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MODIFICATION OF DIVORCE DECREES BY VIRTUE OF THE 1984 TAX AMENDMENTS RELATING TO DEPENDENCY EXEMPTIONS

*Roger M. Baron**

Effective January 1, 1985, section 152(e) of the Internal Revenue Code[1] was amended to simplify the handling of dependency exemptions for the children of divorced parents.[2] Under the prior law, unless otherwise specifically agreed to in writing by the parties or addressed by the court decree, the noncustodial parent could claim a tax exemption if he or she paid more than $1,200 yearly in support, and the custodial parent did "not clearly establish that he provided more for the support of such child during the calendar year than the parent not having custody."[3] Under the amended provisions, the custodial parent is *always* entitled to the dependency exemption unless he or she signs a written declaration disclaiming the child as a dependent for a given tax year.[4] The written declaration must be attached to the noncustodial parent's tax return.[5] The written assignments are to be made yearly or one written instrument may cover a period of years or in perpetuity.[6]

The new provisions provide for the continued recognition of previous divorce decrees and separation agreements which specifically grant a noncustodial spouse the deduction provided he or she pays at least $600 yearly support.[7] Such a previous decree or agreement is described under the statutory provisions as a "qualified pre-1985 instrument."[8]

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1. 26 U.S.C. § 152(e) (Supp. II 1984).

2. Taggart, *Economic Consequences of Emotional Choices: Divorce and Separation Under TRA 84*, 15 CUM. L. REV. 341, 358 (1984-85).

3. I.R.C. § 152(e)(2)(B)(i) and (ii) (1982), *amended by* I.R.C. § 152 (Supp. II 1984).

4. I.R.C. § 152(e)(2)(A) (Supp. II 1984). There is also an exemption for children covered by multiple support agreements under § 152(e)(3) (Supp. II 1984), but this article will not address this additional exemption.

5. I.R.C. § 152 (e)(2)(B) (Supp. II 1984).

6. Taggart, *supra* note 2, at 359 n.83 and accompanying text.

7. I.R.C. § 152 (e)(4) (Supp. II 1984).

8. I.R.C. § 152 (e)(4)(B) (Supp. II 1984) states:

The objective of the new tax provisions is to remove from the Internal Revenue Service the burden of resolving numerous factual disputes between divorced parents over the issue of who actually provides more support for the child.[9] Such disputes arose when, under the previous law, the noncustodial spouse paid more than $1,200 yearly as support. Under the amended provisions, the criterion to be followed by the IRS is much more objective—the custodial parent *always* gets the exemption unless he or she has assigned it to the noncustodial spouse through a written declaration.

The effect of the new tax provisions is that noncustodial parents who have been claiming a dependency exemption under the $1,200 yearly payment rule are no longer able to do so *regardless* of how much child support they pay *unless* the custodial parent agrees in writing to permit the noncustodial parent to do so. Noncustodial parents with a "qualified pre-1985 instrument" may continue to claim the exemption. Undoubtedly, a large number of divorced noncustodial parents who are affected by the new provisions do not have the benefit of a "qualified pre-1985 instrument." There may well be more existing divorce decrees than not in which the parties failed to provide specifically for an award of the exemption in their agreement or in the court's decree. A common reason not to have so provided was the existence of the $1,200 yearly presumption delineated under the former law. The rationale would have been that the tax law had already provided for guidelines in this area, thus removing a potential issue for divorce litigants. Perhaps the best evidence of the magnitude of the numbers of taxpayers dramatically affected by the 1984 change is that the change itself was designed to relieve the Internal Revenue Service from being embroiled in extensive litigation between parents who contested the

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For purposes of this paragraph, the term "qualified pre-1985 instrument" means any decree of divorce or separate maintenance or written agreement (i) which is executed before January 1, 1985, (ii) which on such date contains the provisions described in subparagraph (A)(i), and (iii) which is not modified on or after such date in a modification which expressly provides that this paragraph shall not apply to such decree or agreement.

I.R.C. § 152(e)(4)(A) (Supp. II 1984) provides that:

[A] child . . . shall be treated as having received over half his support during a calendar year from the noncustodial parent if (i) a qualified pre-1985 instrument 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 (ii) the noncustodial parent provides at least $600 for the support of such child.

9. Randall, *The Domestic Relations Tax Reform Act of 1983—New Rules, But Simple*, 19 GONZ. L. REV. 69, 79-80 (1983-84).

$1,200 yearly presumption for the noncustodial parent.[10] The effect of the 1984 change has been to cause postdivorce disputes to bypass the IRS and to channel the parties back to divorce court.

Consider, for example, the case of *Davis v. Fair*[11] in which a noncustodial father, Fair, was paying $750 per month per child for two children under a pre-1985 decree. There was no decree or separation agreement which specifically awarded the father the exemption. Yet, he was paying more than seven times the $1,200 yearly (or $100 monthly) milestone previously used in the Internal Revenue Code to gauge the point at which the noncustodial parent would be presumed to have contributed more support than the custodial parent. After the new law went into effect, Fair went back to court to modify the divorce decree to specifically provide him with the right to claim the children as dependents or, alternatively, to reduce the amount of his child support payments.[12] The trial court entered an order purporting to amend the previous court decree to entitle Fair to continue to take the dependency exemptions.[13] On appeal, the attempted amendment was reversed by the Eastland Court of Appeals, holding that Fair did not hold a "qualified pre-1985 instrument" as of January 1, 1985, and his previous divorce decree could not be converted to a qualifying instrument through a subsequent modification proceeding.[14] Both the plain language of the new statute[15] and the legislative history of the 1984 tax amendment[16] support the rationale of the Eastland Court of Appeals

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10. The legislative history of the Deficit Reduction Act (P.L. 98-369) reported in H.R. Rep. 98-432, Part II, 98th Cong., 2d Sess. 3 (1984), *reprinted in* 1985 U.S. CODE CONG. & AD. NEWS 697, 1140 states:

> Reasons for Change
>
> 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 the 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 spouse 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.

See also Taggart, *supra* note 2, at 358 n.79.

11. 707 S.W.2d 711 (Tex. App.—Eastland 1986).

12. *Id.* at 712.

13. *Id.*

14. *Id.* at 715-17.

15. I.R.C. § 152(e)(4)(B)(ii) (Supp. II 1984) requires that the pre-1985 instrument contain the necessary provisions "on such date"—"on such date" meaning January 1, 1985.

16. As is explained in the legislative history, the custodial parent is given the dependency

decision. The court recognized, however, that the new tax law as set forth in the 1984 amendment might impose a "greater economic burden" upon Fair[17] which required, in the interest of justice, that his case be remanded for a determination of his request for a reduction of child support.[18]

The *Davis* court held that "neither the trial court nor any court can grant to Fair a deduction to which he is not entitled under the Internal Revenue Code."[19] This is consistent with the language of the new statute and with prior Texas case law which discouraged the awards of dependency exemptions by trial courts, this matter either having been deemed to be governed by the agreement of the parties[20] or preempted by the federal government.[21] It is interesting to note that Texas appears to have been the only jurisdiction under the old tax law which discouraged awards of dependency exemptions by the trial court. The vast majority of the reported opinions held that state trial courts could make exemption awards.[22] The new tax provisions make clear that a "qualified pre-1985 instrument" must have specifically provided for the allocation of the dependency exemption as of January 1, 1985,[23] recognizing only subsequent modifications which may serve to remove a pre-1985 instrument from the status of being qualified.[24] In other

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exemption subject to only three exceptions: (1) execution of a written declaration by the custodial parent releasing the exemption to the noncustodial parent; (2) Multiple Support Agreements where no one person contributes over 50% of the support (which generally do not apply in typical divorce situations and also require written waivers by each person who contributes over 10% of the support); and (3) "certain decrees or agreements which are executed before January 1, 1985 under which the custodial parent had agreed to release his or her claim to the dependency exemption." *Davis*, 707 S.W.2d at 716-17 (construing the legislative history of the 1984 amendment to § 152 as reported in H. R. Rep. No. 98-438, Part II, 98th Cong., 2d Sess. 3, *reprinted in* 1985 U.S. CODE CONG. & AD. NEWS 697). The legislative history indicates that the parties may modify a qualified pre-1985 decree or agreement so that it does not come under the recognized third exception; however, the legislative history clearly shows that the intent was for the decree or agreement to have been *executed before January 1, 1985. Id.* The parties may not, through modification, convert a non-qualified pre-1985 instrument into a "qualified pre-1985 instrument" as was attempted by the trial court in Davis v. Fair.

17. 707 S.W.2d at 717.

18. *Id.* at 718.

19. *Id.* at 717.

20. Kolb v. Kolb, 479 S.W.2d 81 (Tex. Civ. App. —Dallas 1972, no writ).

21. Ruiz v. Ruiz, 668 S.W.2d 866 (Tex. Civ. App.—San Antonio 1984, no writ).

22. Morphew v. Morphew, 419 N.E.2d 770 (Ind. App. 1981); Pettitt v. Pettitt, 261 So. 2d 687 (La. App. 1972); Westerhof v. Westerhof, 137 Mich. App. 94, 357 N.W.2d 820 (1984); Greeler v. Greeler, 368 N.W.2d 2 (Minn. App. 1985); Niederkorn v. Niederkorn, 616 S.W.2d 529 (Mo. App. 1981).

23. The IRS has indicated that it will not honor the type of modification sought in Davis v. Fair. Pvt. Ltr. Rul. 8609034 (Mar. 12, 1986). *See also supra* note 15.

24. I.R.C. § 152(e)(4)(B)(iii) (Supp. II 1984).

words, a noncustodial parent may lose his exemption under a "qualified pre-1985 instrument" (if he or she had one) through modifications but the noncustodial parent cannot gain an exemption by attempting to convert an existing non-qualified instrument into a "qualified pre-1985 instrument" through modification.[25]

The greatest impact of *Davis v. Fair* is the recognition of grounds for modification of a child support decree based solely on the greater economic burden imposed on a noncustodial parent by the 1984 amendment to section 152 of the Internal Revenue Code.[26] The facts in *Davis v. Fair* appear to represent an extreme situation with the noncustodial parent actually paying more than seven times the previous standard and then being denied the dependency exemption. Yet, once it is recognized that a change in the tax code can in and of itself constitute grounds for modification, where is the line to be drawn? Would Fair's case have been remanded for consideration of his modification claim if he paid only $350 per month per child, $200 per month per child, or $105 per month per child?

A possible solution not addressed in *Davis v. Fair* is a recasting of the requested relief by Fair in the trial court. In *Davis v. Fair* the trial court attempted to "award" the exemption to Fair.[27] Possibly Fair could have successfully requested the trial court to modify the decree to "order the custodial parent to execute an assignment of the exemption" to him. Then the exemption would be available to him upon receipt of the written assignment by the custodial parent under section 152(e)(2)(A). Such a method has been recognized by at least one other commentator[28] and could also serve a reciprocal purpose in providing an incentive for the payment of child support. The custodial parent could condition the yearly execution of the waiver on the successful payment of child support by the noncustodial parent for the previous year. This suggested method would, however, impose the burden of enforcing the assignment decree on the noncustodial parent through a contempt citation. Only the executed assignment and not the decree itself would entitle the noncustodial parent to the exemption.[29] The noncustodial parent might prefer simply to request a lower child support award based on the loss of the exemptions as suggested in *Davis v.*

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25. *See* discussion in Davis v. Fair, 707 S.W.2d at 716; *see also* Sweeney, *Highlights of the New Tax Act*, 70 A.B.A. J. 76, 79 (November 1984) and *supra* note 16.

26. *See* 707 S.W.2d at 717.

27. *Id.* at 712.

28. Taggart, *supra* note 2, at 359-60.

29. *Id.*

Fair instead of requesting an order requiring the custodial spouse to make the necessary written assignments.

The 1984 amendments to the tax code dependency exemptions for children and divorced parents simplify the task of the Internal Revenue Service.[30] They also impose an increased economic burden on a vast number of noncustodial parents who were previously afforded the dependency exemptions while simultaneously bestowing windfall exemptions on the corresponding custodial parents. One result is an anticipated increase in actions to modify child support awards. *Davis v. Fair* indicates that such a modification may be justifiable based solely on the change in the tax law.[31] No doubt future cases will give guidance as to the extent to which modification is permissible and as to whether or not courts will provide an alternative remedy by ordering custodial parents to execute written assignments in lieu of lowering child support awards.

30. *See supra* note 9, at 75 and note 10.
31. 707 S.W.2d at 717-18.