TAX TRENDS AND DEVELOPMENTS

Court of Appeals Upholds Equal Division of Federal Tax Refund

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Court of Appeals Upholds Equal Division of Federal Tax Refund, *Demil* v *Demil,* Mich App No. 323205 (10/20/15), and Tips on Providing for Tax Overpayments and Estimated Taxes

Facts

- The parties agreed to a settlement in June 2013 which, *inter alia*, provided that they would split the federal tax refund resulting from their 2012 joint income tax return, as follows:

  > "IT IS FURTHER ORDERED AND ADJUDGED that the parties shall equally divide any refund they receive from the 2012 Federal Tax returns. (sic) The defendant shall provide proof of the refund received directly to the Plaintiff within one week of receipt."

- Neither party signed the return which was filed electronically by their tax preparer in April 2013.
- The refund was represented to be "in the approximate amount of $2,372".
- In fact, the refund was $34,318, of which H applied $23,000 to his 2013 federal tax liability.
- During the divorce proceedings, H had represented that $2,300 "was a correct characterization of the refund and that he did not have any other assets to disclose to the court."
- W later learned that the refund was substantially more than what had been previously indicated and filed a motion to enforce the provision in the judgment for equal division.
- The trial court rejected H's claim that a large component of the refund was attributable to his father's income which was reported on the joint tax return "for estate planning and income tax purposes" and ruled the $34,318 refund be divided equally.
- H appealed.

Court of Appeals Decision

- The Court upheld the trial court's decision ruling that it did not err in its interpretation of the tax refund provision in the judgment of divorce.

Tips on Providing for Division of Tax Overpayments Joint and Several Liability

- **Joint Tax Refunds**

  New Address–Most divorce settlements provide for the division of a tax refund on the final joint return. The check will be sent to the address on the return and will be payable to both parties. Thus, delay in receipt of a refund may result if the principal residence is used on the return and the refund is sent after the house is sold and the effective "forwarding address" period has expired. If this is foreseeable, use another address on the return (e.g., in care of the CPA/tax preparer).

  Notification and Documentation–As was done in the *Demil* divorce settlement, it is advisable to provide that the party who receives the refund check must notify the other party and provide documentation of the refund and payment of the other party's share within a specified period of time, e.g., one week.

  Take Away–Consider potential logistical problems concerning receipt of a joint tax refund and make appropriate arrangements, and provide for notification, documentation, and payment.

- **Joint Tax Overpayments Applied to Estimated Tax**

  Advantage of Applying an Overpayment–Many taxpayers apply for extensions rather than file by April 15. And most with income not subject to withholding–LLC income; S Corporation income; investment income–must make estimated tax payments due April 15, June 15, September 15, and January 15 each year.

  An overpayment from a prior year is deemed received by the IRS as of the April 15 initial due date even if the return is filed six months later at or near the October 15

extended due date. Thus, it is often advantageous to apply an overpayment to the succeeding year tax liability, especially if a taxpayer realizes late in the year when the return is filed that preceding estimated payments are insufficient to avoid the underpayment tax liability. This can be done with the entire overpayment, or just part of it with the balance refunded, as in the *Demil* case.

Parties Can Each Apply Part of Overpayment - Parties are free to agree to the application of an overpayment on a joint return to the next year's tax. If the amount so applied is allocated 100% to the husband, nothing needs to be done on either spouse's succeeding year tax return. However, if such amount applied exceeds 50% of the overpayment that is to be divided equally, husband will need to make an after-tax payment to wife to square things off.

If any of the overpayment is to be applied to wife's tax, she must enter husband's SSN in the appropriate space on page one of her Form 1040 followed by "DIV". If wife has remarried, she must enter ex-husband's SSN at the bottom of Form 1040 page one, again followed by "DIV".

Take Away–If either party relies on estimated tax payments and an overpayment is possible, make provisions in advance for potential advantageous use of the overpayment.

- **Estimated Taxes**

  New Requirement for Many–Many recipients of spousal support have never needed to make quarterly estimated tax payments. However, since no income tax is withheld on spousal support payments, estimated tax payments are generally necessary to avoid (1) a large April 15 payment and (2) corresponding underpayment of tax penalties. This applies to both federal and state income taxes.

  The underpayment penalty may be avoided if the amount paid in – via wage withholding or estimated tax payments – exceeds the party's hypothetical prior year tax based solely on his or her individual income and deductions. This often applies in the first year of receipt of spousal support, but not generally to subsequent years.

  Take Away–Attorneys should advise clients awarded spousal support to contact his or her tax advisor regarding estimated tax payment requirements.

About the Author

Joe Cunningham *has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy though his practice is statewide.*