Family Law Newsletter
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SCHILLER DUCANTO & FLECK LLP
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Deductible Maintenance No Longer in the Divorce Attorney's Toolbox after 2018

What was once a common tool used by divorce attorneys to negotiate and formulate support awards for and between divorcing couples has been eliminated for agreements executed after December 31, 2018. Maintenance will no longer be deductible by payors or includible in the gross income of payee recipients after 2018. Consequently, divorce attorneys across the country are receiving many calls and inquiries from their clients about how the new Tax Cut and Jobs Act ("TCAJA") repeal of the deduction for alimony, called maintenance in many states including Illinois, will affect their ability to get sufficient maintenance or negotiate tax favorable deductible maintenance. As a result of the most sweeping tax law changes in the last 30 years, divorcing couples need to be aware of the impact of these changes on the deductibility of maintenance on their divorce, settlement negotiations, and the timing of the execution of their settlement agreement or the court's entry of judgement for dissolution of marriage.

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The TCAJA essentially eliminates the tax subsidy provided by federal law to divorcing families. However, there is still ample time for divorcing couples to take advantage of tax subsidized maintenance by finalizing their agreements by the end of 2018. For agreements or judgments executed before December 31, 2018, it is business as usual.

> "Divorcing couples who want to take advantaage of the current tax deduction for alimony purposes must execute a final settlement agreement no later than 12/31/18."

The TCAJA does not apply to existing divorce or legal separation instruments, as well as divorce and separation instruments that are executed before January 1, 2019. Prior tax laws and rules allowed divorced couples to shift or assign income from the maintenance payor to the payee/recipient of the maintenance. This shift of income allows divorcing parties to maximize the amount of after-tax income available to the family unit by taking advantage of shifting the payor's gross income to the lower income tax bracket of the lower earning spouse. In most cases, the recipient of maintenance makes less money and is in a lower tax bracket than the payor.

How does the TCAJA impact someone either in the middle of a divorce or contemplating divorce? Divorcing couples who want to take advantage of the current tax deduction for alimony payments must execute a final settlement agreement no later than December 31, 2018. For couples that are contemplating separation and divorce and who want to ensure deductible maintenance eligibility, they should not wait until much later than early to mid-June 2018 to separate and/or file their petition for dissolution of marriage in order to meet all of the statutory requirements for a divorce and to allow for ample time for discovery and negotiations; it is likely that an increased number of litigants will be finalizing and executing their agreements in December 2018.

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Schiller DuCanto & Fleck Welcomes Kara Francis-Berry

Schiller DuCanto & Fleck welcomes Kara Francis -Berry as an Associate in our Chicago office. Ms. Francis-Berry joins the firm after working as both a consultant at Deloitte Tax LLP and an Associate at Rinella & Rinella, Ltd. Kara has worked on both pre-decree and post-decree cases involving various family law issues, including: initial determination and modification of maintenance and child support, allocation of property, allocation of parental responsibilities, and attorneys' fees.

Deductible Maintenance No Longer in the Divorce Attorney's Toolbox after 2018

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By Claire R. McKenzie

Simply labeling or designating a payment as "alimony" or maintenance does not mean that it will necessarily be treated as deductible alimony by the Internal Revenue Service ("IRS"). In order for a support payment to be considered or treated as deductible alimony for income tax purposes, the payment must meet all of the requirements of Internal Revenue Code section 71(b), regardless of its label or designation in a settlement agreement or even by court order. For a payment required by a pre-2019 divorce agreement to qualify as deductible maintenance, all of the following requirements must be met:

- Payments are made to or on behalf of an ex-spouse under a divorce or separation decree or instrument.
- The decree may not designate such payment as not includible in gross income of the recipient payee or as not deductible by the payor.
- The payor and the payee may not be members of the same household at the time the payments are made.
- The parties may not file a joint income tax return.
- There is no liability for the payor to make payments after the death of the payee.
- The payments may not be part of the support of the children of the payor or have any child-related contingency (i.e., payments terminate when child reaches age 18 or graduates from high school).

Along with the continuation of the deductibility of maintenance laws comes all of the related former tax rules and regulations. Parties and their attorneys must still be cognizant and aware of the traps and pitfalls of the alimony recapture rules and the potential issue of alimony being characterized by the IRS as either disguised child support or disguised property settlement. One must also be familiar with the IRS regulations concerning support modifications related or incident to a child related occurrence. These pitfalls are still looming and can cause significant problems for parties that can be avoided with careful analysis and drafting.

The repeal of the maintenance deduction may also affect couples negotiating Premarital Agreements and Post Nuptial Agreements. Most of these agreements typically include provisions related to maintenance in the event of divorce. Until the passage of the TCAJA, these maintenance and support clauses and provisions were drafted assuming the deductibility of maintenance. Premarital and Postnuptial Agreements that include alimony or maintenance provisions should now be reviewed as the maintenance to be paid pursuant to these agreements may state that maintenance is deductible or may be based on the deductibility of maintenance which has now been repealed by the TCAJA.

In summary, divorce agreements executed by December 31, 2018 and modifications to those agreements, unless the modifications specifically state that the new TCAJA law will apply, will be grandfathered and will receive prior law deductibility of maintenance treatment and tax subsidy or benefit. All of the former tax rules and regulations will still apply to pre-2019 divorce instruments. For more information about modifications to maintenance in pre-2019 agreements, see " What does the elimination of the maintenance deduction mean for those already (or soon to be) divorced?" ,by Patrick T. Ryan. If you are currently negotiating paying or receiving maintenance, you want to take the TCAJA laws as well as any potential future modifications of your maintenance payments into account when finalizing your maintenance terms.

The TCAJA is expected to have a significant impact and effect on the income of many families and divorces. Breaking up may be even harder to do without the alimony deduction; in many cases there will be less money available to allocate between the parties. Divorce settlements may be more difficult to reach, causing more costly litigation and attorneys' fees. Please contact us if you need help analyzing the effect of the TCAJA on your divorce. There is still some time left to take advantage of the deductible maintenance rules, but time is running out! Waiting too long to finalize an agreement may result in an expensive tax mistake that cannot be rectified or change

What does the elimination of the maintenance deduction mean for those already (or soon to be) divorced?

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The short answer is: not much.

As the tax legislation proposals were emerging, there were competing versions in the House and the Senate. The most significant for divorced and divorcing couples dealt with the issue of spousal support. As written, spousal support (referred to as maintenance or alimony in the Internal Revenue Code) is deductible from the payor's gross income and includible in the payee's gross income. Specifically, Section 215 of the Code provides that "in the case of an individual, there shall be allowed as a deduction an amount equal to the alimony or separate maintenance payments paid during such individual's taxable year."

While the House version of the new tax law struck 215 in its entirety, the Senate version, on the other hand, did not. In fact, the Senate version left 215 intact. When the two competing versions were each passed in their respective chambers, the difference had to be worked out. For procedural reasons and in order to assure passage of the new tax law, rather than sending the House version of the Bill to the Senate or the Senate version of the Bill to the House, they opted to use what is known as a "conference." In a conference, select members of the House and Senate form a committee for the purpose of reconciling the differences in the legislation that passed both chambers. As a result of the conference, Section 215 regarding the deductibility of maintenance was eliminated, meaning that the conference committee went with the House version, not the Senate, in finalizing the maintenance provision of the Tax Cuts and Jobs Act.

In reaching this compromise, however, there was a key distinction added to the conference agreement. Specifically, the effective date of the provision was delayed by one year. Although the Tax Cuts and Jobs Act became effective as of January 1, 2018, the Committee provided that the elimination of the maintenance deduction only applies to divorce or separation instruments executed after December 31, 2018. Additionally, with respect to the modification of any divorce or separation instrument executed on or before December 31, 2018 the elimination of the maintenance deductibility would not apply unless the modification expressly provided that the amendments made to Section 215 apply to such modification, even if the modification occured after December 31, 2018.

So, in reality, what does this mean for those who are going to deal with a modification of their support obligation or award after December 31, 2018? In essence, not too much will change. Although parties modifiying their prior support arrangement will have the option of making future maintenance payments non-deductible and non-taxable, they are not required to do so. In fact, in order to have the new law apply to such a modification, the modification has to specifically opt in to the modification of the tax laws regarding non-deductibility of spousal support.

Parties could obviously agree to adopt the new tax law to their support modifications, and in some circumstances, there may be reasons for a divorced couple to do this. On the other hand, in the event the parties cannot agree, questions arise as to whether or not a judge could even be able to order that future payments would no longer be deductible. As of now, Illinois law is silent. Furthermore, the Committee Agreement does not specifically address the issue of whether the opt in to the modification must be by agreement.

As it stands, Illinois law provides for guidelines of both maintenance and child support. While maintenance is tax deductible, and child support is not, the two are interrelated since prior to determining the allocation percentage of a guideline child support award maintenance received is counted as part of the payee's gross income and deducted from the payor's gross income. In addition, the maintenance guidelines provide for a percentage based calculation which presumably factors in the impact of the tax ramifications. While many people assume that the guidelines will need to be modified to account for the new tax legislation, anyone familiar with the legislative process, and in particular Illinois' recent track record of passing legislation, knows that it can move extremely slow. As a result, it is unlikely that Illinois will make any substantive changes before the end of the year (particularly in an election year like 2018). In fact it is possible, and some would argue likely, that the House and Senate could agree to extend the effective date of this modification for another year. It is not uncommon for the House and Senate to pass legislation that "patches" issues with the tax code, or extends some modifications for one more year (just look at the numerous annual increases to the AMT exemption level).

Overall, it looks as though any modifications of maintenance, so long as they relate back to a divorce that took place before the end of 2018 (and maybe even further out), will still be subject to the provisions of IRC Section 215 (and Section 71) regarding deductibility, meaning there will not really be any change.

Should you file joint tax returns while in the middle of a divorce?

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A common question that arises when parties are in the midst of a divorce is whether it is advisable for a client to file a joint tax return with their soon to be former spouse. Married couples can file a joint tax return for any tax year in which they were still married at midnight on December 31. In fact, it is not uncommon for a couple to delay the entry of their divorce judgment until January 1st or after in any given year in order to be eligible to file a final joint return.

Tax obligations that arise from marital income during a marriage are typically considered a marital debt, whether joint or separate returns are filed, so refusing to file a joint return does not necessarily get a spouse off the hook for their share of the tax liability. Likewise, a refund generating from marital income during a marriage is typically treated as marital property and filing a separate return does not necessarily change the refund's character. However, there are several factors that should be considered and discussed with your tax advisor as well as your divorce counsel in determining whether or not a joint filing is advisable.

Once a joint filing is made, the parties may not amend to separate returns. However, separate returns may be later amended to a joint return if the parties otherwise qualify to file jointly. (There is some question about whether or not the submission of a joint extension request binds you to then file jointly. In order to be sure, a party should not agree to file a joint extension unless they are confident they will be filing a joint return.)

Regardless, some of the factors that should be considered in making the election to file jointly are as follows:

1. Whether there is tax due and whether any such tax due must be paid upon the filing of the return. Once a joint tax return is filed, the parties are jointly and severally liable for the tax due regardless of the source of the income generating the tax and the tax due is collectable from either party. Either party is susceptible to having their accounts levied or having their credit rating negatively impacted as a result of unpaid taxes. If the client is not the income earner and there are not sufficient funds available to pay the taxes due, the client should be advised to file separately.

2. Has there been a history of audit or inaccurate reporting by the other party? If so, a client should seriously consider filing a separate return for obvious reasons. Even where there is no obvious reason to suspect inaccurate reporting of income, anytime a client has a spouse that has complex or self-prepared tax returns, is self-employed or is a shareholder in a closely held business, it is a good idea for that client to demand a Tax Indemnification Agreement before signing a joint return, whereby the income earning spouse indemnifies the other non-income earner against any misreporting or inaccuracies in the tax returns. A Tax Indemnification Agreement does not bind the IRS or a state taxing authority, and the non-income earner is still on the hook for any taxes that might be due.

However, a Tax Indemnification Agreement can allocate any future liability (including accounting or legal fees and taxes due along with any interest and penalties) related to misreporting to the income earner as between the parties. It would be correct to be suspect of any income-earing spouse (like those described above) that possesses the information and knowledge regarding their income who refuse to be responsible for any misreporting of income that might be later uncovered.

3. If an extension is being filed, is there substantial outdated income information that may make it wise not to file a joint extension? It is not completely clear whether or not parties that file a joint extension can then later chose to file joint returns. At the very least a switch from a joint extension to separate returns could create unintended and unnecessary administrative headaches. Therefore, unless a party is sure that they will be filing a joint return (and an Indemnification Agreement is executed if warranted), they should file their own separate extension.

4. Has your client been given sufficient time to properly and fairly evaluate the points made above? If not, there is little relative harm in having your client file a separate return with the option of amending later after proper due diligence has been completed. A client should never be placed in the position of having to do a rushed evaluation of the best approach to filing or expected to sign a tax return at the last minute that could saddle them with significant future liability.

IN THE NEWS

Mackenzie Ditch's blog "The Wedding is Off: Now What?"was published on our Family Law Topics Blog.

Amy N. Schiller's article "Teenage Olympians face different endorsement world" was published in the Chicago Daily Law Bulletin.

Evan D. Whitfield was a 2017 recipient of the American Bar Association Military Pro Bono Project Outstanding Services Award.

Brett Buckley's blog "Impact of Market Volatility on Divorce Agreements" was published on our Family Law Topics Blog.

Jacqueline Stephens Breisch's article "Is a presumption of equal parenting time in a child's best interest?" was published in the Chicago Daily Law Bulletin.

Patrick T. Ryan presented "Tax Issues in Family Law" to the Chicago Bar Association YLS Family Law Committee on March 7, 2018.

Erika N. Wyatt presented "Pet Custody - Who Gets the Pet in a Divorce?" at the DePaul College of Law on April 2, 2018.

Anita M. Ventrelli was interviewed for the article "Valentine's Day: Planning to pop the question? If it doesn't work out, who keeps the ring?" published in USA Today.

Michelle A. Lawless's article "Attorneys need to be on their toes with changing IMDMA calculations" was published in the Chicago Daily Law Bulletin.

Burton Hochberg's blog "Bitcoin and Divorce" was published on our Family Law Topics blog.

Schiller DuCanto & Fleck LLP had 36 attorneys selected to Leading and Emerging Lawyers by Leading Lawyers Network.

Brett Buckley will be speaking about Third Party Intervention in Family Law Litigation under Section 408 of the Illinois Code of Civil Procedure at the Lake County Bar Association Family Law Conference in April 2018.

The materials contained in this Newsletter are intended for general informational purposes only and not to be construed as legal advice or opinion.

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