

Angelina, Brad And Johnny Walk Into The Internal Revenue Service...

By Robert W. Wood

Johnny Depp and Amber Heard split not long ago. Now it is Brad Pitt and Angelina Jolie, and with two huge earners, theirs is bigger and messier. Besides, Depp and Heard had no children from their marriage. Brangelina have six, Maddox, 15, Pax, 12, Zahara, 11, Shiloh, 10, and 8-year-old twins Knox and Vivienne. For these and other reasons, tax issues are going to be more important to the high-powered former couple.

The 41-year-old Jolie filed for divorce from Pitt, 52, after an alleged altercation between Pitt and Maddox on their private plane. Pitt is accused of being "verbally abusive" and getting "physical" with Maddox. There is of course, lots of speculation. Jolie is seeking sole physical custody of their six children.

As it turns out, tax savvy Johnny Depp may be advising Angelina Jolie, who reportedly turned to Depp amid the divorce. According to reports, Pitt and Jolie had a prenuptial agreement. The prenup allegedly says that each will leave the marriage with the money he or she brought to the marriage. Any income earned as a couple — which should be considerable — would evidently be placed in trust for the children.

But that still could leave plenty of territory for disputes. Any time there's big money, there are big taxes, right? Not necessarily. Done right, a divorce can be surprisingly free of taxes, at least on the surface. But that surface calm can be deceptive, and make no mistake, the Internal Revenue Service likes to audit divorcing couples.

Often the split couple take inconsistent tax positions that can get one or both of them into trouble. For example, one person might not report spousal maintenance as income, saying it is a non-taxable property settlement or child support. Yet the other person might deduct it and call it alimony. One or both may be audited.

There are usually tax rules at work that can leave a non-tax savvy spouse paying considerably more in taxes later. A surprising number of tax flubs are committed even by professionals. Very slight differences in mechanics can yield huge tax differences for one or both spouses.

For example, property settlements are tax-free. If you divide property between spouses (or within limits, after marriage), Section 1041 of the tax code says there's no tax to either party. That sounds worry free. This tax-free rule means you can divvy up property however you want.

But when you divide property, you'd better consider future taxes and the tax basis of property in addition to its fair market value. For example, say the couple owns a home worth \$5 million, which they bought 30 years ago for \$200,000. Let's say the wife is awarded the house. A year later she sells it for \$5 million. She has a whopping gain of \$4.8 million, all of which is taxable to her!

The couple might have cash, securities and other assets to divide, some with a high basis, some with a low basis. It can be more equitable for each spouse to take a mix of high and low basis assets. But if you don't know about these rules, you might end up in a world of tax hurt.

Transfers between spouses during marriage are tax-free and transfers "incident to divorce" are too. A transfer is "incident to divorce" if it occurs within one year after the marriage ceases or is "related" to cessation of the marriage. Any transfer more than a year after the end of the marriage is open to scrutiny by the IRS.

However, if the divorce or separation instrument requires a transfer, it is probably tax-free. Any transfer more than six years after the end of the marriage is presumed outside Section 1041. This presumption can be rebutted with documentation.

Sometimes couples want to *avoid* tax-free transfers. If the parties want to sell assets to each other as part of their divorce, can they? Yes, but unless they do it very carefully the sale won't be effective for tax purposes.

Example: Harry and Wanda are divorcing in a community property state. They own a house worth \$1 million with a basis of \$200,000, and other assets they'll split equally. Under community property law, Harry already owns half the house. Harry "purchases" Wanda's interest in the house for \$500,000 by borrowing from a bank. Two years later Harry sells the house for \$1.1 million. Harry's tax basis is still \$200,000, so he's got a whopping \$900,000 gain.

You may be able to orchestrate a sale to avoid this kind of problem. However, you may need a third party to help. Besides, there are other tax rules that will usually need to be considered. Again, alimony or spousal maintenance—generally taxable to the recipient and deductible by the payor.

If Jolie does get sole physical custody, she may well ask Pitt to make hefty child support payments. Child support can be thought of as tax neutral. It is not taxable as income to the recipient spouse or child. That means Jolie will not have to count it as income. As a corollary, Pitt will not be able to deduct it.

Sometimes, taxes can sweeten a settlement. For example, when Johnny Depp settled his case with Amber Heard, it was for a one-time payment of \$7 million. Heard said she would give the entire \$7 million to charity. Heard was probably thinking that she would come out OK tax-wise if she received the \$7 million from Depp, and then handed the full \$7 million to charity.

However, there are annual limitations on charitable contributions — usually 50 percent of adjusted gross income. That means she might have to pay tax on \$3.5 million she had just given away! However, Depp said he would do the deal directly, bypassing Heard and handing the \$7 million straight to the two charities. His income is far bigger, presumably obviating the tax problems.

As for Pitt and Jolie, whatever happens, some of the tax issues are likely to depend on how the prenup is written. Even so, the parties often have some latitude in ascribing tax characteristics. No matter what the prenup says, though, it seems likely that there will be some kind of financial settlement, especially given Jolie's claim for sole physical custody. Stay tuned.



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