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THE IMPACTS OF THE

TRUMP TAX LAW ON ALIMONY

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Still puzzled about how the Trump tax cuts will affect you and your family? You are not alone. The changes arising out of the Tax Cuts and Jobs Act (TCJA) of 2017 impact virtually every taxpaying American. For family law disputes involving children or alimony, some changes took effect in 2018 and arguably the most significant difference for family law starts in 2019.

The full text of the new law can be found at
<http://bit.ly/HLGTaxAlimony>



What is the most significant impact of the Trump tax law on families? **Alimony!**

Across the nearly 900,000 divorces in the US each year, the biggest battle zone, by far, is alimony: one side needs it, and the other side does not want to pay it. One person earns the income, and the other person wants some of it. The parties have created a joint marital lifestyle that neither will likely be able to enjoy post-divorce. Some view alimony as a means to an end, and some view alimony as a way to get even.

Beginning in 2019, alimony is no longer deductible under federal law. For decades, the spouse that paid alimony, or the payor spouse, had the right to deduct the amount of alimony paid from income for tax purposes. Every dollar was deductible. There were no phaseouts. No matter how much you earned, you were able to deduct alimony from your income. The impact of the new tax law on the litigation of a divorce case was huge.

Every conversation about alimony is touchy. It is easy to blend emotions and feelings into a discussion about paying and receiving alimony. When the conversation pivoted from the righteousness of each parties' view of alimony to the cold hard facts that alimony could be written off, a switch would sometimes flip, and the conversation moved from right and fair to business.

Typically, the payor spouse was in a higher income tax bracket than the recipient spouse. So, when alimony was paid, the recipient received a bigger check and the payor enjoyed a big write-off. The government essentially subsidized the difference. For simple math, if someone paid \$100,000 per year in alimony, while in the 30% tax bracket, to someone who was in the 20% tax bracket, the alimony cost the payor \$70,000 per year and the recipient enjoyed a net of \$80,000 per year. The government and the taxpayers paid the difference.

The change in the law, effective for 2019, eliminates the subsidy. For 2019 and going forward, alimony will be paid from taxed dollars and received as net dollars. In other words, the recipient pays no tax on received alimony, and the payor enjoys no write-off on paid alimony. What if alimony is already in place and needs to be changed in 2019 or beyond? Future modifications of alimony awards entered before December 31, 2018 will be honored as alimony under the old law. Your modified court Order must reflect recognition of the applicable law just in case the IRS takes a close look. In the modified Order, repeat the language in your original Order with regard to the applicable law. Repeat that the alimony terminates upon the death of either party or the remarriage of the recipient and repeat the clear intention of the parties to treat the alimony as deductible and taxable. The IRS is looking for ways to gather revenue to pay for some of the Trump tax cuts and careless alimony Orders may very well be a target of eager agents, and they are indeed a target of eager IRS robots that scan every tax return.

How does all of this affect **my case?**



There are no interpretive Revenue Rulings or Tax Court opinions to rely upon. Every divorce litigant, lawyer, mediator, accountant, and judge will work with limited information for 2019. Old "rules of thumb" are out the window. You can protect your interests by really understanding your budget so when it is time to present your budget to the other lawyer, a mediator, or even a judge, no one is left to guess. You can also engage professionals to calculate your net, after-tax income utilizing reasonable scenarios, produced by agreement with the other side of your litigation or in concert with your lawyer, to take away a lot of guesswork.

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What about writing off alimony on a **state income tax return?**

The federal law change has nothing to do with state law. As of this writing, alimony is still deductible and taxable under New Jersey state law.

How does the new law's Child Tax Credit **impact family law?**

Under the new law, children age 16 and younger are worth a tax credit of \$2,000 per year. This doubles the previous credit. The child must be under your care and under your roof for at least one-half of the year, you must provide the child with at least half of his or her support, and the child must be claimed on your federal income tax return as a dependent. The credit phases out at \$200,000 in adjusted gross income for a single person and \$400,000 in adjusted gross income for a married couple. If you have older children, no need to despair.

For children 17 and older who meet the other criteria, a new credit of up to \$500 is available. This credit also phases out based on the adjusted gross incomes mentioned above.

Income is income, **right?**

Wrong. A significant change to the tax law affects business owners who receive income from an S Corporation, LLC, or report income on Schedule C. This income is treated differently than regular W-2 income. The best illustration is a real example.

Spouse A earns \$200,000 working for a large corporation. Assuming an effective tax rate of 25% means that Spouse A has \$150,000 in net income.

Spouse B earns \$200,000 working for an LLC that she owns. Again, let's assume an effective tax rate of 25%. Spouse B's \$200,000 in income is subject to a 20% deduction for income tax calculations. Hence, \$200,000 is only \$160,000 for income tax purposes. \$160,000 in income times a 25% effective tax rate equals \$40,000 in tax. \$200,000 less \$40,000 in tax means a net of \$160,000.

Under this hypothetical, the small business owner, or Spouse B, pays \$10,000 less in tax than Spouse A.

What if the changes to the tax code significantly change the circumstances of the **parties paying and receiving alimony?**

Alimony can be modified based upon the terms of the Judgment of Divorce, the parties' agreement, and by significant changes in circumstances. Changes to the tax law can significantly impact either party's income. If that is the case, you may have grounds to seek a modification of alimony. Be careful here, as courts do not invite you to return to court based upon headlines. Make sure the tax law changes specifically affect you.

What Tax Changes Might Affect Alimony... **How About our SALT Deduction?**

SALT is an acronym for state and local tax. Think state income tax and local property tax. If you itemize your taxes, you will write off your SALT. If you live in a big income tax state and pay hefty property tax, the loss of the SALT deduction can be significant. In a family case, if you are hanging on to the family home and it is strapped to a large property tax bill, this tax change affects you significantly. For example, you pay \$50,000 per year in New Jersey state income tax and \$50,000 per year in property tax... substantial numbers by most standards. Under the prior law, you would have \$100,000 in SALT. You would itemize and, assuming a 30% effective tax rate, your \$100,000 in state and local tax would cost you about \$70,000... \$30,000 would come back to you in tax relief. Under the Trump tax law, only 10% is deductible. Hence, at the same 30% effective tax rate, you have a \$3,000 write-off instead of a \$30,000

“Changes to the tax law can significantly impact either party's income”

write-off. Your \$100,000 in state and local taxes costs you \$97,000 instead of \$70,000 – that is \$27,000 that needs to be found in your budget. That will certainly impact most alimony paying and receiving families.

So, what are the **shortcuts now?**

Unfortunately, it will take a bit of time before practitioners get a handle on Revenue Rulings, Tax Court decisions, the treatment of alimony, income derived from different sources, and child tax credits on people in the family law process. The hypotheticals set forth above are just that - hypotheticals. Use them or extrapolate from them at your own peril.

I am not a tax accountant but let me give a plug to tax accountants. Anyone earning a six-figure income and facing potentially \$10,000 or more in annual alimony would be well-served to run scenarios that calculate the actual taxable income of both spouses before committing to a certain level of alimony. Old “rules of thumb” followed by judges, mediators, and lawyers may fail under the new law. ★



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