

# ABA Proposals Could Aid Divorcing Spouses

THE PRACTITIONER | MITCHELL A. JACOBS

**U**nder existing law, pursuant to Internal Revenue Code 1034, a taxpayer may defer or "roll over" the gain on a sale of his or her principal residence if the property sold is used by the taxpayer as his or her principal residence at the time of sale, and the "new residence" is purchased within the period from two years before the sale to two years after the sale of the old residence.

The family residence frequently is sold during separation or subsequent to divorce. In most cases, however, one of the spouses will vacate the family residence before its sale. As a result of the move by the spouse before sale and during the separation, the family residence is not the spouse's principal residence at the time of sale, and I.R.C. 1034 cannot be applied to the spouse who vacated the residence.

There was legislation pending in Congress, H.R. 2775, which would have allowed the application of I.R.C. 1034 to divorcing spouses who have left the family residence, provided the sale takes place within two years of the separation from their spouse. Had this legislation become law, it would have provided relief to many divorcing homeowners; however, it would not have assisted those divorcing homeowners who, contrary to their wishes, are forced to leave their family residence for a period in excess of two years before their residence is sold. This bill is awaiting action in the Ways and Means Committee, having been vetoed recently by President Bush as part of the Economic Recovery Act. Very often the divorcing spouses do not have complete control over this period, because divorce proceedings may take more than two years, or such financial reasons as the market not allowing them to sell their house as quickly as they may like.

Pursuant to *In Re Marriage of Duke*, 84 Cal.3d 361 (1992), the court may order the sale of the family residence deferred for a period, which often exceeds two years, and allow the custodial parent to remain in the home for the benefit of the minor children.

The requirement that the old residence be the taxpayer's principal residence at the time of sale, under existing I.R.C. 1034, often prevents the ability to roll over to one or both spouses who are divorced or separated, particularly when there are minor children.

There are various reasons a separated spouse may move out of the family resi-

**FAMILY LAW:** Under the ABA's recommendations, divorcing individuals who wish to sell a residence would be placed on equal footing with those whose realization is not encumbered by the personal considerations common in the divorce arena.

dence. Sometimes it is voluntary to alleviate the stress or avoid confrontation from the other spouse, and other times it may be involuntary because the court has ordered that person out pursuant to a residence exclusion order or "kick out" order. Regardless of which reason the spouse leaves the residence, it is unlikely under present law that the family residence will be considered that spouse's principal residence at the time of sale.

Within the dissolution context, when one spouse abandons the family residence, that residence is no longer his or her principal residence, even when he or she intends to return. See *Young v. Commissioner*, 49 T.C. Memorandum 1002 (CCH1985). It is interesting to note that such a result is contrary to the general policy underlining the non-recognition rules of Section 1034, and this result inappropriately punishes those divorcing spouses whose decision to postpone the realization of the gain from their residence is very often not motivated by financial conditions and certainly not by tax avoidance.

The American Bar Association Section of Taxation Committee on Domestic Relations has recommended that the family residence constitute the principal residence under I.R.C. 1034 if either of two rules is met.

**F**irst, under a general rule, (i) if the family residence is sold pursuant to a divorce or separation instrument within a period beginning at the time of separation and ending two years after a decree of dissolution. (ii) The out spouse uses the family residence as his or her principal residence at the time of separation and (iii) the out spouse or the in spouse continues to use the residence as his or her principal residence from the time of separation.

Then, until two years after the divorce, the family residence would be treated as the principal residence of the out spouse.

The recommendations also suggest that if the sale of the family residence is

delayed to permit a custodial spouse or ex-spouse to live with one or more minor children in the residence, then the residence is treated as a principal residence until the later of (i) the periods specified in the first rule above or (ii) six months after the date from which the child reaches the age of majority.

The recommendation also would permit an out spouse to acquire an interim residence and to roll over the gain on this residence as well as the gain from the sale of the family residence treated as a principal residence of the taxpayer under either of the foregoing rules, into a new principal residence.

Furthermore, the recommendations would postpone any basis reduction until the rollover period under Section 1034(a) has expired.

In conclusion, the new amendments that are awaiting action in the Ways and Means Committee would be a step in the right direction; however, they are not enough, and the recommendations of the ABA's Tax Section need to be implemented. They would extend the treatment of the family residence as the principal residence, to a period contemplated by a substantial number of various divorce situations.

The ABA recommendation also would postpone any adjustment to the basis until the completion of the rollover period under Section 1034(a) in order to treat equally those taxpayers who have not purchased an interim residence, or who may sell the interim residence whether before or after the sale of the family residence. The result would be that divorcing individuals would be placed on equal footing with others whose realization is not encumbered by those personal considerations that are common in the divorce arena and influence the timing of the sale of the family residence.

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