

TAX CONSEQUENCES OF PROPERTY TRANSFERS IN DIVORCE

Although the United States Supreme Court has repeatedly approved the fashioning of divorce agreements in accordance with tax consequences, there is great disparity concerning the treatment of such consequences among State Courts. The majority Rule provides that tax consequences are not relevant unless “immediate and specific”.

In New Jersey, pursuant to the leading case law authority of *Orgler v. Orgler*, 273 N.J. Super. 342 (App. Div. 1989), a Court may consider such consequences in an equitable fashion. Accordingly, if a case is contested and distribution may result in substantial tax consequences, expert opinion is critical.

The 1984 Tax Reform Act introduced Section 1041, which provided for no gain or loss recognition in transfers of property between spouses. Subsection (c) included transfers incidental to a divorce proceeding. Significantly, this section does not eliminate gain or loss. Rather, they are deferred. The tax basis for the transferee is the adjusted tax basis of the transferor immediately before the transfer. The adjusted tax basis is generally defined as the original cost adjusted by capital improvements, depreciation or other considerations. With property titled in the name of the parties for a long period of time, determining the adjusted tax basis can become quite complex. For example, if either party previously engaged in a like-kind exchange when acquiring the property, or previously rolled over a principal residence pursuant to former Section 1034, the adjusted tax basis can become quite difficult to sort out. A failure to consider these issues can render perceived value null and void.

The Taxpayer Relief Act of August, 1997 provided some assistance. Old Section 1034 was eliminated and substantial amendments occurred with regard to Section 121. Presently, each taxpayer, regardless of age, can exclude up to \$250,000.00 of capital gain on the sale or exchange of his or her principal residence. There are various criteria of eligibility.

The essence of equitable distribution involves identifying, valuing and distributing assets and debts. It is therefore critical to be aware of any tax consequences related to the valuation. This is especially important when engaging in a process of offsetting assets against others. It is often advisable to have an experienced CPA review any proposed distribution for purposes of identifying relevant tax consequences.