‘Hurry Up and Get a Divorce’? For the Rich, There’s an Incentive

Image

A change in the new Republican tax law will eliminate a tax break for alimony payments that are finalized after Dec. 31.CreditAndrew Caballero-Reynolds/Agence France-Presse — Getty Images

By Jim Tankersley

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WASHINGTON — For the wealthiest Americans, there may never be a better time to get divorced.

A change in the new Republican tax law will eliminate a tax break for alimony payments that are finalized after Dec. 31, prompting financial planners and lawyers to warn wealthy clients that if they have been contemplating filing for divorce, they had better act fast.

Under the law, Americans who finalize or modify divorce agreements in 2019 or later will no longer be able to deduct alimony payments from their taxes. Agreements signed before the end of the year will still qualify for the annual deduction — a distinction with large financial implications for couples where one partner earns substantially more per year than the other.

“I have never wanted to counsel people, hurry up and get a divorce,” said Fern Frolin, a divorce lawyer at Mirick O’Connell in Boston, whose clients often have high incomes. “I always want to say, ‘Take your time, think if this is the right thing for you.’ But in this particular instance, we could be talking about 15 to 20 years of support, and shifting the tax burden for the last years of a person’s working life.”

For decades, Americans paying alimony to a former spouse have been able to deduct the payments from their taxes, providing a potentially generous tax break depending on the size of the payments and the gap in earnings between spouses. About 600,000 taxpayers claim the deduction each year, according to the Internal Revenue Service.

Under the current system, people paying alimony can deduct those payments — no matter how big the amount — from their income before calculating what they owe in taxes. That deduction provides a significant benefit to the wealthiest Americans, whose top tax rate is 37 percent and who would otherwise owe taxes on all of their income, including what they paid out in alimony. Right now, the rich disproportionately deduct alimony — about 20 percent of taxpayers who currently claim the deduction are in the top 5 percent of household income earners.

Eliminating the benefit will hit certain types of divorced couples harder, primarily hurting those who earn vastly different amounts of income and are taxed at different rates. Under the current code, if the person paying alimony earns substantially more than their former spouse, he or she generally negotiates a higher payment because the payer can deduct the full amount from his or her income and the former spouse, who earns less, pays a lower tax rate on alimony payment. The new treatment takes away that benefit, putting pressure on high earners to pay more to support their former spouses — or hurting the lower-earning spouse, if the higher earner demands to pay less to make up for the lost tax break.

The Joint Committee on Taxation estimates elimination of the tax break will increase federal revenues by $7 billion over the course of a decade.

Its elimination is one of several provisions in the new $1.5 trillion law that affect high-earning married couples, including so-called marriage penalties on couples earning more than $600,000 a year. That penalty, which was eliminated for middle- and lower-income couples, makes it less advantageous for high-income married couples to file jointly because they hit the top marginal tax bracket faster than they would if each party filed separately. The law also caps the amount of state and local taxes that couples can deduct at $10,000 a year, which is the same as the cap for single filers — a disadvantage for couples.

Lawyers warn that the loss of the alimony deduction could disproportionately hurt women, who are the more frequent recipients of alimony payments and who face a higher risk of income decline after divorce than men. It could also reduce the welfare of some children.

Child support payments are not deductible, but so-called unallocated support — payments that are meant to help a divorcing spouse and children at the same time — is deductible. That deductibility will also end for any new or modified divorce agreements, starting in 2019.

Divorce professionals are helping high-end clients devise complicated workarounds in the event they cannot complete their agreements before the deadline, including shifting the balance between cash and property changing hands in a settlement and funneling alimony payments through tax-exempt retirement accounts.

But mostly, they advise to finish negotiations before the end of the year.

“It is going to create a bit of a frenzy, especially at the end of the year, to get judgments through,” said David Magnuson, a financial planner in Burlingame, Calif., who earlier in his career worked as a divorce mediator.

It is too soon to tell in official statistics whether the deadline in the law is driving even a temporary increase in divorce rates. More educated, higher-earning Americans are less likely to divorce than their lower-earning, less-educated peers, research shows. Divorce rates have fallen in the United States, both since the 1980s and since the end of the Great Recession. Marriage advocates say the law might slightly reduce divorce rates in the long term, if it ends up hurting women, who are more likely to initiate proceedings.

“If the new tax regime is more likely to disadvantage them economically, that could put some damper, I would say a slight damper, on divorce over all,” said W. Bradford Wilcox, the director of the National Marriage Project at the University of Virginia.

Divorce professionals expect that in many cases, that will mean less money for the spouse receiving alimony — or, at the very least, a major source of contention in negotiations between parties.

“What we are telling clients is, the payer is going to have a lot of leverage to negotiate lower spousal support in 2019,” said Jeremy Runnels, a financial planner at West Coast Financial in Santa Barbara, Calif.