House GOP Tax Proposal and the Impact on Divorce Negotiations

There are several proposed changes to the tax code that could effect divorce settlements.

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Donna Kline, MBA, CDFA™, combines experience as an investment broker and wealth manager, a proven approach to long-term financial planning and the unique skills of a Certified Divorce Financial Analyst™ (CDFA™) to help a divorcing client understand and address the associated financial issues and helping them in obtaining a fair and equitable divorce settlement. She directs the HBKS® CDFA™ practice out of the firm's Pittsburgh offices.

Ms. Kline is the author of Fundamentals of the Futures Market, published by McGraw-Hill in 2000, and has contributed numerous articles to various magazines, including Futures Magazine and Bloomberg BusinessWeek. She is a member of the Institute for Divorce Financial Analysts (www.institutedfa.com), International Academy of Collaborative Professionals (www.collaborativepractice.com) and The Collaborative Law Association of South Western PA (www.clasplaw.org). She holds a B.S. in Genetics from University of California at Davis, and an MBA from Santa Clara University.

Under current Federal tax law, alimony payments are deductible to the individual paying the alimony and are reported as taxable income to the alimony recipient. The proposed "Tax Cuts and Jobs Act" (TCJA) would eliminate the alimony tax deduction for the payor, and no longer make the alimony payments received taxable to the recipient.This change impacts divorce settlement negotiations in several ways.

Family law statutes regarding alimony vary from state to state. Alimony is typically paid by the higher earning spouse, to supplement income to the lower earning spouse for a period of time or in some cases, through retirement. The IRS currently has requirements that must be met for payments to qualify as a taxable event.[1] One area of negotiation between divorcing spouses has been the *net effect* of alimony on ones' tax return in future years. For example, if the payor earns $250,000 per year and pays $18,000 per year in alimony, and we assume no other adjustments in this example, the $18,000 is taken right off the top of the gross income number, which lowers taxable income by *about* 7 percent. On the other hand, the $18,000 received by the payee *adds* to the gross income number on his or her return, which under current code, may or may not bump the recipient into a higher tax bracket.[2] Many times, however, the benefit to the payor would exceed the cost to the payee. This deviation enabled the payee to negotiate for a higher alimony payment, as the net effect to payor was minimal. The TCJA legislation would abolish the alimony tax deduction for the payor, and no longer make the alimony payments received taxable to the recipient. Under the new code, the above avenue of negotiation would be eliminated.

This change in the treatment of alimony would only apply to new alimony agreements entered into after 2017; existing alimony agreements and payments would not be altered, unless the cost/benefit were enough to inspire one party to modify an existing divorce agreement to change the treatment.

Another area of negotiation that would be affected under TCJA is the party allowed to claim minor children as dependents. The proposed increase in the child tax credit from $1,000 to $1,600 per child would offer a greater tax break to the custodial spouse. The proposed elimination of the Alternative Minimum Tax (AMT) may enable the higher earning spouse to benefit financially by claiming one or more children on his or her tax return. Under current code, the AMT would often eliminate any potential benefit of sharing deductions between spouses, enabling the lower earning spouse to claim the children and minimize his or her tax burden. Higher earning spouses have a more level playing field under the new legislation and improved rights to deductions. They also have a greater ability to benefit from filing as Head of Household rather than as single.

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Lastly, tax reform will affect state child support guidelines. Currently, child support in Pennsylvania, for example, is calculated based on the combined monthly *net income* of the parents. The net income and number of children affected is then compared to a guideline grid provided by the courts to determine the basic support obligation. Parents are responsible to provide their proportionate share of support based on those guidelines. This net income is calculated by subtracting federal, state, FICA, local and various line item deductions from gross income. The elimination of alimony deductibility and Alternative Minimum Tax adjust these bottom lines, as will the increase in child tax credit and adjustment to tax brackets.

There are other changes proposed in TCJA legislation involving medical expenses, standard and personal exemptions, mortgage deductions and treatment of capital gains that will affect all individuals across the nation. It is imperative to hire a qualified CDFA ® (Certified Divorce Financial Analyst) and CPA to assist with these distinctions during divorce negotiations. The potential changes could have a significant impact on your financial future. □

1 - https://www.irs.gov/taxtopics/tc450/tc452
2 - The TCJA proposes narrowing the number of tax brackets from six to 4, which expands the distance between tax levels for single filers to 12 percent up to $45,000, 25 percent for up to $200,000, 35 percent up to $500,000 and 39.6 percent for the remainder.

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