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Maintaining Tax Deductible Alimony Under Tax Cut and Jobs Act

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The Tax Cut and Jobs Act (TCJA) impacts divorces occurring after Dec. 31, 2018, through the elimination of taxable/tax deductible alimony. The TCJA essentially nullifies the statutory factor of the consequences from the tax treatment of alimony, N.J.S.A. 2A:34-23, because all future alimony payments will be nontaxable.

Recipients of alimony may naively celebrate the change, believing that they will benefit from the new law because they will not be taxed on their alimony. However, the changes impacting alimony under the TCJA are not likely to increase the net support they will receive, as courts and practitioners will implement revised alimony calculations to account for the change in the tax laws. The bottom line is that alimony obligations will now be smaller than prior awards under the old tax law to avoid an unfair windfall to the recipient, and undue hardship to the payor.

However, there may be occasions where divorcing parties and their respective counsel seek creative alternatives to allow the payor to maintain some form of a tax deduction for support payments. This article explores possible scenarios through the use of real estate, business assets, or the formation of a trust that could potentially allow a payor to get a tax deduction for payments made to a payee, while shifting the tax consequences to the recipient in cases where both parties believe that doing so would be of benefit to them.

Before providing possible methods for achieving this purpose, it is important to remember that no tax professional or matrimonial attorney will condone the use of any of these concepts in an unlawful manner. Both attorneys and accountants must be mindful that creative settlements that appear to be intended to circumvent TCJA may be scrutinized and disallowed by the IRS, which could give rise to potential malpractice liability as well as tax fraud exposure for clients. Therefore, the implementation of any of these suggestions should always be thoroughly vetted by appropriate tax professionals in view of the specific facts of a given case, and all applicable tax laws.

Real Estate

Real estate holdings offer potential methods for transferring income. The real estate owner can set up a real estate management company, designating the former spouse as either as the principal or an employee. The management company would collect a percentage of the rents from each property being managed, which would be paid as a management fee to the former spouse. The management fee would be taxable to the recipient and deductible by the business. To guard against future scrutiny, the recipient should legitimately perform work for the business and keep a detailed calendar of property visits to document the employment. With this type of a structure, the recipient could also deduct usual and ordinary expenses, such as auto, telephone or office expenses, if incurred, which would provide an additional tax benefit. If there is no legitimate employment, and the business owner is only carrying an ex-spouse on the books, the parties are at risk of triggering various unintended consequences, whether from the IRS or other administrative agencies.


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There are other possible uses of real estate that may achieve the same end. The real estate holder can create a non-equity position for the recipient ex-spouse whereby the payee can receive a profit distribution in the form of a guaranteed payment. The guaranteed payment would provide a deduction from revenue for the entity and taxable income for the recipient which, again, is the desired effect that the prior tax law allowed. This may not be appropriate in high conflict situations where divorcing couples are looking to get as far away from each other as possible, as this scenario keeps them joined in a financial relationship through real estate.

Both of these real estate scenarios come with many possible setbacks, the most significant being the sale of the property. In the first scenario, without the property, no management fees could be paid. In the second scenario, no guaranteed payments could be paid. In both instances, the recipient would not be entitled to a share of the sales proceeds, unless a support buyout formula is also negotiated, which creates the potential for abuse by the titled party. If the payee is an employee, termination of employment poses an additional threat to the income recipient. Some sort of security mechanism for the payee is recommended to address these foreseeable risks, such as a lump sum payment in the event of a triggering event, such as sale or termination of employment.

Trust and Estate Planning

Trusts may also be a tool for divorce settlements. An irrevocable trust could be established for the benefit of the former spouse, who would be named as a beneficiary. The grantor would retain the rights to the trust corpus upon the satisfaction of the alimony term, or other terminating events such as the cohabitation of the recipient or death of the recipient. The trust would govern the payment of taxable income to the payee/beneficiary for the alimony term. Any additional income would be retained by the trust and taxable according to the specifications in the trust agreement. There must be sufficient trust income to pay the beneficiary because, otherwise, the trust would have to make a distribution from the corpus, which would not be deductible. To avoid this result, a grantor should fund the trust in a way to ensure that it generates enough income to satisfy the alimony obligation so as to maximize the tax benefit. This approach could also be subject to disallowance by the IRS as an improper attempt to circumvent TCJA. In addition, on a practical level, it would be difficult, if not impossible, to utilize in open durational alimony cases where the alimony term is not fixed. Cohabitation and potential situations where the support might be subject to modification could create problems with this type of structure as well. Therefore, the trust concept may only be a possibility in alimony cases where there is a non-modifiable fixed term.

Business Assets

No-show jobs have been around since the beginning of time, at least since the beginning of corporate taxes. A business owner can put the former spouse on payroll, so that the business can get the deduction for salary paid to the recipient, who would correspondingly be taxed on the income. Of course, there are serious negatives and pitfalls associated with this structure. To be legitimate, the payee must work for the business, which keeps parties who were unable to remain married tied together in a professional relationship. In addition, the payor's payroll would be subject to FICA, Medicare, federal and state unemployment, state disability, and workers' compensation insurance, so the cost is higher than the former traditional alimony structure. For the recipient, there are concerns because the income stream could terminate if the business were to be sold, closed, or if the employment otherwise ends during the alimony term. Both parties would be at risk if audited by the IRS in cases where the payee is not working at the business. Thus, while payments through a business would transfer the tax responsibility, it is probably not necessarily be the best scenario for either party.

The Finances Behind the Law Change

The change in the law is designed to generate higher taxes paid to the government. To accomplish this goal, it shifts the tax burden on alimony to the payor, which results in the payor paying taxes at a higher rate than the rate for the recipient. Here are some examples using differing rates and filing statuses under both the old and new law based on the 2018 tax rates.

Example 1 – The payor spouse has $1 million in taxable income and pays $300,000 in alimony to the spouse, who has no other taxable income. The couple has no dependent children and both will file as "single." Under the prior law, the payor spouse would have gotten the alimony deduction and saved $111,000 in taxes. The payee ex-spouse would have incurred a tax of $80,690. That means that under TCJA, the federal government will receive an additional $30,110 in taxes based on the tax rate differential between the payor's and payee's tax rates. If the couple has two children, and the recipient spouse is the custodial parent, the additional taxes would be $31,702 under the new law.

Example 2 – Using the example of a payor's income of $500,000 and alimony of $200,000, the payor would have saved $70,000, and the recipient would have incurred a tax of $45,690, generating additional taxes of $24,310 captured at the payor's rate under TCJA. If they have two children with the recipient ex-spouse being the custodial parent and filing as "head of household," a tax of $44,298 would have been incurred, creating total additional taxes of $25,702 under TCJA based on the payor's tax rate.

Example 3 – Assuming the payor spouse has taxable income of $300,000 and is paying $100,000 in alimony, the payor spouse would have saved $35,000 in federal income taxes, and the recipient spouse would have incurred $18,290 in federal income tax for a differential of $16,710 in additional federal income taxes under TCJA. With the payor spouse filing as "single" and the recipient ex-spouse filing as "head of household," the savings to the payor would be the same, but the recipient's tax would be $16,898, decreasing the additional tax to $18,102 under TCJA.

For couples who did not get divorced before the Dec. 31, 2018, deadline, there is some possible relief as they can still take advantage of filing a joint tax return for 2018 and most likely reduce their collective tax liabilities.

As time progresses, it is likely that creative methods will surface to try to ameliorate the alimony changes under TCJA. In the meantime, practitioners and tax professionals should remain creative to best assist our clients, while confirming that any atypical alimony structure is confirmed by appropriate tax professionals.

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