



Separating or divorcing this year? Consider these tax issues before year end

Dissolving a marriage involves numerous financial and nonfinancial decisions, and tax considerations can easily fall by the wayside. But decisions made before your divorce is finalized can affect your current-year income tax liability and your tax situation in future years. Let's look at some of the most critical tax issues to consider as you work through a separation or divorce in 2026.

Income tax returns

Your marital status for income tax filing purposes generally is determined as of the last day of the tax year. If by December 31 you're divorced or legally separated under applicable state law, you generally are treated as unmarried for that year and will file as single or, if you have one or more qualifying children or dependents and otherwise meet the requirements, as head of household. Otherwise, you generally are treated as married and must decide whether to file jointly or separately.

If you have children, you'll need to determine who'll claim them on your tax returns in order to potentially claim related tax breaks besides just head-of-household status. Which parent claims a child can affect eligibility for certain tax benefits (based on factors such as the parent's income level), and special rules apply when parents are separated or when custody is shared. If you and your former spouse don't agree on who'll claim a child, federal tie-breaker rules may apply.

As year end approaches, consider how the timing of a final divorce decree or legal separation and decisions related to children could affect your 2026 filing status and tax liability. Also review whether your withholding is still appropriate.

Support payments

For alimony under separation or divorce agreements executed *after* December 31, 2018, there's no deduction for the former spouse making the payments. And the payments aren't included in the gross income of the former spouse receiving them. (The rules are generally different for alimony under agreements executed before 2019.)

No matter when a separation or divorce agreement is executed, child support payments aren't deductible by the paying spouse or taxable to the recipient spouse.

If you're negotiating support payments before year end, make sure to factor in how the payments will be treated for federal tax purposes and the impact on your overall tax situation.

Your home

In general, a taxpayer who sells a principal residence (main home) may be able to exclude up to \$250,000 of gain if the applicable ownership and use requirements are met. Generally, this means owning and using the home as a principal residence for at least two of the previous five years. A married couple filing jointly may be able to exclude up to \$500,000 of gain if they meet additional requirements for the joint exclusion.

If a couple separates or divorces and one spouse continues to live in the home and the other moves out, special rules may allow the spouse who moved out to count certain periods when the home was used as a principal residence by the other spouse under a separation or divorce agreement for purposes of the use test. The wording of the separation or divorce agreement can therefore be important when deciding whether to sell your home before year end, have one spouse retain it or transfer ownership as part of the divorce.

A transfer of the home between you and your spouse as part of a divorce generally won't be treated as a taxable sale. If the applicable ownership and use tests aren't met when the home is later sold, however, all or part of the gain may be taxable. A reduced exclusion may be available in certain circumstances, including some sales resulting from unforeseen circumstances.

Retirement benefits

Retirement benefits are often part of a divorce property settlement. A qualified domestic relations order (QDRO) can give one spouse rights to benefits under the other spouse's employer-sponsored qualified retirement plan, such as a 401(k).

Generally, the spouse who receives retirement plan benefits under a QDRO is taxed on those benefits rather than the spouse who earned them. But when taking withdrawals under the QDRO, the recipient spouse generally is exempt from the 10% early withdrawal penalty that usually applies to retirement plan distributions taken before age 59½.

If you're the receiving spouse and not yet subject to required minimum distributions (RMDs), which generally means you're under age 73, you may have a few options (with varying tax consequences):

- Take a lump-sum distribution of the full amount — this may produce a significant income spike in the year received that might push you into a higher tax bracket, trigger (or increase the impact of) various tax-break phaseouts or produce other negative tax consequences,
- Arrange to receive regular payments, thereby spreading out the taxes over multiple years and avoiding some of the possible negative tax consequences of a lump-sum payment,
- Roll over the assets into your own retirement plan or IRA — if the rollover requirements are met, you'll owe no current tax for the year of the rollover but RMDs generally will apply when you reach age 73 or 75, depending on your year of birth, or
- Leave the money where it is and wait until later to start taking distributions — again, RMDs generally will apply when you reach age 73 or 75.

Before finalizing the divorce agreement, consider the tax consequences of dividing retirement assets, including the timing and tax treatment of distributions. (Keep in mind that many of the tax consequences will be different if the retirement benefits are in a Roth account, where qualified distributions are tax-free.)

Business interests

Business interests require particular attention before a divorce settlement is finalized. For example, a transfer of S corporation stock can affect suspended losses and other tax attributes. Suspended losses generally carry over for the shareholder, but losses that remain suspended when the shareholder disposes of all of the stock generally are lost.

With partnership interests, the partner's tax basis, share of partnership liabilities and other tax attributes merit a close look. A transfer can affect the tax consequences for both the transferring and receiving spouse, so address these issues before completing the transaction.

Review the tax impact

From a tax perspective, separation and divorce can affect much more than your filing status. Before year end, review your withholding, estimated tax payments, ownership of major assets and any property or retirement accounts being transferred as part of the settlement. You'll also want to revisit your estate plan and beneficiary designations when the divorce is finalized. We can help you evaluate the tax consequences of your separation or divorce so you can make informed decisions before year end.