Navigating Divorce and Taxes: How to Anticipate the Changes and Keep Your Taxes Low

Divorce changes everything—even when it comes to tax planning. In addition to planning for a different future than you may have imagined, your financial situation is sure to shift in one way or another. Evaluating exactly what will change is where the expertise of a Certified Tax Planner comes in. Working with a trained professional will help ease the stress of outlining a different tax plan and make sure you are still set up to save as much money as possible.

Below are four key things to be aware of when it comes to divorce and taxes.

NEW FILING STATUS

A top question that taxpayers undergoing a divorce ask is, "*Do we have to file last year's return together since we stayed married the majority of the year?*" If you were officially divorced before the end of the year, then the answer is no. The IRS looks at the last day of the calendar year to determine whether a taxpayer's filing status is single or married. This means that even if you were married for 11.75 months out of the year, as long as you were divorced by or on December 31st, the IRS does not consider you married for that tax year.

One exception is if you and your spouse lived separately for the last 6 months of the year *and* have children. In this case, the custodial parent can file as head of household.

Keep in mind that a taxpayer's filing status determines their standard deduction and whether they are eligible to claim certain tax credits. Below are the standard deduction amounts for 2023:

Filing Status	**2023 Standard Deduction**
Married Filing Jointly	$27,700
Head of Household	$20,800
Single	$13,850

How might a change in filing status affect your available tax credits? One example is the student loan interest deduction. Over 45 million Americans have student loan debt. A taxpayer's modified adjusted gross income (MAGI) determines whether they can claim a loan-related deduction. A married couple filing jointly is eligible for the full $2,500 deduction if their MAGI is $144,999 or less. However, if spouse A makes $90,000 and spouse B makes $50,000, if the couple divorces then spouse A can no longer claim the deduction. This is because for single taxpayers the deduction starts phasing out once their MAGI reaches $70,000.

The situation becomes even more complex when children are part of the equation. If a divorced parent claims their child as a dependent and provides more than half of that child's support, that parent can file as head of household. This enables a taxpayer to deduct an extra $7,050 of their income (see the difference between the MAGI for a single taxpayer vs. head of household). In other cases, a taxpayer may be able to claim their child as a dependent, but their filing status will still be single. Changes in your filing status and dependents can shift the amount of your income that is taxable—which is why divorce can have such a big tax impact.

NEW TAX BRACKET

New tax brackets is another factor facing recently-divorced taxpayers. This often catches taxpayers by surprise, especially if they get divorced toward the end of the tax year. On a federal level, the U.S. has 7 different tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The income thresholds vary depending on a taxpayer's filing status.

To take one example, a single taxpayer in 2023 enters the 24% tax bracket once their taxable income reaches $95,375. However, taxpayers who are married filing jointly don't enter the 24% tax bracket until their taxable income reaches $190,750. In certain situations, single taxpayers can get hit harder at tax time.

Compare the two tables below, featuring the 2023 income thresholds:

Married Filing Jointly

MFJ Taxable Income	Income Tax Owed
Less than $22,000	10% of taxable income
$22,000 - $89,450	$2,200 + 12% of any taxable income over $22,000
$89,450 - $190,750	$10,924 + 22% of any taxable income over $89,450
$190,750 - $364,200	$32,580 + 24% of any taxable income over $190,750
$364,200 - $462,500	$74,208 + 32% of any taxable income over $364,200

$462,500 - $693,750	$105,664 + 35% of any taxable income over $462,500
$693,750 or more	$188,601.50 + 37% of any taxable income over $693,750

Single

Single Taxable Income	**Income Tax Owed**
Less than $11,00	10% of taxable income
$11,000 - $44,725	$1,100 + 12% of any taxable income over $11,000
$44,725 - $95,375	$5,147 + 22% of any taxable income over $44,725
$95,375 - $182,100	$16,290 + 24% of any taxable income over $95,375
$182,100 - $231,250	$37,104 + 32% of any taxable income over $182,100
$231,250 - $578,125	$52,832 + 35% of any taxable income over $231,250
$578,125 or more	$174,238.25 + 37% of any taxable income over $578,125

If a couple had a combined taxable income of $175,000 divorce but they get a divorce in 2023, then their individual tax brackets will be different. Together they were in the 22% tax bracket. If spouse C has a taxable income of $150,000 and spouse D has taxable income of $25,000, after their divorce spouse C goes up to the 24% tax bracket, while spouse D goes down to the 12% tax bracket.

Depending on their financial situation, Spouse C may want to adjust their withholding and estimated tax payments. More importantly, they will want to **sit down with a Certified Tax Planner** for a consultation on reconfiguring their tax plan for the years to come.

SPLITTING EVERYTHING 50/50

Taxpayers undergoing a divorce may be afraid that their spouse will be granted half of everything they earned during their marriage—but this is not always the case. For example, if the couple was working with a tax practitioner, that tax professional may find that there is now a conflict of interest between their recently-divorced clients. This can occur when a client will be "materially limited" by the practitioner's responsibilities to another client.

One example concerns estimated tax payments and capital loss carryforwards. Let's say a couple divorced in 2023 and had a capital loss of $20,000 from 2022. The loss was a result of spouse Q liquidating an investment account—because the account belonged to spouse Q, they are able to use the remaining loss on their tax return. The IRS allocates the loss to the spouse whose loss or deduction created it.

In the case of joint estimated tax payments, the IRS allows spouses to choose how to do the allocation. If they cannot agree, the IRS will allocate the payments based on their prorated share of their combined separate liabilities. So let's say spouse Q and spouse R made $24,000 in joint estimated tax payments for 2023, but they cannot agree on an allocation. If spouse Q owes $7,800 in taxes while spouse R owes $18,200 in taxes, then the IRS will allocate 70% of the payments to spouse R and the remaining 30% to spouse Q.

PROPERTY SETTLEMENTS

If property is transferred between spouses in a divorce, no gain or loss is recognized from a tax perspective. This applies to transfers that occur within one year of the marriage ending and to transfers that happen within six years if they are related to a decree of divorce, a written separation agreement, or similar court decree. This applies to many different types of property including:

- Real
- Personal
- Tangible
- Intangible
- Separate
- Community

One unique situation applies to qualified retirement plans—these benefits are typically safe from assignment and subject to an early withdrawal penalty. However, if the benefits are under a Qualified Domestic Relations Order (QDRO), a spouse, former spouse, or child can receive the benefits. With a QDRO, there is no early withdrawal penalty no matter the age of the beneficiary.

If the plan participant withdraws their retirement funds and then transfers them to their former spouse, the participant will have to pay taxes on that distribution, and it may also be subject to an early withdrawal penalty of 10% if the participant is not yet age 59 ½ or older.

CONCLUSION

Divorces are tricky to navigate without throwing unexpected tax consequences into the mix. Taxpayers who are going through a divorce are not likely focused on how the IRS treats the division of assets or whether they will have to adjust to a different tax bracket in upcoming tax years. Staying ahead of these changes is key to avoiding stress and formulating a new tax plan that works for you. For reliable support in navigating tax changes after a divorce, **make an appointment with a Certified Tax Planner.**