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**Date:** 9/7/05 11:02AM  
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HEADLINE: #11 2005 TNT 172-11 ABA TAX SECTION WANTS WORKING FAMILIES RELIEF ACT MODIFIED. (Section 151 -- Personal Exemptions;) (Release Date: SEPTEMBER 01, 2005) (Doc 2005-18346)

CODE: Section 151 -- Personal Exemptions;  
Section 152 -- Dependent Defined;  
Section 21 -- Child Care Credit;  
Section 32 -- Earned Income Credit;  
Section 24 -- Child Credit

ABSTRACT: In a September 1 letter, Dennis B. Drapkin of the American Bar Association Section of Taxation requested that changes to the Working Families Tax Relief Act of 2004 to correct previous modifications and eliminate unintended consequences regarding the allocation of dependency exemptions between parents of a common child.

AUTHOR: Drapkin, Dennis B.  
American Bar Association;  
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House Committee on Ways & Means  
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Re: Tax Technical Corrections Act of 2005

Gentlemen:

I am writing on behalf of the Section of Taxation<sup>1/</sup> of the American Bar Association concerning section 3(a) of the Tax Technical Corrections Bill recently introduced in both houses of Congress<sup>2/</sup> and related matters. The views expressed in this letter represent the position of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Working Families Tax Relief Act of 2004, Pub. Law 108-311 (hereinafter "WFTRA"), made changes to Code section 152(e), a rule that governs allocation of a dependency exemption between parents of a common child. Section 3(a) of the Tax Technical Corrections Bill proposes a statutory change that addresses some of the unintended consequences. Further revisions are needed, however, to eliminate all of the unintended consequences of the changes created by WFTRA, as well as certain undesirable consequences of WFTRA that may or may not have been intended.

The legislative history of the WFTRA amendments to section 152 indicates that with respect to a custodial parent's release of the right to claim a dependency exemption for a child, it is possible that the prior law was not intended to be changed<sup>3/</sup>. Nevertheless, taking into account the proposed technical correction to section 152(e), certain aspects of the prior law would be lost. The Section, therefore recommends that section 152 be further modified as discussed below to assure that the prior law is reinstated.

#### Discussion

One of the major changes made by WFTRA was to create a uniform definition of qualifying child for five tax provisions related to children--dependency exemption, Code section 152; head of household filing status, Code section 2(b); child tax credit, Code section 24; dependent care credit, Code section 21 and earned income credit, Code section 32. In general, the uniform definition awards the tax benefit to the taxpayer with whom the child resides, regardless of who provides support for the child. The overall objectives of adopting a uniform definition were to reduce the complexity of these provisions and improve compliance.

In enacting WFTRA, Congress modified Code section 152(e) to require that a divorce decree or written

separation agreement provide for the release of the dependency exemption from a custodial parent to a noncustodial parent. Under prior law, no divorce decree or written separation agreement was required. A custodial parent could shift the dependency exemption to the noncustodial parent simply by signing a written release form that the noncustodial parent would attach to his or her tax return. Further, the exemption could be shifted on a year-to-year basis by the custodial parent controlling when he or she provided the written release form.

For reasons set forth below, we believe the requirement of a divorce decree or written separation agreement is inconsistent with the stated objective and legislative history of WFTRA. The technical corrections proposed in the Tax Technical Corrections Bill do not address all of the consequences of WFTRA, intentional or otherwise, and, therefore, we recommend additional technical and related revisions to section 152(e).

Code section 152(e) before WFTRA

Prior to WFTRA, the pertinent subsections of Code section 152(e) read as follows:

Section 152(e) Support test in case of child of divorced parents, etc. ---

(1) CUSTODIAL PARENT GETS EXEMPTION. -- Except as otherwise provided in this subsection, if --

(A) a child (as defined in section 151(c) (3)) receives over half of his support during the calendar year from his parents --

(i) who are divorced or legally separated under a decree of divorce or separate maintenance,

(ii) who are separated under a written separation agreement, or

(iii) who live apart at all times during the last 6 months of the calendar year, and

(B) such child is in the custody of one or both of his parents for more than one-half of the calendar year,

such child shall be treated, for purposes of subsection (a), as receiving over half of his support during the calendar year from the parent having custody for a greater portion of the calendar year (hereinafter in this subsection referred to as the "custodial parent").

(2) EXCEPTION WHERE CUSTODIAL PARENT RELEASES CLAIM TO EXEMPTION FOR THE YEAR. -- 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 (in such manner and form as the Secretary may by regulations prescribe) that such custodial parent will not claim such child as a dependent for any taxable year beginning in such calendar year, and

(B) the noncustodial parent attaches such written

declaration to the noncustodial parent's return for the taxable year beginning during such calendar year.

For purposes of this subsection, the term "noncustodial parent" means the parent who is not the custodial parent.

The prior law applied to divorced or legally separated parents or parents who lived apart at all times during the last six months of the calendar year, whether or not the parents were ever married. If the parents provided over one half of a child's support during the calendar year and the child was in the custody of one or both parents for more than one half of the year, the parent having custody for the greater portion of the year was deemed to satisfy the support test required to claim a dependency exemption. In such situations, however, the custodial parent could release the dependency exemption to the noncustodial parent by signing a written declaration that was filed with the IRS by the noncustodial parent with his or her tax return. Generally, this was done using IRS Form 8332. The decision to sign a release was either a voluntary choice made by the custodial parent or a requirement of a divorce instrument or domestic relations order. This rule applied to unmarried parents who lived apart, as well as parents who married but later divorced or separated. See *King v. C.I.R.*, 121 T.C. 245 (2003). Thus, in this regard, the law prior to WFTRA provided a simple, bright-line rule that taxpayers and the IRS could easily administer.

Code Section 152(e) after WFTRA

After WFTRA, the pertinent subsections of Section 152(e) read as follows:

Section 152 (e) Special rule for divorced parents ---

(1) IN GENERAL -- Notwithstanding subsection (c)(1)(B), (c)(4), or (d)(1)(C), if

(A) a child received over one-half of the child's support during the calendar year from the child's parents --

(i) who are divorced or legally separated under a decree of divorce or separate maintenance,

(ii) who are separated under a written separation agreement, or

(iii) who live apart at all times during the last 6 months of the calendar year, and

(B) such child is in the custody of 1 or both of the child's parents for more than one-half of the calendar year, such child shall be treated as being the qualifying child or qualifying relative of the noncustodial parent for a calendar year if the requirements described in paragraph (2) are met.

(2) REQUIREMENTS--For purposes of paragraph (1), the requirements in this paragraph are met if --

(A) A decree of divorce or separate maintenance or written separation agreement between the parents applicable to the taxable year beginning in such calendar year provides that --

(i) the noncustodial parent shall be entitled to any

deduction allowable under section 151 for such child,  
or

(ii) the custodial parent will sign a written declaration (in such manner and form as the Secretary may prescribe) that such parent will not claim such child as a dependent for such taxable year, or

(B) in the case of such an agreement executed before January 1, 1985, the noncustodial parent provides at least \$ 600 for the support of such child during such calendar year.

For purposes of subparagraph (B), amount expended for the support of a child or children shall be treated as received from the noncustodial parent to the extent that such parent provided amounts for such support.

The substantial rewording of Section 152(e), especially the new requirement in section 152(e)(2)(A) that a divorce decree or written separation agreement specify the allocation of the dependency exemption, created the problem. Thus, no longer can a properly executed Form 8332, standing alone, be used to shift the dependency exemption from a custodial parent to a noncustodial parent. This change represents a radical departure from the pre-WFTRA rule that used a voluntary written release signed by the custodial parent, and results in three consequences that Congress may not have intended in adopting the uniform definition of a qualifying child.

#### 1. Discrimination against unmarried parents and parents who live apart without a court order or written separation agreement

If the release of a dependency exemption from a custodial parent to a noncustodial parent must be memorialized in a divorce decree or written separation agreement, the new rule fails to authorize the transfer of a dependency exemption from a custodial parent to a non-custodial parent in the case of never married parents or married parents who live apart for the last 6 months of the tax year, but who do not have a divorce decree or written separation agreement. Never married parents would not have a divorce decree, a separate maintenance order, or a written separation agreement because such documents address the termination of a marital relationship and the rights of parties as spouses. Moreover, parents may live apart but remain legally married for years, before seeking a divorce or while divorce proceedings are pending. Low and moderate income families in this situation do not usually have a separate maintenance or separation agreement. See *Frazier v. Commissioner of Internal Revenue*, 638 F.2d 63 (8th Cir. 1981), *aff'g*, *per curiam*, T.C. Memo 1979-515. Even some higher income taxpayers may lack a court order or a written agreement during a long period of negotiation. Thus, a custodial parent in this situation would not be able to release a dependency exemption to a noncustodial parent.

#### 2. Elimination of the ability to make an allocation of a dependency exemption each tax year in response to changing circumstances

Under the law prior to WFTRA, a custodial parent retained the flexibility to keep a dependency exemption or release the exemption to a noncustodial parent each year in the best interests of the child and the family unit. Since the new rule may now require that the allocation must be documented in a divorce decree or written separation decree, the decision must be made at one point in time with unalterable consequences for future tax years. Further, when the decree or agreement allocates the dependency exemption to the noncustodial parent, that parent's right to claim the exemption is irrebuttable and absolute.

For example, assume that Mother and Father of Child are separated during year 2005 pursuant to a written separation agreement. Mother is the custodial parent because Child lives with Mother for the ten months of each calendar year while school is in session. Child lives with Father during the summer

vacation, two months each year. Under the agreement, Father is required to pay child support of \$ 300 a week to Mother and is allowed to claim the dependency exemption for tax year 2006. Assume that Father stops paying child support in March, 2006 and remains delinquent for the rest of 2006. Under the law prior to WFTRA, if the noncustodial parent was delinquent in paying child support, then the custodial parent could refuse to honor the agreement provision allowing Father to claim the dependency exemption by not executing the IRS form. The Father could go into state court to litigate the noncompliance with the separation agreement, but would risk the court addressing his nonpayment of child support. Under the new rule, the Father would be entitled to the dependency exemption even though he has breached another provision of the agreement by failing to pay child support.

### 3. Renewal of pre-1984 administrative burdens on the IRS and Tax Court in resolving disputes related to conditional allocations of dependency exemptions

IF WFTRA is not appropriately revised in order to retain desirable flexibility, divorce decrees or written separation agreements are likely to be written so as to allocate the dependency exemption to a noncustodial parent only if certain conditions are met. For example, to provide an incentive to a noncustodial parent to make child support payments regularly, the divorce decree may require that the noncustodial parent be substantially compliant with child support obligations in order to claim a dependency exemption.

As a result, absent the pre-WFTRA bright-line rule of a signed waiver, many disputes will arise between parents who each claim the dependency exemption for a common child. In such cases, the IRS or the Tax Court will need to obtain evidence and/or testimony on whether or not the noncustodial parent is delinquent, as well as interpret the language in the decree or agreement. This is precisely the problem that Congress fixed over 20 years ago when it adopted the pre-WFTRA version of Code section 152(e).

Prior to the enactment of this bright-line rule in 1984, parents could provide for the allocation of the dependency exemption in divorce or separation agreements. Under pre-1984 law, the IRS and courts, especially the United States Tax Court, were left with the job of interpreting language used in decrees or agreements to determine which parent was entitled to the dependency exemption and determining whether the party claiming the dependency exemption had provided the requisite level of support. The primary focus of these agreements was dissolution of marriage, not division of tax benefits. Additionally, the support test requirements entailed intensive factual determinations, often including testimony. Consequently, these cases absorbed considerable judicial time and resources.

The legislative history of the 1984 changes makes clear that Congress intended to make the allocation of tax benefits to be presumed in favor of the custodial parent, but to allow the parents to shift the exemption through the execution by the custodial parent of a waiver on an IRS form. The report of the House Ways and Means Committee stated:

The present rules governing the allocations of the dependency exemption are often subjective and present difficult problems of proof and substantiation. The Internal Revenue Service becomes involved in many disputes between parents who both claim the dependency exemption based on providing support over applicable thresholds. The cost to the parties and the Government to resolve these disputes is relatively high and the Government generally has little tax revenue at stake in the outcome. The committee wishes to provide more certainty by allowing the custodial parent the exemption unless that spouse waives his or her right to claim the exemption. Thus, dependency disputes between parents will be resolved without the involvement of the Internal Revenue Service. H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 3, at 1498-99 (reprinted in U.S. Code Cong. & Admin. News 697, 1140).

Legislative History of WFTRA does not support change.

The focus of WFTRA in amending section 152 was to conform all affected Code sections to the new uniform definition of qualifying child. This new definition strongly favors parents with whom a child resides as the appropriate taxpayer to claim certain benefits, including the dependency exemption. In adopting the uniform definition, Congress intended to retain the old rule that created a presumption in favor of the custodial parent to claim the dependency exemption, but to allow a voluntary written release of the dependency exemption to the noncustodial parent on a year-by-year basis. The Conference Report states: "[t]he Senate amendment retains the present-law rule that allows a custodial parent to release the claim to a dependency exemption (and, therefore, the child credit) to a noncustodial parent." H.R. Conf. Rep. No. 108-696, at 37 (2004).

But because the statute was drafted to require a decree of divorce or separate maintenance or written separation agreement to effectuate the release, the legislation as enacted unintentionally limits the right to make a voluntary release only to those parents with judicial decrees or written separation agreements that specifically address the issue. See Section 152(e)(2)(A). Therefore, by its language, new section 152(e) changes the law applicable prior to WFTRA that required a custodial parent to merely consent in writing, separate and apart from any decree, agreement or contract, to allow a noncustodial parent to claim the dependency exemption. In doing so, it also eliminates the right of a never married, noncustodial parent to claim the dependency exemption even if the custodial parent consents. Further, it eliminates the ability of the custodial parent with a divorce instrument to annually choose whether or not to make a waiver.

Moreover, and contrary to Congressional intent dating back to 1984, section 152, as amended by WFTRA, may well cause the IRS and United States Tax Court to become involved again in the administrative tangle of resolving disputes about the allocation of dependency exemptions. Rather than contribute to simplification and ease of administration, as was the intended purpose of adopting the uniform definition of child, the language of the statute restores complexity that had previously been eliminated.

The technical corrections to section 152(e) proposed in the Tax Technical Corrections Bill.

The technical corrections to section 152(e) proposed in Section 3 of H.R. 3376 and Section 3 of S. 1447 read as follows:

(a) Amendment Related to Section 201 of the Act-Paragraph (2) of section 152(e) is amended to read as follows:

'(2) REQUIREMENTS -- For purposes of paragraph (1), the requirements described in this paragraph are met if --

'(A) a decree of divorce or separate maintenance or written separation agreement between the parents applicable to the taxable year beginning in such calendar year provides that the noncustodial parent shall be entitled to any deduction allowable under section 151 for such child, and in the case of such a decree or agreement executed before January 1, 1985, the noncustodial parent provides at least \$ 600 for the support of such child during such calendar year, or

'(B) the custodial parent signs a written declaration (in such manner and form as the Secretary may prescribe) that such parent will not claim such child as a dependent for such taxable year.

For purposes of subparagraph (A), amounts expended for the support of a child or children shall be

treated as received from the noncustodial parent to the extent that such parent provided amounts for such support.'

The technical amendment to section 152(e) proposed in the Tax Technical Corrections Bill, if enacted, would be effective on the effective date of the provisions of the WFTRA.

The Tax Technical Corrections Bill, as proposed, does not clearly address and resolve the problems discussed above. The proposed technical amendment may leave disparities in treatment between divorced or separated parents and those parents who never married or who lived apart at all times during the last 6 months of the calendar year without a divorce decree or written separation agreement.<sup>4/</sup>

The Tax Technical Corrections Bill may allow a divorce decree or written separation agreement to override a custodial parent's right to voluntarily waive the dependency exemption. Further, it retains the language of WFTRA which allows a judicial order or separation agreement to permanently allocate the dependency exemption to the noncustodial parent. The 1984-2004 version of section 152(e) allowed a custodial parent to determine on an annual basis whether to release the dependency exemption to the noncustodial parent. This allowed flexibility and did not force parents into unfavorable, inequitable and potentially costly bargaining positions.

Present law, as modified by the technical amendments proposed by the Tax Technical Corrections Bill, may return to the IRS and the Tax Court the job of resolving family law matters. Separation agreements and divorce or separation decrees which condition the allocation of the dependency exemption on payment of child support or the parties respective economic circumstances pose problems of interpretation when more than one parent claims the exemption for a common child. The introduction of a judicial decree or separation agreement as an additional mechanism for allocating the dependency exemption would eliminate the bright-line test afforded by the use of a simple form under the pre-WFTRA section 152(e). The proposed technical correction in the Tax Technical Corrections Bill may not, therefore, fully reinstate the above aspects of prior law.

Both the legislative history of WFTRA and the policy for the prior law support the need for a modification to the proposed technical correction legislation. In enacting the uniform definition of a qualifying child Congress did not articulate any intention to modify the rule that permitted all custodial parents, both married and never married, to claim the dependency exemption for children in their custody unless they signed a form for tax purposes releasing the exemption. Such a rule is, in fact, consistent with the entire focus of the new uniform definition of qualifying child--i.e., it focuses on which parent the child resides with for the greater part of a year in awarding tax benefits. Furthermore, the WFTRA change to section 152(e) that would remain after the Tax Technical Corrections Bill may well have the result possibly unintended, of forcing the IRS and courts, especially the United States Tax Court, into interpreting state law and state agreements, the precise problem that the amendment of section 152(e) in 1984 was meant to correct. See *Morris v. Comm'r*, TC Memo. 1978-68.

#### Proposed Technical Correction

We recommend that the following language be adopted in making the technical corrections to section 152(e):

Section 152(e) Special rule for parents who are divorced, separated, or living apart --

(1) IN GENERAL. Notwithstanding subsection (c)(1)(B), (c)(4), or (d)(1)(C), if

(A) a child receives over one-half of the child's support during the calendar year from the child's parents --

(i) who are divorced or legally separated under a decree of divorce or separate maintenance,



(ii) who are separated under a written separation agreement, or

(iii) who live apart at all times during the last 6 months of the calendar year, and

(B) such child is in the custody of 1 or both of the child's parents for more than one-half of the calendar year,

such child shall be treated as being the qualifying child or qualifying relative of the parent having custody for a greater portion of the calendar year (hereinafter in this subsection referred to as the "custodial parent").

(2) EXCEPTION WHERE CUSTODIAL PARENT RELEASES CLAIM TO EXEMPTION FOR THE YEAR.--  
A child of parents described in paragraph (1) shall be treated as the qualifying child or qualifying relative of the noncustodial parent if --

(A) the custodial parent signs a written declaration (in such manner and form as the Secretary may by regulations prescribe) that such custodial parent will not claim such child as a qualifying child or qualifying relative 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.

For purposes of this subsection, the term "noncustodial parent" means the parent who is not the custodial parent.

Our proposal utilizes the pre-WFTRA language in order to correct the difficulties addressed by the Tax Technical Bill because this language provides both a more global solution and a bright-line test which will ensure simplicity in the reporting, administration and adjudication of dependency exemptions.

We appreciate your consideration of these comments. Representatives of the Section would be pleased to discuss them in further detail with you or members of your respective staffs. Please contact William Paul, the Section's Vice-Chair for Government Relations, at (202) 662-5600 if that would be helpful.

Sincerely,

Dennis B. Drapkin  
Chair,  
Section of Taxation

cc:

Hon. John Snow, Secretary of the Treasury

Eric Solomon, Acting Deputy Assistant Secretary of the Treasury (Tax Policy)

George Yin, Chief of Staff, Joint Committee on Taxation

Kolan Davis, Republican Staff Director and Chief Counsel, Senate Finance Committee

Russell Sullivan, Democratic Staff Director, Senate Finance Committee

Robert Winters, Republican Chief Tax Counsel, House Ways and Means Committee

John Buckley, Democratic Chief Tax Counsel, House Ways and Means Committee

#### FOOTNOTES

/1/ Principal responsibility for these comments was exercised by Susan Morganstern, Elizabeth Hay, Diana Leyden, and Toni Robinson of the Section's Low Income Taxpayers, Domestic Relations, and Court Procedure and Practice Committees. Substantive contributions were made by Elizabeth Copeland and William Nelson.

/2/ H.R. 3376, 109th Cong. section 3 (2005) and S. 1447, 109th Cong. section 3 (2005).

/3/ Staff of the Joint Comm. on Taxation, 109th Cong., 1st Sess., General Explanation of Tax Legislation Enacted in the 108th Congress, p. 127 (2005), states "[t]he Act retains the present-law rule that allows a custodial parent to release the claim to a dependency exemption (and, therefore, the child credit) to a noncustodial parent.fn." Fn 226: "A technical correction may be necessary so that the statute reflects this intent."

/4/ The Joint Committee on Taxation's explanation of the purpose of the technical change in H.R.3376/S.1447 seems to be directed only to the availability of the waiver to legally separated or divorced parents: "The provision clarifies Code section 152(e) to permit a divorced or legally separated custodial parent to waive, by written declaration, his or her right to claim a child as a dependent for purposes of the dependency exemption and child credit (but not with respect to other child related tax benefits). By means of the waiver, the noncustodial parent is granted the right to claim the child as a dependent for these purposes." Description of the Tax Technical Corrections Act of 2005, July 21, 2005, JCX-55-05

END OF FOOTNOTES

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