

How the TCJA Could Drive You to Divorce

by Stephanie Cumings

The repeal of the alimony deduction has created a possibly unintended incentive for couples contemplating divorce.

Because the repeal was delayed in the final version of the Tax Cuts and Jobs Act (P.L. 115-97), couples who want to take advantage of the deduction should hurry and finalize their divorce by the end of 2018. “Anyone who has an alimony case will be struggling this year to finish it up and get it finalized by the court,” Regina Snow Mandl, a family law attorney based in Boston, told Tax Analysts March 8. She said the rush to get a decree and lock in the deduction will likely put a strain on family law courts across the country.

Michael S. Goode and Ann Ralls Niewold of Stites & Harbison PLLC agreed that the looming end of the deduction could put pressure on some couples to finalize divorces, but noted that alimony is just one factor couples weigh in deciding whether to divorce.

The TCJA eliminated the deduction for alimony and separate maintenance payments. Consequently, alimony payments are no longer includable in the income of the recipient spouse. The original House proposal to repeal the deduction would have been effective at the beginning of 2018, but the final law delayed it until the beginning of 2019.

Hastening divorces may not have been what some lawmakers had in mind. The House Ways and Means Committee description of the provision said repealing the deduction would “eliminate what is effectively a ‘divorce subsidy’ under current law, in that a divorced couple can often achieve a better tax result for payments between them than a married couple can.”

Mandl said the deduction’s repeal is a massive change to her state’s divorce system, in which alimony is included in the equation because many of the state’s divorce laws are predicated on the deduction being available. Other states are likely facing similar issues, she said.

For example, Massachusetts’s Alimony Reform Act requires that the spouse paying general-term alimony pay between 30 and 35 percent of the difference between the spouses’

incomes. Mandl said these figures were based in part on the availability of the federal deduction. She added that the courts will have to consider if the figures are fair given that the alimony payments won’t be deductible by the payer or taxable to the payee, resulting in a possible windfall for the spouse receiving alimony as well as a hardship for the spouse making the alimony payments. To adjust the percentages, Massachusetts law requires judges to make findings of fact to explain why they’re deviating from the law.

The deduction’s repeal caught many practitioners by surprise in part because it’s been around for decades, Mandl said. She found the changes affecting divorce in the tax law to be so extensive that she wrote an article dubbing them the “New Federal Divorce Law.” Mandl wrote that the economic calculus of a divorce will also be greatly affected by the repeal of the personal exemption, the increase in the child care tax credit, changes to section 529 plans, and the repeal of the deduction for interest on home equity loans.

Modification Risks

The grandfather clause that protects pre-2019 alimony deductions raises questions about what happens to the deduction when divorce decrees are modified, as well as the impact on premarital and post-marital agreements. The deduction repeal applies to any “divorce or separation instrument” executed after December 31, 2018. In addition to post-2018 decrees, it applies to instruments “modified after [December 31, 2018] if the modification expressly provides that the amendments made by this section apply to such modification.”

Mandl said couples who want to modify their agreements or judgments that are grandfathered — and who agree that the alimony deduction should be preserved — will likely be able to keep it. But if they disagree about the deduction, a judge may have to decide its fate, she said. Even if couples agree that they want to keep the deduction, Mandl said the judge still must approve that decision, and so there’s inherently a risk that the deduction could be lost upon modification.

The law defines a “divorce or separation instrument,” and Goode and Niewold said that a literal reading of the definition doesn’t seem to encompass premarital and post-marital agreements, so they wouldn’t benefit from grandfathering. They said that the change in the economics regarding these agreements is of great concern, and that it will likely create legal issues because the bargained-for economics between the parties will have also changed. Mandl said there’s a reasonableness requirement applied when courts look at enforcing premarital and post-marital agreements, adding that some may no longer be considered reasonable if the alimony deduction was an important factor in their terms.

The repeal of the alimony deduction led to section 682 on the income tax treatment of alimony trusts being repealed. Catherine Hughes, attorney-adviser, Treasury Office of Tax Legislative Counsel, said in February that Treasury and the IRS may issue guidance on the treatment of existing alimony trusts in the future. ■