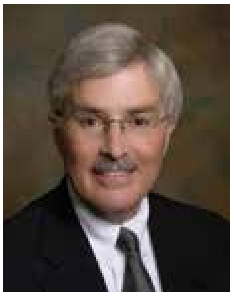

TAX TRENDS AND DEVELOPMENTS

Estimated Tax Payments and Taxes Withheld During Pendency of Divorce Proceedings

By Joseph W. Cunningham, JD, CPA

It is generally accepted that income earned during marriage–including, absent an agreement to the contrary, income earned during the pendency of divorce proceedings–is marital.

Thus, quarterly estimated income tax payments made and income taxes withheld on salary/wages during marriage consist of marital funds applied to current year federal and state income tax obligations.

This aspect of divorce often receives scant attention from family law attorneys. Particularly when one party is in a position to "manipulate" estimated tax payments and/or taxes withheld, counsel for the other party should not overlook the possibility his/her client could be meaningfully short-changed.

Example 1

H owns a company (ABC) that operates as an LLC. Thus, ABC's income "passes through" and, accordingly, is taxable to H on his personal income tax return. Thus, H makes quarterly estimated income tax payments to cover the taxes on the ABC pass-through income. Though both his and W's names and SSNs are on the estimated tax forms he files, the tax payments will be credited to his SSN.

They have reached a divorce settlement and entered a judgment on September 30, 2014. ABC's income and corresponding estimated income tax payments are as follows:

- H's ABC pass-through income for 2014 is projected at $120,000.
- His federal and state income tax on the $120,000 is projected at $36,000.
- H, with the divorce in mind, made estimated tax payments of $15,000 in each of April, June, and September 2014 – a total of $45,000.

Here's how this plays out:

	2014 Full Year	2014 Through 9/30/14
ABC income taxable to H	120,000	90,000
Income tax on ABC income	36,000	27,000
Paid in at 9/30/14 date of divorce	45,000	45,000
Tax overpayment	9,000	18,000

So, by "strategically" overpaying estimated taxes, H will receive 100% of the $18,000 excess payment as a credit on his separate 2014 income tax returns. Since the $18,000 was paid with marital funds, the result is a $9,000 windfall to him.

Example 2

W is a salaried executive at a company (XYZ) of which she owns 50%. Early in 2014, aware that her and H's divorce will be final later in the year, she arranges for a significant increase in her income tax withholdings. The divorce judgment is entered on September 30, 2014.

W's XYZ salary and income tax withholdings are as follows:

- Salary projected for the year - $150,000.
- Projected income tax on the $150,000 - $48,000.
- Salary through 9/30/14 - $112,500.
- Income tax on $112,500 - $36,000.
- W's deliberately inflated income tax withheld as of 9/30/14 - $50,000.

Outcome

	2014 Full Year	2014 Through 9/30/14
W's XYZ salary income	150,000	112,500
Income tax on XYZ income	48,000	36,000
Paid in at 9/30/14 date of divorce	50,000	50,000
Tax overpayment	2,000	14,000

Thus, by inflating her income tax withholdings, W will receive 100% of the resulting $14,000 excess payment on her separate 2014 income tax returns. Since the $14,000 was paid with marital funds, the result is a $7,000 windfall to her.

Observations

- It is advisable for divorce counsel to check on the status of year-to-date estimated tax payments and/or taxes withheld in relation to corresponding income as the date of divorce approaches. This is advisable even if there is no reason to suspect the other party might manipulate the tax payments/withholdings.
- If divorce occurs early in a calendar year, as is commonly arranged to accommodate a final joint return filing, then the focus should then be on proper division of a tax refund or payment due.
- It is somewhat more complicated to calculate "strategic" excess tax payments in the year of divorce if taxable temporary spousal support payments are made. However, if the opportunity to deliberately overpay to reap a windfall exists, the possibility that such has been done should not be overlooked.

About the Author

__Joe Cunningham__ has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy though his practice is statewide.