

Basis in Property is a Big Issue

In divorce cases, one question often overlooked by attorneys is, “What is the basis in the house (or stocks, other real estate, or other investments in the couple’s portfolio)?”. Consider the following case study:

Melanie and Mac have been married for 18 years. They have no children. They have decided everything except how to divide the remaining three assets equally. Those assets are a cottage in Hawaii worth \$350,000, an IRA worth \$150,000 and a savings account worth \$250,000. The \$250,000 in the savings account represents a loan taken against the cottage in Hawaii.

Mac proposed to Melanie that she take the cottage and sell it. She would net \$100,000. And she should also take the IRA worth \$150,000. He would take the savings account and they would each end up with \$250,000.

His proposal looked like this:

	Assets	Melanie	Mac
Cottage	\$350,000		
	<u>-250,000</u>		
	100,000	100,000	
IRA	150,000	150,000	
Savings	<u>250,000</u>		<u>\$250,000</u>
Total	\$500,000	\$250,000	\$250,000

Melanie talked this over with her attorney and they thought that this sounded fair. But, we find that the one question most overlooked by attorneys is, “What is the basis?”

What Melanie’s attorney should have asked Mac would have revealed that Mac had paid \$90,000 for the cottage 15 years earlier. It was sold at an incredible estate sale.

There was a \$260,000 capital gain, which created a tax of \$52,000 (capital gains tax at 15% plus state tax at 5%). Melanie received \$100,000 and had to pay out \$52,000, so she had only \$48,000 left.

Capital gain	\$260,000
Federal tax (15%)	39,000
State tax (5%)	<u>13,000</u>
Total capital gains tax	52,000



Great outcomes.
Done well.

	Assets	Melanie	Mac
Cottage	\$48,000	\$48,000	
IRA	100,000	100,000	
Savings	<u>250,000</u>		
Total		\$148,000	\$250,000

The after-tax value of the IRA is approximately \$100,000 (not counting penalties as she is not planning to liquidate it immediately), so Melanie ends up with \$148,000. The \$250,000 that Mac borrowed from the cabin and put in the savings account was his, tax-free and clear.

He ends up with \$250,000 and she ends up with \$148,000, because the question was not asked about the basis. Do you think Melanie's attorney had some liability here? Absolutely!

Be sure to investigate the basis in all assets. Then there will be no surprises.