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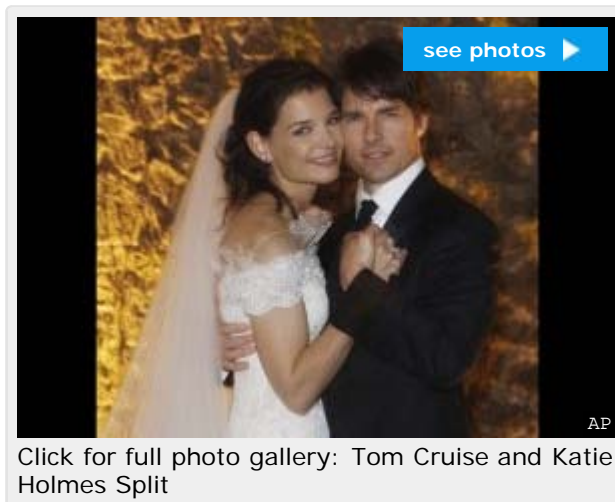
Katie Holmes Divorcing Tom Cruise, Scientology And Taxes

Katie Holmes' split from Tom Cruise may not involve much couch-jumping, but there's [sure to be](#) big money involved. Her prenup reportedly pays \$3M for each of the 5-years of marriage. But her take is likely to be far more than \$15M. Besides, any time there's money, there's taxes, right?

Not necessarily. Done right, a divorce can be surprisingly free of taxes at least on the surface. Yet there are usually tax rules at work that can make an untutored spouse end up paying lots more later.

By filing in New York (where Cruise may try to avoid taxes and residence), Holmes may already have shown her chops. (See [Katie Holmes May Have SCREWED Tom by Filing in NYC.](#)) But 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.

Property settlements are tax-free. If you divide property between spouses (or within limits, after marriage), [Section 1041](#) says there's no tax to either party. This tax-free rule means you can divvy up property



Click for full photo gallery: Tom Cruise and Katie Holmes Split

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.

TomKat bought their Beverly Hills home in 2007 for \$30.5M but it seems unlikely to be worth more today. Appreciation can be killer in divorce.

Example: Al and Betty are getting divorced and own a home worth \$5 million, which they bought 30 years ago for \$200,000. Betty is awarded the house. A year later Betty sells the house for \$5 million. She has a whopping gain of \$4.8 million, all of which is taxable to her! Al and Betty 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.

TomKat have only been married five years, but they still probably have some assets that have appreciated and that could trigger tax.

Transfers “incident to divorce” are covered too. 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's 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 you'll 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.

Under limited circumstances you can orchestrate a sale to avoid this. However, you may need a third party to help and a competent tax lawyer. Besides, there are also special tax rules on alimony or spousal maintenance—generally taxable to the recipient and deductible by the payor. See [How To Make Divorce Less Taxing](#).

What about when Cruise makes child support payments for Suri? They are not income to Suri or Katie and not tax deductible when paid by Cruise.

For more, see:

[Taxing Mr. and Mrs. Zuckerberg](#)

[IRS vs. Scientology: Here We Go Again](#)

[IRS Stirs The Kabbalah Pot](#)

[Kris Humphries v. Kim Kardashian: LaLa Land Lawsuit?](#)

[Top Tax Tips From Zuckerberg's Facebook Bonanza](#)

[Can IRS Add Penalties When You Rely On Professionals?](#)

[Watch Out Assigning Assets in Divorce](#)

[How To Make Divorce Less Taxing](#)

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