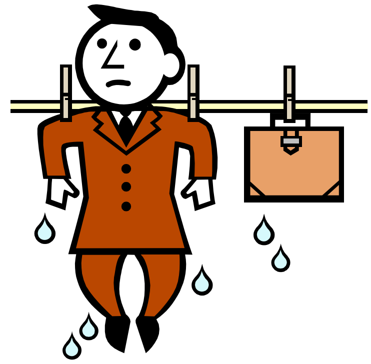
Tax implications of divorce



Divorce not only upsets your personal life, but without a little knowledge and some careful planning, it can upset you tax life as well.

Tax-free transfers:

State laws define how assets are to be divided between divorcing spouses, and the Internal Revenue Code allows for tax-free transfer of most of them.

The spouse that receives the asset takes over the existing basis and holding period for figuring a gain or loss in the event the item is sold. For example, one spouse may receive the family home, and the other spouse may receive the vacation property. The spouse with the family home would possibly qualify for an exclusion of the gain in the event of a sale, the spouse that receives the vacation property might be faced with a taxable capital gain when the property is sold. Each property has its own unique tax consequence.

Transfers of qualified retirement accounts:

To transfer a retirement account to your ex-spouse, special QDRO (qualified domestic relations order) language needs to be a part of your divorce decree. The QDRO causes your ex to be responsible for taxes on any withdrawals, not you. Failure to include QDRO language would make the distribution taxable, most likely with a penalty, to you.

If you are the recipient of you ex-spouses retirement account set-up with a QDRO, you are the co-beneficiary and can roll over the money tax-free to your own IRA if the plan permits.

Transfers of IRA type accounts:

To make a tax-free transfer of your IRA type account, the transfer **must** be ordered by the divorce or separation agreement. Do not transfer IRA money before the decree is in effect, and do not neglect to include the wording ordering the transfer.

Support:

Support payments from one spouse to the other are deductible by the payor and taxable to the payee if they qualify as alimony. These payments must be:

- Required under the divorce decree
- In cash
- Required to end at the death of the recipient

Support payments for children are not deductible by the payor nor taxable to the recipient.

Dependency exemptions:

No matter what the divorce decree says, the IRS awards the dependency exemption to the parent with physical custody. The non-custodial parent, however, can claim the child with a waiver signed by the custodial parent.

Adjusting withholding:

Your tax situation after a divorce will be totally different. You may need to adjust your withholding at work.

Deducting legal fees:

A divorce is a personal issue, but in many cases, divorce negotiations include tax issues. If the Attorney can separate the tax issues from the personal issues, a misc. deduction is possible.