

Client Bulletin

Smart tax, business and planning ideas from your Trusted Business AdvisorSM

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The new tax law will change divorce tactics



When couples divorce, financial negotiations often involve alimony. The tax rules regarding alimony were dramatically changed by the Tax Cuts and Jobs Act (TCJA) of 2017, but existing agreements have been grandfathered. In addition, the old rules remain in effect for divorce and separation agreements executed during 2018. Next year, the rules will change, and the roles will be reversed.

Under divorce or separation agreements executed in 2018, and for many years in the past, alimony payments have been tax deductible. Moreover, these deductions reduce adjusted gross income, so they may have benefits elsewhere on a tax return. While the spouse or former spouse paying the alimony gets a tax deduction, the recipient reports alimony as taxable income.

Shifting into reverse

Beginning with agreements executed in 2019, there will be no tax deduction for alimony. As

an offset, alimony recipients won't include the payments in income.

Example 1: Joe and Kim Alexander get divorced in 2018. Joe expects to be in a 35% tax bracket in the future, whereas Kim anticipates being in a 22% bracket. Suppose that the proposed agreement has Joe paying \$3,500 a month (\$42,000 a year) in alimony.

Joe will save \$14,700 in tax (35% times \$42,000), but Kim will owe \$9,240 (22% times \$42,000). Net, the couple will save over \$5,000 per year in taxes. This type of calculation will affect the negotiations, as it has in the past. Assuming the relevant rules are followed, it may make sense to tip the agreement toward Joe paying alimony to Kim, perhaps in return for other considerations.

Example 2: Assume that the Alexanders' neighbors, Len and Marie Baker, have identical finances. They divorce in 2019. If Len pays \$42,000 a year in alimony, he will get no deduction and won't get the \$14,700 in annual tax savings that Joe did in example 1. Marie, on the other hand, will pocket \$42,000, tax-free, without the \$9,240 tax bill faced by Kim in example 1.

Moving things along

Just as people shouldn't "let the tax tail wag the investment dog," so taxes shouldn't dominate divorce or separation proceedings. However, it's also true that taxes shouldn't be

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Global expansion

The broadest global expansion in seven years occurred during 2017, with economic growth in 120 countries that accounted for three-fourths of world economic output.

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