Taxes and Financial Settlements in Divorce

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Many couples today already have financial issues – houses with mortgages higher than their market value, credit card debt or employment related. A divorce will only exacerbate these issues as the couple will need to support two households on the same income. To make matters worse, the current low tax rates and structures are only in force until 2012.

President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 into law on December 17, 2010. The law provides a two year extension of many of the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) or "Bush tax cuts" ("2001 tax cuts" in this article). On the surface, the new law merely extends the tax rules we have been using for the last several years. The reality, however, is very different and anyone dealing with the financial side of divorce needs to be aware of several of the finer details of the law to properly assist their clients.

THE 2010 STATUTE

First and foremost is the short term nature of the extension. When the 2001 tax cuts were first passed, the rules were changed for up to 10 years, depending on the specific area. At the end of 2010, the tax laws that were in place prior to 2001 would be reinstated, in full, without affirmative action by Congress and a signature from the President. The latest extension expires in less than two years. One cannot just assume that today's rules will continue indefinitely.

Second, the nature of the tax cuts are a political hot potato. When the 2001 tax cuts were first passed, we had a Republican President and Republicans controlled the House and the Senate. At the time, the Senate Republicans knew they could not get 60 votes to bring the measure to the floor for a vote. Instead, they needed to use a process called "reconciliation" to get an "up or down" vote and pass the legislation. This process allowed the bill to be passed, but by rule would have to expire in 10 years. When he ran for President in 2010, Senator Obama's campaign promise was to allow the tax cuts to expire for people with the highest income levels. Senator McCain's campaign promise was to make the tax cuts permanent. Bowing to political pressure and the state of the economy, President Obama and Senate Republicans agreed to a two year extension for all taxpayers, not just for those making less than $250,000.

ISSUES IN EVALUATING DIVORCE SETTLEMENTS

It is important to understand the history behind our current tax structure because it demonstrates that the future of these tax rules cannot be taken for granted.

Jeff Kostis is an independent Fee-Only financial planner and the President of JK Financial Planning with offices in Vernon Hills and Chicago, IL. As a Fee-Only planner, Jeff sells expert, objective advice, not insurance or financial products. Jeff's expertise is helping people prepare for, and get through, the multiple transitions in their lives that have significant financial impacts, including divorce. In addition to earning the CFP® (Certified Financial Planner) designation, Jeff is a CPA with a certification as a Personal Financial Specialist (PFS) by the AICPA. Most recently, he received the Certified Divorce Financial Analyst (CDFATM) designation. Jeff has been quoted in national publications such as The Wall Street Journal, the New York Times, Reader's Digest, Newsweek, Consumer Reports Money Adviser, Investment News and the Chicago Tribune. He is a member of the National Association of Personal Financial Advisors (NAPFA), the Garrett Planning Network and the Greater North Shore Estate and Financial Planning Council.