three main groups: taxpayers, attorneys and the courts.

The proposed, straightforward approach will be more easily comprehended by the average taxpayer.¹⁴⁴ Most divorcing couples are not sophisticated in matters of tax and finance.¹⁴⁵ Many divorcing couples are represented by general practice attorneys, who are also not experts in tax and finance.¹⁴⁶ Some taxpayers are not represented by attorneys at all during divorce. Such a system, of taxing both alimony and child support to the recipient, would allow the typical taxpayer to understand the tax consequences of his or her divorce and better negotiate settlements.¹⁴⁷ It will reduce the need for divorcing couples to seek sophisticated tax counsel to sort through the complicated tax consequences of divorce.¹⁴⁸ It will also produce fewer problems for those taxpayers who were not able to afford sophisticated tax counsel in the first place.

Taxing alimony and child support to the same person would also affect the attorneys who represent divorcing clients.¹⁴⁹ Many divorcing taxpayers are represented by general practice attorneys, not tax specialists.¹⁵⁰ The complex rules of the present system make it difficult for such attorneys to effectively advise their

¹³⁹See Schenk, *supra* note 17, at 162.

¹⁴⁰See Moran, *supra* note 13, at 165.

¹⁴¹See Moran, *supra* note 13, at 166.

¹⁴²See Moran, *supra* note 13, at 166.

¹⁴³See Moran, *supra* note 24, at 166.

¹⁴⁴See Moran, *supra* note 24, at 166.

¹⁴⁵See Hjorth, *supra* note 11, at 175.

¹⁴⁶See Hjorth, *supra* note 11, at 175.

¹⁴⁷See Moran, *supra* note 24, at 118.

¹⁴⁸See Hjorth, *supra* note 11, at 175.

¹⁴⁹See Schenk, *supra* note 17, at 161.

¹⁵⁰See Hjorth, *supra* note 11, at 175.

clients.¹⁵¹ Thus, taxing alimony and child support in the same manner would make advising divorcing taxpayers much easier for general practice attorneys.

The final group that would benefit from this simplification of the system is the courts. Under the current system, judicial inquiry is often necessary to sort through the complexities of divorce taxation.¹⁵² The proposed treatment would eliminate the complex rules of Section 71(b), which would consequently make court interpretation of these rules obsolete. No longer would the courts need to delve into complicated divorces to determine whether a payment was technically alimony or child support. Implementing this proposal would therefore reduce the amount of litigation involving the tax implications of divorce.¹⁵³

2. Eliminates Traps for the Unwary

This proposal also eliminates the traps for the unwary that plague the current system. The exact language to differentiate the payments required by the current system is what traps many taxpayers.¹⁵⁴ If alimony and child support are taxed the same, a taxpayer can no longer inadvertently create one form of payment, while attempting to create the other.¹⁵⁵ For example, there will no longer be the chance that one party will fail to report a payment (thinking it is child support) that the other party deducts (thinking it is alimony).¹⁵⁶ Both forms of payment will be includable and deductible. Thus, there will be fewer traps for the unwary since it will no longer be possible to be caught by complicated code language differentiating between the types of payments.

3. Eliminates Taxpayer Manipulation

A further benefit from this sort of taxation is that it will completely eliminate the incentive for taxpayer manipulation of payments. Under the current system, taxpayers can disguise one type of payment as the other to receive the desired tax treatment.¹⁵⁷ With the proposed change, there will be no incentive to disguise one type of payment as another since alimony and child support are taxed the same.¹⁵⁸ This will avoid attempts at unfair treatment by one spouse and litigation to determine the correct treatment.

4. Incentive to Pay

There is an important non-tax reason to tax the recipient on both forms of support. There is a “deeply disturbing reality of widespread failure of ex-husbands

¹⁵¹See Schenk, *supra* note 17, at 161.

¹⁵²See Kelly, *supra* note 12, at 803.

¹⁵³See Kelly, *supra* note 12, at 803.

¹⁵⁴See Schenk, *supra* note 17, at 160-61.

¹⁵⁵See Schenk, *supra* note 17, at 160-61.

¹⁵⁶See example *supra* Part III.C.

¹⁵⁷Kelly, *supra* note 11, at 802-03.

¹⁵⁸Kelly, *supra* note 11, at 808.

to meet their child support obligations.”¹⁵⁹ Sixty-five percent of absent fathers do not contribute alimony or child support.¹⁶⁰ One quarter of individuals who were awarded child support received only partial payments and one quarter received no payments at all.¹⁶¹ These statistics show that “there is a need for a comprehensive program to encourage the payment of child support.”¹⁶² The federal income tax system could provide such a program.¹⁶³ By providing a deduction to the payor for both alimony and child support, it will serve as an incentive to pay. Thus, by providing a financial incentive, in the form of a tax deduction, it might encourage “deadbeat dads” to pay their support obligations.

There is also an emotional incentive for allowing the payor spouse a deduction for child support. Divorce can be an alienating time for a non-custodial father and his children.¹⁶⁴ By not allowing the father to deduct child support, it “reinforce[s] the already existing feeling that he is no longer regarded by the state as an important part of the child’s life, and that his contributions are meaningless.”¹⁶⁵ The current system functions to further alienate a non-custodial father from his children.¹⁶⁶ The allowance of a deduction for child support will allow the non-custodial parent to feel as if his contribution is valuable.¹⁶⁷ Such a simple change as allowing a tax deduction will allow a non-custodial father to support his children without discouragement or resentment.¹⁶⁸

5. Overall Tax Savings

Further support for the payor-deduction/payee-inclusion model is that the higher income earner receives a deduction, while the lower income earner, who is in a lower tax bracket, pays the taxes.¹⁶⁹ Although it is somewhat counter-intuitive, this allows more money to be paid for the support of the ex-spouses’ children. Since the tax is paid by the spouse in the lower tax bracket, the recipient can have more after-tax income than if she foregoes inclusion but must accept a much lower gross payment in view of the payor’s inability to deduct the payment. For example, suppose that

¹⁵⁹William A. Klein, *Tax Effects of Nonpayment of Child Support*, 45 TAX L. REV. 259, 279 (1990).

¹⁶⁰Jacqueline Pons-Bunney, *Non-Custodial Fathers’ Rights: State’s Lack of Incentives for the Father to Remain in the Child’s Life*, 19 J. JUV. L. 212, 221 (1998).

¹⁶¹Shaller, *supra* note 13, at 332.

¹⁶²Shaller, *supra* note 13, at 335.

¹⁶³Shaller, *supra* note 13, at 335.

¹⁶⁴Pons-Bunney, *supra* note 160, at 228.

¹⁶⁵See Pons-Bunney, *supra* note 160, at 229.

¹⁶⁶See Pons-Bunney, *supra* note 160, at 229.

¹⁶⁷See Pons-Bunney, *supra* note 160, at 229.

¹⁶⁸See Pons-Bunney, *supra* note 160, at 229.

¹⁶⁹*Untying the Knot Tangles Taxes IRS has Many Pitfalls for Divorcing Couples*, CLEVELAND PLAIN DEALER, Mar. 3, 1997, at 4D.

Jack and Jill are in the process of getting a divorce.¹⁷⁰ Jack, if single, would be in the 39.6% marginal rate bracket,¹⁷¹ and Jill would be in the 15% marginal rate bracket. They are negotiating child support payments, and Jill would like \$500 per month. If the \$500 were nondeductible by Jack and excludable by Jill, then Jill's after-tax benefit would be \$500. Jack's after-tax cost would also be \$500. Thus, \$500 would be available for child support. However, if the payments are deductible by Jack and includable by Jill, then Jack should be willing to agree to, say, a \$600 payment, since the after-deduction cost of that payment would be approximately \$360 ($\$500 \times .40 = \240 deduction). Jack is much better off under this approach. However, Jill is better off as well. The after-tax benefit to her of the \$600 includable payment is \$510 ($600 \times .15 = 90; 600 - 90 = 510$).¹⁷² In sum, \$510 would be available for child support. Even more money would be generated (and an even higher deduction) if the amount of support were increased.¹⁷³ Therefore, under the proposed payor-deduction model, although it seems counter-intuitive, more money can actually be paid as support.

6. Payment is Income to the Recipient

Another reason to tax the recipient of alimony and child support is because these payments represent income to her. The Supreme Court defined income as "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion."¹⁷⁴ Under this definition the recipient has income since support payments are accessions to wealth over which she has dominion.¹⁷⁵ Furthermore, the Internal Revenue Code includes in gross income, "all income from whatever source derived,"¹⁷⁶ which again makes alimony and child support income to the recipient. It would be unfair to allow the payee to completely escape taxation for such income received.

7. Assignment-of-Income Doctrine

Even if alimony and child support payments do not fit within the definition of income supplied by the Supreme Court¹⁷⁷ or the catch-all language of I.R.C. section

¹⁷⁰The numbers from the following hypothetical were taken from a problem in the tax textbook, JOSEPH M. DODGE ET AL., FEDERAL INCOME TAX: DOCTRINE, STRUCTURE, AND POLICY 201 (2d ed. 1999).

¹⁷¹The 39.6% rate has been rounded to 40% for simplicity.

¹⁷²Indeed, Jill should demand even more in child support to take advantage of her ex-husband's tax savings.

¹⁷³For example, if support is fixed at \$800 per month under the proposed system, Jill will end up with after-tax cash in hand of \$680. The \$800 would be includable in her gross income, which produces a tax of \$120. Jack, on the other hand, would get a deduction of \$320 ($800 \times .40$), producing an after-tax cost of \$480 ($800 - 320$). In sum, due to their different tax brackets, an after-tax cost of \$480 to Jack will result in an after-tax benefit of \$680 for Jill.

¹⁷⁴Commissioner v. Glenshaw Glass, 348 U.S. 426, 431.

¹⁷⁵For support of this proposition, see discussion *supra* Part IV.A.7.

¹⁷⁶I.R.C. § 61(a) (2000).

¹⁷⁷See *supra* note 174, and accompanying text.

61,¹⁷⁸ they still may be considered income to the recipient. Under the assignment-of-income doctrine, control should indicate who bears the tax burden on a particular item of income.¹⁷⁹ Although alimony is already taxed to the person who controls it (the payee), this is not the case with child support. By also taxing child support to the recipient, the person with control and dominion of the money will correctly be taxed.

Child support and alimony should both be treated as under the control of the recipient since there is essentially no economic difference between child support and alimony payments.¹⁸⁰ Child support, like alimony, is cash paid to the recipient without an obligation on the part of the recipient to account for the use of the payments.¹⁸¹ Since there is no obligation to account for the use of the payments, the recipient is under full control of the funds. After divorce, the payor does not control the recipient.¹⁸² In fact, “they are arm’s length economic antagonists.”¹⁸³ Similarly, the payor does not control how the recipient will spend the payments.

When an ex-husband makes a payment of support, whether alimony or child support, to his ex-wife, he has completely relinquished control over such money.¹⁸⁴ The payor of alimony and child support feels less wealthy than before transferring the money.¹⁸⁵ Furthermore, the transfer is not revocable so money paid is gone forever.¹⁸⁶ Once the payor has made the payments, he no longer has any dominion or control over them and should not be required to pay the corresponding taxes.¹⁸⁷

¹⁷⁸See *supra* note 176, and accompanying text.

¹⁷⁹See *supra* notes 120-36, and accompanying text.

¹⁸⁰See JOSEPH M. DODGE, *THE LOGIC OF TAX, FEDERAL INCOME TAX THEORY AND POLICY* 118 (1989).

¹⁸¹*Id.*

¹⁸²See Asimow, *supra* note 121, at 108.

¹⁸³See Asimow, *supra* note 121, at 108.

¹⁸⁴This is completely different than the parties in the cases cited *supra* Part III,D and accompanying notes. In those cases, the taxpayer deliberately attempted to shift income to a member of his family. He would still have substantial control over the income shifted to his wife or children. Thus, the Court found it inequitable for him to escape taxation on such income, *see supra* notes 124, 126. However, in the context of divorce and alimony payments, an ex-husband will have no control over payments made to his ex-wife.

¹⁸⁵See Asimow, *supra* note 121, at 108; *see supra* notes 133-35, where the Court declares that the husband feels no less wealthy when he allows trust payments to go to his wife (in the context of their intact marriage). Again, this is a different situation than in divorce where a husband’s payments of support function to decrease his wealth.

¹⁸⁶See Asimow, *supra* note 121, at 108.

¹⁸⁷This situation is fundamentally different from the situation described *supra* note 132 in *Helvering v. Horst*, 311 U.S. at 118. In that case, which dealt with interest on a coupon bond, the Court said the exercise of the power to dispose of income is the enjoyment and equivalent of ownership of it. In contrast, in divorce, the husband is ordered to make the payments of support. It is not his “enjoyment” or even an “exercise” of power because he is legally obligated to make such payments.

Even if taxation follows who benefits from the payments rather than who controls them, the recipient is also the proper person to tax.¹⁸⁸ Assuming taxing children is not an option, it is the payee-spouse who uses and benefits from the child support. She has full control of how the payments will be used, and thus she should be taxed on them. One way to view child support is as payments made to a custodial parent to help fulfill her obligation of support to her children.¹⁸⁹ If it is viewed in this way, the recipient should pay taxes since the money is a function of her independent budget from which she benefits.¹⁹⁰

By adopting the proposed changes to the system and taxing both alimony and child support to the recipient, the person who controls and enjoys the money will appropriately be taxed on it. This treatment is consistent with the assignment-of-income doctrine, where control dictates the appropriate taxpayer for specific items of income. It is also consistent with the benefit principle, where taxation on income should be attributed to the person who benefits from the income.

8. Horizontal Equity

Along the same lines, taxing the recipient on both child support and alimony is consistent with the tax policy of horizontal equity. Under the principle of horizontal equity, similarly situated taxpayers should be taxed the same.¹⁹¹ A taxpayer who receives payments as excludable child support is better off than a taxpayer with the same gross taxable income who does not receive such payments.¹⁹² Thus, an ideal system would tax the recipient of child support on this increased standard of living.

For example, imagine there are 2 single mothers who both have total incomes of \$60,000 per year. Mother X earned all \$60,000 herself and receives no outside child support. Under the present system, she is taxed on all \$60,000 of income. Mother Y, on the other hand, earns \$35,000 herself and receives the other \$25,000 in child support from her ex-husband. Currently, she is only required to pay taxes on the \$35,000 of wage income. The remaining \$25,000 is hers to use in any manner she wishes, tax-free. Both women have \$60,000 to spend on raising their family, but Mother X is taxed on the full amount and Mother Y is taxed only on \$35,000. This provides a considerable advantage to Mother Y, the recipient of child support. It violates horizontal equity to tax these similarly situated taxpayers differently. By taxing child support to the recipient, these two mothers will be taxed in a like manner. Both women will pay taxes on their full income of \$60,000, and horizontal equity will be maintained.

¹⁸⁸Michael J. McIntyre, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573, 1575 (1977).

¹⁸⁹Kelly, *supra* note 11, at 807.

¹⁹⁰Kelly, *supra* note 11, at 807. The author states, “the wife’s obligation to support her children is an element of the wife’s independent budget, just as her own rent, food, or clothing are budget items.”

¹⁹¹Dodge, *supra* note 170, at 22.

¹⁹²Shaller, *supra* note 13, at 329.

9. Counteractive Measures

Finally, in the interest of fairness, there are tax consequences that somewhat counteract the deduction given to the payor. There are many tax benefits that a custodial parent receives for being the caretaker of the children. First, the Internal Revenue Code provides for a tax dependency exemption for the custodial parent.¹⁹³ This exemption automatically belongs to the custodial parent unless that parent specifically waives this right.¹⁹⁴ Also, only the parent who is entitled to claim the dependency exemption may receive a \$500 per child credit under I.R.C. § 24.¹⁹⁵ Similarly, only the parent who claims the dependency exemption may claim either a Hope Scholarship or lifetime learning credit on behalf of the child under I.R.C. § 25A,¹⁹⁶ another perk for the custodial spouse.

Another benefit provided in the tax code for the custodial parent is the classification as “head of the household.”¹⁹⁷ As the head of the household, the mother’s income is taxed at a lower rate than the non-custodial father, who is now classified as “single.”¹⁹⁸ Therefore, under the proposed change, even though the recipient of child support would be taxed on the payments, she is able to be taxed at a lower rate on this income than the payor by taking advantage of ‘head of the household’ status.

One final benefit the custodial parent receives is a tax credit for child care.¹⁹⁹ Custodial parents are permitted to credit a percentage of the amount spent each year on child care against their tax debt.²⁰⁰ This means such credit may cancel part of the

¹⁹³I.R.C. § 152(e)(1)(A) (2000). This provision applies regardless of the amount of support actually provided by either of the parents. Thus, even if the non-custodial parent provides nearly all of the financial support, the custodial parent may still claim the child as a dependant. See McMahon, *supra* note 5, at 236-37.

¹⁹⁴I.R.C. § 152(e)(2)(A). The statute reads: “A child of parents described in paragraph (1) shall be treated as having received over half of his support during a calendar year from the noncustodial parent if—(A) the custodial parent signs a written declaration . . . that such custodial parent will not claim such child as a dependent for any taxable year beginning in such calendar year, and (B) the noncustodial parent attaches such written declaration to the noncustodial parent’s return for the taxable year beginning during such calendar year.”

¹⁹⁵See McMahon, *supra* note 5, at 237-38 (discussing I.R.C. § 24). This article points out that the § 24 child credit is refundable against FICA taxes as well as income taxes if it exceeds the taxpayer’s income tax liability and the taxpayer has three or more qualifying children.

¹⁹⁶See McMahon, *supra* note 5, at 238. This is especially significant because the parent receives the credit even if the tuition is paid with the child’s own funds or even out of child support.

¹⁹⁷See Braver, *supra* note 20, at 123.

¹⁹⁸See Braver, *supra* note 20, at 123. The mother can be declared head of the household even if she is not the primary provider for the children’s material needs. This means that even if the father is the primary financial supporter of his children, the mother is the one who benefits from this status.

¹⁹⁹See Braver, *supra* note 20, at 123.

²⁰⁰See I.R.C. § 32 (2000).

mother's tax debt.²⁰¹ Fathers, on the other hand, may not receive a tax credit for child care.²⁰² Again, this presents a tax advantage for the recipient of child support as the custodial parent.

Therefore, there are many provisions built into the system that allow tax breaks for custodial parents. Under the current system, not only does the custodial parent have the above-mentioned benefits, but she also receives the child support payments tax-free. Thus, viewed in light of these benefits to the custodial parent, the proposed system in which child support and alimony are taxed to the recipient is equitable.

Another tax consequence is the federal tax refund offset for nonpayment of child support.²⁰³ This is a program that combines the effort of the Internal Revenue Service, Federal Office of Child Support Enforcement, and State Child Support Enforcement Agencies.²⁰⁴ The program identifies individuals who are past due on their child support payments and takes this amount out of their tax refund, if any, due.²⁰⁵ This serves as a penalty for nonpayment of child support while also attempting to get the money (in the form of intercepting the payor's tax refund) and placing it in the hands of the recipient.

Therefore, under the current system there are tax penalties for not paying child support, yet there are no tax benefits to paying child support. However, as has been demonstrated, there are several tax benefits for the recipient of child support.²⁰⁶ Therefore, these consequences should be balanced with a tax benefit (in the form of a deduction) to the ex-husband if he does pay child support.

²⁰¹Braver, *supra* note 20, at 123.

²⁰²*See* Braver, *supra* note 20, at 123. A non-custodial parent may not receive a tax credit for child care, even on money spent by the parent to care for the child during periods of temporary visitation, such as summer visitation.

²⁰³*See* Federal Tax Refund Offset (visited Jan. 6, 2000) <<http://www.acf.dhhs.gov/programs/cse/fct/cstrop.htm>>.

²⁰⁴*Id.*

²⁰⁵*Id.* Since 1982, almost ten million tax refunds have been intercepted by this program. Over six billion dollars have been collected. The process entails a cooperative effort between the IRS, OCSE and State CSE agencies. State CSE agencies submit names, social security numbers, and the amount in default of people who are past due on child support payments to the IRS. The IRS then flags the tax returns of those individuals. If a refund is due, the proper amount is collected to offset past due child support payments. The money taken out of the refund check is sent to the OCSE and then to the state which submitted the case. From that point, it depends whether the case is an Aid to Families with Dependent Children (AFDC) case. If so, the state keeps the money to help make AFDC payments. In non-AFDC cases, the state gives the money directly to the parent and child. If the case is both AFDC and non-AFDC, the AFDC arrearages are paid first.

In order for a case to be eligible for a tax refund offset, there must be a delinquent child support order. However, if the child support order includes an award for alimony, the tax refund may also cover past due spousal support. The parent who owes support must be at least three months behind in child support payments. In AFDC cases, the amount owed must be at least \$150, and in non-AFDC cases, the amount must be at least \$500.

²⁰⁶*See* discussion in Part IV.A.9.

B. Arguments Against Proposal

Although there are many reasons in support of this proposal, there are also some arguments that could be made against it. One outspoken argument that has been made is that taxing the recipient “intensif[ies] the economic hardship generally suffered by women after divorce or separation.”²⁰⁷ Another argument is that treating the payments the same for tax purposes eliminates a negotiation tool for divorcing spouses.²⁰⁸ Finally, it has been argued that such treatment creates inequities between divorced and non-divorced couples.²⁰⁹ However, it will be demonstrated that all of these arguments are invalid and do not provide enough support to discredit the proposed method of taxing both alimony and child support to the payee spouse.

1. Intensifies Economic Hardship to Women Following Divorce

One major argument against taxing both child support and alimony to the recipient is that it further economically disadvantages the ex-wife after divorce.²¹⁰ However, there is recent research to suggest that the economic hardship suffered by women has been greatly exaggerated.²¹¹ Even if there is such a hardship, the payor-deduction/payee-inclusion method of taxation does not contribute to the hardship. Indeed, as demonstrated earlier,²¹² allowing a deduction to the higher earning spouse for child support can increase the amount that the payor is willing to pay, compared to a no-deduction world.

The hardship suffered by women is not as great as it was once believed.²¹³ It was previously believed that following divorce, mothers’ and children’s standard of living sharply declined while fathers’ standard of living on average increased.²¹⁴ The most publicized advocate of this research was Lenore Weitzman, who conducted a study in the 1980’s on the economic status of women and men following divorce.²¹⁵ Weitzman concluded that, following divorce, the average divorced woman’s standard of living dropped by 73%, while the average divorced male’s standard of living increased by 42%.²¹⁶ These figures were cited in legislative debates, newspapers, magazines, law review articles, social science articles, appeals cases and

²⁰⁷Moran, *supra* note 24, at 117.

²⁰⁸Schenk, *supra* note 17, at 165.

²⁰⁹Coe, *supra* note 22, at 983.

²¹⁰Moran, *supra* note 24, at 117.

²¹¹Braver, *supra* note 20, at 115-16.

²¹²See *supra* notes 170-73 and accompanying text.

²¹³Braver, *supra* note 20, at 116.

²¹⁴Braver, *supra* note 20, at 113.

²¹⁵LENORE J. WEITZMAN, THE DIVORCE REVOLUTION: THE UNEXPECTED SOCIAL AND ECONOMIC CONSEQUENCES OF DIVORCE FOR WOMEN AND CHILDREN IN AMERICA 323-56 (1985).

²¹⁶*Id.*

even some U.S. Supreme Court cases.²¹⁷ However, current research has proven that these numbers are highly exaggerated.²¹⁸ In reality, the difference between the economic status of men and women after divorce is negligible.²¹⁹ In fact, in some states fathers may now be more impoverished by divorce than mothers.²²⁰

Furthermore, even if there is an economic disadvantage for women after divorce, it is not ameliorated by the tax system. As the Jack and Jill example from above demonstrates,²²¹ allowing the payor spouse to deduct alimony and child support payments actually allows the recipient to receive more money after taxes. By taxing the person in the lower tax bracket, the overall tax liability is less. This means that, as a whole, more after-tax money will be available as support.

2. Eliminates Negotiation Tools

Another possible criticism of the proposed tax system is that if alimony and child support are treated the same, there will be no room for divorcing spouses to negotiate.²²² Although ideally they should not, taxes often play a major role in divorce negotiation.²²³ If alimony and child support are taxed the same, some of this negotiation will be eliminated. For example, under the current system, an ex-husband may be willing to pay more money in the form of child support (which is not includable/nondeductible) in exchange for his ex-wife meeting one of his demands. Similarly, the ex-wife may allow more payments to be classified as alimony if one of her demands is met.

Although the proposed system would eliminate this realm of negotiation, there are several other areas left for ex-spouses to negotiate. One previously mentioned option is the tax dependency exemption.²²⁴ Since the custodial parent may opt to

²¹⁷Braver, *supra* note 20, at 113. This author states, “It would probably be fair to say that Weitzman’s findings are the most widely known and influential social science results of the last twenty years.”

²¹⁸Braver, *supra* note 20, at 113. Although Weitzman’s figures were the most highly publicized of research on the economic impact of divorce, they substantially departed from other researchers’ findings. Therefore, efforts were made to reproduce her findings using her exact sample. In 1996, Peterson re-analyzed Weitzman’s computer and paper records, and he yielded drastically different results. He found her sample to yield only a 27 percent drop in standard of living for women following divorce and a 10 percent rise in men’s standard of living. Later, Weitzman acknowledged that her original calculations were wrong due to an error made by a research assistant. Braver, *supra* note 20, at 115-16.

²¹⁹Braver, *supra* note 20, at 134. Braver re-examined the economic impact that divorce has on fathers versus mothers. He revisited research previously performed by himself and others on the topic. This time, he factored in the payment of taxes and sharing expenses of children between the two households. After making these adjustments, he concluded that the gender gap after divorce was “vanishingly small.” *See id.*

²²⁰*See* Braver, *supra* note 20, at 134.

²²¹*See supra* Part V for an explanation of how providing a deduction to the payor spouse can generate more after-tax income to the payee spouse.

²²²*See* Schenk, *supra* note 17, at 165.

²²³*See* Schenk, *supra* note 17, at 165.

²²⁴*See infra* notes 193-94 and accompanying text (discussing I.R.C. § 152(e)).

waive this right, the exemption could remain a tax negotiating tool for divorcing spouses.²²⁵ A custodial parent could offer the dependency exemption to the non-custodial parent in exchange for more support. Furthermore, there are many other areas of negotiation, not within the scope of this paper, such as property settlements that still leave options for divorcing couples.

3. Creates Inequities Between Divorced and Non-Divorced Couples

A final argument against this proposal is that it creates an inequity between divorced and intact families.²²⁶ The argument goes as follows: Parents in an intact family are not allowed to deduct payments made to support their children, so why should parents in divorced families get such a deduction?²²⁷ From this viewpoint, it appears that divorced couples get a tax break that is not available for married couples.²²⁸ However, this argument is flawed.²²⁹ A married couple is taxed only once on income used to support their children.²³⁰ This is also the case in a divorce situation.²³¹ Under the proposed system, the economic unit is still taxed only once, in the form of the recipient including the child support payment in gross income.²³² Thus, divorced parents are not given an advantage over married parents. Despite these possible arguments opposing it, the proposed method of taxing only the recipient on alimony and child support is the best way to reform the tax system as it pertains to divorce.

V. CONCLUSION

The current system of taxing alimony to the recipient and child support to the payee cannot stand. It has been demonstrated that this system is unnecessarily complex and causes confusion among average taxpayers, excess litigation, and traps for the unwary.²³³ The present system is also inconsistent with the values of the assignment-of-income doctrine which advocate taxing the person who controls and enjoys the money. Furthermore, the current system is no longer justified by the economic disparity between spouses following divorce.²³⁴

²²⁵Taggart, *supra* note 68, at 358.

²²⁶*See* Coe, *supra* note 22, at 983. This paper analyzes the taxation of alimony and child support in Canada. Canada recently switched from allowing a deduction for child support payments to disallowing such a deduction. However, alimony remains taxable to the payee. Now, Canada and the United States have the same system of taxation for alimony and child support. The author suggests that these changes will do more harm to Canada's system of taxation than good. *Id.* at 994.

²²⁷*See* Coe, *supra* note 22, at 983.

²²⁸*See* Coe, *supra* note 22, at 983.

²²⁹*See* Schenk, *supra* note 17, at 164.

²³⁰*See* Schenk, *supra* note 17, at 164.

²³¹*See* Schenk, *supra* note 17, at 164.

²³²*See* Schenk, *supra* note 17, at 164.

²³³*See* Moran, *supra* note 24, at 117-18.

²³⁴*See* Braver, *supra* note 20, at 117.

Congress and the Supreme Court have struggled over the past century to determine the proper tax treatment of alimony and child support. There have been several different systems in effect, starting with the no-deduction/exclusion model of *Gould*.²³⁵ The Tax Code of 1954 changed this system and codified a method of deduction/inclusion for alimony but retained the *Gould* no-deduction/exclusion for child support.²³⁶ Through many amendments and finally a major overhaul in 1984, changes were made. However, the basic structure of taxing alimony and child support differently was retained.²³⁷ Unfortunately, none of this reform has produced a system that is workable in the present divorce context. The system must be reformed in order to make the tax consequences of divorce more straightforward and consistent with tax policy.

By treating alimony and child support the same for tax purposes, it will eliminate the confusion and traps for the unwary that the current system causes.²³⁸ Since there will not be a difference in the way such payments are taxed under the proposed system, there will be no incentive for taxpayer manipulation.²³⁹ Furthermore, it will serve as both a financial and emotional incentive²⁴⁰ for individuals to meet their obligations of alimony or child support, and it will tax the person who actually controls and enjoys the money, which is consistent with the assignment-of-income doctrine. Taxing the recipient will maintain horizontal equity and generate more after-tax money to be used as support than the present system. Finally, taxing alimony and child support to the recipient is not a windfall for the payor. There are penalties for an ex-husband who does not meet his support obligations.²⁴¹ There are also several tax benefits for the recipient of child support that somewhat equalize the deduction/inclusion treatment.

Divorce is a devastating event both emotionally and financially. The tax laws should not make divorce even more difficult. The tax consequences of divorce should be simple, straightforward and fair. The taxpayers, attorneys and judges involved in divorce should be able to understand and apply the provisions.²⁴² Therefore, the present system must be changed. Alimony and child support should be treated the same for tax purposes. Both forms of payment should be taxed to the recipient in the form of an inclusion in her gross income and a corresponding deduction for the payor.

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²³⁵*Gould v. Gould*, 245 U.S. 151.

²³⁶I.R.C. § 71(a)(b) (1954) (codified as amended at I.R.C. § 71(b)(c)).

²³⁷I.R.C. §§ 71, 215 (2000).

²³⁸See Schenk, *supra* note 17, at 160-61.

²³⁹See Kelly, *supra* note 11, at 802-03.

²⁴⁰See Pons-Bunney, *supra* note 160, at 228.

²⁴¹See Federal Tax Refund Offset, *supra* notes 203-05.

²⁴²See Hjorth, *supra* note 11, at 190.