**Transferring Primary Residence Pursuant to Divorce and the Tax Consequences**
**By Sheila May, CPA**

There are several options about how to handle the house as part of a divorce settlement. Each one involves details that require attention. Besides the issue of the sale of the house, costs such as upkeep, insurance, and repairs must be considered. Options include:

**1. Selling the Property**

The proceeds of the sale pay off the loan and the couple can use the amount leftover as liquid assets to be distributed according to the agreement. If the home sale results in a loss, the loss will have to be distributed as well. Of course, in addition to negotiating the terms of a divorce, both will now be finding new housing and dealing with the sale of a home.

The timing of the sale needs should be considered to get all available tax benefits. A married couple filing jointly may exclude up to $500,000 (an individual, $250,000) of capital gain upon the sale of their principal residence. To qualify, each spouse must have owned and lived in the residence for at least two of the previous five years from the sale date. If you acquire ownership of a home as part of a divorce settlement, you can count the time the place was owned by your former spouse as time you owned the home for purposes of passing the two-out-of-five-years test. For divorcing spouses who fail to meet the two-year-residency requirement, the IRS does provide for a pro-rated exclusion.a husband or wife who moves out and gives the ex-husband or wife exclusive use of the house under a divorce decree, can still qualify for the exclusion as if he or she continued to live there. Further, even if you are compelled to sell the house in less than two years from the date of purchase because of an unforeseen divorce, each spouse can claim a percentage of the $250,000 exclusion.

**2. Interspousal Transfer Grant Deed or Quitclaim Deed**

Both cannot release your mortgage debt obligations on the home. An interspousal transfer grant is a transfer of property that changes community property into separate property. An Interspousal Transfer Grant Deed is not subject to a transfer tax and does not come with a required reappraisal.

A quitclaim deed transfers interest in a property from one person to another. If proper precautions are not taken, the home could be reassessed resulting in higher taxes. When property is transferred from one spouse to another as part of a divorce settlement, the original tax basis is transferred to the spouse receiving the property. The capital gains tax on the property when it is subsequently sold is calculated using the original basis.

**3. Refinancing**

Refinancing the loan allows the new mortgage to be changed to one spouse. When you refinance a mortgage, however, you have to deduct the points over the life of the loan. Also, in the year you pay off the loan—because you sell the house or refinance again—you get to deduct all the points not yet deducted. Other closing costs, such as appraisal fees and processing fees, generally are not deductible.

**4. Assuming the Mortgage Fees**

A mortgage assumption transaction can be significantly less complicated than those for refinancing, but not all mortgages are assumable and not all mortgage holders are keen on assumption. The lender may charge a fee which cannot be added to your basis or deducted on your tax return.

**5. One spouse can buy out the other**

When one spouse is buying the marital property from the other, the selling spouse must make sure that all prior mortgages are paid off and that the new financing obligates only the buying spouse. The cost of writing a new title for the house adds to its basis. However, if you buy or "trade" your share of the home from your spouse you will only be able to claim your own $250,000 capital gains exemption in any future sale. Your tax basis generally will be the same as your basis as a couple at the time of the divorce.