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Tax Basics in Divorce

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When going through a divorce, there are basic tax issues you should keep in mind. An experienced divorce attorney or tax professional can help you navigate these complicated issues.

Dependency Exemptions

If you have children, every settlement agreement in a divorce should address who gets the dependency exemption for the children. Make sure the person not entitled to claim the exemption completes and signs IRS Form 8332, so there is no dispute going forward about who is entitled to claim the exemption.

The dependency exemption reduces your taxable income so you end up paying less income tax. In 2015, each qualified dependent would reduce your taxable income by $4,000 (up to a maximum of $20,000 or 5 dependents). If you have a 30% marginal tax rate, that could mean a tax savings of $1,200.

Typically, divorcing couples share the exemptions available between them, but only if there is some benefit to doing so because not every wage earner qualifies to take advantage of the tax deduction. If you have a low income (even with alimony coming in), the exemption may not benefit you in which case the high wage earning spouse should take the deductions. The IRS has rules that phase out the benefit of the exemption if your adjusted gross income (AGI) is above a certain amount so if your income is too high, the dependency exemption wouldn't benefit you either. These phase-out amounts can change from year to year.

Practice Tips:

- Consult your tax advisor or an experienced family law attorney to determine if you and/or your spouse benefit from taking the exemption given your income and anticipated filing status.
- Allocate the exemptions explicitly in your settlement agreement so there is no confusion.
- Have the party not entitled to claim the exemption sign IRS Form 8332.

Filing Jointly or Separately

A common question that arises during divorce litigation is whether to file jointly or separately. If you were still married at the end of the tax year, you have the option to file jointly or separately. If you were divorced before the end of the tax year, you can only file as single or head of household. There are pitfalls to filing jointly with a spouse you are divorcing.

Filing jointly usually reduces the overall tax burden but not always. If one spouse underpaid taxes for the year, perhaps the other spouse does not wish to share that tax burden and therefore filing separately may be more appropriate. When you sign a joint return you become equally liable for the contents of that return and any taxes that are due or underpaid, even for previous years' tax returns.

Filing jointly may result in a refund of a tax overpayment begging the question of who is entitled to that refund.

Practice Tips:

- Discuss with your divorce attorney or accountant whether you should file jointly or separately.
- Evaluate whether there was an underpayment of tax.
- Determine in your agreement who should be liable for any current or past tax liabilities.
- If a refund is due, make sure your settlement agreement allocates those funds appropriately.

Marital Home

The marital home is often the single largest asset of divorcing couples. If the house is to be sold as part of the divorce, capital gains taxes will be due on any gain in excess of $250,000 per person as long as the home was your principal residence.

If you intend to keep the house and buy out your spouse, no capital gains taxes are due because the sale is part of a divorce. Capital gains taxes will be due when you sell subject to the $250,000 exclusion as long as you lived in the home for 2 years before selling. There are exceptions to this rule so always consult a tax adviser when planning a buy out.

If both spouses are going to remain on the title to the home but only one spouse will live there, exercise caution because in that situation the $250,000 capital gains tax exclusion may not apply. Your settlement agreement or divorce decree has to be explicit that this arrangement was incident to a divorce settlement.

Many divorcing couples forget to deal with the tax liability associated with the capital gain taxes due in reaching a settlement of their financial issues.

Practice Tips:

- Consult an accountant or experienced divorce attorney to understand the best way to deal with the marital home in a divorce.
- Evaluate the gain that might be realized if the home were sold or if one party were to retain it after divorce.
- Estimate the capital gains taxes that may be due and how they will be paid.