



TAX TRENDS AND DEVELOPMENTS

TIPS ON PROVIDING FOR JOINT TAX REFUNDS, OVERPAYMENTS, AND ESTIMATED TAXES IN A DIVORCE CONTEXT

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With the tax return filing season getting into high gear, the following are tax matters often overlooked in divorce settlements. Where applicable, simply providing a copy of this article to a client with the recommendation to consult with a tax advisor is a potentially valuable service.

Joint Tax Refunds

Address on Tax Return—Most divorce settlements provide for the division of a tax refund on the final joint return. The check will be sent to the address on the return and will be payable to both parties. Thus, delay in receipt of a refund may result if the principal residence is used on the return and the refund is sent after the marital home is sold and the effective “forwarding address” period has expired. If this is foreseeable, use another address on the return (e.g. in care of the CPA/tax preparer).

Notification and Documentation —It is advisable to provide that the party who receives the refund check must notify the other party, provide documentation of the refund, and make payment of the other party’s share within a specified time frame – e.g., one week.

Take Away—Consider potential logistical problems concerning receipt and division of a joint tax refund and make

appropriate arrangements, and provide for notification, documentation, and payment.

Joint Tax Overpayments Applied to Estimated Tax

Advantage of Applying an Overpayment—Many taxpayers apply for extensions rather than filing by April 15. And most with income not subject to withholding – LLC income; S Corporation income; investment income – must make estimated tax payments due April 15, June 15, September 15, and January 15 each year.

An overpayment from a prior year is deemed received by the IRS as of the April 15 initial due date even if the return is filed six months later at or near the October 15 extended due date. Thus, it is often advantageous to apply an overpayment to the succeeding year tax liability, especially if a taxpayer realizes late in the year when the return is filed that preceding estimated payments are insufficient to avoid the underpayment tax liability. This can be done with the entire overpayment, or just part of it with the balance refunded.

Parties Can Each Apply Part of Overpayment—Parties are free to agree on the application of an overpayment on a joint return to the next year’s tax. If the amount so applied is allocated 100% to the husband, nothing needs to be done

on either spouse's succeeding year tax return. However, if the overpayment is to be divided equally, husband will need to make an after-tax payment to wife to square things off.

If any of the overpayment is to be applied to wife's tax, she must enter husband's SSN in the appropriate space on page one of her Form 1040 followed by "DIV". If wife has remarried, she must enter ex-husband's SSN at the bottom of Form 1040 page one, again followed by "DIV".

Take Away—If either party relies on estimated tax payments and an overpayment is possible, make provisions in advance for potential advantageous use of the overpayment.

Estimated Taxes

New Requirement for Many—Many recipients of taxable spousal support provided in pre-2019 divorce settlements have never needed to make quarterly estimated tax payments. However, since no income tax is withheld on spousal support payments, estimated tax payments are generally necessary to avoid (1) a large April 15 payment and (2) corresponding underpayment of tax penalties. This applies to both federal and state income taxes.

The underpayment penalty may be avoided if the amount paid in – via wage withholding or estimated tax payments – exceeds the party's hypothetical prior year tax based solely on his or her individual income and deductions. This often applies in the first year of receipt of spousal support, but not generally to subsequent years.

Take Away—Attorneys should advise clients awarded taxable spousal support to contact his or her tax advisor regarding estimated tax payment requirements.

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.

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