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Divorce: What Tax Reform Means for Alimony Deduction

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Are any of your clients planning to get divorced? They should get the paperwork started sooner rather than later if they intend to preserve the tax deduction for alimony payments under the new Tax Cuts and Jobs Act (TCJA). In fact, in some states like California, the proceedings should be wrapped up before the end of this month.

Previously, divorced taxpayers were entitled to write of the full cost of qualified alimony payments above the line on a federal return. On the flip side, alimony recipients had to report the payments as taxable income. But child support payments, as well as most other payments pursuant to a divorce, were neither tax-deductible nor taxable.

To qualify as deductible alimony, the following requirements must be met:

- The spouses don't file a joint return with each other.
- The payment is in cash (including checks or money orders).
- The payment is to or for a spouse or a former spouse made under a divorce or separation instrument.

- The divorce or separation instrument doesn't designate the payment as not being alimony.

- The spouses aren't members of the same household when the payment is made. (This requirement applies only if the spouses are legally separated under a decree of divorce or of separate maintenance.)

- There's no liability to make the payment (in cash or property) after the death of the recipient spouse.

- The payment isn't treated as child support or a property settlement.

But these requirements will soon become a moot point. Under the TCJA, alimony will no longer be deductible by payors and, accordingly, such payments won't be taxable to recipients. The changes generally apply to divorce and separation agreements executed after December 31, 2018 and prior agreements modified on January 1, 2019 and thereafter. What's more, unlike most other TCJA provisions for individual taxpayers that are effective only for 2018 through 2025, these new rules are a permanent part of the tax code.

Why the sense of urgency? Some states, including California, require a six-month "waiting period" after papers are finalized for a divorce to take effect. Therefore, if a client is counting on alimony deductions, the agreement should be signed before the end of June. In New Jersey, the waiting period for a no-fault divorce is six months if both spouses consent to it and 18 months if they don't. Check into the applicable state laws for any clients in this situation.

Also, the tax law changes will likely shift the dynamics at the bargaining table. If a payor won't be able to deduct alimony in the future, he or she may not be willing to pay as much. One possibility is to arrange for a lump-sum payment before 2019 instead of providing the usual ongoing payments. As a result, the full amount will be deductible.

Similarly, someone who expects to be on the receiving end may use stalling tactics to avoid being taxed on alimony income. If the recipient is forced to give in, some concessions may have to be made by the payor.

Finally, ex-spouses might revisit prior agreements to reflect the new law changes. For instance, if you signed a prenuptial agreement in the past based on the assumption that any alimony would be deductible, you may seek to have the agreement modified.

Undoubtedly, the new rules will inspire many taxpayers and their professional advisors – including accountants and attorneys — to review existing documents.

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