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White Paper

Divorce and Tax Filing Status Considerations

www.selectportfolio.com • Toll Free 800.445.9822 • Tel 949.975.7900 • Fax 949.900.8181

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Divorce and Tax Filing Status Considerations

What are filing status considerations?

If you're separated, considering a divorce, or are already divorced, you should be aware of the income tax ramifications of your divorce-related financial decisions. An important consideration should be the filing status you select for your federal income tax return. Your filing status is important because it determines (in part) the deductions and credits available to you, the amount of standard deduction that you may be entitled to, and your correct amount of tax. Depending on your situation, you may or may not have a choice regarding your filing status. Generally speaking, there are four filing statuses available to individuals who are divorced or are considering a divorce: single, married filing jointly, married filing separately, and head of household.

Thorough familiarity with the concept of filing status also involves some understanding of the innocent spouse rules, as well as divorce timing considerations.

For filing status purposes, when are you considered married or unmarried?

Your selection of a filing status for a given year will depend on your marital status as of the last day of your tax year (usually December 31).

Example(s): Assume you marry on December 31, 2008. You'll be considered married for all of 2008. Assume, instead, that you married on December 31, 2007 and divorce on December 31, 2008. You'd be considered married for all of 2007 but unmarried for all of 2008.

Divorce and separate maintenance decrees

You're considered unmarried for the entire year if, on the last day of your tax year (usually December 31), you're unmarried or legally separated from your spouse by a divorce or separate maintenance decree.

Caution: You're still considered married if you're separated under an interlocutory (not final) decree of divorce.

Caution: State law governs your legal status under a decree of separate maintenance. If the domestic relations laws of your state view you as married when a separate maintenance decree has been issued, you're considered married for purposes of filing federal income tax returns.

Caution: If you and your spouse obtain a divorce solely for the purpose of filing tax returns as unmarried individuals (with the intent to remarry) and you remarry the same individual the following tax year, you and your spouse will be treated as if you were never divorced.

Legal annulments

If you obtain a court decree of annulment (which holds that no valid marriage ever existed), you are considered unmarried for the tax year, provided that you have not remarried.

Tip: You must also file amended federal income tax returns (IRS Form 1040X) for all tax years affected by the annulment (if not barred by the statute of limitations). These returns should amend previously filed tax returns to single (or head of household, if you qualify) filing status. The statute of limitations generally doesn't expire until three years after your original return was filed.

Married persons living apart

Generally, if you live apart from your spouse but are not legally separated by a decree of divorce or separate maintenance, you're still considered married. However, if you meet all of the following requirements in addition to living apart from your spouse, you're considered unmarried for the entire year:

- You file a separate return (meaning that you don't file jointly),
- You paid more than half the cost of keeping up your home for the tax year,
- Your spouse did not live in your home during the last six months of the tax year, and
- Your home was, for more than half the year, the main home of your child, stepchild, or adopted child, whom you can claim as a dependent. This qualification is also met if your home was the main home of a foster child (whom you can claim as a dependent) for the entire year.

If you're considered unmarried under the above requirements, you probably will qualify for head of household status. For more information, see Head of Household.

Common law marriage

You're considered married if you live in a common law marriage that is recognized in the state where you now live or in the state where the common law marriage began. This is true even if you later moved to a state that does not recognize common law marriage.

What filing status should you select?

Taking into consideration that marital status is determined on the last day of the year (December 31), the following rules will apply:

Single

You must select single as your filing status if you were unmarried as of the last day of the tax year and were not eligible to claim head of household, or qualifying widow(er) status. For additional information, see Single.

Head of household

The head of household rules vary, depending on whether you're single (including divorced) or married.

If you're single:

- You must provide more than one-half of the costs of maintaining your household, and
- Your household must be the principal home of at least one dependent.

If you're married:

- You must file a separate return,
- You must maintain your home and have your child or stepchild living there for more than one-half of the tax year,
- You must claim the child as a dependent or waive that claim,
- You must furnish more than one-half of the cost of maintaining the household during the tax year, and
- Your spouse must not have lived in your household at any time during the last six months of the year.

Example(s): Assume John and Mary have an eight-year-old son, Jimmy. John and Mary obtain a divorce on January 1, 2006, whereby Mary is awarded custody of Jimmy. Jimmy lives with Mary throughout the year. When Mary files her 2006 tax return, she can file using head of household status.

Married filing jointly

You and your spouse (or former spouse) can choose to file a joint return if you were married to each other through the last day of the tax year, even if you were living apart. If living apart, you can't file as married if you are legally separated under a final decree of divorce or separate maintenance. You can, however, file as married if you are separated under an interlocutory (not final) decree of divorce.

Example(s): Assume John and Mary unofficially separate on February 1, 2008. Mary continues to reside in the family house, while John rents an apartment. On September 8, 2009, they divorce. When considering their 2008 tax situation, John and Mary can choose to file a married filing jointly return, since they remained married through December 31, 2008.

Married filing separately

You can select married filing separately as your filing status if you're married or if you're no longer married but had remained married to your former spouse up to and including the last day of the tax year (December 31).

Tip: If you and your spouse are unable to agree on which filing status to select, you should file separately. This is because your two separate returns can be amended later (if necessary) into a married filing jointly return. The opposite is not true, however; you can't subsequently amend a joint return into two separate returns.

What other filing status considerations should you keep in mind?

You should know how the timing of your divorce can impact your tax liability. Also, joint filers should be aware of the rules for innocent spouse relief.

Timing of divorce

If filing as married individuals (either jointly or separately) would be more beneficial than each of you filing as single, consider delaying a divorce until after the end of the tax year. Conversely, finalizing a divorce before the end of the tax year will allow both of you to file as unmarried individuals; that is, as single or, if one of you qualifies, as head of household.

Tip: If you desire to file as a single individual, also, consider obtaining a decree of separate maintenance before the end of the tax year. This will also allow you to file your tax return for the year as an unmarried individual.

Innocent spouse relief

If you file a joint return, each spouse is generally jointly and severally liable for 100 percent of the taxes due on the return (as well as for any penalties and interest assessed). Even after your divorce is finalized, you will be liable for any unpaid taxes attributable to prior years unless you qualify for relief as an innocent spouse. For more information, see Innocent Spouse Relief.

Tip: If you're going to file a joint return while in the process of a divorce or separation, consider utilizing an indemnification clause or an escrow arrangement as a way of protecting yourself from future liability. An indemnification clause is a clause within a divorce decree that states that one spouse agrees to reimburse the other for future tax liabilities. An escrow arrangement can be used to set aside funds for estimated future taxes that will be due as the result of a joint return.

Caution: The IRS doesn't care whether you have an indemnification clause or an escrow arrangement. The IRS can still collect any tax deficiency from either you or your former spouse.

Disclosures

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State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

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