Brigham Young University Prelaw Review

Volume 34 Article 9

4-2020

Alimony: The Taxing Economic Implications of Divorce

Jared Mason
jaredkmason@gmail.com

Amaia Kennedy
amaiamkennedy@gmail.com

Alimony: The Taxing Economic Implications of Divorce

Amaia M. Kennedy[1] *and Jared Mason*[2]

In 2017 alone, over 750,000 American couples chose to divorce[3]. Nationally, fifty percent of marriages end in divorce, with each of these marriages lasting eight years, on average[4]. Put another way, a divorce occurs every 13 seconds[5], and each of those divorces is expensive, with an average cost of approximately $15,000 per person[6]. Expenses usually include a divorce attorney and court fees but can also include tax advisors, child custody evaluators[7], private

---

1 Amaia Kennedy is a junior studying English and French at Brigham Young University. She plans to attend law school in the Fall of 2022.

2 Jared is a Senior at Brigham Young University studying Applied Statistics. He plans to graduate in the winter of 2020. He wishes to acknowledge Neal Hillam for his exceptional guidance as a Board member of the journal.

3 CDC/Centers of Disease Control and Prevention, Marriage and Divorce, National Center for Health Statistics (Jan. 31, 2020), https://www.cdc.gov/nchs/fastats/marriage-divorce.htm.

4 Wilkinson & Finkbeiner, Divorce Statistics: Over 150 Studies, Facts and Rates for 2018, The Smart Choice for Divorce and Family Law Issues (Feb. 1, 2020), https://www.wf-lawyers.com/divorce-statistics-and-facts/.

5 Wilkinson & Finkbeiner, Divorce Statistics: Over 150 Studies, Facts and Rates for 2018, The Smart Choice for Divorce and Family Law Issues (Feb. 1, 2020), https://www.wf-lawyers.com/divorce-statistics-and-facts/.

6 Terrin Miller, How Much does a Divorce Cost on Average in 2019?, TheStreet (Feb. 2, 2020), https://www.thestreet.com/personal-finance/education/how-much-does-divorce-cost-14882536.

7 NOLO, How Much Will My Divorce Cost and How Long Will It Take?, Legal Articles (Feb. 23, 2020), https://www.nolo.com/legal-encyclopedia/ctp/cost-of-divorce.html.

investigators, fees for serving subpoenas, an accountant, as well as the costs of finding separate living arrangements[8]. With a median American household income of just over $60,000, a divorce would cost a couple (and their children) almost half of their yearly income, on average, a significant challenge as both individuals look to move on from the failed relationship. Although already difficult for couples who can afford divorce, the repercussions can be truly debilitating for those who earn significantly less than the median, as the proportional cost of divorce would be much higher, and the resources available more limited.

After 1960, the divorce rate in America more than doubled over the course of just two decades, increasing from 9.2 divorces per 1,000 married women to 22.6 divorces per 1,000 married women[9]. American culture has kept up with the increase in divorce rate; divorce has moved from the edges of society toward the center, becoming increasingly more common in America.

When a couple chooses to divorce or change their marital status to "legal separation", alimony may be awarded based on a mutual agreement between the divorcing spouses. However, if a mutual agreement cannot be reached, a decision may be made by the judge assigned to the case[10]. Alimony is separate from the division of marital property and is different from child support, legally. Additionally, alimony within each divorce is considered on a case-by-case basis[11]. In terms of tax treatment, the Internal Revenue Service (IRS) states, "Amounts paid to a spouse or former spouse under a divorce or separation instrument (including a divorce decree, a separate maintenance

8 HUFFPOST, Divorce Is Expensive (Can You Really Afford It)?, Life (Feb. 23, 2020), https://www.huffpost.com/entry/divorce-is-expensive-can-_b_11595584.

9 Bradford Wilcox, The Evolution of Divorce, National Affairs (Feb. 2, 2020), https://www.nationalaffairs.com/publications/detail/the-evolution-of-divorce.

10 Catherine Schnoubelt, Determining and Collecting Spousal Support in a Divorce, Forbes (Feb. 2, 2020), https://www.forbes.com/sites/catherineschnaubelt/2019/04/08/determining-and-collecting-spousal-support-in-a-divorce/#2b220cf54402.

11 *Id*.

decree or a written separation agreement) may be alimony for federal tax purposes."[12] Although legal separation and divorce share many similarities under the law, for the purposes of this article, we will focus only on alimony as it relates to divorce.

Spousal support, spousal maintenance, and alimony are often used synonymously, but spousal support and spousal maintenance must meet certain requirements in order to qualify as alimony. For tax purposes, the IRS imposes six qualifications for a payment to be considered alimony: (1) former-spouses must not file a joint income tax return; (2) payments must be made in cash (including checks or money orders), and exchanges of items or assets cannot be considered alimony; (3) the payment must be to or for a former-spouse made under a divorce; (4) former-spouses must not be living together; (5) the agreement must state that payments end after the death of the receiver; and (6) the payment is not treated as child support or a property settlement[13].

The tax treatment of alimony changed when the President of the United States signed The Tax Cuts and Jobs Act (TCJA) into law on December 22, 2017[14]. The TCJA was focused on tax reform and made many changes to federal tax codes. One of the changes causes divorcees to pay more in tax, making divorce and life after divorce more difficult and expensive. These changes are neglectful of the purpose of alimony—to level the economic playing field by limiting any unfair economic effects of divorce (by providing supplemental income for the lower-income-earning spouse)[15].

Using previous and existing federal codes, in this article we examine the law in relation to divorce and tax law surrounding alimony.

12 IRS, Tax Treatement of Alimony or Separate Maintenance, Topic No. 452 Alimony and Separate Maintenance (Feb. 2, 2020), https://www.irs.gov/taxtopics/tc452

13 *Id*.

14 U.S. Const. art. 26, § 1986.

15 David M. Gabriel & Associates, What is the Purpose of Alimony?, Law Offices of David M. Gabriel & Associates (Feb. 2, 2020) https://www.attorneydavidgabriel.com/blog/2015/10/what-is-the-purpose-of-alimony.shtml.

We argue for the removal of the 2018 revisions to the tax code (in relation to the treatment of alimony) and a reversion to the previous principles, as the imposed changes do not fulfill the intended purposes of alimony. The proceeding sections will do the following: first, provide a detailed explanation of the TCJA changes in relation to the treatment of alimony; second, address their negative impact on divorcing Americans; and third, outline a viable solution.

In section one, we will define alimony-related terminology that we will use in this article and provide a recent history of alimony. In section two, we will discuss the changes to alimony-related tax, and thoroughly explore the impact these changes have in the United States. In section three, we will outline a three-pillared solution and give our reasoning for proposed changes.

I. Background

Alimony provides an income, after the marriage is dissolved, to the lower-wage-earning or non-wage-earning spouse[16]. Alimony is justified by the cohesive and sacrificial nature inherent in a marriage: spouses may specialize, choosing to forego certain economic benefits or opportunities in order to better the couple as a unit. For example, if a spouse chooses not to pursue a career and instead support the family at home—so that the other spouse can focus more on securing economic benefits—alimony ensures that his or her contributions and sacrifice are not lost in the divorce, and any potential economic disadvantages of such choices made to benefit both partners are mitigated. In this article, we will refer to the spouse who makes alimony payments as the payer and refer to the spouse who receives alimony payments as the receiver.

Each state considers each of the many influencing factors differently when determining how much alimony should be awarded and for how long, but there are common factors: the recipient's needs, the payer's ability to pay, the length of the marriage, the couples'

16 FindLaw Team, Spousal Support (Alimony) Basics, FindLaw (Jan. 29, 2020), https://family.findlaw.com/divorce/spousal-support-alimony-basics.html.

previous lifestyle, and the age and health of each spouse[17]. Alimony cannot be assumed; just because one spouse makes less than another, it does not guarantee any alimony. It is granted depending on the individual circumstances of the divorcing couple. Any former agreements between spouses may not be legally binding and may not be applicable in future negotiations regarding the terms of any awarded alimony[18]. Similarly, if one spouse receives support at the time of the divorce, they are not guaranteed continued support after the marriage through alimony. Certain circumstances can end alimony, including but not limited to death, remarriage, a change in the recipient's financial status, or a change in the payer's financial status[19]. Although states weigh factors differently, federal tax statutes are consistent; all alimony, regardless of the state it was ordered in, is treated the same.

Prior to January 2019, Sections 62, 71, and 215 of The Internal Revenue Services' Internal Revenue Code allowed deductions for alimony payers, and tax on those payments were paid by the receivers. Section 215 outlined deductions relating specifically to alimony, and stated that for payers, "there shall be allowed as a deduction an amount equal to the alimony or separate maintenance payments paid during such individual's taxable year"[20]. Section 62, titled "Adjusted Gross Income Defined", outlined allowable deductions to adjusted gross income and referenced Section 215 directly in subsection (a)

17 Catherine Schnoubelt, Determining and Collecting Spousal Support in a Divorce, Forbes (Feb. 2, 2020), https://www.forbes.com/sites/catherineschnaubelt/2019/04/08/determining-and-collecting-spousal-support-in-a-divorce/#2b220cf54402.

18 FindLaw Team, Spousal Support (Alimony) Basics, FindLaw (Jan. 29, 2020), https://family.findlaw.com/divorce/spousal-support-alimony-basics.html.

19 Meriwether & Tharp, When Does Alimony End?, Meriwether & Tharp: The Atlanta Divorce Team (Feb. 2, 2020), https://mtlawoffice.com/when-does-alimony-end.

20 Bloomberg, Internal Revenue Code, § 215. Alimony, Etc., Payments [Repealed], Bloomberg Tax (Feb. 2, 2020), https://irc.bloombergtax.com/public/uscode/doc/irc/section_215?trackingcode=BTAX18523.

paragraph (10): "Alimony. —The deduction allowed by section 215"[21]. This deduction was allowable for all payers, but not for receivers. Section 71, titled "Alimony And Separate Maintenance Payments", outlined who held the burden of tax for alimony payments. It stated "Gross income includes amounts received as alimony or separate maintenance payments"[22].

To understand the significance of the deductions outlined in Section 62, it is necessary to understand the process of calculating taxable income. Taxpayers (1) determine their gross income, (2) calculate their adjusted gross income, and (3) subtract tax deductions[23]. In the second step, "above-the-line" deductions can apply to gross income, reducing adjusted gross income. After adjusted gross income is determined, other "below-the-line" deductions can be applied. Thus, adjusted gross income is the symbolic "line". Section 62 outlines above-the-line deductions, and because Section 62 referenced Section 215, alimony was considered an above-the-line deduction. Step three allows taxpayers to apply one of two deduction options: an Itemized deduction or the Standard deduction. Itemized deductions are outlined in Section 63 (outlined in Section 63 of IRC[24]). Generally, taxpayers should choose to take the Itemized deduction if their individual deductions exceed the Standard deduction[25]. The "standard deduction is a specific dollar amount that reduces the amount

21 Bloomberg, Internal Revenue Code, § 62. Adjusted Gross Income Defined, Bloomberg Tax (Feb. 2, 2020), https://irc.bloombergtax.com/public/uscode/doc/irc/section_62?trackingcode=BTAX18523.

22 Bloomberg, Internal Revenue Code, § 71. Alimony, Etc., Payments [Repealed], Bloomberg Tax (Feb. 2, 2020), https://irc.bloombergtax.com/public/uscode/doc/irc/section_71?trackingcode=BTAX18523.

23 BALANCE, Tax Guide: Calculating Your Federal Income Taxes, Financial Fitness Program (Feb. 27, 2020), https://www.balancepro.net/education/publications/taxguide.html.

24 63 I.R.C. § 63a- 63g (2018).

25 IRS, Topic No. 501 Should I Itemize?, Tax Topics (Feb. 23, 2020), https://www.irs.gov/taxtopics/tc501.

of income on which you're taxed[26]. The TCJA increased the Standard deduction from $6,500 to $12,000 for individuals. However, because alimony was considered an above-the-line deduction, it was irrelevant whether you chose to itemize or take the Standard deduction; you were always entitled to a deduction if you were making alimony payment (as they are defined by the IRS).

In short, the Internal Revenue Code made clear that payers were entitled to a deduction on the amount of alimony they paid in the payer's taxable year, and that receivers were to include alimony as income (as if they had earned the alimony themselves). An important implication exists due to the latter statutory tax law; alimony was taxed in the marginal tax bracket of the receiver, who almost certainly made less in income, and was therefore in a lower bracket. This resulted in a net tax savings for the couple. The payer saw no personal benefit, could not use the money for themselves, and as divorcing spouses generally do not desire to give any of their income to their former spouse unless required to, the IRC allowed a deduction to offset the economic loss that would have been incurred by the payer. The receiver saw the benefit of the money and had control of its usage, so they were required to pay the tax. This system provided more financial optionality for the receiver, who was only awarded alimony because of the limitations their financial situation imposed on them.

II. Implications of Tax Changes

The Internal Revenue Service summarized and clarified the implications of the changes: "Beginning Jan. 1, 2019, alimony or separate maintenance payments [were] not deductible from the income of the payer spouse, or includable in the income of the receiving spouse, if made under a divorce or separation agreement executed

26 IRS, Topic No. 551 Standard Deduction, Tax Topics (Feb. 23, 2020), https://www.irs.gov/taxtopics/tc551.

after Dec. 31, 2018.[27]" The IRS explicitly stated who the changes apply to: generally "alimony or separate maintenance payments are deductible from the income of the payer spouse and includable in the income of the receiving spouse, if made under a divorce or separation agreement executed on or before Dec. 31, 2018, even if the agreement was modified after December 31, 2018, so long as the modification"[28] does not change the terms of alimony or explicitly state that payments are "not deductible by the payer or includable in the income of the receiving spouse"[29].

A. Deduction Implications

Because the (now outdated) deduction only applied to the payer, they therefore shoulder the economic losses caused by the amendment to Section 62 and repeal of Section 215. In the current code, there are no federal tax statutes to assist payers. Compared to the old code, payers now lose a larger proportion of their income to taxes, limiting their financial situation. A payer who makes $100,000 per year and pays $20,000 in annual alimony would lose over $4,000 in taxes[30] under the current IRC when compared with the pre-TCJA IRC.

B. Tax Burden Shift Implications

The receiver is harmed more than the payer by the repeal of Section 71. Income disparity is one of the most important factors for deter-

27 IRS, Clarification: Changes to deduction for certain alimony payments effective in 2019, IRS (Jan. 29, 2020), https://www.irs.gov/forms-pubs/clarification-changes-to-deduction-for-certain-alimony-payments-effective-in-2019.

28 *Id*.

29 *Id*.

30 Detroit Free Press, Trump tax rule change has some rushing to divorce before 2019, Susan Tompor Detroit Free Press (Feb. 23, 2020), https://www.freep.com/story/money/personal-finance/susan-tompor/2018/12/19/divorce-alimony-income-tax-deduction/2310068002/.

mining alimony[31]; in other words, if each spouse earned an equal income, it is significantly less likely that alimony would be awarded at all. If incomes are different, the payer is almost certainly in a higher tax bracket and must pay the tax at a higher rate on the alimony before giving it to the receiver: this ultimately results in a loss for the receiver.

The pre-TCJA IRC provided a tax savings for the couple, and comparatively provided more resources for lower-wage-earning or non-wage-earning spouses. Thus, the changes to the federal statutory tax law almost certainly cause divorcees to pay more in taxes, placing a greater economic burden on the couple. This change neglects and fails to accomplish the purpose of alimony, when compared to the pre-TCJA IRC.

The United States Congress' Joint Committee on Taxation estimated that these changes would generate $6.9 billion in tax revenue between 2018 and 2027. $6.9 billion appears substantial, but it amounts to 0.46 percent of the $1.5 trillion tax cuts provided by the TCJA[32]. While proponents of repealing the alimony deduction may point out that it raises revenue for the federal government, it does so largely at the expense of people who can least afford to contribute to the reduction of the deficit by reducing their economic options.

C. IRA Contribution Implications

The IRS mandates that Traditional Individual Retirement Account (IRA) contributions must meet specific requirements: contributors (1) "must be under age 70 ½ at the end of the tax year", and (2) you

31 Divorce Net, Alimony, Find out how Alimony (spousal support) is determined in a divorce (Feb. 23, 2020), https://www.divorcenet.com/topics/alimony.

32 Bloomberg tax, Alimony Tax Change Upends Payments in Divorce Negotiations, Daily Tax Report (Feb. 23, 2020), https://news.bloombergtax.com/daily-tax-report/alimony-tax-change-upends-payments-in-divorce-negotiations.

"must have taxable compensation"[33]. They state that taxable alimony is treated as compensation for IRA purposes, but because Section 71 was repealed and the burden of tax shifting from the receiver to the payer, alimony is no longer considered taxable to the receiver. This prevents receivers, who are usually lower-wage-earning individuals, from contributing money received via alimony to a tax-advantaged Traditional IRA account, hindering their chance for a financially secure retirement. The implications continue--contributions to a Traditional IRA account are tax deductible depending on whether you are covered by a retirement plan. Those covered are limited in their deduction amounts[34]. Conversely, those who are completely uncovered are entitled to receive the full value of their contributions as a deduction. Deductions can amount to as much as $6,000 if you are younger than 50 years old or $7,000 if you are 50 or older, for the 2020 tax year[35]. The consequences of the repeal of Section 71 extend beyond the decrease in payment amount due to taxes. In addition to receiving less money, receivers also face limitations surrounding retirement planning as it relates to Traditional IRA's and the deductions associated with those IRA's.

III. Solution

To combat the negative economic effects of divorce, it is imperative that federal and state tax codes focus on providing divorcees with the financial resources they need. With more resources, ex-spouses have a greater chance of moving past the many non-financial-related obstacles that accompany divorce. In many ways, the pre-TCJA IRC better served the needs of divorcees and was more in line with the purposes of alimony. Three changes to the current code will rectify existing issues with taxes associated with alimony: (1) reinstating Section 71, once again allowing alimony to be includable in the

33 IRS, Retirement Topics-IRA Contribution Limits, IRS (Jan. 29, 2020), https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits.

34 *Id*.

35 *Id*.

income of the receiver; (2), reinstating an amended version of Section 215, entitling lower-income payers to receive a deduction for alimony; and (3) reinstating Section 62(a)(10), making alimony an above-the-line deduction for payers.

If reinstated, Section 71 will pave the way for many positive repercussions, most of which will benefit the receiver. Alimony will again be includable for the receiver and they will have the ability to use alimony to make contributions to a Traditional IRA, increasing the probability of a financially secure retirement. Additionally, income will no longer be includable for the payer, thus they would no longer bear the burden of tax. Instead, the burden will shift back to the receiver, who is usually in a lower tax bracket. The receiver would retain a greater proportion of their alimony. In other words, although the change is seemingly small, it will almost certainly result in a tax savings for the couple. Furthermore, all of the tax savings will go to the receiver therefore increasing their overall support.

As previously explained, reinstating and amending Section 215 will help the payer retain a greater proportion of their income. Instead of an exact reinstatement of Section 215, an amended version, that accounts for the need to reduce the deficit, may be most helpful. Preserving the alimony deduction for all, except the very highest income earning payers, will ensure all payers receive the resources they need while maintaining additional tax revenue, which would contribute to the reduction of the federal deficit. While the amount contributed to the reduction would be less, it is unjust to take from alimony-paying individuals who are already experiencing a tumultuous and expensive lifestyle change. To bring the deduction above-the-line, reinstating the amendment to Section 62 would be also necessary.

The losses incurred because of tax burdens shifts and the elimination of the deduction may seem insignificant, but they are more accurately depicted when considered in the context of divorce. With a $15,000 average cost of divorce, and the additional cost of supporting two households instead of one, life after divorce can be financially aggravating, and more expensive. Couples can pay more for housing, utilities, insurance, vehicles, and many other costs that were previously shared. These additional costs require divorcing individuals to make on average 30 percent more if they hope to maintain an equal standard of living after divorce[36].

IV. CONCLUSION

If the Internal Revenue Codes that pertain to alimony are not changed, thousands of divorcing Americans will continue to suffer financially. In the United States, there were over 780,000 divorces in 2017 alone[37]With a nationwide divorce rate of approximately 45 percent[38], it seems that divorce will continue to affect many. Thus, it is imperative that federal tax codes adhere more closely in fulfilling the purposes of alimony, eliminating financial disparities between payers and receivers. Although the post-TCJA tax code generates revenue for the federal government, it harms divorcing couples, making the process more painful and expensive, and making it more difficult to escape the negative financial repercussions.

This article has used previous and existing federal tax codes to examine the financially harmful tax treatment of alimony in the United States of America. We have identified specific issues with the existing federal tax codes. It seems evident that siphoning resources from divorcing couples, to provide a minor contribution to the deficit reduction, is ineffective. For this reason, we call on federal legislatures to reinstate Section 71, reinstate an amended version of Section 215, and reinstate Section 62(a)(10). These changes will bring tax codes more in line with the purposes of alimony, alleviate alimony-related financial issues, and empower divorcees because the laws

36 Men's Divorce, Understanding How Divorce Affects Your Standard of Living, From Bottom Line to Dotted Line (Feb. 23, 2020), https://mensdivorce.com/standard-of-living/.

37 Marriage and Divorce, Centers for Disease Control and Prevention, National Center for Health Statistics (Feb. 28, 2020), https://www.cdc.gov/nchs/fastats/marriage-divorce.htm.

38 PolitiFact, Steve Sweeney claims two-thirds of marriages now end in divorce, Stephen Sweeney says "67% of marriages now wind up in divorce" (Feb. 23, 2020), https://www.politifact.com/factchecks/2012/feb/20/stephen-sweeney/steve-sweeney-claims-more-two-thirds-marriages-end/.

will inherently value each spouses' future as they move beyond the failed relationship, and on to a new life.