

Tax Reform and Divorce

By Marilyn Kapaun and Courtney Bain September 7, 2018

Whether you are heading down the aisle or on the road to divorce, the new tax law could affect you in a dramatic way.

Alimony

Beginning on January 1, 2019, alimony is no longer taxable or deductible which effectively eliminates alimony payments as a negotiation tool. However, divorces finalized prior to 2019 will be subject to the former tax law. Therefore, if you are planning to get divorced and expect to pay alimony, your best option is to finalize by the end of the year in order to keep the deduction. However, if you expect to receive alimony payments, you may want to hold off until the new year as you will no longer have to include it in income.

This provision impacts couples with vastly different amounts of income the most. In addition, this portion of the Tax Cuts and Jobs Act (“TCJA”) is part of the permanent tax code unlike many provisions which extend only through 2025. For those with an existing alimony agreement, you will continue receiving the same tax treatment.

Exemptions

Tax reform eliminated the dependency exemption. However, the child tax credit was doubled from \$1,000 to \$2,000. This credit is only available if children are claimed as dependents and \$1,400 of this is refundable at the end of the year for children under the age of 17. The income phase-outs were also increased to \$200,000 adjusted gross income for individuals and \$400,000 adjusted gross income for joint filers which allows a larger number of taxpayers to take advantage of the credit.

If we revert back to the current tax law once this provision expires in 2025, those of you divorcing with younger children will still be eligible for a dependency exemption. For example, a four-year-old child will be age eleven in 2025. Under current law, this deduction is automatically allocated to the custodial parent but this can be altered by agreement. Thus, if you have young children, you may consider adding a sentence to your agreement that allocates the exemption to you if the tax law provides for an exemption.

Under the TCJA, a 529 distribution up to \$10,000 per student is permitted for tuition at elementary or secondary schools. Previously, these distributions were only allowed for college.

Business valuations

You may also want to delay the divorce if you or your spouse owns a business because the new tax law

could raise its value. For example, under the qualified business income (“QBI”) deduction, some pass-through business owners can deduct up to 20% of their taxable income. It should be noted that several businesses are excluded from the definition of “qualified businesses” including services in the fields of accounting, health, law, actuarial science, performing arts, consulting, athletics, financial services, and brokerage services. Architectural and engineering firms are exempted and are classified as qualified businesses meaning they are eligible for the 20% deduction.

Prenuptial agreements

If your prenuptial agreement has a provision for deductible alimony, it may not be enforced given the change in alimony treatment. Reach out to a family law attorney to discuss potential impacts on your agreement before the end of the year.