New Tax Law Eliminates the Alimony Tax Deduction: What it Means

The new tax law has officially been passed. One of the provisions in the tax law that will have a substantial impact on divorcing couples is the elimination of the alimony deduction. What does that mean for those potentially impacted by the change?

First, let's look at what happened under the old law. If the payor spouse is a high earner, he or she is subject to a higher tax bracket (especially when filing single) while the payee spouse is typically in a lower tax bracket. This had the effect of shifting income from the party in a higher tax bracket to the party in a lower tax bracket. This was supportive as a justification for a higher amount of alimony (spousal support) because the paying spouse has been able to take a tax deduction which has not been subject to limitations or phase-outs as are some other deductions (since it is an above-the-line deduction).

It is important to note that the new tax law impacts agreements and orders entered into or after December 31, 2018.

Elimination of this deduction may have a chilling effect on alimony payments and may serve to reduce alimony to a lower level in the future. Payor spouses will want to pay less in alimony because they will not get the benefit of the tax deduction and some courts may award less due to this change in the law. However, what about states that use a spousal maintenance formula, such as New York? The formulas were put in place under the old tax law, but what will happen now that the new tax law changes the ability to deduct alimony? Will New York make changes to the alimony formula? If not, there will be significant differences in cash flow for those paying alimony who are able to deduct it (for agreements/orders in place in 2018 or earlier) versus those who are not able to deduct it (for agreements/orders entered in 2019 and thereafter).

Likewise, there will be significant differences in cash flow for those receiving alimony. Those who are required to claim alimony payments as income and pay tax on it will have less cash flow (all else being equal) than those who are not required to report the alimony as income and will receive it on a tax-free basis.

We prepared estimated tax calculations to see what kind of an impact such a change may make to the payor and recipient spouses and looked at the estimated tax impact for federal and state taxes for several different states. We then estimated the amount of estimated cash flows to each spouse after federal, state and local taxes and found the following (states are listed in alphabetical order):

Assumptions for the Hypothetical Scenarios:

- Assumes single filing status for payor and payee after divorce.
- Payor spouse income - $500,000 (wages).
- Other income to each spouse - $12,500 each (taxable interest and ordinary dividends) – assumes 50/50 split in equitable distribution of investment assets.
- Utilizes the new standard deduction of $12,000 for single filers.
- Utilizes federal 2017 tax rates and brackets (taxfoundation.org/2017-tax-brackets/).
- New York – assumes alimony will still be taxable/deductible at NY State level (per tax forms).
- New Jersey – assumes alimony will still be taxable/deductible at NJ State level (per tax forms).
- Connecticut – CT State uses federal AGI (adjusted gross income from Form 1040); therefore, it will no longer be taxable/deductible at State level.
- Pennsylvania – alimony is not taxable/deductible for PA State income taxes.

NEW YORK – Following is an example showing estimated taxes and after-tax cash flow both under the current tax law (alimony is taxable/deductible) and under the House proposal (eliminating the deduction):

	If Alimony (Spousal Support) is Deductible/Taxable at Federal Level				If Alimony (Spousal Support) is NOT Deductible/Taxable at Federal Level		
	Payor Spouse		Payee Spouse		Payor Spouse		Payee Spouse
Wages, salaries, tips	$ 500,000		$ -		$ 500,000		$ -
Taxable interest	2,500		2,500		2,500		2,500
Ordinary dividends	10,000		10,000		10,000		10,000
Alimony received	-		125,000		-		-
Total income	$ 512,500		$ 137,500		$ 512,500		$ 12,500
Alimony paid	(125,000)		-		-		-
Adjusted gross income	$ 387,500		$ 137,500		$ 512,500		$ 12,500
Standard deduction	(12,000)	(a)	(12,000)		(12,000)	(a)	(12,000)
Exemptions	-	(b)	-		-	(b)	-
Taxable income	$ 375,500		$ 125,500		$ 500,500		$ 500
Tax	(107,314)	(c)	(28,122)		(154,017)	(c)	(50)
After-tax income per tax return (before state & local taxes)	$ 268,186		$ 97,378		$ 346,483		$ 450
Combined federal income tax (payor & payee)	($135,436)				($154,067)		
Difference in combined federal income tax				($18,631)			
Alimony paid/received not included in taxable return					$ (125,000)		$ 125,000
Add-back amount of standard deduction	$ 12,000		$ 12,000		$ 12,000		$ 12,000
Estimated cash flows (before state & local taxes)	$ 280,186		$ 109,378		$ 233,483		$ 137,450
Estimated State Tax	$ (25,006)		$ (8,052)		$ (25,006)		$ (8,052)
Estimated Local (City) Tax	$ (13,692)		$ (4,572)		$ (13,692)		$ (4,572)
Estimated cash flows (after state & local taxes)	$ 241,489		$ 96,755		$ 194,786		$ 124,827

As you can see in the chart above, the parties will now be paying $18,631 more in federal taxes (considering both payor and payee spouse taxes) under the new tax law than under the old law. It also has a significant impact on the estimated cash flows for both the payor spouse and the recipient. It reduces estimated cash flows for the payor spouse by almost $47,000 per year while increasing the estimated cash flows for the recipient spouse by just over $28,000 per year.

NEW JERSEY – the top portion of the chart remains the same, but the bottom portion of the chart shows:

Estimated cash flows (before state & local taxes)	$ 280,186		$ 109,378		$ 233,483		$ 137,450
Estimated State Tax	$ (22,494)		$ (6,569)		$ (22,494)		$ (6,569)
Estimated Local (City) Tax	$ -		$ -		$ -		$ -
Estimated cash flows (after state & local taxes)	$ 257,692		$ 102,809		$ 210,989		$ 130,881

CONNECTICUT – the top portion of the chart remains the same, but the bottom portion of the chart shows:

Estimated cash flows (before state & local taxes)	$ 280,186		$ 109,378		$ 233,483		$ 137,450
Estimated State Tax	$ (26,889)		$ (7,502)		$ (32,424)		$ -
Estimated Local (City) Tax	$ -		$ -		$ -		$ -
Estimated cash flows (after state & local taxes)	$ 253,297		$ 101,876		$ 201,059		$ 137,450

Pennsylvania – the top portion of the chart remains the same, but the bottom portion of the chart shows:

Estimated cash flows (before state & local taxes)	$ 280,186		$ 109,378		$ 233,483		$ 137,450
Estimated State Tax	$ (15,734)		$ (384)		$ (15,734)		$ (384)
Estimated Local (City) Tax	$ -		$ -		$ -		$ -
Estimated cash flows (after state & local taxes)	$ 264,452		$ 108,995		$ 217,749		$ 137,066

Please note that all of the above are estimates using the assumptions noted.

Now that the tax law with respect to the deductibility of alimony is set to be changed beginning in 2019, it will have a significant impact on taxes and cash flow for both parties in a divorce. Stay tuned to see if states will make any changes to their tax laws as a result of the change in federal law. It will also be worth noting what the impact is on awards of alimony/spousal maintenance in future cases where alimony will no longer be taxable/deductible.

More Information

To get a Case Assessment or further insight on the implications of Tax Reform, please contact:

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