

ALIMONY Then and Now

Adjusting to the Tax Changes for 2019

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Any divorce or separation instrument executed after December 31, 2018 will be treated very differently from a tax perspective than it would have been if it were finalized on or before that date. The main difference is that alimony will no longer be tax deductible to the payor and will no longer be included as income for the person receiving the payments. This change will make after-divorce cash flow planning even more important.

What is alimony?

Alimony is defined in the Internal Revenue Code (Section 71) as “payments made in cash...under a divorce separation instrument.” The code defines the separation instrument as a decree of divorce, a separate maintenance agreement, a written separation agreement, or a decree that requires one spouse to support the other spouse. For the payments to qualify as maintenance, the payments end with the death of the payee spouse (the spouse that is receiving the payments). Additionally, the payor (the spouse making the payments) and

payee spouse are not members of the same household. For the payor, alimony payments are currently tax deductible, and for the payee, alimony payments need to be included in income. IRS code section 71 as it is in 2018 came in with the Tax Reform Act of 1986. Even in the Internal Revenue Code of 1954, section 71 was very similar to the code on 2018. The main difference for the 1954 law is terminology; it states that the wife, when separated from her husband, must include support payments in her gross income.

How Alimony Works Now

Let’s look at an example:

Jack and Diane sign their separation agreement on January 1, 2017. Jack pays Diane \$12,000 every month. Under the agreement, \$2,000 is designated as child support. Diane has no other income in the year. In this situation, \$10,000 each month, or the total amount of cash payments minus the child support, are considered

alimony (a.k.a. spousal support). Therefore, while Diane will claim \$120,000 as alimony received on her tax return, Jack can deduct the alimony payments on his tax return.

Let's look at the tax forms for 2017 (filed in April of 2018) in more detail:

On line 31-a of his tax return, Jack reported the amount of cash alimony payments: \$120,000. On line 31-b, Jack reports Diane's social security number. One of the most important things to keep in mind is that child support can never be deducted by the payor or included in the recipient's taxable income, only alimony—and that is changing soon for many people starting in 2019.

On line 11 of Diane's tax return, she reports alimony received. In the instructions for line 11, it states that the person receiving the alimony payments needs to report their social security number to the person making the payments. This is how Jack knows what to put on his line 31-b.

In addition, this is how the Revenue Service knows how to match the payments. The instructions then refer to IRS publication 504, which is titled "Divorced or Separated Individuals." This publication provides a lot of important information and examples. Any amount Diane reports on line 11 will increase her total taxable income.

If you are wondering how this will work for 2018, it will likely be very similar. Based on released drafts, the 2018 IRS 1040 will be the shortest that many of us have seen. Along with that form, there are several additional schedules which are also still in draft form. Therefore, it is possible by the time we are filing form 1040 in the spring of 2019 for tax year 2018, things may have changed.

Under the current published draft forms: Jack will still report alimony paid on line 31-a, and he will put Diane's social security number on line 31-b, but he will also find that line on Schedule 1 of form 1040 in 2018. Diane will report the alimony received on Schedule 1 line 11. That amount will flow to the main form 1040 onto line 6 labeled Total Income, which is taxable income for Diane.

This reporting and income shifting of alimony payments has been going on since the 1950s, and it created a benefit to people going through the life transition of divorce. Most often, the person making the payments will earn more money than the person receiving the payments. This is because in many States, one of the first of multiple factors that need to be considered to calculate alimony (or spousal support) is the need for and ability to make these payments.

Let's look at the overall 2018 tax implications (Table 1) of these payments to both Jack and Diane, and their overall tax liability. We are assuming that Jack's filing

status will be single, while Diane's filing status will be head of household. The following table greatly simplifies this topic and only considers the alimony payments. We are assuming that Diane's only income was the received alimony. We are assuming that Jack made \$280,000. We are ignoring a lot of other factors, like standard deductions and so forth, to focus on the benefit that still exists for 2018, but which will go away in the near future.

TABLE 1

Filing Status	Head of Household		JACK & DIANE
	JACK	DIANE	
Tax Rate	35%	\$ 80,000	
	32%	\$ 40,000	
	22%	\$ 54,602	
	12%	\$ 51,799	
	10%	\$ 13,599	
Amount of Tax	\$ 40,800 Tax Benefit	\$ 19,588 Tax Burden	\$ 21,212 Net Benefit

This benefit of more than \$1,750 per month will go away for separation agreements signed after December 31st, 2018. This benefit helped separating couples who are faced with the fact that running two households is much more expensive than one household. Therefore, we will now take a more detailed look into what some of the perils will be from 2019 onward.

The New Normal for 2019

Along with many other changes, the Tax Cut and Jobs Act of 2017 (TCJA) has brought about a shift in negotiating alimony (a.k.a. spousal support). In many jurisdictions, either presumptive or guideline alimony statutes have been adopted over the years, and with the tax law changes these statutes will require amendment to compensate for the changes in taxation of maintenance.

In divorce settlement negotiations, now that alimony will no longer be tax deductible, calculating an appropriate amount of maintenance carries along with it new complexities. This is because under the old law, the alimony tax deduction allowed us to carve out fairly significant tax savings by shifting the income from the higher wage earner's tax bracket to the lower wage earner's. When dividing one household into two financially, this tax savings gave divorcing clients a chance to meet their monthly reasonable needs. This is because the taxes

saved due to the deduction and from shifting income from the higher wage earner to the lower were kept in the family “bank” to make ends meet for both parties post-divorce.

Now that maintenance is not tax deductible, no longer can we use *gross income* in the calculation of maintenance; will need to calculate, as realistically as is possible, *net, after-tax income* available to the parties, as this is the true picture of disposable income. Remember, too, that many times the clients’ tax filing status will change at divorce time from married filing jointly to single or head of household.

The tax bands as well as the marginal tax rates are higher for single taxpayers than for those who are married filing jointly. Also of note, the head of household (HOH) tax filing status no longer affords the tax break it once did, as shown by the Table 2 below:

Summing Up

In summary, let’s take a look at an example of the difference in cash flow (or disposable) income comparing the 2017 laws to the 2018. (See Table 4)

With the upcoming changes, the need for more detailed financial planning quickly becomes obvious. The separating couples’ combined after-tax cash available for living expenses will be greatly reduced. Therefore, maximizing benefits like the child tax credit will become vital.

Clearly, understanding and maximizing tax filing status might also help couples, if they are able to negotiate their agreement with the tax code in mind. Even if they work together, divorcing couples will have less money available. Working together, they may be able to minimize the quickly approaching reduction of income.

TABLE 2

2018 TAX BRACKETS FOR HOH			
Income	Income	Rate	Amount
\$—	13,600	10%	1,360
13,600	51,800	12%	4,584
51,800	82,500	22%	6,754
82,500	157,500	24%	18,000
157,500	200,000	32%	13,600
200,000	500,000	35%	105,000
500,000		37%	

2018 TAX BRACKETS FOR SINGLE			
Income	Income	Rate	Amount
\$—	9,525	10%	953
9,525	38,700	12%	3,501
38,700	82,500	22%	9,636
82,500	157,500	24%	18,000
157,500	200,000	32%	13,600
200,000	500,000	35%	105,000
500,000		37%	

In 2018 the HOH and SGL marginal brackets are the same at 24%. In 2017 the HOH and SGL marginal brackets were not the same until the 35% bracket.

On the positive side, those of us who work in the area of divorce no longer need to worry about tax-affecting alimony buy-outs, the alimony recapture rule, or handling “phantom alimony” in calculating the income available for child and spousal support.

Many of our tax planning tools have been taken away, but the child tax credit is even more valuable under the new law. It is now \$2,000 per qualifying child. Income phase-out levels have been greatly expanded, meaning that more of the higher wage earners can take advantage of it. So, make sure the child tax credit is on the agenda for divorce settlement negotiations! (See Table 3)

In my view, as the alimony changes outlined in the new law are implemented, clients need to utilize financial professionals (CPA, CFP, CDFIA®) to assist with maintenance negotiations, as this tax law change not only impacts them at the time of divorce from a cash flow perspective, but also has a significant impact on their financial futures.



TABLE 3

	CHILD TAX CREDIT	
	2017	2018
	\$ 1,000	\$ 2,000
	INCOME UNITS	
	2017	2018
MFJ	\$ 110,000	\$ 400,000
Single	\$ 75,000	\$ 200,000
HOH	\$ 75,000	\$ 200,000

TABLE 4

COMPARISON OF 2018 AND 2019 TAX LAW CHANGES RELATING TO DISPOSABLE INCOME FOR THE HIGHER INCOME EARNER & LOWER INCOME EARNER

	2019 NON- TAXABLE	2018 TAXABLE
Higher Income Earner		
Maintenance/Month	\$ 10,617	\$ 10,617
Child Support/Month	\$ 581	\$ 581

Disposable Income Calculation		
Total Income before C/S and Alimony	\$ 29,167	\$ 29,167
MINUS Child Support	— \$ 581	— \$ 581
MINUS Maintenance	— \$ 10,617	— \$ 10,617
MINUS Taxes (Income and Payroll)	— \$ 10,022	— \$ 5,743

Tax Impact of Spousal Support	0	< \$ 4,279>
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Net Disposable Income Per Month	\$ 7,947	\$ 12,226
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Net Disposable Income Per Year (Higher Income Earner)	\$ 95,364 38% of the after-tax cash	\$146,712 54% of the after-tax cash
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As compared to the Lower Income Earner	\$158,124 62% of the after-tax cash	\$ 29,167 54% of the after-tax cash
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	2019 NON- TAXABLE	2018 TAXABLE
Lower Income Earner		
Maintenance/Month	\$ 10,617	\$ 10,617
Child Support/Month	\$ 581	\$ 581

Disposable Income Calculation		
Total Income before C/S and Alimony	\$ 1,750	\$ 1,750
PLUS Child Support	+ \$ 581	+ \$ 581
PLUS Maintenance	+ \$ 10,617	+ \$ 10,617
MINUS Taxes (Income and Payroll)	< \$ 229>	\$ 2,487

Tax Impact of Spousal Support	0	< \$ 2,716>
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Net Disposable Income Per Month	\$ 13,177	\$ 10,461
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Net Disposable Income Per Year (Lower Income Earner)	\$158,124 62% of the after-tax cash	\$125,532 46% of the after-tax cash
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As compared to the Higher Income Earner	\$ 95,364 38% of the after-tax cash	\$146,712 54% of the after-tax cash
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Deb has been involved in the financial services industry in an advisory capacity for over 20 years. She received her designation as a Chartered Financial Consultant (ChFC) from the American College in Bryn Mawr, Pennsylvania. Deb is the founding member of the Divorce Resource Centre of Colorado, Inc. She is well known for her work in the area of divorce financial planning and analysis, as well as her pioneering work in the area of Collaborative Divorce. She is also a settlement consultant and works in divorce among special needs families.



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