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12 DIVORCE TAX TIPS

By Victor Sy, CPA, MBA

As marital discord continues to be part of our lives in America, let us learn how to cope with tax problems of divorce, separation and annulment. Please see separate article on the subject of alimony.

1. Your legal marital status is determined as of **December 31** of each year. Even if you were married for the previous 364 days if you were divorced on the 365th day of the year, you are considered unmarried for the entire year.
2. You can file single only if you receive a **final decree** by the end of that year. If you do not receive a decree by the end of the year, you cannot file as a single taxpayer. A couple living under a legal separation agreement but without any court decree is not legally separated for tax purposes because such an agreement could be abrogated by the parties upon reconciliation and resumption of cohabitation.
3. If you don't get the final decree by end of year and you cannot get together without fighting, then you are forced to file married **separately** (higher rates, folks).
4. You may file as **head of household** to take advantage of lower tax rates if you paid more than half the costs of maintaining your home for your child (provided your spouse did not live with you from July 1 to December 31). By so doing, you may claim the standard deduction even if your spouse itemizes on a separate return.
5. Community property states require that **community income** be split unless you live apart for the entire year (the following are community-property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin).
6. Because of the income tax consequences of divorce on both parties, you have to plan four areas of concern: **child custody, property settlement, child support, and alimony**.
7. A problem arises when there is no clear-cut distinction between **alimony** (deductible by payor, taxable to recipient) and **child support** (neither deductible nor taxable). Payments are merely described as "**family support**." Alimony must terminate on the death of the recipient. Most family support agreements do not include a provision for support to terminate on the death of the payee; therefore, payments fail to qualify as alimony and become nondeductible/nontaxable child support.
8. If the divorce decree does not specify who is entitled to the **dependency exemption**, the parent with the custody for the greater part of the year gets it. The non-custodial parent must attach form 8332 to the tax returns. (**Tip:** If you are the non-custodial parent, have your spouse sign Form 8332 for all future years while you are at it instead of fighting for it every single year in the future.
9. No gain or loss is recognized on **property transfers** that are incident to a divorce. This rule applies when properties are transferred within one year after the marriage ends or even within six years if it is made under a divorce or separation instrument.
10. Before you insist on keeping the house, consult your tax adviser on new rules on the **exclusion of gain on the sale of personal residence**.
11. **Palimony** payments to a live-in companion do not qualify as alimony. It's not income to the recipient and not deductible by the payer. Palimony may even be subject to gift tax.
12. A problem arises when an employee's **retirement plan** is **distributed to the ex-spouse**. Distributions made to you as an employee are taxable to you while distributions made to your spouse are taxable to him/her. In a community

property such as California, the IRS has ruled privately that a participant employee is not taxed on the spouse's interest. (Tip: Guard against paying tax on what your ex-spouse receives by including such provision in a Qualified Domestic Relations Order (QUADRO). Remember also that early distribution to your spouse is exempt from the 10% excise tax penalty. Your ex-spouse can also rollover distributions from an IRA to defer taxes.