WEEKEND INVESTOR

TAX REPORT | By Laura Saunders

House Plan Isn't Amicable for Those Divorcing

Divorcing couples and their advisers are scrambling to cope with the possibility that alimony won't be tax deductible for divorce agreements signed after Dec. 31.

Under current law, alimony payments are deductible by the payer and count as income to the recipient. This is different from the treatment of property settlements and child support, as those are neither deductible nor count as income.

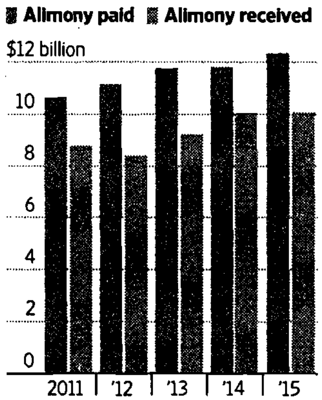
In its version of the tax-overhaul bill, the House included a provision repealing the current treatment of alimony for divorce agreements signed after 2017. The change is projected to raise $8.3 billion over 10 years.

It is unclear whether the provision will be enacted, as the Senate's tax bill doesn't have a similar provision.

In 2014, more than 814,000 couples divorced in the U.S., according to the latest data from the Centers for Disease Control and Prevention. In 2015, according to the latest Internal Revenue Service data, about 600,000 filers deducted alimony payments.

Mismatch

The amount of alimony taxpayers said they paid is greater than the amount ex-spouses said they received.



Source: Internal Revenue Service
THE WALL STREET JOURNAL.

If the alimony deduction is scrapped, "it would change the economics of many divorces," says Madeline Marzano-Lesnevich, a New Jersey-based lawyer and national head of the American Academy of Matrimonial Lawyers. The group has declared its opposition to the provision.

Alimony, also called maintenance, is typically used when one spouse of a divorcing couple earns far more than the other. Alimony payments continue for a period of years and help defray the expense of splitting one household into two.

The tax code often provides a benefit to such couples, because the partner who deducts payments is typically in a higher tax bracket than the recipient.

For example, say high-earning Spouse A agrees to make alimony payments of $100,000 annually for 10 years to Spouse B. Spouse A might save $40,000 a year through the deduction, while Spouse B—who is in a lower tax bracket—could owe $15,000 on the $100,000.

In justifying its repeal of the alimony deduction, the House Ways and Means Committee said the change "prevents divorced couples from reducing income tax through a specific form of payments unavailable to married couples."

Elena Karabatos, a matrimonial lawyer in New York, disagrees with this reasoning, because the tax code provides favorable treatment to married couples in which one spouse earns far more than the other.

She argues that the alimony deduction offsets the loss of this favorable treatment for a few years after divorce, when the lower-earning spouse is adjusting to a different status.

The alimony deduction especially is important when the paying spouse doesn't have liquid assets to fund a settlement or pay support. "The deduction helps with cash flow," says Ms. Karabatos.

Ms. Marzano-Lesnevich says the write-off is also an important bargaining chip if couples are considering a lump-sum settlement. The recipient may want such a settlement to receive money sooner, and the payer may be willing to make it because the forgone tax deduction helps to shrink the lump sum.

Thus $1 million of alimony due over 10 years could turn into a lump-sum payment of about $500,000 because of various discounts, including the one for the forgone alimony deduction.

Without the alimony deduction and tax benefit, maintenance payments to the lower-earning spouses will be smaller, says Ms. Marzano-Lesnevich. And higher-earning spouses may be less willing to agree to lump-sum settlements because there is not a discount for the tax deduction.

As a result of the proposed change, some couples who have hammered out agreements are pushing to finish them by year-end, says Ms. Karabatos, who had a client ask her to work over Thanksgiving to ready documents for signing.

Some attorneys also are writing in language to address the potential change in the law.

If the alimony deduction is repealed, one beneficiary would be the IRS. It will no longer have to police a large tax gap between what is deducted by alimony payers and what is reported by alimony recipients.

A 2014 study by the Treasury Inspector General for Tax Administration, an official watchdog, found that nearly half of returns with alimony payments or income had discrepancies, estimating the loss of revenue to be more than $380 million a year.