



# Divorce Taxation: Community Property Laws and Property Settlements

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Course #3122A

Taxes

2 Credit Hours

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# DIVORCE TAXATION: COMMUNITY PROPERTY LAWS AND PROPERTY SETTLEMENTS

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This course covers how community property laws affect how assets will be divided and the tax issues associated with property settlements due to divorce.

## LEARNING ASSIGNMENTS AND OBJECTIVES

*As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.*

### SUBJECTS

#### **Community Property Tax Issues In Property Settlements**

Study the course materials from pages 1 to 53

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

#### **Objectives:**

- Recognize how community property laws affect how assets will be divided in community property states when a couple divorces.
- Recall the tax issues associated with property settlements due to divorce.

### NOTICE

This course is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional advice and assumes no liability whatsoever in connection with its use. Since laws are constantly changing, and are subject to differing interpretations, we urge you to do additional research and consult appropriate experts before relying on the information contained in this course to render professional advice.

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Program publication date 1/31/2020

## EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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# CHAPTER 1: COMMUNITY PROPERTY

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## Chapter Objective

### After completing this chapter, you should be able to:

- Recognize how community property laws affect how assets will be divided in community property states when a couple divorces.

## Note



This chapter addresses community property issues as they relate to marriages (including same-sex marriages) but does not cover registered domestic partnerships, which are not the same in many cases. The rules relating to same-sex marriages and registered domestic partnerships continue to evolve and change. Check your state's law for current rules.

## I. DISTINGUISHING COMMUNITY AND SEPARATE PROPERTY

### A. "COMMUNITY PROPERTY" DEFINED

Community property is a classification-based system that divides all marital assets into one of two categories: (1) community property; and (2) separate property. The general rule is that all property, real or personal, acquired by a married person during the marriage while domiciled in a community property state is community property. The term "property" refers to both real and personal property of all types, including stocks, bonds, jewelry and cash.

## Example



John and Mary were married in 2018. They live in Washington, a community property state. In 2019, the couple purchased a home in Washington. Both John and Mary work outside the home. John is a sales manager with an annual salary of \$100,000. Mary is a nurse with an annual salary of \$70,000. The home and the salaries of each spouse are community property.

#### 1. Importance of Distinction

The distinction between community and separate property is very important! If a couple domiciled in a community property state gets divorced, community property law determines how their assets will be divided. In general, each spouse is entitled to all of his or her separate property and one-half of the

community property. Since divorcing couples typically do not get along very well, they often argue over the correct characterization of the couple's assets.

In addition, community property laws are important because they affect how taxpayers figure their income on their federal income tax return if they are married, live in a community property state or country, and file separate returns. Married persons will usually pay less tax if they file a joint return. Sometimes, however, it can be advantageous to file separate returns. In such cases, each spouse must determine his or her community income and his or her separate income. Community property laws also affect an individual's basis in certain property and therefore affect tax liability.

## 2. Presumption of Community Property

The law in community property states generally creates a presumption that any property acquired during the course of a marriage is community property. This presumption places the burden of proof on the party challenging such a classification to come up with evidence to show that the property in question should be classified as separate property. Such evidence includes:

- Showing that the property was acquired by gift, devise, or bequest;
- Tracing the property to separate property assets; or
- Showing a clear agreement between the parties regarding the nature of the property.

### Example



Bill and Angie were married in 2007 and have their domicile in Texas, a community property state. In 2010, Angie's grandmother died and left her \$100,000 worth of stocks and bonds. Angie transferred the stocks and bonds into a brokerage account in her name only. In 2019, Bill and Angie decided to divorce. The value of the brokerage account had grown to be worth \$150,000. Because the portfolio was a bequest and because it was maintained as her separate property, the \$150,000 is Angie's separate property and Bill is not entitled to any of it. As an aside, if Angie elects to sell the assets to pay for her legal fees, her basis in the property will be its fair market value on the date she inherited it, or \$100,000.

## B. SEPARATE PROPERTY

Simply put, property that is not community property is separate property. This includes property acquired prior to marriage and not gifted to the community, inheritances received during the marriage (so long as they are not subsequently commingled) and certain insurance proceeds. A married person may, without the consent of the person's spouse, dispose of his or her separate property at will (although legal, it could result in marital discord). Remember that the laws in each community property state may be different. In most cases, separate property will include the following:

- All property owned by the person before marriage;

- All property acquired by the person after marriage by gift, bequest, devise, or descent; and
- The rents, issues, and profits of the property described above.

In addition, the earnings and accumulations of a spouse and the minor children living with, or in the custody of, the spouse while living separate and apart from the other spouse are the separate property of that spouse.

### 1. Determining Date of Separation

When a married couple in a community property state decides to separate, it is important to determine the exact date of separation. This date is necessary to determine what property is community and what property is separate. Property acquired by a spouse after separation but before a divorce is final is separate property.

The date of separation is typically when either one of the spouses makes a decision that he or she does not intend to resume the marriage, or, based upon his or her actions, such an intention can be presumed. Remember that determining the date of separation is crucial because all income after that date is the separate property of each spouse.

## Example



Doug and Holly were married in 2010 and remained happily married until 2019, at which time Holly discovered that Doug was having an extra-marital affair. While Doug was at work one day, Holly packed her bags and moved into an apartment across town. She subsequently filed for divorce and the divorce decree was eventually handed down nine months later. For purposes of determining what assets are community and what assets are separate property, the date Holly moved into an apartment will be considered the couple's date of separation. While Holly never said to Doug, "you are a dog and I am leaving you," her actions clearly showed her intent to end the marriage.

### 2. Presumed Gift

Where one party contributes a separate asset to the community, it is presumed to be a gift to the community and will not be reimbursed unless the person who made the gift can prove there was an agreement to the contrary.