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How Tax Reform Could Radically Change Divorce

By Malcom S. Taub, Next Avenue Contributor Nov. 9, 2017

A proposed dramatic change to the tax rules of divorce in the House Republicans' tax reform bill (the Tax Cuts and Jobs Act) would undoubtedly create additional burdens to couples getting divorced if it becomes law.

The bill would eliminate the tax deduction for alimony and make alimony income tax-free to the recipient for divorce decrees executed after December 31, 2017; it wouldn't affect existing divorces. It's unclear whether the Senate Republicans' tax reform bill, due to be released today, will include a similar provision.

The Current Tax Law for Alimony and Divorce

Under current law, ex-spouses who pay alimony can deduct the expense from their federal income taxes; ex-spouses receiving alimony payments have to claim the money as taxable income. (The bill's alimony provision is projected to raise about $8 billion in tax revenue over 10 years.)

The bottom line: The elimination of the tax deductibility of alimony means, in most cases, the government will no longer help support the spouse receiving the income, usually the former wife and the couple's children.

Tax Brackets and Divorcing Couples

Currently, in most cases, after a divorce, the spouse paying the alimony is in a considerable higher tax bracket than spouse receiving the money. The difference between these tax brackets provides a benefit to the spouse paying the alimony and an even greater benefit to the one receiving it. Essentially, the spouse receiving alimony is getting considerably more in actual dollars than the spouse paying it.

Here's an example: Say a spouse is required to pay $10,000 a month as alimony (or spousal maintenance) and is in the 50% tax bracket, including state and local taxes, and the spouse receiving the alimony is in the 30 to 35% tax bracket. A payment of $10,000 per month in alimony would result in a net payment of $5,000 a month for the spouse paying it. The spouse receiving the alimony might owe only $3,000 in tax on the money. Since the person getting the alimony would receive a net payment of $7,000 per month while the person providing it is paying only a net $5,000, the government is supporting the spouse receiving the alimony to the extent of $2,000 a month.

Why Tax Reformers Want to Change Alimony Rules

The House bill explains the rationale for changing the alimony rules this way: "The provision would eliminate what is effectively a 'divorce subsidy' under current law, in that a divorced couple can often achieve a better tax result for payments between them than a married couple can."

The arbitrage created by the difference in tax rates has long served as a benefit to the spouse paying the alimony and has been a factor both in negotiating matrimonial settlements and in bridging the gap between the parties' needs and their actual income. Judges ruling in contested matrimonial matters typically take the tax deductibility and taxable income of alimony into account.

What the Effect Might Be on Couples Who Divorce

If alimony is no longer deductible, the ability of an ex-spouse to pay it may be limited, due to other fixed expenses, such as child support payments, and education expenses for children. There is only so much juice that can be squeezed from the orange.

Everyone understands that divorce creates a trauma not only for couple involved, but most particularly for their children. Two separated families cannot live as cheaply as one. The present tax structure helps lessen or ameliorate those burdens. It is very difficult for divorcing couples to instantaneously make lifestyle adjustments which coincide with the necessary reduction of income to each party.

If the alimony provision of the Tax Cuts and Jobs Act takes effect, it would clearly make a difficult and painful experience more difficult and more painful.

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