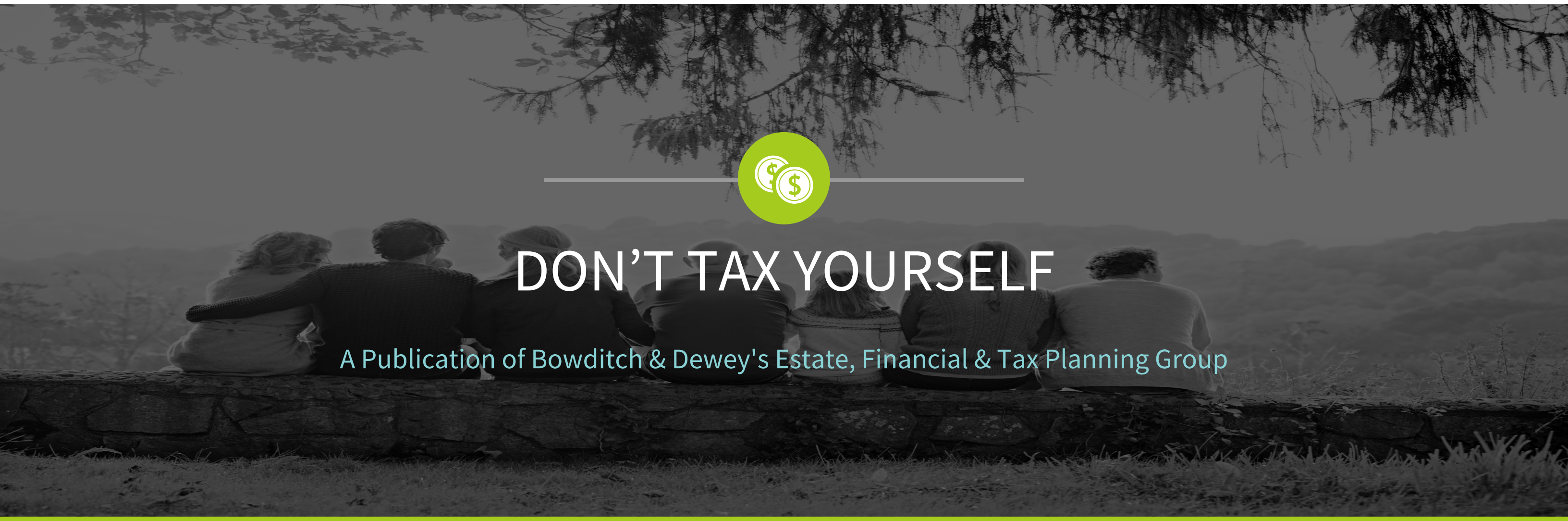

8 Important Tax Considerations During Divorce

BY SCOTT C. CASHMAN • AUGUST 3, 2022

Income tax effects are often the last thing on one's mind when going through a divorce, but having sound tax advice during a divorce is important for many reasons.

FILING STATUS

Divorce will change your income tax filing status. Filing status is used in determining whether a taxpayer must file a return and the amount of the standard deduction. Filing status is also used in calculating a taxpayer's income tax.

Filing status is determined, at least in part, on a taxpayer's marital status on the last day of the year. State law will determine whether someone is legally divorced. If under state law you are considered divorced on the last day of the year, for income tax purposes, you are considered unmarried for the entire year.

FILING STATUS DURING THE DIVORCE

If a divorce is not finalized by the end of the year, the divorcing couple must decide whether to file a joint tax return. Both the taxpayer and spouse must understand that when filing a joint tax return each is separately and individually liable for the tax due. In other words, one spouse could be held liable for the tax even though the income reported was all earned by the other spouse. For many divorcing couples, it will make financial sense to continue to file jointly during the divorce process, but if there is any suspicion that one spouse is not accurately reporting income (e.g., if one spouse was self-employed and not maintaining good books), filing jointly should be carefully considered.

TAX WITHHOLDING

Once a divorce is finalized, a taxpayer is required to complete within 10 days a new Form W-4 to update their tax withholding.

NAME CHANGE

If a taxpayer is changing their name, the taxpayer should notify social security of the change.

ALIMONY

Alimony or separate maintenance payments under a divorce or separation instrument executed after 2018 is no longer deductible by the payer. In addition, the recipient does not have to include alimony received as income. This controversial change in the law can create a windfall for the recipient spouse and must be considered by all parties during the negotiation of a separation agreement or during trial.

CHILD SUPPORT

Child support is not deductible by the payer spouse and not includible in income by the recipient spouse.

DEPENDENTS

As a general rule, the custodial parent is entitled to claim a child as a dependent. A custodial parent for tax purposes is the parent with whom the child spent the greater number of nights. If a custodial parent releases the right to claim a child for a year or years, the custodial parent must execute Form 8332 that the noncustodial parent attaches to their tax return.

PROPERTY SETTLEMENTS

Generally, there is no gain or loss on property received in a divorce. However, there can be significant income tax consequences when property received in a settlement is sold. For example, a couple may have a personal residence and a stock portfolio with significant unrealized capital gains. In the divorce, one spouse may end up with the house while the other spouse ends up with the stock portfolio. When these assets are sold, however, the spouse with the residence may qualify for the exclusion of gain on the sale of the personal residence thereby avoiding all or part of the capital gain, whereas the spouse with the stock portfolio will owe tax on the entire gain. Competent tax counsel will be able to evaluate the tax ramifications of any proposed property settlement.

Divorcing couples should consider consulting with tax counsel during the divorce process. Even couples who think their situation is “simple” may find that when dealing with the division of property, paying child support, claiming dependency tax benefits, the receipt or payment of alimony and pension division, their situation is anything but simple when it comes to the tax implications.