

Divorce and Taxes—“Why NOW is the Time to Pay Attention”

On December 22, 2017, President Donald Trump signed H.R. 1, more commonly known as the "Tax Cuts and Jobs Act," into law. Included in this major tax overhaul, under Section 1309, is a provision that turns the alimony/maintenance payment scheme as we know it inside out. Prior to passage of the Tax Cuts and Jobs Act, maintenance payments were tax deductible for the payor, and the payee was required to recognize the payments as income and pay taxes on them. Under the new law, maintenance payments will neither be deductible by the payor nor includible in the income of the payee.

Why should this matter to you? The good news is that if you're already divorced and making or receiving maintenance payments, it doesn't really matter to you. The new rules will not affect anyone who finalizes their divorce on or before December 31, 2018. However, if you get divorced after December 31, 2018, you will be subject to these changes. It's hard to know exactly what courts will do when awarding maintenance payments after the new law takes effect. It's likely that here, in Illinois, that the legislature will amend our statute prior to December 31, 2018 to change the gross numbers, currently used, to net numbers in our maintenance formula¹. Especially in scenarios where one spouse wasn't working or had limited income, this change will result in a loss of the benefit of leveraging the recipient's lower tax rate, and a reduction in the payor's tax rate, to increase the available after tax cash to both parties.

Things get even murkier for married couples with prenuptial agreements drafted before this new legislation was introduced. A prenuptial agreement drafted before Republican lawmakers introduced their bill would have been drafted in the shadow of the old law, taking into account that all maintenance payments would be treated as tax deductible by the payor and taxable income for the payee. Couples that entered into prenuptial agreements before the new law was passed, who then get divorced after December 31, 2018, are left in a gray area wondering whether or not a court will enforce their maintenance provision in light of the new law. In other words, if there was a maintenance provision in the prenuptial agreement, it was almost certainly based on taxable/deductible maintenance, which will no longer be allowed after December 31, 2018.

These married couples have two (2) options to consider. The first is to wait and see how a court will enforce their maintenance provision should they get divorced after December 31, 2018. The new law has not gone into effect yet, and it's impossible to tell what a court will do with a taxable maintenance provision. By leaving this matter to chance, couples are at risk of an unfavorable outcome for one or both sides, likely to result in costly and contentious litigation. In other words, the wait and see approach is not recommended. Alternatively, these couples can and should be proactive and amend their prenuptial agreement to address the new tax provision and avoid the high cost of future litigation. While an amendment to a prenuptial agreement still comes with a price tag, it's a small price to pay for making sure the original intent of the parties is served and to bring peace of mind and the assurance of avoiding costly and unnecessary litigation.

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¹ The current maintenance formula in Illinois is 30% of the payor spouse's gross income less 20% of the recipient spouse's gross income, but not to exceed 40% of the total gross income, however, this only applies to households where there is \$500,000 or less of combined gross income.