DEDUCTIBILITY OF

SPOUSAL MAINTENANCE PAYMENTS

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INTRODUCTION

In 1984 Congress mounted its second major attempt at describing the tax treatment of interspousal payments made incident to divorce and separation. Further changes were made with the enactment of the 1987 Tax Reform Act. Basically, spousal maintenance and separate maintenance payments remain includible in the gross income of a payee spouse and deductible by the payor. However, many of the standards which must be met to qualify for such treatment were changed by the 1984 legislation and slightly altered yet again in 1986.

CONSIDERING THE PARTIES TAX BRACKET IN AWARDS OF SPOUSAL MAINTENANCE

If divorce occurs at any time during the calendar year, each party must file a separate tax return for that year with a single person status.

These are the tax rate schedules for Single Persons and Single Persons filing as Head of Household. The exemption below will show the net cost after taxes to the Payor Spouse for payment of spousal maintenance will range from 81.7% to 55.2% of the actual payment made.

The Payor normally would receive a much greater tax benefit from the payment than the Payee would receive as a tax detriment. Conversely, the net proceeds received by the Payee Spouse, depending on the Spouse's income from other sources and the amount of spousal maintenance, normally would be larger than the net after tax cost to the Payor.

2008 Tax Rates and Brackets

(these tables can help you estimate your tax bill)

FOR SINGLE TAXPAYERS		
If taxable income is at least …	But not more than …	Your tax is …
$0	$8,025	10% of the amount over $0
$8,026	$32,550	$802.50 plus 15% of the amount over $8,025
$32,551	$78,850	$4,481.25 plus 25% of the amount over $32,550
$78,851	$164,550	$16,056.25 plus 28% of the amount over $78,850
$164,551	$357,700	$40,052.25 plus 33% of the amount over $164,550
$357,701	No limit	$103,791.75 plus 35% of the amount over $357,700
FOR HEADS OF HOUSEHOLDS		
If taxable income is more than…	But not more than …	Your tax is:
$0	$11,450	10% of the amount over $0
$11,451	$43,650	$1,145 plus 15% of the amount over $11,450
$43,651	$112,650	$5,975 plus 25% of the amount over $43,650
$112,651	$182,400	$23,225 plus 28% of the amount over $112,650
$182,401	$357,700	$42,755 plus 33% of the amount over $182,400
$357,701	No limit	$100,605 plus 35% of the amount over $357,700

FOR MARRIED COUPLES FILING JOINTLY	(or qualifying widow or widower)	
If the taxable income is at least…	But not more than …	Your tax is:
$0	$16,050	10% of the amount over $0
$16,051	$65,100	$1,065 plus 15% of the amount over $16,050
$65,101	$131,450	$8962.50 plus 25% of the amount over $65,100
$131,451	$200,300	$25,550 plus 28% of the amount over $131,450
$200,301	$357,700	$44,828 plus 33% of the amount over $200,300
$357,701	No limit	$96,770 plus 35% of the amount over $357,700
FOR MARRIED COUPLES FILING SEPARATELY		
If taxable income is at least…	But not more than…	Your tax is:
$0	$8,025	10% of the amount over $0
$8,026	$32,550	$802.50 plus 15% of the amount over $8,025
$32,551	$65,725	$4,481.25 plus 25% of the amount over $32,550
$65,726	$100,150	$12,775 plus 28% of the amount over $65,725
$100,151	$178,850	$22,414 plus 33% of the amount over $100,150
$178,851	No limit	$48,385 plus 35% of the amount over $178,850

1. PAYMENTS MUST BE OBLIGATED UNDER A DIVORCE OR SEPARATION INSTRUMENT.

Code Sec. 71(a)(2)(B). Every qualifying payment must be required by the terms of a decree or written agreement. Voluntary payments do not qualify as spousal maintenance or separate maintenance. Payments must be made to discharge a legal obligation of support based on the marital relationship.

2. PAYMENTS IN CASH.

3. NO PAYMENT OBLIGATIONS AFTER PAYEE SPOUSE'S DEATH.

Code Sec 71(b)(1)(D) Reg §1.71T. The divorce or separation instrument should expressly state that "there is no liability for any period after the death of the payee spouse to continue to make any payments which would otherwise qualify as spousal maintenance or separate maintenance." The Tax Reform Act of 1986 retroactively repealed a requirement that the instrument itself contain language expressly terminating payments in the event of payee's death, but §71(b)(1)(D) continue to require that there be no obligation if and when the payee dies. An express provision is certainly the most surefire way of satisfying this requirement.

An arrangement for guaranteed payments for a certain term, such as might reasonably be negotiated in order to compensate the payee for property rights recognized under state law, will be rendered completely non-qualifying: "... and none of the payments, whether made before or after the death of the payee spouse, will qualify as spousal maintenance or separate maintenance payments."

Note that the Code requirement can be satisfied even if the instrument is not explicit on the absence of any post-death liability to the payee, provided that state law eliminates all liability to make support payments after the payee's death. A.R.S. §25-327(B) (See #3, page 12)

4. PAYMENTS NOT DESIGNATED AS EXCLUDIBLE AND NON DEDUCTIBLE.

5. PAYMENTS NOT CHILD SUPPORT.

6. PAYMENTS CANNOT VIOLATE THE EXCESS FRONT LOADING RULES.

Code Sec. 71(f) Reg. §1.71-1T. Examples as rules

contained herein. (See page 14-17)

7. THE PAYOR AND PAYEE, IF MARRIED, MUST FILE SEPARATE RETURNS. THE PARTIES, IF DIVORCED OR LEGALLY SEPARATED, MUST RESIDE IN SEPARATE HOUSEHOLDS. (See #7, page 21)

GENERAL REQUIREMENTS FOR SPOUSAL MAINTENANCE TREATMENT OF PAYMENTS UNDER POST-1984 INSTRUMENTS

Spousal maintenance payments are deductible from gross income to arrive at adjusted gross income. Code Sec. 62(13), as of 12/31/03. The deduction is available whether or not the taxpayer itemizes.

Spousal maintenance is an amount paid to a spouse or former spouse under a divorce or separation agreement. The payee spouse must include these payments in gross income. Code Sec. 71(a), as of 12/31/03. The payor spouse can deduct the spousal maintenance payments from gross income in finding adjusted gross income. Code Sec. 215, as of 12/13/03. See ¶2154 et seq.

In order for any payment to be taxable to a recipient spouse under §71(a) and thus be deductible by the payor spouse pursuant to §215(a), several requirements must be met.

1(a). DIVORCE OR SEPARATION INSTRUMENT: Three Types Compared.

In order to be taxable to the recipient and deductible by the payor, a payment must be obligated by the terms of a "divorce or separation instrument." Voluntary payments never qualify.

§ 71 (b)(1)(A) states the requirement and §71(b)(2) contains the definition of divorce or separation instrument by reference to certain decrees and agreements. Brief descriptions of the three classes of such instruments are presented in the three subparagraphs of §71(b)(2), as follows:

(A) A decree of divorce or separate maintenance, or an instrument incident to such a decree

(B) A written agreement between parties

(C) A support decree

These are the same types of instruments as were formerly referred to in §71.

§ 71(b)(2)(A) covers payments under a written instrument incident to a divorce or legal separation decreed by a court. There is no need for the court to order any payments, or to make and reference to the written contractual instrument that requires such payments. An instrument may satisfy the incident to requirement of subsection (b)(2)(A) by its referring to (and possible being made contingent upon) the change in marital status that results from a decree of divorce or legal separation.

Supplementing this coverage of payments incident to a change in marital status, §71(b)(2)(B) applies to payments that are required by a written separation agreement. Under subsection (b)(2)(B), there is no need for the contractual writing to be incident to anything, as contrasted with the requirement in subsection (b)(2)(A).

Finally, §71(b)(2)(C) covers payments under a decree of support. There is not need for any legal separation under subsection (b)(2)(C). Under prior law the couple must have been separated and be living apart, but that is no longer the case. As the regulations state, if the spouses are not legally separated under a decree of divorce or separate maintenance, a payment under a written separation agreement or decree described in § 71(b)(2)(C) may qualify as an spousal maintenance or separate maintenance payment notwithstanding that the payor and payee are members of the same household at the time the payment is made.

Where the parties are members of the same household and are also legally separated under a decree or divorced by a decree of divorce or separate maintenance, payments between them will generally be disqualified from receiving spousal maintenance treatment.

1(b). PAYMENTS ORDERED BY DECREE OF DIVORCE OR SEPARATE MAINTENANCE OR INSTRUMENT INCIDENT THERETO.

The first of three categories of divorce or separation instruments in §71(b)(2) is a "decree of divorce or separate maintenance or a written instrument incident to such decree." This paragraph can only apply when the requisite decree is present. Among the various divorce or separation instruments, only a decree of divorce or separation renders the parties legally separated, if not divorced.

Once parties have become legally separated by decree, or divorced, §71(b)(1)(C) imposes an additional requirement upon payments that are intended to qualify as spousal maintenance. At that juncture, the parties must no longer be members of the same household. Otherwise, any further payments cannot qualify for taxable and deductible treatment. This problem can only arise when a divorce or separation decree is entered.

1(c). VALIDITY OF DIVORCE OR SEPARATION DECREE IS IMMATERIAL.

It should not and generally does not matter, for purposes of determining §71(a) applicability, whether the decree of divorce or separate maintenance is valid or unenforceable. The Internal Revenue Service apparently agrees with this reasoning, albeit only to a limited extent. It "will not question for Federal income tax purposes the validity of any divorce decree until a court of competent jurisdiction declares the divorce to be invalid."

Where the validity of a foreign divorce decree is attacked by an affected spouse, payments pursuant to the decree of questioned validity are in satisfaction of the §71(b)(1)(A) requirement of a "divorce or separation instrument."

A successful collateral attack upon validity of a divorce decree issued in another jurisdiction should have no effect for tax purposes for payments previously made.

1(d)(1). BEWARE OF VOLUNTARY PAYMENTS.

One of the real tax traps in the spousal maintenance and support payment deductibility is sprung whenever a payment is not expressly obligated to be made pursuant to the terms of a decree of divorce or separate maintenance, a support decree, or a written separation agreement -- whichever it is that controls the parties' rights and duties in any given case.

Note that the existence of a decree or agreement is not enough. For deductibility, the specific payment amount and the time it is to be made must be expressly required by the decree or agreement terms.

Payments are not deductible unless "made in discharge of a legal obligation at the time they are made." This requirement obviously means that payments made prior to the execution of an

agreement, issuance of a decree, or entry of a court order do not qualify as taxable or deductible within §§71 and 215. Moreover, payments made prematurely -- as determined from the directives of an already operative agreement, decree, or order -- are also nontaxable to the recipient and nondeductible by the payor. If the obligor spouse simply prepaid the spousal maintenance amount that would have been paid over the course of time pursuant to the interspousal agreement, which conditioned payments upon the payee spouse's not remarrying and the payee spouse did remarry shortly after receiving the advance payment, thereby rendering the prepayment voluntary. All payments made after the marriage are not deductible by the payor spouse.

It is imperative that a separation agreement or a temporary support order calling for the payments be in effect before the first payment is made. Otherwise, deductibility will be denied to all payments made prior to the effective date. If an interspousal agreement cannot be reached, no payments should be made until a temporary support order is issued.

1(d)(2). WRITE AN AGREEMENT BEFORE WRITING A CHECK.

Either pressure or moral compulsion might prompt a spouse to make payments before an agreement or decree. But in any such case, a simple writing that functions as both a receipt and an agreement should be considered. The following is an example of such a receipt-agreement:

Agreement: (H/W) hereby promises to pay (W/H) monthly the sum of $X as support until a final settlement agreement is executed by (H) and (W) or until a court decree or order imposing support payment duties is obtained by either of them, whichever occurs first; provided, however, that no payment duty will continue beyond the life of (H or W, whoever is the payee spouse) in any event.

_____ _____ (signature)
(Date) (W)

_____ _____ (signature)
(Date) (H)

Note that a mere letter reciting the terms of one spouse's unilateral commitment does not suffice. A receipt and brief agreement in writing, complying with §71, would work to render an informal allowance payment deductible.

By the same token, when either an increased or a special supplemental payment in under consideration, no such payment should be made before a mutual agreement is executed in writing to amend the interspousal agreement if that is the operative instrument. If payments are pursuant to a decree, the securing of a court order that mandates the proposed increase or supplement may be necessary before any extra payment is made, but if the parties mutually agree, it should suffice for them to execute a written agreement providing an increase in support (above the level of court-decreed payments).

Once payments above the level required by a court order have been made, an amendatory order retroactive nunc pro tunc will not be respected for tax purposes to cure the voluntariness of prior payments. Only payments not in excess of the amount required by the then-effective decree or agreement can be taxable to the recipient under §71(a) and deductible by the payor under §215(a).

1(e). A CHANGE IN MARITAL STATUS COULD DISQUALIFY PAYMENTS.

Payments between members of the same household can qualify for spousal maintenance treatment only if those members are not legally separated. Thus, a change in status can obviously bear upon the tax treatment that is accorded payments between parties who are living under the same roof. Relevant state law may also have a bearing upon the tax characterization of payments, in the event of the recipient spouse's remarriage. In Arizona, pursuant to A.R.S. §25-237(b), spousal maintenance terminates upon the remarriage of the payee spouse.

Any payments made after a change in the status of the recipient spouse that affects her or his right to continued spousal maintenance under general principles of state law must be made under a binding contractual or judicial decree, the terms of which oblige continuing payments despite the usual local rule. For example, remarriage of a recipient spouse often terminates spousal maintenance rights in Arizona. If payments cease, naturally no problem is presented; but ongoing payments are voluntary and a disqualification of spousal maintenance treatment results.

As a general proposition, state law will respect the spouse's freedom of contract. Accordingly, separation agreement terms should be able to transcend any change in status which might otherwise terminate the obligor spouse's duty to make payments under domestic relations and family law principles. Absent an

absolute contractual payment obligation that will override state law provision for its extinguishment upon a change in status, any payments made after such a change in status actually occurs will be voluntary and thus not qualify for spousal maintenance treatment.

Taxability to the recipient and deductibility by the payor will generally continue until the right to receive spousal maintenance or support is actually extinguished under the local law standard (e.g. remarriage of payee).

1(f). TEMPORARY SUPPORT-ORDERED PAYMENTS.

Support orders comprise one of the three classes of divorce or separation instruments coming within §71(b)(2)(C). Any court order or decree that is not a decree of divorce or separate maintenance, falls into the §71(b)(2)(C) category.

While temporary support orders may be commonplace, they do not abound in reported tax cases. Nonetheless, one example can be seen in a private ruling where the Service allowed spousal maintenance treatment of payments made pursuant to a temporary support order. Initially, the payments as ordered were indirect (utility costs, newspaper subscription, food, and garbage pick-up expenses), but after a stated date the order required a set amount to be paid monthly to the recipient spouse. All such payments, both indirect and direct, were ruled taxable and deductible. (Certain mortgage, real property tax, and insurance premium payments were ruled taxable/deductible only to the extent of the payee spouse's ownership interest in the underlying real estate or insurance policy.)

2. PAYMENTS IN CASH.

Code Sec 71(b)(1) Reg. §1.71T. As required by §71(b)(1), payments must be in cash. There appear to be no exceptions, though checks and money orders payable on demand are considered cash for this purpose. Although one objective of the 1984 Act was "to prevent the deduction of amounts which are in effect transfers of property," it would seem acceptable if a cash payment obligation involved a transfer of property -- provided that both spouse's considered (and reported for tax purposes) the transaction as a cash payment and receipt, followed by a sale of property for cash. It could be argued that the substance of this arrangement is a property transfer with the cash aspect susceptible of being disregarded.

3. PAYEE'S DEATH MUST TERMINATE ALL PAYMENT LIABILITIES (WITH NO SUBSTITUTIONS)

Taking the place of former statutory requirements that payments be periodic and for support, there are new safeguards against property settlements qualifying for spousal maintenance treatment imposed by the Tax Reform Act of 1984. These require payments to be in cash and made expressly terminable upon the payee's death. The Tax Reform Act of 1986 deleted the requirement that a terminability provision be contained in the divorce or separation instrument itself, but it is nonetheless advisable to include such a provision in order to assure compliance with the §71(b)(1)(D) requirement of terminability.

However, the danger of having payments disqualified by §71(b)(1)(D) must first be averted. Pursuant to that statutory provision, all payment duties must be terminable upon the payee spouse's death in order to qualify as spousal maintenance. Be aware that the cost of any failure to comply will involve more than nontaxable/nondeductible treatment of any post-death payment; a corresponding amount of otherwise qualifying payments during the life of the payee spouse will also be denied spousal maintenance treatment.

Illustration: Payments of $10,000 per year are required by the terms of a divorce or separation instrument to continue for three years or until the payee's death, whichever is sooner; in the event of the payee's death, a lump sum payment is to be made, the amount of which will be $30,000 minus the total of payments received by the payee before death.

Note that the annual payments are terminable upon the payee's death. Nonetheless, the overall economic obligation transcends the payee's death. As a result, none of the payments will ever qualify as spousal maintenance.

The preceding illustration vividly illustrates the implications of an instrument's failure to comply with §71(b)(1)(D). It serves to point up the need for an express provision in the decree or agreement which clearly states that "anything herein to the contrary notwithstanding, all payment obligations will cease upon the payee's death." There should be little trouble complying with the Code language requiring that "there is no liability to make any ... payment for any period after the death of the payee spouse." Inclusion of a simple provision in the divorce or separation instrument to that effect will suffice.

Substitute Transfer Provisions Disqualify Pre-death Payments.

The Code prohibition against "any payment (in cash or property) as a substitute for such payments after the death of the payee spouse" can prove troublesome. Regulations interpreting this language threaten to disqualify otherwise includible and deductible spousal maintenance payments, under circumstances where a payment or transfer will be treated as a substitute for the continuation of payments.

One example involves as spouse who is obligated by decree to make annual spousal maintenance payments of $30,000, terminating at the end of six years or upon the earlier death of the payee spouse. The decree further requires that if any minor children are living in the custody of the payee at such spouse's death, then $10,000 per year is to be paid into a trust for the benefit of such children until the youngest of them attains the age of majority. In analyzing this situation, the regulations state: "These facts indicate that [the payor spouse's] liability to make annual $10,000 payments in trust for the benefit of ... minor children upon the death of [the payee spouse] is a substitute for $10,000 of the $30,000 annual payments to [the payee spouse]." Of significance here is the indication that a payment to some other person -- not the payee's estate -- brings §71(b)(1)(D) into play. Applying the statute in this example results in a disqualification of $10,000 of each year's payments while the payee is alive; only $20,000 per year will obtain spousal maintenance treatment. It should be noted that this conclusion does not hinge at all on the fact that benefits inure to children who obviously are natural objects of the payee's bounty.

Any obligation to continue payments after the payee's death, and any duty to initiate payments upon the payee's death, will cause a disqualification in corresponding amounts of pre-death payments. Such is the impact of §71(b)(1)(D).

4. PAYMENTS NOT DESIGNATED AS EXCLUDIBLE AND NONDEDUCTIBLE.

Code Sec. 71(b)(a)(B) Reg. §1.71-1T. A divorce or separation instrument (decree or agreement) can render payments excludible from income of the payee that would otherwise be taxable as spousal maintenance to a recipient spouse.

Where the parties have a written agreement between them, any writing signed by both spouses which designates payments as excludible from the payees income and nondeductible by the payor will invoke the disqualifying option of §71(b)(1)(B).

This statutory election under §71(b)(1)(B) opens the door to agreement or decree provisions which can serve to reverse the usually preferable, includible and deductible treatment of payments. An election might be desirable, for example, in the event that the payee spouse's marginal tax bracket were to become higher than the payor's. A designation of payments as excludible and nondeductible may be temporary in its application, covering some years' payments but not others.

5. PAYMENTS NOT CHILD SUPPORT.

Code Sec. 71(C) Reg. §1.71-1T. It is a long-standing rule that child support payments do not constitute spousal maintenance or separate maintenance. Efforts to maximize the amount of interspousal payments qualifying as includible in the payee's gross income (so as to provide for payor deductibility and thereby take the greatest advantage of any spread between the respective spouse's marginal income tax brackets) have customarily involved blending spousal maintenance and child support. However, to do so successfully now presents a major challenge for the drafts-person inasmuch as §71(c)(2) is difficult to sidestep. First, the instrument must not fix an amount or portion of any payment as payable for support of children of the payor spouse. Moreover, if a termination or any reduction in the amount of payments is to occur upon the happening of a specified contingency relating to a child (such as attainment of age 18, 21, or the local majority, or a child's emancipation, marriage or death), or at a time which can be "clearly associated with" such a contingency, then the payments will be treated as child support. To the extent of the amount of any such scheduled reduction in spousal maintenance payments that will or may occur upon or in association with an event in the life of a child, spousal maintenance treatment will be denied from the outset.

6. RECAPTURE OF FRONT-LOADED PAYMENTS.

6(a). Section 71(f) of the Internal Revenue Code:

RECOMPUTATION WHERE EXCESS FRONT-LOADING OF SPOUSAL MAINTENANCE PAYMENTS.

(1) IN GENERAL, if there are excess spousal maintenance payments--

(a) The payor spouse shall include the amount of such excess payments in gross income for the payor spouse's taxable year beginning in the 3rd post-separation year, and

(b) The payee spouse shall be allowed a deduction in computing adjusted gross income for the amount of such excess payments for the payee's taxable year beginning in the 3rd post-separation year.

(2) EXCESS SPOUSAL MAINTENANCE PAYMENTS For the purposes of this subsection, the term "excess spousal maintenance payments" means the sum of--

(a) the excess payments for the 1st post-separation year, and

(b) the excess payments for the 2nd post-separation year.

(3) EXCESS PAYMENTS FOR 1st POST-SEPARATION YEAR. For the purposes of this subsection, the amount of the excess payments for the 1st post-separation year is the excess (if any) of--

(a) the amount of the spousal maintenance or separate maintenance payments paid by the payor spouse during the 1st post-separation year, over

(b) the sum of--

(i) the average of--

(1) the spousal maintenance or separate maintenance payments paid by the payor spouse during the 2nd-post-separation year, reduced by the excess payments for the 2nd post-separation year, and

(2) the spousal

maintenance or separate maintenance payments paid by the payor spouse during the 3rd post-separation year, plus

(ii) $15,000.

(4) EXCESS PAYMENTS FOR 2nd POST-SEPARATION YEAR. For the purposes of this subsection, the amount of the excess payments for the 2nd post-separation year is the excess (if any) of--

(A) the amount of the spousal maintenance or separate maintenance payments paid by the payor spouse during the 2nd post-separation year, over

(B) the sum of--

(i) the amount of the spousal maintenance or separate maintenance payments paid by the payor spouse during the 3rd post-separation year, plus

(ii) $15,000.

(5) EXCEPTIONS:

(A) WHERE PAYMENT CEASES BY REASONS OF DEATH OR REMARRIAGE. Paragraph (1) shall not apply if--

(i) either spouse dies before the close of the 3rd post-separation year, or the payee spouse remarries before the close of the 3rd post-separation year, and

(ii) the spousal maintenance or separate maintenance payments cease by reason of such death or remarriage.

(B) SUPPORT PAYMENTS. For purposes of this subsection, the term "spousal maintenance or separate maintenance payment" shall not include any payment received under a decree described in subsection (b)(2)(C).

(C) FLUCTUATING PAYMENTS NOT WITHIN CONTROL OR PAYOR SPOUSE. For purposes of this subsection, the term "spousal maintenance or separate maintenance payment" shall not include any payment to the extent it is made pursuant to a continuing liability (over a period of not less than 3 years) to pay a fixed portion or portions of the income from a business or property of from compensation for employment or self-employment.

(6) POST-SEPARATION YEARS. For purposes of this subsection, the term 1st post-separation year" means the 1st calendar year in which the payor spouse paid to the payee spouse spousal maintenance or separate maintenance payments to which this section applies. The 2nd and 3rd post-separation years shall be 1st and 2nd succeeding calendar years, respectively.

6(b). Rationale for the Front Loading Prohibition.

The issue is where to draw the line of demarcation between spousal maintenance payments, on the one hand, and property division payments, on the other. The first of these rules was the requirement that payments terminate at the death of the spousal maintenance recipient; and the second was the three-year spousal maintenance recapture rule, which was intended to force a moderate stretch out of payments.

The requirements can often be met in a significantly shorter period, even as short as 12 months and two days. The present recapture rule entails a single computation at the end of the third year. If recapture is indicated, there is a deemed inclusion in the income of the payor of so-called excess payments, as well as a correlative deduction for the payee.

6(c). Calculating the Recapture.

The steps that should be used at the planning stage for computing such excess payments (i.e., total recapture) are summarized as follows:

Step 1: Determine second-year recapture by adding

$15,000 to third-year spousal maintenance payments and subtracting the result from second-year spousal maintenance payments.

Step 2: Determine adjusted second-year spousal maintenance by reducing actual payments by the second-year recapture (as determined under Step 1).

Step 3: Determine the average of (i) second-year spousal maintenance (as adjusted under Step 2) and (ii) third-year spousal maintenance; and then increase the average by $15,000.

Step 4: Determine first-year recapture by subtracting the amount determined in Step 3 from first-year spousal maintenance.

Step 5: Determine total recapture by adding the previously determined amounts of second and first-year recapture (i.e., amounts determined in Steps 1 and 4).

In terms of this five-step process, a single one-shot $50,000 payment would generate $35,000 of recapture, as shown in Example 1.

If (in terms of Example 1) $20,000 more were paid in Year 2, significant spousal maintenance recapture would still result, as Example 2 shows, again in terms of the five-step process.

Example 1:

Spousal maintenance:

Year 1:	$50,000.00
Year 2:	$0.00
Year 3:	$0.00

Recapture Computation:

Step 1:	$0.00 - $0.00 =	$0.00
Step 2:	N/A	
Step 3:	($0.00 + $0.00 divided by 2) + $15,000.00 =	$15,000.00
Step 4:	$50,000.00 - $15,000.00 =	$35,000.00
Step 5:	$0.00 + $35,000.00 =	$35,000.00

Total recapture.

Example 2:

Spousal maintenance:

Year 1:	$50,000.00
Year 2:	$20,000.00
Year 3:	$0.00

Recapture Computation:

Step 1:	$20,000.00 - ($0.00 + $15,000.00) =	$5,000.00
Step 2:	$20,000.00 - $5,000.00 =	$15,000.00
Step 3:	($15,000.00 + $0.00) divided by 2 + $15,000.00 =	$22,500.00
Step 4:	$50,000.00 - $22,500.00 =	$27,500.00
Step 5:	$5,000.00 + $27,500.00 =	$32,500.00

Total recapture.

Example 3: ($3,000.00 per month for 30 months, starting in a January)

Spousal maintenance:

Year 1:	$36,000.00
Year 2:	$36,000.00
Year 3:	$18,000.00

Recapture Computation:

Step 1:	$36,000.00 - ($18,000.00 + $15,000.00) =	$3,000.00
Step 2:	$36,000.00 - $3,000.00 =	$33,000.00
Step 3:	($33,000.00 + $18,000.00) divided by 2 + $15,000.00 =	$40,500.00
Step 4:	$36,000.00 - $40,500.00 =	$0.00
Step 5:	$3,000.00 + $0.00 =	$3,000.00

Total recapture.

Example 4: ($3,000.00 per month for 30 months, starting in a February not January)

Spousal maintenance:

Year 1:	$33,000.00
Year 2:	$36,000.00
Year 3:	$21,000.00

Recapture Computation:

Step 1:	$36,000.00 - ($21,000.00 + $15,000.00) =	$0.00
Step 2:	N/A	

Step 3:	($36,000.00 + $21,000.00) divided by 2 + $15,000.00 =	$43,500.00	
Step 4:	$33,000.00 - $43,500.00 =	$0.00	
Step 5:	$0.00 + $0.00 =	$0.00	Total recapture.

Example 5: ($3,000.00 per month for 20 months, starting in a December)
Spousal maintenance:

Year 1:	$3,000.00
Year 2:	$36,000.00
Year 3:	$21,000.00

Recapture Computation:

Step 1:	$36,000.00 - ($21,000.00 + $15,000.00) =	$0.00	
Step 2:	N/A		
Step 3:	($36,000.00 + $21,000.00) divided by 2 + $15,000.00 =	$43,500.00	
Step 4:	$3,000.00 - $43,500.00 =	$0.00	
Step 5:	$0.00 + $0.00 =	$0.00	Total recapture.

"Three years," means three calendar years. The starting time for monthly payments in the first year of the three-year period, therefore, often plays an important role, as shown by a comparison of Examples 3 and 4.

In some, monthly payments that start late in the first year shorten the period over which monthly payments can be made, as Example 5 demonstrates.

6(d). Exceptions to the Applications of the Spousal Maintenance Recapture Rule.

1. Recapture is not triggered if spousal maintenance payments cease because of the death of either party or the remarriage of the recipient. §71(f)(5)(A).

2. Payments pursuant to a predivorce temporary support order, within the scope of §71(b)(5)(C), are exempt from recapture.

3. Under §71(b)(5)(C), payments constituting a fixed portion of income from a business or property or from compensation for employment or self-employment (if required to be

paid for at least three years) are excepted from the recapture rules. Termination of spousal maintenance due to cohabitation, however, can present a problem in some cases.

Arrearage payment in the second year could bunch spousal maintenance together, causing a recapture problem. More specifically, computations for calculating recapture are based on the amounts actually paid within the period in question, not the scheduled payments. Thus, failure to make scheduled payments the first year or two, followed by arrearage payments in year two or three, can result in recapture. This result occurs even if the payments, as initially scheduled, would not have triggered this result.

6(e). Shifting the Burden of Recapture.

To the extent that there is spousal maintenance recapture triggered for the spousal maintenance payor, there is a correlative deduction available to the spousal maintenance recipient. Thus, there are corresponding benefits and burdens, whenever recapture occurs. In this regard it is perfectly permissible for the parties to make monetary adjustments to offset, in whole or in part, the ultimate cost of recapture. For example, it is permissible to shift the entire recapture burden to an ex-wife if there is a premature termination of spousal maintenance due to her cohabitation.

7. PAYMENTS BETWEEN LEGALLY SEPARATED MEMBERS OF THE SAME HOUSEHOLD ARE DISQUALIFIED.

If parties who are divorced or legally separated by court decree remain as members of the same household, payments between them will not qualify as spousal maintenance or separate maintenance. Where the parties are legally separated, the requirement is that they must be more than just physically separated if payments are to obtain spousal maintenance treatment. This limitation, contained in §71(b)(1)(C), disqualifies payments "even if the parties physically separate themselves within the dwelling unit." There is narrowly limited allowance for one qualifying payment to be made between spouses who are members of the same household, provided that one of them is "preparing to depart" and does in fact depart "not more than one month after the date of the payment is made."

It has been correctly observed that Sec. 71(b)(1)(C) denies spousal maintenance treatment only if the payments are made while

the spouses who are living together are "legally separated ... under decree of divorce or of separate maintenance." The requirement of separate households does not apply to payments made under separation agreements or support decrees. This is confirmed by the regulations:

If the spouses are not legally separated under a decree of divorce or separate maintenance, a payment under a written separation agreement or a decree described in § 71(b)(2)(C) may qualify as an spousal maintenance or separate maintenance payment notwithstanding that the payor and the payee are members of the same household at the time the payment is made.

It is understandable why the separate household limitation pertains only to taxpayers who are divorced or legally separated; this neatly dovetails with the determination of marital status for income tax return filing purposes. Pursuant to §7703(a)(2), spouses who are legally separated under a decree of divorce or of separate maintenance are not considered as married, and more favorable tax rate schedules apply to unmarried taxpayers in comparison with married taxpayers who file separately. Because of the fact that a qualifying spousal maintenance payment has the effect of shifting income between taxpayers, and the respective spouses' income tax will be reduced to the lowest level if (after becoming divorced legally separated) their incomes are made equal, Congress imposed the rule of §71(b)(1)(C) as a bar to abuse.