

# Divorce after Trump's 2017 Tax Cuts and Jobs Act

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No one gets a divorce to take advantage of tax benefits. Divorce and separation are two of the most stressful and painful life events, and while property division and support are weighty factors, they generally are not what drives the decision to end a marriage. Yet divorce can bring about some major tax consequences, and the newly enacted Tax Cuts and Jobs Act ("TCJA") could make an already tumultuous time in one's life beset with traps for the unwary. This article will highlight some of the recent changes to Federal tax law that potentially have a significant impact on divorce settlement negotiations.

## **Effective January 1, 2019 Alimony will no longer be tax deductible**

In Texas, there are two types of alimony: court ordered spousal maintenance and contractual alimony. Court ordered spousal maintenance can last for a duration of 5, 7, or 10 years, and is generally dependent upon the length of the marriage.<sup>1</sup> It is also limited to the lesser of \$5,000 or 20% of the payor spouse's (the person ordered to pay the alimony) average monthly gross income.<sup>2</sup> Generally, the court does not order spousal maintenance unless the couple has been married for at least ten years.<sup>3</sup> Whereas, contractual alimony is a written agreement entered into by the spouses to promote an amicable settlement of disputes in a divorce concerning the division of property and support of either spouse.<sup>4</sup> For our purposes, we will refer to both court ordered spousal maintenance and contractual alimony as alimony.

Traditionally, under current Federal tax law, alimony is a dollar-for-dollar deduction from gross income of the payor and is included as taxable income to the recipient. Effective January 1, 2019, the TCJA repeals the alimony deduction, so it will no longer be deductible by the payor and no longer treated as income to the recipient. Existing alimony agreements and those entered into by December 31, 2018 will remain deductible by the payor and taxable to the recipient. Under the current law, with alimony still deductible, there is generally considered to be an advantage to the parties if the higher income earning spouse, who usually pays alimony, deducts it from income because it could reduce taxes owed and the applicable tax rate. Both parties benefit from the current law because the recipient could negotiate for a

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<sup>1</sup> Tex. Fam. Code §8.054.

<sup>2</sup> Tex. Fam. Code §8.055.

<sup>3</sup> Tex. Fam. Code §8.051.

<sup>4</sup> Tex. Fam. Code §7.006(a).

higher alimony payment while the net effect to the payor was minimalized. The new legislation with respect to alimony applies to all agreements and court orders starting in 2019, as well as modifications which makes the timing of your divorce especially important. Couples contemplating divorce or in the middle of one should take steps to finalize it by 2018 in order to secure the deduction and ensure the parties have a larger pool of funds available to split.

While the changes to alimony will not take effect until January 1, 2019, the rest of the changes to tax law that will affect divorce cases are operative now.

### **Personal Exemptions no longer available**

Personal exemptions are deductions subtracted from adjusted gross income to reduce taxable income and, ultimately, taxes in proportion to the taxpayer's tax bracket. Prior to the TCJA, taxpayers were able to deduct \$4,050 for each exemption claimed in 2017.<sup>5</sup> Taxpayers were allowed to claim one exemption for each person claimed as a dependent and only one parent was permitted to claim a dependent each year. Generally, the custodial parent or the parent with primary custody of the child claimed the dependent. Parents could also agree to alternate which parent claimed the dependent and execute a signed release. In many divorces, these dependency exemptions were highly negotiated as trade-offs for other economic considerations. The TCJA repeals these exemptions making them no longer available.<sup>6</sup> However, the ability to claim a child as a dependent remains important with respect to the child tax credit and the taxpayer's head of household status.

### **Child Tax Credit increased**

Traditionally, a basic tax relief for families was the dependency exemption, which included dependent family members. The child tax credit was added for each qualifying child under the age of 17.<sup>7</sup> The TCJA significantly increases the child tax credit from \$1,000 to \$2,000 per qualifying child per calendar year. A new \$500 nonrefundable credit is added for qualifying dependents other than qualifying children. The Act also increases the adjusted gross income phase-out threshold limits from \$110,000 to \$400,000 for married taxpayers filing joint returns and from \$75,000 to \$200,000 for all other taxpayers.<sup>8</sup> This

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<sup>5</sup> INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. NO. 504, DIVORCED OR SEPARATED INDIVIDUALS: FOR USE IN PREPARING 2017 RETURNS 7 (2017), [Link](#).

<sup>6</sup> 115 P.L. 97, 131 Stat. 2054, §11041, 2017 Enacted H.R. 1, 115 Enacted H.R. 1, [The Tax Cuts and Jobs Act](#).

<sup>7</sup> 26 U.S.C. §24.

<sup>8</sup> See §11022 of The Tax Cuts and Jobs Act.

change increases the number of families who are eligible and allows more parties to use the Child Tax Credit.

Because the TCJA did not change the definition for “dependent” there is some speculation as to whether the IRS would allow a release of the child tax credit to the non-custodial parent in the same manner as the dependency exemption. The IRS has not yet promulgated any formal guidance on the matter. Until the IRS issues new regulations, it is not clear if divorcing parents can bargain over who is able to claim the child tax credit. Moreover, child tax credits decrease a taxpayer’s tax liability dollar-for-dollar whereas the child dependency exemption merely reduced taxable income. For these reasons and more, the child tax credit could be a valuable bargaining chip during mediations.

### **Head of the household standard deduction increased**

Filing as head of the household has certain advantages. You can claim a higher standard deduction and your tax rate usually will be lower than it is if you claim a filing status of single or married filing separately. The TCJA increased the standard deductions for single (from \$6,350 to \$12,000), head of household (from \$9,350 to \$18,000), and married filing jointly (from \$12,700 to \$24,000). In order to qualify for head of the household, you must be unmarried or considered unmarried on the last day of the year, paid more than half the cost of keeping up a home for the year, and have one or more qualifying dependents whom have lived with you for at least half of the year. Generally, the parent with custody (the custodial parent) of the child the majority of the year can take the standard deduction as head of the household.

### **Home Sales and Mortgage Interest**

Divorce can often drive a couple to sell their home. This can result in capital gains tax consequences that should be considered during the mediation process. The TCJA left much of the tax laws involving capital gains unaffected. Accordingly, for tax payers who satisfy the ownership and use test of having lived in their homes for at least two years out of the last five years, may exempt \$250,000 gain when they sell their home. The number is doubled to \$500,000 for married couples filing jointly if at least one of the spouses owned the residence and both resided in the home for at least two of the last five years. Divorced couples may exclude up to \$250,000 of the gain on their individual tax returns. If one spouse is awarded the home in the divorce decree, that spouse may also sell the home and exclude \$250,000 of gain.

The TCJA eliminated the tax deduction for interest paid on home equity lines of credit (“HELOC”) unless it is used for acquisition purposes. Generally, acquisition purposes include improvements to the home. Mortgage interest is still deductible. The loan limit was reduced from \$1 million to \$750,000. However, a more important issue for divorcing couples is when one spouse is ordered to pay the mortgage on the home and is allowed to take the mortgage interest deduction. Prior to the TCJA, a spouse ordered to pay all of the mortgage payments on the jointly owned marital home could deduct half of interest paid as mortgage interest and deduct the other half as alimony.<sup>9</sup> Now that alimony is no longer allowed as an IRC §215 deduction, the mortgage payments made on the marital home could substantially lose their tax benefits.

### **529 Plans expanded**

To encourage families to save money for higher education, i.e. college, Congress enacted Internal Revenue Code 529. Generally, 529 plans are savings accounts. Although contributions are not deductible, earnings in a 529 plan grow tax-free and will not be taxed when the money is taken out to pay for the beneficiary’s education. Enacted in 1996, 529 plans were limited to “qualified higher education expenses”, the definition of which has been expanded to include computers. With the enactment of the TCJA, the definition has been further expanded to include tuition in connection with enrollment or attendance at an elementary or secondary public, private or religious schools.<sup>10</sup> The expansion of 529 plans should make them a point of consideration in divorce mediations.

### **Going forward**

Many of these changes brought on by the Tax Cuts and Jobs Act are set to expire in 2025, without further legislation. While it would be difficult to predict with any certainty the laws of 2025, prudence dictates that settlement agreements should contain language that provides options if, as and when the tax laws should revert back to 2017. It is important that clients work closely with counsel that is up to date and educated on changes that affect their clients in a divorce as well as its associated financial issues in order to obtain a fair and equitable settlement.

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<sup>9</sup> INTERNAL REVENUE SERV., U.S. DEP’T OF THE TREASURY, PUB. NO. 504, DIVORCED OR SEPARATED INDIVIDUALS: FOR USE IN PREPARING 2017 RETURNS 7 (2017), [Link](#).

<sup>10</sup> See §11032 of The Tax Cuts and Jobs Act.