

Alimony Interest and NOL Carryin

Mr. Bulakites is an insurance consultant specializing in life insurance and annuities. He is also frequently an expert witness on the subjects and trains others in the field. He worked for a firm whose clients were mostly accountants in need of advice on anything from how to sell their services to how to decide if a client is due a refund for a particular service sold. Mr. Bulakites chose to use TurboTax to prepare his personal income tax return for 2011 & 2012, the years in front of Tax Court. There are three issues in front of the court – Alimony, Interest Deduction, and NOL carryin.

** ALIMONY – Mr. Bulakites was divorced and was ordered to pay \$2,000/month in alimony to his ex-wife. He fell behind in his payments but in an effort to “do the right thing” he orally agreed with his ex-wife to increase his payments to \$5,000 per month. Prior to 2011 he became current on his alimony but he continued to pay \$5,000 per month to help cover shortfalls that may happen in the future.

Although he didn’t make all of the agreed upon payments during 2011 & 2012 he did pay \$50,000 during each of the years and claimed this on his tax return.

The Court agreed with IRS limiting the deduction to \$24,000 each year. Section 215 limits the deduction for alimony to the amounts required to be included in the income of the recipient under Section 71. One of the conditions in order to be income under Section 71 is the amount must be specifically required by a written divorce or separate instrument. An oral agreement does not meet this condition, therefore the deduction is limited to the amount designated in the written instrument which stated \$2,000 per month (\$24,000 for the year).

** INTEREST DEDUCTION – Back in 2007 Mr. Bulakites was found liable for \$500,000 in a lawsuit settlement connected to his self-employment activity. He borrowed this using his home as equity. The loan had a balloon payment date in early 2008. He testified that he expected to sell his house and pay the loan off on the balloon payment date.

On his 2011 and 2012 income tax returns he claimed an interest deduction on Schedule C in connection with interest portion of the payments on a loan. Tax Court denied the deductions for various reasons including:

- 1) The evidence showed payments made to the lender but the evidence had different amounts of interest than the amount Mr. Bulakites claimed. He did not provide any explanation of the discrepancy.
- 2) He did not provide any business records regarding the loan, any loan statements, or any loan-repayment schedules.
- 3) He also did not produce copies of the loan documents, any explanation of what happened with his original \$500,000 loan which should have been repaid in 2008, nor any paperwork showing a refinance or extension of the original loa.

Tax Court decision = No paperwork to support the validity of the deduction equals no deduction. This shows the importance of keeping loan records, refinancing, and repayments for as long as the loan interest is being claimed on the tax return; not the “3 years” that many tax clients commonly hear.

** NOL Carryin – Mr. Bulakites claimed an NOL of over \$180,000 on his 2011 income tax return. Section 172 requires the taxpayer to attach substantiation to the tax return to support the NOL deduction such as the computation of the deduction.

Mr. Bulakites did not include any of this documentation with his tax return nor did he produce any such documentation at trial. Court decision = Taxpayer failed to comply with the rules so the deduction was denied.

This case shows the importance of keeping the NOL computations and worksheets for the entire period that the NOL is used on the tax returns.

** Mr. Bulakite blamed TurboTax for the mistakes stating it lured him into claiming too much. Tax Court rejected this argument stating “tax preparation software is only as good as the information one puts into it.”

Barry Leonard Bulakites, TC Memo 2017-79. This case can be found by going to www.ustaxcourt.gov, clicking on Opinion Search, and entering Bulakites in the “Case Name Keyword” box.

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