

Tax Implications of Divorce: Compliance

The legal process of divorce often brings about many difficult challenges and changes in the lives affected by the personal and family turmoil. It is understandable, then, that a person might fail to appreciate the changes to his or her tax reporting obligations. Nonetheless, at the appropriate time, every divorced taxpayer must focus on them, at least long enough to ensure compliance with income tax filing requirements, rules on retention of appropriate tax returns and supporting documents, and current withholdings adjustments. Let us explore the scintillating world of tax compliance for divorcees with a volunteer to be known as “Jane.”

Filing Status. The timing of Jane’s divorce (or separation) will affect her filing status for her income tax return. If a final decree of divorce or, in the case of separation, decree of separate maintenance, is issued by the end of the calendar year, then she must file as a “single” taxpayer. However, if she provides more than half of the costs of the household in which her child lives, she may qualify for the more favorable “head of household” filing status.

If a final decree of divorce or separate maintenance has not been issued by year-end, Jane is treated as though she is still married (even if separated from her spouse under a separation agreement or temporary decree). In this case, Jane may still file jointly with her spouse with the intent to reduce the overall income tax liability for the couple. However, this plan may put Jane at risk for any unpaid income tax obligations of her spouse (assume she is not protected under “innocent spouse relief” rules). Furthermore, they could not take an alimony deduction, if available, on the joint return. For additional information on innocent spouse relief and the alimony deduction, see our companion articles in the series entitled, “Tax Implications of Divorce.”

Tax Records. Jane must make certain to obtain copies of, or gain access to, all records or documents that may have an impact on her tax situation, such as previous joint returns filed with her spouse (along with supporting documentation). In addition, Jane should retain all records relating to the adjusted cost basis of jointly owned property or property transferred to her from her spouse during the divorce, since she will need them to establish her basis in the assets if she later sells them. Needless to say, Jane should also retain all documents relating to the divorce or separation itself for many possible reasons.

Income Tax Withholding Adjustments. The changes caused by Jane’s divorce will likely require her to adjust the amount of income tax withheld from her salary by her employer. Since the calculation of Jane’s withholdings on the existing Form W-4, Employee’s Withholding

Tax Implications of Divorce: Compliance (cont.)

Allowance Certificate, was based on Jane's marital status and the earnings of both spouses, she should submit a new Form W-4 with the revised information to her employer when her divorce or separation becomes final. Jane should also consider whether she will be receiving alimony payments (taxable) or making alimony payments (deductible) when completing her new Form W-4, since this information will alert the employer to adjustments necessary to withhold the correct amount of tax from her paycheck.

Notice of Name Change or New Address. If Jane will be changing her name in the context of the divorce proceedings, or even if she is only changing her address, Jane should file Form 8822 (Change of Address) with IRS so she (and not the former spouse) will receive all future notices and correspondence from the IRS promptly.

Deduction of Legal Fees. Finally, to the inevitable question on the lips of every newly divorced litigant: may I deduct legal fees incurred in the divorce from my taxes? Unfortunately, the law - and the IRS - views the divorce as a "personal" undertaking and, consequently, these legal fees are not deductible. However, as Jane may have discovered by now, some complex tax issues may arise during and following a divorce, and legal fees paid for tax advice on these matters are deductible as a miscellaneous itemized deduction (to the extent the total amount of miscellaneous deductions exceeds 2% of Jane's adjusted gross income).

WHAT IF EX-SPOUSE IS ORDERED TO PAY OR AGREES TO PAY JANE'S?

Notice - This information is not legal advice or counsel absent an extant attorney-client relationship with the recipient; this information does not create an attorney-client relationship. Seek legal counsel before taking any action on the matters referenced above..