

Tax Tips for Divorce Planning: Key Considerations for a Smooth Financial Transition

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Divorce can be an emotionally and financially challenging process. Among the many complexities, navigating the tax implications of divorce is often overlooked but critically important. Understanding how your filing status, child-related deductions, support payments, and asset transfers impact your tax obligations can help you make informed decisions that protect your financial future.

1. Timing of Divorce & Filing Status

The timing of your divorce plays a significant role in your tax filing status. The IRS considers you married for filing purposes until you receive a final divorce decree or separate maintenance. This means your marital status on **December 31** determines whether you file as married or single for the entire tax year. We recommend reviewing with a tax professional to determine which filing status offers the most tax advantages based on your situation.

- **If you are divorced or legally separated by the end of the year**, you must file as Single or Head of Household (if you qualify) unless you have remarried.
- **If you are still legally married on December 31**, you have two filing options:
 - **Married Filing Jointly:** This often results in lower tax liability due to favorable tax brackets and potential access to valuable credits. However, both spouses are jointly and severally liable for any taxes owed, inaccuracies, or penalties.
 - **Married Filing Separately:** This keeps your tax responsibilities separate. It can be beneficial if you suspect inaccuracies or potential fraud in your spouse's tax filings. However, filing separately may disqualify you from certain tax credits. [\[1\]](#)

2. Child-Related Deductions & Exemptions

Ensure your divorce decree clearly outlines who claims the child and in which years to avoid future disputes or missed tax benefits.

- **Dependency Exemption:** The custodial parent (with whom the child resides for more than half the year) typically claims the child as a dependent. For 50/50 custody agreements, parents can alternate who claims the child or specify a consistent arrangement in the divorce settlement.
- **Child Tax Credit:** The parent who claims the child as a dependent can receive the Child Tax Credit, which offers up to \$2,000 per qualifying child (subject to income limits).

3. Child Support & Spousal Maintenance: Tax Treatment

Review these support payments with your tax and financial planner.

- **Child Support:** Payments are not tax-deductible for the payer, and the recipient does not report child support as taxable income.
- **Spousal Maintenance (Alimony):** For divorce agreements finalized in **2019 or later**, spousal maintenance payments are not tax-deductible by the payer and are not considered taxable income for the recipient.

4. Asset Transfers & Capital Gains Considerations

The division of marital assets has tax implications that can significantly impact your financial future.

- **Property Transfers:** When assets are transferred between spouses as part of a divorce settlement, there are generally no capital gains or losses recognized at the time of transfer. However, the asset's original cost basis carries over, which could lead to substantial capital gains tax liability when the asset is sold. Carefully review the cost basis of all transferred assets. Failing to account for future tax consequences could result in unexpected tax liabilities.
- **Primary Residence Sale:**
 - If you sell the marital home before the divorce and file jointly, you may exclude up to \$500,000 of profit from the capital gains tax, provided you've used it as your primary residence for at least two of the last five years.
 - If you sell the home post-divorce, you'll each qualify for the \$250,000 exclusion if filing separately.

5. Retirement Asset Division

Retirement accounts are another area where tax implications play a significant role. Transfers made pursuant to divorce are not taxable, but future withdrawals will be taxed according to the rules of the specific IRA type.

- **Employer Retirement Plans**, such as 401(k)s and 403(b)s, fall under the Employee Retirement Income Security Act (ERISA). Withdrawals from employer-sponsored retirement plans can be made and allocated to the non-employee spouse without an early withdrawal penalty if handled through a Qualified Domestic Relations Order (QDRO). Ensure the QDRO or settlement agreement is properly executed to avoid tax penalties. The receiving spouse can roll the funds into their retirement account to avoid immediate taxation.
- **Traditional & Roth IRAs** do not require a QDRO for division. Instead, they are split based on the divorce settlement terms.

6. Updating Your Financial Plan Post-Divorce

Divorce significantly impacts your financial plan, and re-evaluating your long-term financial goals and strategies are essential. Reviewing your financial plan when analyzing divorce settlement options is vital to ensure you make the best decisions to meet your long-term goals. At Evergreen, we help clients model different settlement options to understand their impact on retirement savings, tax liabilities, and overall financial stability. Contact our team today to learn how we can help you create a tax-efficient divorce strategy and secure your financial future.

[1] <https://www.irs.gov/individuals/filing-taxes-after-divorce-or-separation>

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