

Your Financial Guide to the Big D

Part 2 of 2

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According to the late Zsa Zsa Gabor, “You never really know a man until you have divorced him.” Some of my clients would add that you never really know how poor your ex-spouse is until you have been to court over child support or alimony! August’s article covered suggestions for navigating the financial maze of divorce and this month we focus on the tax effects of certain decisions.

Divorce is a complex process and causes pain to all concerned, but it is especially sad when children are involved. To add to the confusion, complicated rules affect the taxes you pay. One of the most common is child support and who gets the exemption. What is important for you to know?

Tax issues if you have children

- Child support is neither taxable to the recipient nor deductible by the payor. Be sure to keep written records of support paid (and received) in case there is a dispute.
- The child dependency exemption is automatically given to the custodial parent. The exemption can be transferred to the non-custodial parent as part of a divorce settlement and can be for one year or for several years. Note that regardless of the wording in the divorce settlement, Federal law governs. To comply, you must attach a signed Form 8332 (or a written waiver signed by the relinquishing parent) to your tax return.
- A partially refundable tax credit of \$1,000 is available for children under age 17 (2009), but phases out beginning at \$75,000 of adjusted gross income (“AGI”). This credit is available to whoever gets the dependency exemption. When a client and an ex are trading exemptions each year, I suggest my client schedules the exemption for the year the child is 16.
- Parents with more than one child may split their exemptions.
- The childcare (“daycare”) credit goes to the primary custodian parent.
- I always recommend that both spouses run the numbers to see who has the most tax savings. Usually, it is wiser for the party who benefits the most from the exemptions to claim all of them and consider compensating the other spouse. Be sure to include alimony in tax calculations.

Your filing status matters

- The custodial parent has the right to file as head of household and may be eligible for the Earned Income Credit as long as they provide over half of the support for the child.
- If you are separated on December 31 but not divorced, you have the option of filing a joint return or a MFS (Married Filing Separately) return. In rare cases, you may have the option of filing HOH (“Head of Household”), but be sure to check with your financial advisor to see if you qualify.
- Generally, your taxes will be lower if filing a joint return. But have you ever wondered why the IRS offers tax breaks to couples filing jointly? Consider that when signing a joint return, you are accepting responsibility for everything reported on the return and for any tax due. If you have doubts about what your spouse is reporting on his/her return, filing separately may be better.
- If you have filed a joint return with your spouse, the IRS will not allow you to amend to file separately. Obviously, this can be a very important decision if your relationship is contentious.
- If you and your spouse file separate returns and one of you itemizes deductions, the other spouse must itemize, too.
- Innocent Spouse Relief may be available in certain situations. See IRS Publication 971 or check with your financial advisor if you think you may qualify.

Handling divorce-related costs

Clients typically ask if the huge legal bills they have run up in the divorce are deductible. Unfortunately, the answer is generally “no.” If you itemize, however, you can write off certain costs pertaining to the production or collection of gross income, such as legal fees to get alimony. You may

also be able to deduct fees you pay to appraisers, actuaries, and accountants for services in determining your correct tax or in helping to get alimony. These fees are miscellaneous itemized deductions subject to the 2%-of-adjusted-gross-income limit.

Community Property states are “different”

If you and your spouse live in – or have lived in – a community property (“CP”) state, special rules apply. For example, in a CP state, deductions are generally divided equally between you and your spouse. The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. CP rules for assets owned while living there generally remain with you when you move to a non-CP state, so be sure to check with a qualified professional if these rules may apply to you.

A final piece of advice...

If you have a choice of sharing a toothbrush or an attorney with your divorcing spouse, I'd recommend you go with the toothbrush.

Emotions may rule temporarily, but the financial implications of divorce can last for the rest of your life. Take it slowly and get the best advice you can afford before you sign on any dotted lines. Best wishes during a difficult time and feel free to contact me if you have any questions about either of the articles in this series!

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