The End of the "Alimony" Deduction Under the "Tax Cuts and Jobs Act of 2017": The Need to Deviate on Presumptive Spousal Support and the Unknown Future

By Lee Rosenberg, Editor-in-Chief

As those following the national news are aware, the "Tax Cuts and Jobs Act of 2017" is a major revision of United States tax law. What is lost on the general public, but as most practitioners know beginning in 2019, this legislation also eliminates the "alimony deduction"[1] which we all rely upon in calculating and negotiating spousal support.[2] The effect of same throws out decades of settled principle which interacts with child support as well as equitable distribution. By way of negotiation, the incentive of the deduction to the payor is gone—as is the ability to make the payment tax free in the course of those negotiations. Beyond this, New York's enactment of a presumptive spousal support award for both temporary and final support[3] continues to provide a formula to be followed which, like the Child Support Standards Act (CSSA), does not consider federal or state tax consequences in its determination of income to which the formula will apply. So, what now?

This article suggests that unless and until the New York State Legislature amends the statute to provide for the consideration of taxes in the income calculation, courts should not hesitate to deviate from the presumptive formula in light of the elimination of the alimony deduction.

The Tax Law

Under the previously existing United States Tax Code, "alimony" as was defined in Internal Revenue Code (IRC) Section 71 is deducted from the payor's income under IRC 215 and added to the recipient's income under IRC 71, as long as the requisite criteria are met. State divorce courts did have discretion to make awards non-deductible and tax free in certain cases.[4] A departure from the norms envisioned by those Internal Revenue Code provisions may otherwise have been considered to be error.[5] Practitioners also had to be aware of the dangers of "alimony recapture" to make sure that the agreed-upon spousal support did not lose its deductibility when front-loading spousal support in the first three "post-separation" years[6] of payment.[7]

Under the "Tax Cuts and Jobs Act of 2017," the repeal of the existing law relating to deductibility is set forth in Section 1309 in its elimination of IRC 71 and 215. The former IRC 71(b)(2) which defined the "Divorce or Separation Instrument" will be found in a new Section 121(d)(3)(C) as follows:

> DIVORCE OR SEPARATION INSTRUMENT.—For purposes of this paragraph, the term 'divorce or separation instrument' means—
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> ''(i) a decree of divorce or separate maintenance or a written instrument incident to such a decree, (ii) a written separation agreement, or (iii) a decree (not described in clause (i)) requiring a spouse to make payments for the support or maintenance of the other spouse.''[8]

Related provisions of the prior law were then amended/stricken to correspond with the elimination of the alimony deduction and the following also added:

> SPECIAL RULES FOR SUPPORT.—
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> ''(A) IN GENERAL.—For purposes of this subsection—
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> ''(i) payments to a spouse of alimony or separate maintenance payments shall not be treated as a payment by the payor spouse for the support of any dependent, and (ii) in the case of the remarriage of a parent, support of a child received from the parent's spouse shall be treated as received from the parent.
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> ''(B) ALIMONY OR SEPARATE MAINTENANCE PAYMENT.—For purposes of subparagraph (A), the term 'alimony or separate maintenance payment' means any payment in cash if—

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> "(i) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument (as defined in section 121(d)(3)(C)), (ii) in the case of an individual legally separated from the individual's spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and (iii) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse."[9]

The law will be effective as to any divorce or separation instrument executed *after December 31, 2018 and* to any such instrument [as defined under the old law at 71(b)(2)][10] executed on or before December 31, 2018 and subsequently modified, if the modification *expressly* provides that the new law will apply to such modification.

Prior "Divorce or Separation Instruments"

So for purposes of protection on existing agreements and orders, as far as the IRS will be concerned will a Stipulation of Settlement pending a Judgment of Divorce be deemed a separation instrument or an agreement incident to the decree if the decree is signed after December 31, 2018? Are tax deductible pendente lite orders still good for the time being until the case is finalized or will there be an automatic *retroactive* adjustment? What about the time lag between a trial decision and entry of judgment—even if called a "decision and order" with decretal paragraphs? Navigating these issues without consulting with qualified tax professionals would seem to be a recipe for disaster in advising our clients. If, for example, transferring an IRA under a Stipulation of Settlement (to be incorporated into and to survive the final decree) in advance of the court's signing the judgment would result in a tax consequence, can we define with certainty how the IRS would treat the support deduction? Will the court "So Order" the stipulation of settlement? Can we still look to prior Tax Court decisions to guide us? This is all uncharted territory. In the June 1, 2017 decision in *Mudrich v. Commissioner of Internal Revenue*,[11] the United States Tax Court discussed the issue of the agreement:

> Section 71(b)(1)(A) requires that the payment be "received by (or on behalf of) a spouse under a divorce or separation instrument." Section 71(b)(2) defines a "divorce or separation instrument" as a decree of divorce or a written instrument incident to such a decree, a written separation agreement, or a decree requiring a spouse to make payments for support or maintenance of the other spouse. The record does not support a conclusion that the payment at issue was made pursuant to a divorce or separation instrument.
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> The record *does not contain sufficient evidence* to indicate that the bonus agreement is a decree or a written instrument incident to a decree. There is no evidence in the record showing that the bonus agreement ever became an order in the divorce proceeding. Moreover, the bonus agreement is not a written separation agreement. *The term "written separation agreement" has been interpreted to require a clear, written statement memorializing the terms of support between the parties and entered into in contemplation of separation status*. (Endnote omitted). There is no question that Mr. Mudrich and Lauri entered into a bilateral written agreement; however, that agreement specifically provides for division of community property and not support. Thus, the bonus agreement is also not a written separation agreement.
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> Because the bonus agreement was not a divorce or separation instrument, the payment to Lauri pursuant to the bonus agreement is not alimony. (Emphasis added).

Mudrich cites to *Jacklin v. Commissioner* from 1982,[12]

> *Neither section 71(a)(2) nor the regulations promulgated thereunder define what constitutes a "written separation agreement*." (Endnote omitted). The predecessor of section 71 was enacted to tax support payments to the recipient spouse and to relieve the payor spouse from the burden of being taxed on such payments by making them deductible by him. H. Rept. 2333, 77th Cong., 2d Sess. 46 (1942), 1942-2 C.B. 427; S. Rept. 1631, 77th Cong., 2d Sess. 83-87 (1942), 1942-2 C.B. 568. Initially, this benefit was available only in the case of divorce or a legal separation. Sec. 71(a)(1).9 Section 71(a)(2) extended this benefit to spouses who are not divorced or legally separated under a court decree but who are in fact separated and enter into a written separation agreement. H. Rept. 1337, 83d Cong., 2d Sess. 9 (1954); S. Rept. 1622, 83d Cong., 2d Sess. 10 (1954).
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> ...Another somewhat analogous case lends support to our approach here. *Bo-*

gard v. Commissioner, 59 T.C. 97 (1972). Like the present case, *Bogard* involved a written agreement between the spouses providing for the wife's support and maintenance. However, the agreement itself made no reference to the spouses' separation. Respondent argued that the agreement did not constitute a "written separation agreement" within the meaning of section 71(a)(2) because the document did not state that the parties had separated and were living apart. The Court declined to follow such a formalistic approach and held that the statute merely required an actual separation which could be established by extrinsic evidence. The husband was permitted to prove that he and his wife were in fact separated. The Court declined to hold that the agreement was insufficient as a matter of law.

Leventhal v. Commissioner,[13] which references *Jacklin*, is also cited by the *Mudrich* court:

> As no decree of divorce or separate maintenance was in effect during the years in issue, we must decide whether all or some of the payments were received by or on behalf of Hermine under a written separation agreement.
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> The term "written separation agreement" is not defined in the Code, the applicable regulations, or in the legislative history. *Jacklin v. Commissioner* [Dec. 39,278], 79 T.C. 340, 346 (1982); *Keegan v. Commissioner* [Dec. 52,190(M)], T.C. Memo. 1997-359. A written separation agreement has been interpreted to require a clear statement in written form memorializing the terms of support between the parties. See *Jacklin v. Commissioner*, supra at 350; *Bogard v. Commissioner* [Dec. 31,570], 59 T.C. 97, 101 (1972). Letters which do not show a meeting of the minds between the parties cannot collectively constitute a written separation agreement. (Citations omitted) However, where one spouse assents in writing to a letter proposal of support by the other spouse, a valid written separation agreement has been held to exist. See Azenaro v. Commissioner [Dec. 45,684(M)], T.C. Memo. 1989-224. Furthermore, a written separation agreement will not fail simply because it does not enumerate a specific amount of required support, so long as there is some ascertainable standard with which to calculate support amounts. See *Jacklin v. Commissioner*, supra at 348-351.

Leventhal then cites back to a 1949 decision in *Jefferson v. Commissioner*[14] in which the court discusses whether or not a May 20, 1941 letter addressing support for the years 1942 and 1943 was a "written instrument" that was "incident to" a divorce decree initially entered on July 23, 1941:

> The doctrine is well settled that an instrument purporting to set forth the mutual obligations of the parties signed and performed by one of the parties and acquiesced in by the other, is to be regarded as a written contract. See 17 C. J. S., Contracts, p. 409, § 59. We agree with the contention of petitioner that the terms of the letter of May 20 with reference to the support and maintenance of Violet constituted a "written instrument" within the intendment of section 22 (k), supra.

Since, however, the new Tax Law will be untested and it will be unknown how new judicial appointees may view the deductibility issue, it would seem that *at the very least,* we must do the following: (1) Use separation language in our settlement agreements; (2) add language that it is intended for the agreement to be incident to the parties' divorce; (3) provide for adjustments in the agreement in the event the deductibility is lost; (4) consult with qualified tax experts; (5) make sure any agreements are specific on the issue regarding the client's consultation with tax experts, and carefully set forth all related exculpatory provisions; (6) be prepared to present evidence of the tax ramifications on the issue in motion practice and at trial; (7) don't forget to add all appropriate language to *prenuptial agreements*; (8) beware of merging 2018 agreements into the judgment of divorce as the agreement will no longer separately exist.

The Effect of the Tax Change on Presumptive Support Guidelines

After much discussion, controversy and debate, New York's current support statute on final maintenance went into effect as to those cases commenced on or after January 25, 2016. The temporary support statute [DRL§ 236B(5-a)] went into effect initially on October 12, 2010 and was then amended as to cases commenced on or after October 25, 2015. Under all, income to be used is governed by the definitions used in the determination of child support under the CSSA beginning with "Gross (total) income as should have been or should be reported in the most recent federal income tax return."[15] For child support purposes, the adjusted gross income in calculating that presumptive award will consider spousal maintenance which is paid.[16] Presumptive child support is then calculated after allowable deductions, including spousal

support payments, based upon CSSA-defined adjusted gross income.

Under the long existing tax law, the "alimony" deduction is set forth on the IRS Form 1040 at line 31a, "Alimony paid" in the "Adjusted Gross Income" Section. Such payments, if qualifying under IRC §§ 71 and 215, reduce the taxpayer's income by 100% of the payment before determining the amount of tax which is due and adds the payment to the recipient's income. Under the CSSA, taxes, other than New York City or Yonkers taxes actually paid,[17] are *not* deductible from gross (total) income when calculating the presumptive basic child support obligation so that the child support payment is tax free to the recipient and the payor gets no financial tax benefit. While this is a "given" in calculating child support, the maintenance guidelines are presumptively established with the historic notion that the spousal support payment will be deductible by the payor and income to the payee. The change in the tax law now unfairly skews that presumption.

Deviation

Given that in the enactment of the maintenance formulas, such a drastic change in the tax law was not considered, the recipient receives a windfall by virtue of a tax-free payment that was not contemplated, and the payor loses a tax deduction which may very well have also been used in arriving at the temporary order and in a settlement agreement. This is simply "unfair and inequitable."

When the initial temporary spousal support law was passed, it was widely criticized for what the law did not consider. It was then left up to the courts to correct the inadequacies so as to provide fairness. It took the legislature some six intervening years to statutorily catch up and given that history, further amendment to adjust for the change in the tax law could very well be far off. Such a change is imperative and necessary. Our courts, however, sitting in equity and with the ability to deviate from the "presumptive" and now tax-free award, do not and should not have to wait for that to occur. The statute provides for deviation when the result would be unjust, based upon stated factors, specifically including the "tax consequences to each party" as is set forth in factor "j" of DRL §§ 236B(5-a)(h)(1) and 236B(6)(E)(1) and the catch-all "any other factor which the court shall expressly find to be just and proper."

When the initial temporary support law was passed, it was legislatively designed to "income shift."[18] But, as was referenced in *Khaira v. Khaira*,[19] the law did not contemplate or address the issue of "whether the statutory formulas are intended to include the portion of the carrying costs of their residence attributable to the non-monied spouse and the children." Accordingly, the court had to fashion an equitable remedy which is "reasonable and logical" by "view(ing) the formula adopted by the new maintenance provision as covering all the spouse's basic living expenses, including housing costs as well as the costs of food and clothing and other usual expenses." In considering the statutory factors, the court is within its discretion to find the presumptive award to be unjust or inappropriate.[20] In *Harlan v. Harlan*,[21] the court, considering statutory factors *vis-a-vis* the presumptive guidelines in the wife's claim for an *upward* deviation, noted "the statute's attempt to reserve to the court a *seemingly endless equitable power* to achieve a 'just and proper' temporary maintenance allocation. In prior cases, this court, among others, have used the broad scope of the (q) factor to evaluate temporary maintenance proposals." (Emphasis added). The court then, among many other factors cited, "calculate(d) the tax consequences" to the parties in trying to find that "just and proper" result.[22]

Such basis for deviation should now be used in light of the elimination of the alimony deduction.

The Rush to Resolution

As the last minute adjustments to the Tax Cuts and Jobs Act of 2017 provided an extension of time for its effectiveness until December 31, 2018, there is some time for the bench and bar to start examining the ramifications of the elimination of the alimony deduction. In the interim, there will be a push to get cases settled and tried to conclusion—with the entry of judgment—before the end of 2018. Given the overwhelming caseloads of our trial and appellate courts, however, the squeeze will be on. Whether the New York State Legislature will want to, or be able to, adjust the maintenance statutes after having previously undertaken the arduous path to enactment and amendment, remains to be seen. As is most often the case, it will be up to counsel to be creative and our matrimonial courts to provide equity, as new law will have to be made to address the "upside down"[23] created by the change in the tax law. Once more into the breach, dear friends.[24]

Endnotes

1. The United States Tax Code has continued to use the term, "alimony" while New York transitioned from "alimony" to maintenance" as part of the statutory changes made in 1980.
2. While the elimination of the alimony deduction went largely undiscussed in light of other controversial aspects of the legislation, the American Academy of Matrimonial Lawyers voiced its opposition to the provision by Resolution on November 15, 2017.
3. DRL §§ 236B(5-a) and 6.
4. Internal Revenue Code (26 USC) §71(b)(1)(B); *Bragar v. Bragar*, (1st Dep't 2000); *Kesten v. Kesten*, 234 A.D.2d 427 (2d Dep't 1996); *Lowe v. Lowe*, 211 A.D.2d 595 (1st Dep't 1995).
5. *Siskind v. Siskind*, 89 A.D.3d 832 (2d Dep't 2011); *Grumet v. Grumet*, 37 A.D.3d 534 (2d Dep't 2007).
6. IRC 71(f)(6) "Post-separation years. For purposes of this subsection, the term "1st post-separation years" means the 1st

calendar year in which the payor spouse paid to the payee spouse alimony or separate maintenance payments to which this section applies. The 2nd and 3rd post-separation years shall be the 1st and 2nd succeeding calendar years, respectively."

7. IRC 71(f)
8. The new language is essentially the same as in the prior definition which was, "The term "divorce or separation instrument" means (A) a decree of divorce or separate maintenance or a written instrument incident to such a decree, (B) a written separation agreement, or (C) a decree (not described in subparagraph (A)) requiring a spouse to make payments for the support or maintenance of the other spouse."
9. Section 152(d)(5)
10. *Supra*, note 6.
11. T.C. Memo 2017-14.
12. 79 T.C. 340 (1982).
13. 79 T.C. 1670 (2000).
14. 13 T.C. 1092 (1949). *See also Micek v. Commissioner*, T.C. Summary Opinion (2011-45) from April 6, 2011 involving a spousal support affidavit signed only by the husband qualifying as a "written separation instrument."
15. DRL § 240(1-b)(b)(5)(i).
16. See DRL § 240(1-b)(b)(5)(iii)(I); DRL § 240(1-b)(b)(5)(vii)(C); DRL §§ 236B(5-a)(c)(1)(f); and DRL §§ 236B(6)(c)(1)(g).
17. Also, the full amount of self-employment tax, which is in lieu of the Social Security/Medicare deductions. *See Myesha M. v. Omel McL.*, 61 A.D.3d 534 (1st Dep't 2009); *Haas v. Hass*, 265 A.D.2d 887 (4th Dep't 1999); *Carlin v. Carlin*, 217 A.D.2d 679 (2d Dep't 1995).
18. *Scott M. v. Ilona M.*, 31 Misc. 3d 353 (Sup. Ct., Kings Co. 2011).
19. 93 A.D.3d 194 (1st Dep't 2012).
20. *Osha v. Osha*, 101 A.D.3d 481 (1st Dep't 2012); *Goncalves v. Goncalves*, 105 A.D.3d 901 (2d Dep't 2013); *Su v. Su*, 128 A.D.3d 949 (2d Dep't 2015).
21. 46 Misc. 3d 1003 (Sup. Ct., Monroe Co. 2014). Notably, Harlan also provides an interesting discussion on the efficacy of the ongoing prohibition against the pendente lite sale of a marital residence under *Khan v. Khan*, 43 N.Y.2d 203 (1977).
22. The former "catch-all" factor "q" is now "m" under the temporary statute and "o" under the post-divorce support statute. Again, both the temporary and final maintenance statutes at factor "j" specifically reference "tax consequences to each party" for purposes of income over the statutory cap and deviation where the guideline amount is unjust or inappropriate.
23. Stranger Things, Netflix (2016).
24. W. Shakespeare, Henry V, Act III, Scene I.