

Understanding the Tax Treatment of Alimony

Learn about this and other important divorce considerations

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Key points

- Under today's current tax law, alimony payments are not treated as taxable income to the recipient, and cannot be deductible by the payer
- This applies to divorce instruments finalized on or after January 1, 2019
- The federal tax treatment of alimony was made permanent, absent any future legislative change





The 2017 Tax Cuts and Jobs Act represented the most significant overhaul of federal tax law in over 30 years. The tax law changes were sweeping in their reach, and divorce situations were not immune from their influence.

Prior to the enactment of the current tax law, spousal support payments that qualified as alimony were characterized as taxable income to the recipient and deductible by the payer. Under today's law, alimony payments made pursuant to a divorce instrument finalized (or modified) on or after January 1, 2019 are not treated as taxable income to the recipient, and alimony payments cannot be deductible by the payer. The tax treatment of alimony for agreements completed by December 31, 2018 was not changed by this legislation and payments that qualify as alimony are taxable income to the payee and tax deductible to the payer.

Unlike many of the changes in the individual income tax provisions of the federal tax law which are set to sunset at the end of 2025, the change in federal income tax treatment of alimony is permanent, absent future legislative change.

In addition to potentially changing the manner in which property settlement agreements are reached by divorcing spouses and their advisors, the net effect of this change in the tax law is that the de facto shifting of tax brackets (i.e., lower income taxes paid) no longer occurs. Beginning with divorces finalized (or modified) on or after January 1, 2019, the presumed higher tax-bracket spouse lost an often significant deduction, and can no longer shift a portion of his or her income tax burden to the presumed lower tax-bracket spouse.

Additional considerations

Other changes in the federal tax law also have an impact in divorce matters and may be worth considering, either prospectively or if former spouses decide to revisit a divorce agreement already in place:

• **Personal exemption has been eliminated:**

Before 2018, the exemption per child could only be taken by one parent. Today, personal exemptions for dependents are eliminated, until the provision sunsets after 2025. If this tax benefit was part of a settlement agreement negotiated before the benefit was eliminated, impacted taxpayers should consider the effect of its elimination.

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Divorces finalized on or after January 1, 2019:

Alimony payments not treated as taxable income to recipient and not deductible by payer

Divorces finalized by December 31, 2018:

Grandfathered under rules of prior law

Divorcing spouses and their advisors should be aware how the tax treatment of alimony under today's laws will impact divorce settlements moving forward.

- **Limitations on/elimination of deductions (such as professional advisor fees):**

The professional fees paid during the course of a divorce can be substantial. The inability to deduct such fees should be factored in by divorcing parties as they negotiate the property settlement agreement.

- **Decreased corporate tax rates:**

The lowering of federal income tax rates applicable to corporations could result in higher business valuations for closely held businesses, which are often a component of property settlement agreements. The higher the percentage of a divorcing couple's net worth that is represented by less liquid and harder to split business interests, the greater the strain on the more liquid assets.

- **Education expenses:**

The current law allows for distributions from 529 Plans to be used for qualified education expenses, not only for college, but also for tuition expenses for elementary, middle, and high school (up to \$10,000 per year). Divorce instruments often address responsibility for maintaining assets for payment of education expenses. Agreements already in effect may need to be re-examined to be sure that both parents are aligned as to funding and purposes of, and distributions from, these established education accounts.

- **Child tax credit:**

The annual child tax credit, which is typically available to the custodial parent, increased from \$1,000 to \$2,000. Existing divorce instruments should be reviewed to determine if this merits consideration of possible modification.

Divorcing spouses and their advisors should be aware how the current law impacts divorce settlements. Further, taxpayers should review with their advisors any existing pre-nuptial, post-nuptial, and property settlement agreements, or other marital or divorce agreements, to consider whether possible modification under today's federal tax system is desirable and appropriate.

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