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LEARNING SERIES PART IV: HOW WILL TAX REFORM IMPACT YOU?

If You Are Heading For a Divorce, Things Could Get Messier

According to the American Psychological Association, roughly 40% of marriages will end in divorce, which equates to more than 800,000 divorces per year in the U.S. One of the most significant changes to come from President Trump's Tax Reform is the elimination of alimony as a tax deduction, beginning in 2019. For individuals who are required to pay alimony, this could have a substantial impact given the large tax savings from being able to deduct alimony payments. **In Part IV of our Learning Series, we explain what these changes mean and discuss how it may impact your marital decisions.**

Determining spousal alimony has always been challenging for divorce lawyers, mediators and spouses that no longer wish to remain legally married. In some divorce cases, one ex-spouse may become legally obligated to make payments to the other ex-spouse, if they meet certain requirements. One thing has always been clear: before the Tax Cuts and Jobs Act (TCJA), alimony payments that met the requirements of the tax-law could be written off above-the-line on the payer's federal income tax return. That means the payer does not have to itemize to benefit from the deduction. On the flip side, recipients of alimony payments had to report those payments as income on their tax return.

How Was Alimony Treated Prior to the Tax Reform?

Alimony is the transfer of money from one spouse (who is typically in a higher tax bracket) to their former spouse (that is presumably in a lower bracket). The current formula is based on the paying spouse's income tax bracket. For example, if he/she typically pays 39.6% marginal rate in taxes, then he/she can deduct the amount they pay in alimony and save 39.6% of that amount on their tax bill. To illustrate, if the higher earner makes $1 million per year and pays $100,000 a year in spousal support, then he/she would only pay taxes at a rate of39.6% on their remaining $900,000 in income. For the receiving ex-spouse, if he/she in a 20% tax bracket, then he/she would pay $20,000 in taxes on the $100,000 received in alimony.

What's Changing & When Do These Changes Go Into Effect?

It's business as usual for alimony payments made under pre-2019 divorce agreements.
However, for payments made after 12/31/18, things will change dramatically.

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LEARNING SERIES CONTINUED: HOW WILL TAX REFORM IMPACT YOU?

The new tax code will eliminate the tax deduction on alimony beginning in 2019, which will likely create an urgent need to finalize in divorces 2018, followed by a total re-evaluation of how divorce cases are handled in years to come. Offering tax relief to alimony payers often helps negotiations between spouses seeking a divorce progress faster and smoother. As a result of these changes, divorces may become messier.

What's My Best Course of Action?

The tax implications for both parties in a divorce are often a very significant matter. To summarize, there's no change in the federal income tax treatment of divorce-related payments that are required by divorce agreements executed before 2019. However, for these payments to qualify as deductible alimony, payers must still satisfy a number of specific tax-law requirements.

For those who are contemplating a divorce or in the middle of a divorce, your best course of action depends on if you pay or receive alimony. If you will be required to pay alimony and deducting alimony results in a significant tax savings, the new Tax Code gives you a major incentive to get your divorce agreement official by 12/31/18.

On the other hand, if you will be the recipient of payments, you have may have an incentive to put off finalizing your agreement until next year, because the payments would be tax-free to you. However, taking steps to make sure that the divorce is final by the end of 2018, thereby retaining the deduction, could result – for some - a larger pool of funds available to split between the divorcing spouses.

A few of our clients receiving alimony from their ex-spouse have asked us if they should modify their existing alimony agreements to adhere to the new tax code — so they don't have to pay taxes on it anymore. Unfortunately, it is still unclear if existing alimony agreements modified in 2019 would be subject to the new rules but Restivo Monacelli is monitoring announcements closely.

The fact of the matter is if you are divorced or in the process of getting a divorce, you should contact a qualified Tax Accountant sooner rather than later to get the best tax results for your own specific situation. Waiting too long could turn out to be an expensive mistake tax-wise, and you may have to live with that expensive mistake for years.

If you would like to discuss how the Tax Reform changes will effect your particular situation, and any strategic planning moves you should consider, please give us a call at 401-273-7600.