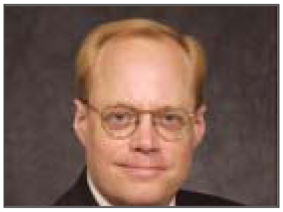
Forbes



Robert W. Wood

THE TAX LAWYER

TAXES | 3/25/2013

Tax Bite On Oil Billionaire Harold Hamm's Record $5B Divorce

Divorcing couple Harold and Sue Ann Hamm at the TIME 100 gala in 2012. (AP Photo/Evan Agostini).

If Harold Hamm's divorce could be world's most expensive at over $5B, it makes you wonder how much the IRS will get. After all, the tax man gets a piece of most transactions, often on both sides of the deal. With no prenup, second wife, lawyer and economist Sue Ann Hamm could get the biggest settlement in history, worth over $5 billion.

Oklahoma oil mogul Harold Hamm is worth $11.3 billion, mostly shares of oil giant Continental Resources. Sue Ann Hamm could receive half of his 68% stake, leaving the self-made oilman without control of the company he founded. And then there's taxes.

Despite the huge dollars, the IRS may not get much at first. If you're careful, it's possible to divorce and not face major tax bills immediately. The tax problems often occur down the road.

If you divide property between spouses during marriage (or within limits, even post-divorce), Section 1041 of the tax code says there's no tax to either party. Enacted in 1984, it reversed a Supreme Court case that ruled property divisions were taxable. Now you can divvy up property between spouses however you want (as long as both spouses are U.S. citizens).

But don't assume "tax-free" means there are not big tax consequences. When you divide property, don't only consider the fair market value of the property. You'd better consider the tax basis of the property you divide since that controls ***future*** taxes.

Example: Say the Hamms divvy up shares worth billions. Mr. Hamm founded Continental Resources in 1967, so his tax basis is likely tiny. If Mrs. Hamm ends up with billions of stock and sells it, she alone is taxable on a whopping gain. If the Hamms divide cash, securities, and houses, with a mixture of high and low bases, each spouse could take some of each. That way the future tax burden will be equalized. But that's tough if most of the value is in the shares and if they are highly appreciated.

Couldn't the parties sell assets to each other as part of their divorce? Yes, but that's tricky and carries risks. Selling assets can trigger gain or loss so unequal basis problems can be avoided. But unless you do it ***very*** carefully the sale won't be respected for tax purposes. The IRS can disagree and try to tax the later sale too. For more, see How To Make Divorce Less Taxing.

With all the debate over same sex marriage, it's worth noting that the tax-free division rule only applies to married couples. If there's no legal marriage there can be no divorce. That means there can be no tax-free division of property. When unmarried couples (same sex or otherwise) divide property it usually triggers taxes just like a sale.

Yet since the parties are just dividing assets, there's no cash to pay the taxes. That makes resolving palimony and cohabitation cases tough from a tax viewpoint. Some people in this quandary actually get married (where it's legally permitted). That way they can promptly get divorced to take advantage of Section 1041! See Biggest Injustice Of Denying Same-Sex Marriage? Tax-Free Divorce.

Robert W. Wood practices law with Wood LLP, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards &

Settlement Payments (4th Ed. 2009 with 2012 Supplement, Tax Institute), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.