

Nondeductible Spousal Maintenance: Who Wins Under the New Tax Law?

By Mitchell Reichman

Under the recently enacted tax reform act, spousal maintenance ordered by a decree or agreement executed after Dec. 31, 2018, will no longer be deductible by the payer and will be tax free to the recipient. Supporters of this tax law change suggested that the deduction for “alimony” was a federal government subsidy that supported divorce. Additionally, there are changes to tax brackets, tax rates and the standard deduction in 2018 tax year.

For purposes of the examples below, the following simple assumptions were used:

- Payer of spousal maintenance and the recipient both take the new standard deduction for single filers of \$12,000.
- There were no minor children and therefore no child support.
- The examples apply both the new tax rates and brackets.
- Total income is random.

I don't pretend to be a tax specialist or an accountant. These are illustrative examples only.

Example 1

Payer has total annual income of \$186,000 and pays spousal maintenance of \$36,000 annually, giving payer an adjusted gross income of \$150,000. Payer is single and takes standard deduction of \$12,000, leaving \$138,000 of income to be taxed. Under the new tax law, the payer's total tax liability is \$27,409. Cash flow is \$122,600 annually and \$10,216 monthly.

Using the same example with the maintenance no longer deductible, the payer's adjusted gross income is \$186,000 and the standard deduction is \$12,000. The taxable income is \$174,000. The total tax liability is \$37,368 which is \$9,960 more in tax liability from the loss of the maintenance deduction. Cash flow is \$9,385 monthly which is \$830 less per month.

The recipient of the maintenance has W-2 income of \$38,000. When the \$36,000 maintenance is reported as income the recipient's adjusted gross income becomes \$74,000. After taking the standard deduction of \$12,000 there is \$62,000 taxable

income and the tax liability using the new rates is \$9,578. The recipient's cash flow is \$64,423 annually and \$5,368 monthly.

If the recipient no longer had to report the \$36,000 in maintenance as income, their adjusted gross taxable income would be reduced to \$38,000. After the standard deduction of \$12,000, taxable income is \$24,000 and tax liability tax on that amount is \$2,689. This lowers tax liability by \$6,888. Cash flow is \$71,312 annually and \$5,942 monthly which is a monthly increase of \$524.

Focusing on the recipient's needs, it is determined they can be met with the \$5,368 a month. If the spousal maintenance is non-taxable, the payer's maintenance obligation might be lowered to \$29,100 or \$2,425 a month. With this reduction, monthly cash flow for the Payer is \$9,961.

Example 2

Assume the payer has total income of \$360,000 and spousal maintenance of \$7,500 a month or \$90,000 annually. With the payer taking the standard deduction of \$12,000 and if maintenance is deductible the tax liability is \$58,986. Cash flow is \$211,014 annually and \$17,584 monthly.

If the payer's maintenance is no longer deductible, again assuming standard deduction, total tax liability increases by \$38,500. Cash flow is now \$14,376 monthly which is \$3,207 less than when maintenance was deductible.

Assume the recipient earns \$25,800 annually and receives \$90,000 in spousal maintenance. If this must be reported as income by this recipient and standard deduction is taken, tax liability is \$19,198. Cash flow is \$96,602 annually and \$8,050 monthly.

When this new tax law provision is effective, recipient's spousal maintenance would no longer be reported as taxable income. Total tax liability of the recipient would decrease to \$1,464. Cash flow is \$114,336 annually and \$9,528 monthly. This is monthly increase of \$1,478.

Analysis

Once the change making spousal maintenance non-deductible takes effect, it is reasonable to predict that lawyers representing

clients who expect to be obligated to pay spousal maintenance will be advising their clients to offer less because the recipient spouses will derive a greater net benefit. The incentive for “buying” a maintenance claim by offering a non-taxable lump sum of cash will be significantly less advantageous as the discount calculated as the tax savings to the recipient spouse would no longer apply.

Analytically, it is fair to expect that more lawyers will encourage judges to focus on the reasonable needs of the spouse seeking maintenance, urging the court to recognize the economic effect of spousal maintenance no longer being taxable to the recipient. The anticipated difficulty in that approach is in building a model that survives the challenge of tax consequences being speculative given the number of different variables that would-be components of such a model.

The clearest “winner” once the new tax law takes effect making spousal maintenance non-deductible is the U.S. Treasury which has restructured the law so that the total combined income of divorcing spouses generates more tax revenue.

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