

AABY FAMILY LAW



TAX LAW CHANGES

Since tax time is approaching, we want you to be aware of a possible deduction for you to take on your tax returns. In general, the Internal Revenue Code allows a deduction for reasonable and necessary expenses incurred in the production of taxable income. This may entitle a client to a deduction for all, or part of, the attorney's fees paid to our firm for the pursuit of post-separation support, alimony, and/or taxable pension payments.

Check with your tax advisor or tax preparation professional so that he/she can assist you in determining your entitlement to this deduction. You may take your monthly statements and use them as proof of money expended in pursuit of alimony or pension division. Also, as a service to our clients, we will send you another copy of your monthly invoice(s) for use in calculating any possible deduction. Let us know if you would like to obtain a 2007 summary of charges. There is no charge for this.

IRS CLARIFIES CLAIMS FOR DEPENDENTS

IRS Notice 2008-5 clarifies whether someone can be claimed as a dependent by an unrelated taxpayer. Changing its position previously taken for 2005 and 2006, the IRS now says a qualifying dependent includes unrelated persons who lived in a home provided by the taxpayer for the entire year and met other dependency tests, such as primary support by the taxpayer.

Blood, foster or adoption relations are no longer a requirement. In order to qualify, the dependents cannot be claimed as dependents by someone else. Further, they must not be required to file a tax return and do not file a tax return, or only do so to claim a refund of all income taxes withheld.

For example, assume boyfriend supports, as members of his household, girlfriend and girlfriend's two kids. Girlfriend works, but only makes modest income. She files a return solely to get a refund of all of her income taxes withheld, and does not claim an earned income credit or her children as dependents. Boyfriend can file a return with single filing status, claiming himself, girlfriend, and girlfriend's kids as his exemptions.

This notice clarifies dependent claims only in cases where qualifying dependents are not related to the taxpayer. For other situations, such as for parents claiming their children, the rules have not changed.

The Notice does not apply to the child tax credit, earned income credit, or head of household filing status (none of which would apply to boyfriend in the above example).

The Notice does apply to 2005 and following years. Some taxpayers may consider amending prior affected years to claim exemptions they previously were not allowed.

[Questions about the above or other tax issues may be addressed to Gary S. Leavitt, CPA, CVA (Sherman, Young & Associates, PC, 1165 Molalla Avenue, Oregon City, OR 97045; telephone 503-657-9447; e-mail Leavitt@shermanyoung.com). Gary is a tax advisor to individuals and businesses, and has consulted on tax or business valuation matters in more than 900 divorces.]

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EARLY WITHDRAWAL OF 401(K) CASH CAN BE COSTLY

Most people fund their retirement accounts with pre-tax money. They do so based on their expectation that when they reach retirement age and withdraw those funds, they will be at a lower tax bracket. However, a withdrawal of the funds prior to the time the individual reaches the age of 59 ½ can subject that person not only to taxes on the withdrawn amount, but also to income a 10% penalty for early withdrawal.

A *hardship distributions* allows an individual to withdraw money from their retirement accounts without incurring a 10% penalty. Most companies allow an individual to qualify for a *hardship distribution* based on categories approved by the Internal Revenue Service: medical expenses, purchase of a principal residence, to prevent foreclosure or eviction, repair of storm damage, payment of tuition or payment of funeral expenses.

If you need additional funds, but do not qualify for a *hardship distribution* it makes sense to consider taking out a loan against your 401(k), rather than cashing it out. Loans are generally paid with deductions from a worker's paycheck. Workers can continue to contribute to the plan, though many find it necessary to lower their contribution until the loan is repaid. One thing to keep in mind is that if the worker defaults on the loan or leaves the employment prior to the time the loan is paid, then the loan may be subject to the 10% penalty.

(Before withdrawing funds from a retirement account you should consult with your tax advisor or CPA.)

FEDERAL STIMULUS PAYMENTS - 2008

Starting in May 2008, the Treasury will begin sending economic stimulus payments to more than 130 million households. The vast majority of Americans who qualify for an economic stimulus payment will not have to do anything other than file their 2007 individual income tax return to receive their payment this year. They will not have to complete applications, file any extra forms or call the Internal Revenue Service to request the payment, which is automatic. The IRS will determine eligibility, figure the amount and issue the payment.

The IRS will use the 2007 tax return to determine eligibility and calculate the basic amount of the payment. In most cases, the payment will equal the amount of tax liability on the return with a maximum amount of \$600 for individuals (\$1,200 for taxpayers who file a joint return) and a minimum of \$300 for individuals (\$600 for taxpayers who file a joint return).

Even those who have little or no tax liability may qualify for a minimum payment of \$300 (\$600 if filing a joint return) if their tax return reflects \$3,000 or more in qualifying income. For the purpose of the stimulus payments, qualifying income consists of earned income such as wages and net self-employment income as well as Social Security or certain Railroad Retirement benefits and veterans' disability compensation, pension or survivors' benefits received from the Department of Veterans Affairs in 2007. However, Supplemental Security Income (SSI) does not count as qualifying income for the stimulus payment.

For more information, go to www.irs.gov and search for 2008 Stimulus Payments.

The information contained in this newsletter is of a general nature and is not intended to be legal advice regarding your particular situation. Each case is different. If you have any questions about your particular matter, it is always wise to consult an attorney.