

ETHICS AS RELATED TO TAX CONSEQUENCES IN DIVORCE

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ETHICS AND THE TAX CONSEQUENCES OF DIVORCE ¹

I. TAX CONSEQUENCES OF DIVORCE- WHY ARE THEY RELEVANT?

a. Relevance.

There is no specific provision in the Missouri Dissolution of Marriage Statute requiring the divorce court to consider the tax implications of the division of property or the award of maintenance at divorce. §452.330 RSMo states the court should divide the marital property in such proportions as the court deems just after considering "...all relevant factors..." The case law is quite clear to the effect that tax consequences are "relevant factors" and should be considered by the court in arriving at an equitable division of the estate.

In Lewis v. Lewis, 808 S.W. 2d 919 (Mo. App. 1991), the appellate court found the trial court gave due consideration to the tax consequences involved in liquidating certain retirement annuities in order to reach an equitable division of property. 808 S.W. 2d 919, 924.

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In Clark v. Clark, 801 S.W. 2d 95 (Mo. App. 1990), the Court of Appeals ordered the remand of a divorce case for the express purpose of "re-examining" the property award for consideration of capital gains tax liability to be incurred by the recipient of the marital home. The expense of the tax attendant to the gain on the residence had not been considered by the trial court below, and resulted in an inequitable division of the property. 801 S.W. 2d 95, 99.

In Mika v. Mika, 728 S.W. 2d 280 (Mo. App. 1987), the appellate court specifically held the tax consequences of a dissolution are a factor to consider in making property division awards. 728 S.W. 2d 280, 285.

QUERY: What ethical obligation does the trial lawyer have to inform the court about tax consequences when they would affect his or her client adversely, if considered by the court?

b. Burden of Proof.

The burden of proof of adverse tax consequences lies upon the party desiring their consideration; a party failing to present evidence regarding such consequences will not be heard to complain upon appeal.

Schneider v. Schneider, 824 S.W. 2d 942 (Mo. App. 1992). The adverse tax consequences must ordinarily be established with some particularity at trial if those consequences are to be considered on appeal. In Re Harrison, 657 S.W. 2d 366, 371 (Mo. App. 1983).

QUERY: Where the tax considerations affect the opponent, should opposing counsel be advised he has the burden of proof?

c. Relationship to Valuation Determinations.

In Hogan v. Hogan, 796 S.W. 2d 400 (Mo. App. E.D. 1990), the trial court considered the taxable gain on a parcel of real estate in arriving at the fair market value of the property. The court first determined the fair market value, and then deducted a reasonable real estate commission, repayment of the indebtedness, and the amount which would have to be paid in taxes upon the gain. Id. at 408. The appellant complained there had been no evidence the property in question was to be sold. However, the Court of Appeals held the "...the concept of fair market value assumes the sale of the property to an interested buyer." Hogan v. Hogan, 796 S.W. 2d 400, 408 (Mo. App. E.D. 1990).

In Stein v. Stein, 789 S.W. 2d 87 (Mo. App. 1990), the Court of Appeals held the trial court properly considered the tax liability attendant to the liquidation of a pension or profit sharing plan in determining its value.

QUERY: What obligation does the trial lawyer have to correct erroneous tax evidence proffered by his opponent?

d. Relationship to Maintenance Awards.

Section 71 of the Internal Revenue Code addresses the taxability and deductibility of alimony (what we call maintenance under the Missouri Dissolution of Marriage Act). The failure to meet the requirements of the Internal Revenue Code in fashioning a maintenance award may result in a future determination by the Internal Revenue Service that the maintenance does not qualify as "alimony." If that occurs, the maintenance deductions taken by the obligor will be subject to recapture, resulting in the loss of a very significant benefit (the ability to deduct maintenance payments from taxable income) as well as the addition of an unhappy

former client.

The recent Missouri Supreme Court case of Cates v. Cates, 819 S.W. 2d 731 (Mo. banc 1991) indicates maintenance in gross is no longer available as a means to provide support to a recipient spouse in Missouri. The attorney should be aware of this change in the law when advising his client about paying maintenance and the forms of maintenance available. The attorney should also be aware of potential taxation pitfalls.

QUERIES: 1.) Assume you represent the recipient of maintenance pursuant to a separation agreement drafted by opposing counsel. You notice the language in the agreement results in an award of maintenance which is both non-taxable to your client and non-deductible to the opponent. Are you ethically obligated to advise opposing counsel?

2.) Assume you represent the recipient of maintenance pursuant to a separation agreement drafted by opposing counsel. You notice the maintenance payable to your client will result in alimony recapture to the opponent. Are you ethically obligated to advise opposing counsel?

e. Relevance to Child Support Orders.

1. Child Care Credits- Two recent appellant opinions address the Federal Child Care Credits and their relevance to the determination of child support. In KRW V. DBW, 830 S.W.2D 38 (Mo. App. W.D. 1992), the court suggested it may be permissible to introduce evidence, at trial, of federal income tax child care credits available and to offset the Rule 88.01 Child Support costs calculation with them. However, in the Eastern District it has recently been determined the federal tax credit for child care costs should not be used to offset the Rule 88.01 calculation. Behnke v. Behnke, 829 S.W. 2d 45 (Mo. App. E.D. 1992).

2. Dependency Exemptions- In Vohsen v. Vohsen, 801 S.W. 2d 789 (Mo. App. E.D. 1991) the Eastern District Court of Appeals held the trial court may order the custodial parent to execute the necessary release (IRS Form 8332) to award the dependency exemptions to the noncustodial parent. The right to claim the dependency exemptions relative to the minor children is a frequent bone of contention in divorce cases. However, many times the argument is moot because the utility of the dependency exemptions is phased out as

income increases. The party whose taxable income exceeds certain thresholds set out in the Internal Revenue Code will benefit little, if at all, from the right to claim these exemptions. 3.

Health Insurance Premium- A recent case held the cost of a health insurance premium being paid by the child support obligor should be considered in determining the Form 14 Child Support amount. The amount of the premium being paid for the children's coverage should be deducted from the Form 14 child support amount. Switzer v. Switzer, 821 S.W. 2d 125 (Mo. App. E.D. 1991), citing §452.353.10 RSMo.

QUERY: Assume opposing counsel miscalculates the Form 14 Child Support amounts because he fails to account for one of the above considerations, resulting in a child support figure which is better for your client than it otherwise should be. Are you ethically obligated to point this out to counsel?

PRACTICE TIP: Regarding the dependency exemption, consider the need to include language in the agreement to protect the agreed-upon arrangements in the event of a change in the tax code.

II. ETHICAL CONSIDERATIONS FOR TAXATION ISSUES IN DIVORCE

1. Published ethical standards.

The ethical rules guiding our conduct in the practice of divorce law appear in Missouri Supreme Court Rule 4. Rule 4 codifies the Rules of Professional Conduct as enacted in Missouri, and became effective in its present form on January 1, 1986.

In addition to the Supreme Court Rules, the American Academy of Matrimonial Lawyers has set forth its own proposed standards of conduct, entitled Bounds of Advocacy, for consideration and guidance in divorce cases.

Rule 4 MRCP and the Bounds of Advocacy published by the American Academy of Matrimonial Lawyers provide comprehensive ethical guideposts to the divorce practitioner which should also be considered when advising a client about the application of tax law to his or her divorce. These guidelines should also be followed in an attorney's dealings with opposing

counsel, and vice versa. The authors have attempted to highlight the particularly relevant citations in the materials below.

a. Competence.

1. Rule 4-1.1:

"A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."

2. AAML Model Rule 1.1:

"An attorney is responsible for the competent handling of all aspects of a representation, no matter how complex."

3. AAML Model Rule 1.3:

"An attorney should not advise a client about a matter concerning which the attorney is not sufficiently competent."

b. Relationship to Opposing Counsel and Court.

1. Rule 4-3.3(a)(1) & (2) MRCP:

"A lawyer shall not knowingly:

(1) make a false statement of material fact
or law to a tribunal;

(2) fail to disclose a material fact to a tribunal when disclosure is necessary to

avoid assisting a criminal or fraudulent act by the client..."

2. Rule 4-3.4(a) MRCP:

"A lawyer shall not:
(a) unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value... "

3. Rule 4-1.2(d): "Scope of Representation":

"A lawyer shall not counsel a client to engage, lawyer or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law."

4. AAML Model Rule 3.2:

"An attorney should never deceive or intentionally mislead opposing counsel."

5. AAML Model Rule 3.3:

"An attorney should not induce or rely on a mistake by opposing counsel as to matters agreed upon to obtain an unfair benefit for the client."

c. Discovery.

1. AAML Model Rule 3.6:

"An attorney should cooperate in the exchange of information and documents whenever possible. An attorney should not use the discovery process for delay or harassment, or engage in obstructionist tactics."

d. Duty of Confidentiality.

1. Rule 4-1.6(a) and (b) MRCP:

"(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).

(b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:

(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client."

2. Other ethical dilemmas relative to tax implications of divorce.

- may
- a. The Accountant/Client privilege (§326.151 RSMo 1986) and the inference its use raise.
- witnesses.
- b. Use of and reliance upon expert
- c. Professional negligence of trial experts-
Murphy v. Mathews, Mo. banc slip op.
November 24, 1992.

