

**THE NEW TAX LAW:  
WHAT YOU SHOULD KNOW AND  
CONSIDERATIONS FOR DRAFTING  
SEPARATION AND PRENUPTIAL  
AGREEMENTS**

**MCLE**

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# TAX CUTS AND JOBS ACT OF 2017

- Almost all individual tax provisions EXCEPT ALIMONY are not permanent. They expire in 2026
- BUT – different political climate may mean the repeal or amendment of these provisions. Blue Wave at mid-terms?
- Corporate tax rate reduction to 21% is permanent
- **Reason for different treatment** – Republicans wanted to enact the bill through the Reconciliation process which requires only 51 votes. But the *Byrd* rule allows Senators to block legislation if it would significantly increase the budget deficit beyond a 10 year term.

## **ALIMONY: THE LAW AS WE KNEW IT WILL SOON BE A FADED MEMORY**

- IRC, section 71 **CURRENT LAW**

Payments that qualify as alimony are taxable income for the recipient.

- IRC, section 215 – Alimony, etc. payments **CURRENT LAW**

Permits the deduction of alimony payments that are includable in the gross income of the recipient under section 71

# ALIMONY TAX DEDUCTION REPEALED

- IRC section 11051(a) repeals IRC section 215
  - “...Part VII of subchapter B is amended by striking section 215...”
- IRC section 11051(b)(1)(B) repeals IRC section 71
  - “...Part II of subchapter B of chapter I is amended by striking section 71...”
- **“Permanent” repeal** -- no sunset like other provisions
- But future Congress could repeal

## APPLIES AFTER 12/31/2018

- TCJA section 11051(c)
- TCJA applies to “**divorce or separation instrument**” executed after December 31, 2018.
- Alimony paid under a pre-2019 agreement or court order is **grandfathered** unless parties “opt-in” to the new law. In other words, **section 71 and 215 still apply provided there is no “opt-in”**.

## WHAT IS A “DIVORCE OR SEPARATION INSTRUMENT”?

- **Same definition as always -- section 71 (b)(2).** (Actually – TCJA struck IRC s.71 and replaced this part with identical language.)
  - (i) a decree of divorce or separate maintenance or written instrument incident to such a decree
  - (ii) a written separation agreement, or
  - (iii) a decree, not described in clause (i) above requiring a spouse to make payments for the support or maintenance of the other spouse.

**Assumption – look to existing case law for guidance.**

## QUALIFICATIONS FOR GRANDFATHERING PRE-2019 AGREEMENTS

- *Micek v. CIR*, T.C. Summ.Op. 2011-45 (2011)
- Couple separated in 1997. Oral agreement in 1999 that H pay W alimony of \$1,250 per week. Later in 1999, H signed a “spousal support affidavit” agreeing to pay alimony in same amount. In 2003, H stopped paying because he was disabled. W attorney wrote to H: why has the alimony stopped? (A few years later – not clear when – H filed for divorce. Parties agreement incorporated in divorce contained mutual waivers of alimony.) IRS filed a notice of deficiency disallowing H’s alimony deductions for the years 2000 to 2003.
- H filed in Tax Court.

## MAIN ISSUE FOR MICEK COURT

- Was alimony paid pursuant to a “written instrument incident to a divorce decree” ? Tax Court – YES\*
- -- “spousal support affidavit” signed by husband in combination with the letter from W’s attorney indicating her client’s understanding that alimony was to be paid
- -- written instrument signed by one party PLUS written evidence of W’s understanding = “written instrument incident to a divorce decree.”
- -- Writing and meeting of minds critical

\*no focus on “incident to divorce decree” particularly considering time gap between instrument and divorce filing



**LEVENTHAL V.  
COMMISSIONER, 19 TC  
1670 (2000)**

- **What kind of writing would suffice to grandfather tax deductible / includible alimony treatment?**
- -- Must show “meeting of minds”
- -- “Clear statement in written form memorializing the terms of the support between the parties.”
- -- “One spouse assents in writing to a letter proposal of support by the other spouse”
- -- Not necessary to articulate specific amount of support so long as “there is ascertainable standard with which to calculate support amounts”

# PRENUPTIAL AGREEMENTS

- Is it a written instrument incident to a divorce?
- “written instrument – **YES**
- ”incident to a divorce” – **NOT CLEAR**
- What do we tell clients with prenups?
- Should we consider postnuptials?
- What about getting a declaratory judgments, or asking IRS for a private letter ruling?

## **WHAT IF PRE-2019 ALIMONY IS MODIFIED?**

- If pre-2019 alimony is modified, it is still taxable/deductible unless the modification expressly applies TCJA non-deductibility.
- BUT: What about a 2018 temporary alimony order followed by a 2019 judgment of divorce that includes an alimony order?



## 2018 TEMPORARY ORDERS FOLLOWED BY 2019 JUDGMENT

- How did IRS treat the issue in 1984 when the last big tax reform was enacted?
- If [decree of divorce] executed after 12/31/84 incorporates or adopts without change the terms of the alimony [amount or length of time payments are to be made] under a divorce or separation instrument executed before 1/1/85 such decree will be treated as executed prior to 1/1/85 and therefore GRANDFATHERED. 26 CFR s1.71-1T (Q-A #26)

# MASS. ALIMONY REFORM ACT

- -- Alimony [is defined as] the payment of support from a spouse, who has the ability to pay, to a spouse in need of support for a reasonable length of time, under a court order **GL c 208 s 48** **SAYS NOTHING ABOUT TAXABILITY**
- -- Except for reimbursement alimony or circumstances warranting deviation for other forms of alimony, the amount of alimony should generally not exceed the recipient's need or 30 to 35 per cent of the difference between the parties' gross incomes established at the time of the order being issued. Subject to subsection (c), income shall be defined as set forth in the Massachusetts child support guidelines. **GL c 208 s 53(b)**
- -- **30%-35% OF GROSS INCOME THAT PAYOR CANNOT DEDUCT IS GROSSLY INEQUITABLE!**

## **LEGISLATURE NEEDS TO AMEND THE ARA**

Will they do it? And when?

Meanwhile:



## DEVIATION PERMITTED UNDER CURRENT ARA

- (e) In setting an initial alimony order, or in modifying an existing order, the court may deviate from duration and amount limits for general term alimony and rehabilitative alimony upon written findings that deviation is necessary.  
**Grounds for deviation may include:**
  - (2) **tax considerations applicable to the parties;**
    - G.L. c.208 s.53(e)(2)
- **MAKE SURE TO POINT TO COURT'S DISCRETION IF NECESSARY IN AN ALIMONY CASE!!!**

## **ALIMONY DEDUCTIBLE UNDER STATE LAW?**

- Schedule X, line 1 – Alimony received
- Schedule Y, line 3 – Alimony paid
- Unclear whether Massachusetts will change tax treatment of alimony



# DEDUCTION OF CERTAIN LEGAL FEES

- TCJA eliminated most “Miscellaneous Deductions” *except certain of those related to production of income.*
- **Legal fees related to producing or collecting taxable income or getting tax advice are deductible. IRC s.212**
- Divorcing clients can deduct legal fees related to alimony – when the alimony is taxable income
- **If alimony not taxable income, then legal fees not deductible**
- NOTE – these deductions only matter if you itemize and they are subject to 2% floor. (That is, deductible to extent they exceed 2% of AGI.) With standard deductions increased, fewer people will itemize.

# RECAPTURE

- Recapture in 13 words – avoid big differences in alimony payments in the first 3 years after divorce.
- No more recapture to worry about with non-grandfathered alimony orders/agreements!!! IRC s. 71 (f)

**BUT, WATCH OUT** for any big swings in the first 3 post-separation years: if parties agree to opt-in for TCJA when they modified pre-2019 agreement, could there be recapture issues?

## SUGGESTED LANGUAGE RE: FUTURE LAW CHANGES

- This Agreement has been negotiated and executed on the assumption that the payments described in this paragraph will be deductible to xx and taxable to xx. If, as a result of a final and binding judicial determination or because of a subsequent change in the governing law or its authoritative interpretation, it is established that any or all of said payments are not deductible by xx, the parties agree to renegotiate the amount of the alimony payments so that this amount is consistent with the intention of the parties. If they are unable to agree, they shall [do so by a modification action in the appropriate jurisdiction] or [arbitration, mediation, etc]
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**SUGGESTED LANGUAGE FOR PRE-  
1/1/2019 PRENUPTIAL &  
SEPARATION AGREEMENTS  
CONTAINING ALIMONY**

- This Agreement has been executed prior to the effective date of the Tax Cuts & Jobs Act of 2017 (“TCJA”), with the mutual intent of the parties that the alimony payments provided by this paragraph shall be deductible to the payor under IRC section 71 and taxable to the recipient under section 215. If the alimony payments should be modified hereafter by an agreement or court order subsequent to the effective date of the TCJA, the parties agree that they shall NOT elect to apply the TCJA to the alimony payments made after such modification. **The parties intend and agree that all alimony payments made pursuant to this divorce instrument, and any modification of its alimony provisions, shall continue to be treated as “alimony” deductible to the payor and taxable to the recipient** under IRC section 71 and 215 if eligible in all other respect.

**SUGGESTED LANGUAGE FOR PRE-  
1/1/2019 PRENUPTIAL &  
SEPARATION AGREEMENTS  
CONTAINING ALIMONY CONT'D**

- **If the payor's alimony tax deduction should be disqualified**, as a result of a final and binding judicial or administrative determination, or because of a subsequent change in the governing law or its authoritative interpretation, **the amount of alimony shall be reduced by an amount equal to the payor's intended tax benefit**, effective on the earliest date in which the deduction is disqualified. The payor's intended tax benefit shall be calculated by a certified public accountant using the "with-and-without" method to measure the individual income tax payable by the payor with and without the section 71 alimony tax deduction. Any tax refund received by the recipient shall be paid over to the alimony payor toward reimbursement of the payor's increased tax liability as a result of the disqualification. Any deficiency, or other dispute arising between the parties with regard to this provision, must be submitted to mediation before the parties may proceed to court for a judicial determination.

**SUGGESTED LANGUAGE FOR POST-  
12/31/2018 PRENUPTIAL AND SEPARATION  
AGREEMENTS CONTAINING NON-  
TAXABLE PERIODIC PAYMENTS**

- This Agreement has been executed subsequent to the effective date of the Tax Cuts & Jobs Act of 2017 (“TCJA”), with the mutual understanding of the parties that the periodic payments provided by this paragraph shall be neither taxable to the recipient as alimony nor tax-deductible to the payor. **If**, prior to the expiration of the payor’s obligation, the **alimony tax deduction should be restored to its pre-TCJA form** by a change in the governing law or its authoritative interpretation, **the parties agree that they shall designate the periodic payments as taxable to the recipient and deductible to the payor**; as they would have been entitled to do under section 71(b)(1)(B).

# ALIMONY TRUSTS

- IRC section 682 also repealed
- Treasury will be issuing guidance for **existing trusts**

# DEPENDENCY EXEMPTION

- Dependency Exemption was \$4,050 per child in 2017 (eg. it is worth about \$1,200 to someone with an effective rate of 30%)
- TCJA **reduces dependency exemptions to zero** through 2025 – they are not eliminated. They are not, however, worthless because certain other benefits follow the person who holds the exemption (eg. child tax credit) (§ 11041 (a)(2) )
- **Tip:** Allocate dependency exemption in agreements (eg. Dad will get the exemption, *if available*)
  - Particularly where kids are young
  - Even if not young, remember TCJA could be repealed anytime as the politics change





# DEPENDENCY EXEMPTION (CONT'D)

- What happens to **existing agreements** in which dependency exemptions were allocated?
- Maybe they split the exemptions and the new law is a loss for both
- **BUT: what if one of the parties negotiated this tax benefit as a trade off for another concession?**
- Is the fact that it is worth ZERO now grounds for modification?

# CHILD TAX CREDIT

- **CREDIT MORE VALUABLE THAN DEDUCTION, APPLIES DIRECTLY AGAINST TAXES**
- **Child Tax Credit - 2017**
- \$1,000 per kid
- Reduced by \$50 for each \$1,000 over AGI of \$75,000 for single or HOH, \$110,000 for MFJ, and \$55,000 for MFS
- Refundable up to 15% of earned income over \$3,000
- Refundable Credit = credit can be used to increase your tax refund or create a tax refund when you didn't already have one.

## **CHILD TAX CREDIT (CONT'D)**

- **Child Tax Credit - 2018**
- Increases to \$2,000 per kid -- **MORE VALUABLE USUALLY THAN DEP EXEMPTION**
- Refundable amount limited to \$1,400 per kid
- Phase-out thresholds increased to \$400,000 for MFJ and \$200,000 for all other taxpayers
- **NOTE – AS BEFORE, CHILD MUST BE UNDER 17 ON 12/31 OF THE TAX YEAR FOR CTC TO APPLY**

## CHILD TAX CREDIT (CONT'D)

- Pre-TCJA, Child Tax Credit was available only to the person who had the dependency exemption
- Divorced parents could allocate dependency exemption
- Dependency exemption reduced to zero through 2025 but not eliminated (§ 11041(a)(2) )
- **Child Tax Credit can be allocated to person who has dependency exemption**
- Assumption: Continue to Use Form 8332