

New Federal Law Eliminates the Alimony Deduction

THE TAX CUTS AND JOBS ACT¹ has a major impact on tax rates and deductions, but it also has a significant effect on separating and divorcing spouses. This act repeals Internal Revenue Code Section 71 and related sections, which defined alimony and allowed an above-the-line tax deduction to the payor spouse and requires the receiving spouse to declare this as income on his or her tax return. This provision of the new act becomes effective as to “(1) any divorce or separation instrument (as defined in section 71(b)(2) of the Internal Revenue Code of 1986 as in effect before the date of the enactment of this Act) executed after December 31, 2018, and (2) any divorce or separation instrument (as so defined) executed on or before such date and modified after such date if the modification expressly provides that the amendments made by this section apply to such modification.”² This means that agreements and orders made after January 1, 2019, will be affected by the new law. Until then, alimony can still be deductible to the payor and includible in the recipient’s income. If a pre-2019 order or agreement is modified after January 1, 2019, it will be deductible to the payor and includible as income to the payee as long as the post January 1, 2019, order or agreement expressly states that it is deductible to the payor and includible as income to the payee.

It was not known until virtually a couple of days before the Tax Cuts and Jobs Act was signed that there would be a one-year period before this part of the act would be effective. Before practitioners in the field knew there would be delay in the elimination of the alimony deduction, they were advising their clients to obtain a judgment of dissolution of marriage by the end of last year to take advantage of the alimony tax deduction. Now, couples have the rest of this year to obtain a judgment of dissolution of marriage or legal separation that will allow them to take advantage of the alimony deduction. It is likely that some divorcing spouses will accelerate their divorces so they can enter a judgment before the end of this year to be able to deduct spousal support on their tax returns and obtain the corresponding tax benefits.

Spousal support, however, is not going away. It is a fundamental element of any divorce when there is a disparity of income. For marriages less than 10 years long, the duration of spousal support typically is one-half the length of the marriage.³ For marriages of more than 10 years, there is no presumption with regard to duration. A court must determine how long spousal support is needed and justify any reductions (step-downs) in the amount of spousal support.⁴ Courts are reluctant to terminate jurisdiction over spousal support in marriages of more than 10 years long.

Roughly speaking, if the receiving spouse’s net taxable income

is over \$41,000 per month (\$500,000 annually), including any spousal support, he or she is going to be in the same tax bracket as the payor, so the alimony tax deduction simply shifts the tax from the payor to the payee. For these high earners, there may be no benefit to the deduction. On the other hand, when there is a differential between the payor’s higher tax bracket and the payee’s lower tax bracket, there is a tax savings, and in some cases it is significant.

The software used by family lawyers to determine temporary spousal support⁵ (and often permanent spousal support⁶), shows

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the tax savings and in “recommending” an amount of spousal support it divides the tax savings between the parties. Many couples benefited from the savings. With the tax savings, payors of spousal support could pay more support (than if there was no deduction at all). Consequently, there was more money available to the family than there will be after January 1, 2019, when the alimony deduction is eliminated.

Support software is one of the essential tools of family law practice. In order to calculate spousal support, the support software is programmed with an algorithm that calculates the tax savings for the alimony deduction. It then recalculates the net income available for support and repeats this process again and again until an internal stasis is reached. The algorithm could be turned off by hitting the “B” key on a computer keyboard. The spousal support number is lower without the algorithm engaged. Some attorneys (and maybe some judge and mediators) might take the average of the “B” key output and the temporary spousal support guideline output to arrive at a settlement number for permanent spousal support. Some in the industry call this algorithm “the bump.” The case of *In re Marriage of Schulze*⁷ makes it clear that the guideline cannot be used to determine permanent spousal support, and it has a scathing attack on the software, calling the manner in which it calculates spousal support an “Alice in Wonderland...hybrid

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of quantum physics and Zen philosophy... reminiscent of an attempt to pin down an electron or the image of a snake eating its own tail." Soon, this method of recalculating spousal support to maximize the benefits of deductibility will be a relic of family law history.

County Guidelines

The spousal support calculation built into the software applies Santa Clara, Alameda, Marin, Yolo, Humboldt, or Kings County guidelines depending on which county the case resides. The Santa Clara County guideline,⁸ used by the Los Angeles County Superior Court, states as follows:

Temporary spousal or partner support is generally computed by taking 40% of the net income of the payor, minus 50% of the net income of the payee, adjusted for tax consequences. If there is child support, temporary spousal or partner support is calculated on net income not allocated to child support and/or child-related expenses. The temporary spousal support calculations apply these assumptions.⁹

Because this formula was developed when spousal support was tax deductible, leaders in the field believe it will have to be adjusted to reduce the 40 percent of the payor's income now that the payor will have less net income available to pay spousal support under the new tax law. Changes are anticipated to be coming to local court guidelines soon. In the meantime, practitioners should be prepared to argue that the guideline does not any longer represent a fair allocation of the financial resources between the payor and the payee. The rule in Los Angeles states that the court may use the Santa Clara County guideline, not that it must apply the guideline.

Another consequence of the loss of alimony deductibility will be that there is going to be no need for family support orders (also known as Lester Agreements).¹⁰ Family support is a combination of undifferentiated child support and spousal support.¹¹ The benefit was that the entirety of the combination of the support was deductible (and thereby taxable to the recipient). In some cases the differential in the tax brackets of the payor and the payee resulted in more money to take care of the family. The caveat of drafting these orders was that the order for family support could not change in amount when a child reached the age of majority, graduated from high school, or graduated from college.¹² These orders were difficult to draft properly. These orders are essentially a thing of the past—there will be no deductions for fam-

ily support beginning in 2019.

Another quirk relating to the tax deductibility of alimony that will be eliminated are the recapture rules.¹³ The drafters of the laws allowing for deductibility of alimony wanted to prevent parties to a divorce from disguising a property settlement as alimony to obtain a significant tax deduction. The rules were arcane at best and trapped many an unwary party to a divorce, not to mention the attorneys that represented them. Essentially, if the order for alimony reduced in amount (i.e., were stepped down) too much in the first three years that spousal support was paid, the deduction would be disallowed and recaptured later. No one should miss this arcane provision of the Internal Revenue Code, except the family law test examiners who loved to stump the so-called experts.

According to *Mother Jones*,¹⁴ eliminating the deduction for alimony will save the government less than \$1 billion a year. That is very little compared with the enormity of this \$1 trillion tax bill. If that is so, why did Congress seek to terminate the alimony tax deduction? *Mother Jones* speculates that some republicans saw this deduction as a divorce subsidy and that it encouraged people to get a divorce. Regardless of the politics, because of the loss of the alimony deduction, it will be more costly for many people to live after divorce. Divorce was never good financial planning. Now it is even worse because there will be less money to support a divided family. ■

¹ An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, Pub. L. No: 115-97, 131 Stat. 2054 (2017), available at <https://www.congress.gov/bill/115th-congress/house-bill/1/text>.

² *Id.* §11051(c).

³ FAM. CODE §4320(l).

⁴ *In re Marriage of Richmond*, 105 Cal. App. 3d 352 (1980).

⁵ Dissomaster™, available at <https://childsupportca.com/the-dissomaster-program>; Family Law Software, available at http://www.familylawsoftware.com/fls_test/ca/index.html (both last viewed Apr. 25, 2018).

⁶ *In re Marriage of Zywiiciel*, 83 Cal. App. 4th 1078 (2000) (the court cannot use temporary spousal support guidelines in setting permanent spousal support).

⁷ *In re Marriage of Schulze*, 60 Cal. App. 4th 519 (1997).

⁸ L.A. COUNTY SUPER. CT. FAM. DIV. R. 5.10.

⁹ SANTA CLARA SUPER. CT. FAM. L.R. 3.C.

¹⁰ *C.I.R. v. Lester*, 366 U.S. 299 (1961).

¹¹ FAM. CODE §92.

¹² I.R.C. §71(c), Treas. Reg. §1.71-1T, Q 16.

¹³ I.R.C. §71(f).

¹⁴ Kevin Drum, *The Peculiar Story of the Republican War on Alimony*, MOTHER JONES, Nov. 4, 2017, available at <http://www.motherjones.com/kevin-drum/2017/11/the-peculiar-story-of-the-republican-war-on-alimony>.

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