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Expert Analysis

The New Tax Code's Impact on Divorce: A Mediator's Perspective

The most sweeping federal tax code overhaul in decades, the Tax Cuts and Jobs Act of 2017 (TCJA), was signed into law on Dec. 22, 2017. New provisions in the law affect both businesses and individuals. Many of these changes will have a direct impact on the practice of family law, specifically in the area of divorce. Generally, the provisions in the TCJA took effect on Jan. 1, 2018, but the most significant change in the law with respect to divorcing parties, however, has not yet taken effect. This dramatic change will apply to situations where alimony/spousal maintenance is paid pursuant to divorce or separation agreements executed after Dec. 31, 2018. Thus, it is critical that parties contemplating divorce, family law practitioners counseling them, and mediators assisting them understand the changing law and can intelligently weigh the risks and benefits of negotiating and filing for divorce in 2018, while the deductibility and taxability of alimony remains in effect. Likewise, while the change in the alimony deduction won't affect existing alimony orders, other changes in the TCJA may

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render previously negotiated divorce settlements and pre-nuptial agreements inequitable or no longer reflective of the parties' intentions. It may be advantageous to make modifications to these prior agreements in 2018, while the alimony deduction remains available, and in light of the TCJA changes.

Alimony Provisions

In instances where there is a sufficient disparity in the income of divorcing spouses, alimony/spousal maintenance may be a part of a negotiated settlement or ordered by a court. Previously, Section 215 of the tax code allowed alimony payments to be deductible by the payor-spouse. Section 11051 of the TCJA, entitled "Repeal of Deduction for Alimony Payments," eliminates Section 215. Under the TCJA, alimony payments are no longer deductible by the payor-spouse and are not included in income to the recipient-spouse. Such payments

have been removed from the definition of gross income found in Section 61 of the tax code. Income used for alimony/spousal maintenance will be taxed at the (higher) rate of the payor-spouse and not the previous (lower) rate of the recipient-spouse. Alimony payments will be treated the same as child sup-

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port and will not be deductible by the payor nor taxable to the payee.

The new alimony provisions under the TCJA apply to: (1) any divorce or separation instrument (as defined in Section 71 (b) (2) of the Internal Revenue Code of 1986...) executed after Dec. 31, 2018, and (2) any divorce or separation instrument (as so defined) executed on or before such date and modified after such date if the modification expressly

provides that the amendments made by this section apply to such modification.

In New York, there are written guidelines and factors that govern the distribution of marital assets in a divorce. Courts, counsel and mediators will, *inter alia*, consider investments and savings, relative incomes, the parties' lifestyle, educational background, past employment, the ability to work, health, length of the marriage, and the number and age of any children. Historically, in setting child support and determining whether alimony/spousal maintenance is warranted, judges, counsel and mediators focus on the pre-tax income of each spouse.

Deductions

When alimony payment deductions are permitted, the (higher tax bracket) payor-spouse receives a deduction that is higher than the amount the recipient (lower tax bracket) spouse has to pay on the alimony as taxed income. This after-tax net savings is, thus, available to the payor for the support of the payee. Additional monies from an alimony deduction will soon no longer be available. Likewise, the change in alimony deductibility and taxability will soon change the total net income of the parties under child support guidelines. Clearly, courts, counsel and mediators will then have to look to the after-tax income of each spouse to determine the appropriate amount of any alimony/spousal support and child support payments.

The change in the treatment of alimony will, no doubt, impact future divorce negotiations and settlements and the way spousal and child support needs are analyzed. Commentators have argued about whether the repeal of the alimony deduction in the TCJA

will favor the payor (typically the higher income husband) or the recipient (typically the lower income wife). Commentators point to the fact that recipients will no longer be taxed as evidence of the change benefitting women. Some fear that because payor-husbands will lose the deduction, they will ultimately be ordered to pay less. Of course, such concerns presume that parties won't act collaboratively to obtain and share the best net tax outcome for their families. Nonetheless, a review of the numerous changes contained in the TCJA suggests that its net effect will not be much different.

With the elimination of the alimony deduction, the IRS will tax the higher-earning spouse at the higher rate. Additionally, the IRS will no longer face administrative and tax loss problems resulting from alimony deductions taken on the payee's return but not reported as income on the recipient's return. Theorists will debate whether the alimony deduction functions as a tax payer subsidy benefitting divorcing couples or whether its repeal constitutes a divorce tax.

Substantial changes and benefits in the TCJA will blunt the effect of the change in the tax treatment of alimony. The most significant TCJA change is the lowering of tax rates for individuals and the adjustment of bracket amounts. This should provide most higher-earning spouses with more income to meet the needs of their supported spouses and children. Additionally, the standard deduction and the child tax credit have been nearly doubled; the list of qualified expenses for Section 529 education plans has been increased; and estate and gift tax exemptions have been substantially expanded. Another significant change under the TCJA is the

tax treatment of pass-through income from a business. Taxing this income at individual tax rates less a significant deduction will dramatically reduce the tax rate on this income and provide greater income for spousal and child support.

Conclusion

Now is the perfect time to review with a tax planner how numerous changes in the tax code will specifically impact 2018 and future returns and effect previously negotiated and anticipated divorce settlements as well as pre-nuptial agreements. With the assistance of a mediator and counsel, parties can modify portions of or entire prior agreements that no longer equitably reflect their intentions or best interests. Similarly, parties contemplating divorce may determine that it is beneficial to negotiate and file for divorce in 2018. Both can act while the tax deductibility of alimony and the enhanced changes are simultaneously in effect, only in 2018. Working with a mediator will provide an efficient, time saving, less costly, and less stressful confidential process in which to resolve these issues.

