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TAX MATTERS

## No exclusion for former spouse from assignment of disability income

BY JANET A. MEADE, CPA, PH.D.  
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The Tax Court recently clarified that disability retirement benefits assigned to a former spouse under a divorce agreement are ineligible for exclusion from income, even though the benefits would qualify for exclusion as compensation for personal injury had the other ex-spouse received them. The former spouse's argument that she was an alternative payee eligible to be treated as the distributee under a qualified domestic relations order (QDRO) was rejected by the court. Likewise, the court rejected her claim that she stepped into the shoes of her ex-husband and should therefore receive the same exclusion from income that he received.

Shannon Fernandez married her husband in 1976. In 1993, Mr. Fernandez became disabled, and because he did not qualify for normal retirement on the basis of age and years of service, he opted for a "service-connected disability" retirement. Mr. Fernandez then began receiving disability retirement benefits. These benefits were nontaxable to him because, under [Sec. 104\(a\)\(1\)](#) and associated regulations, gross income does not include amounts received by an employee or the survivor of a deceased employee under workers' compensation acts as compensation for personal injuries or sickness incurred in the course of employment.

In 1995, the couple legally separated. Two years later, their divorce became final, and the California Superior Court awarded Shannon Fernandez a percentage of her ex-husband's disability retirement benefits, payable over the remainder of his life.

During 2007, the tax year at issue, Shannon Fernandez received \$11,850 in benefits attributable to her ex-husband's retirement. She also received a [Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.](#), treating \$11,691 as taxable and \$159 as nontaxable. She did not include any of the amounts received in her 2007 federal income tax return and, consequently, the IRS determined a deficiency. Shannon Fernandez contested the deficiency and petitioned the Tax Court for redetermination.

Shannon Fernandez contended that the exclusion under [Sec. 104\(a\)\(1\)](#) available to her former husband also applied to her. She relied on two arguments: First, she argued that the benefits should be excluded because [Sec. 402\(e\)\(1\)\(A\)](#) allows an alternative payee who is the spouse or former spouse of the participant and who is receiving distributions from a qualified plan under a QDRO to be treated as the distributee. This argument was unsuccessful because the Tax Court declined to extend the reach of [Sec. 402\(e\)\(1\)\(A\)](#) to [Sec. 104](#) absent congressional approval.

Second, she argued that she should be taxed in the same manner as her former husband because she stepped into his shoes and he had been injured at the time of his early retirement. This issue was, to Judge Robert A. Wherry Jr.'s knowledge, one that had not been previously addressed.

Nonetheless, the court again decided against Shannon Fernandez because [Sec. 104\(a\)\(1\)](#) explicitly reads "as compensation for personal injury," and the compensation was for the personal injury of her former husband, not hers.

*Fernandez*, [138 T.C. No. 20](#) (5/14/12)

By **Janet A. Meade**, CPA, Ph.D., University of Houston, Houston.

