

**TAX TREATMENT OF ALIMONY PAYMENTS IN NEW JERSEY**  
**Impacts of Changes in Federal Tax Law and Proposed Legislative Response**

**A. Changes to the Federal Tax Code Impact the Tax Treatment of Alimony Payments.** Under the newly enacted changes to the Federal tax code, alimony paid to an ex-spouse will no longer be deductible by the payer, and alimony payments will no longer be included in the recipient's gross income. This effectively shifts the tax burden of alimony from the recipient to the payer. This provision is effective for divorce and separation agreements signed after December 31, 2018.

**B. Impacts.** Simply stated, the spouse paying alimony cannot deduct it, and the spouse receiving the money no longer is to pay taxes on it. This is the exact opposite of the current law that has been in effect for 75 years. The following hypothetical case illustrates the practical effect of this change in the law:

Current Tax Treatment: Spouse A now pays and deducts \$30,000 a year in alimony. Spouse A's income is federally taxed at 33 percent, so the deduction saves her \$9,900. Lower-earning Spouse B owes taxes on the alimony at a 15-percent rate, paying \$4,500 instead of the \$9,900 that would be due at Spouse A's rate. The two have saved \$5,400 between them, and the availability of the deduction to Spouse A makes more of her income available to her following the divorce.

Future Tax Treatment: Spouse A will pay \$30,000 per year in alimony plus \$9,000 in taxes. Spouse B will receive tax free income.

The following practical effects of the change in the tax treatment of alimony can be expected:

1. The arbitrage created by the difference in tax rates has long served as a benefit to the spouse paying the alimony and has been a factor both in negotiating matrimonial settlements and in bridging the gap between the parties' needs and their actual income. If alimony is no longer deductible, the ability of an ex-spouse to pay it will be limited by the need to pay other necessary fixed expenses such as child support payments and education expenses for children.

2. It is very difficult for divorcing couples to instantaneously make lifestyle adjustments that coincide with the sudden establishment of two households and the consequent reduction of discretionary income to each party. The two households created by a divorce simply cannot function as cheaply as the single household of an intact family. The present tax structure that helps ameliorate those burdens has now been eliminated.

3. The change in tax treatment that gives one party tax-free income creates a perverse disincentive to settle divorce cases because the potential alimony recipient is incentivized to hold out for the highest possible alimony award to maximize tax-free income. Conversely, the potential alimony payer is incentivized to fight to maximize the net income available to preserve their lifestyle. By eliminating the current tax treatment of alimony that splits the financial pain of the divorce, an already difficult and painful process is made even more agonizing by protracting the proceedings. Protracted divorce litigation is contrary to the well-established public policy that favors judicial economy and the settlement of disputes and likely to result in greater emotional trauma that adversely impacts the welfare of the litigants and the children of the marriage.

4. Eligibility for Medicaid-based programs or educational financial aid is based on an individual's taxable income. Because alimony has always been taxable income for the receiving party, a former spouse receiving alimony is often required to contribute a greater share towards his or her medical coverage or educational expenses. By making alimony tax-free to recipients, we can expect more former spouses to qualify for free health care, as well as other means-tested government programs that are based on taxable income, despite the fact that they are receiving significant amounts of tax-free income.

**C. Problems Arising Under Current New Jersey Law.** Under N.J.S.2A:34-23, the amount and duration of alimony is determined by an analysis of 13 factors, including marital lifestyle and tax considerations with no individual factor being given greater weight than any of the others unless the judge considering the matter makes specific written findings of fact and conclusions of law in that regard. Accordingly, a judge considering an alimony award has the discretion to minimize the tax effects and emphasize the continuance of the marital lifestyle in setting an award. (Lawyers negotiating settlements are guided by the same principles although by making a judgement as to "what a judge would do"; in the new tax environment family lawyers will have no such guidance.) The manner in which temporary *pendente lite* support is awarded compounds the problems.

A wage-earner in New Jersey with a \$100,000 taxable income taxed at 24% with a consequent tax liability of \$24,000 could nonetheless be ordered to pay \$50,000 in spousal support based on an assessment of the marital lifestyle; this would leave the \$100,000 wage earner paying alimony with only \$26,000 per year to live on after taxes. While this may seem like an extreme outcome to someone unfamiliar with the workings of family courts, New Jersey has for many years permitted an award of interim *pendente lite* support at the commencement of the case based on limited evidence that (as will be the case under the new tax code) is typically not deductible by the payer and not reportable as income by the recipient. These *pendente lite* awards that are intended to maintain the marital lifestyle during the pendency of the divorce proceedings can require the wage-earner to pay as much as 70% or even 80% of the pre-tax income to support the recipient spouse. This practice of allocating pre-tax income, among other adverse consequences, enhances the risk that an individual may fall into tax arrears putting the prompt payment of tax liabilities at risk.

Furthermore, the potential unsustainable financial burden of *pendente lite* is justified by the courts on the theoretical grounds that the support is considered temporary until the final judgment of divorce is granted; unfortunately, the reality is that because of the heavy caseload and lack of resources in New Jersey family courts *pendente lite* support can last for years before the case concludes. Finally, the alimony awarded in the final judgment of divorce will generally not deviate greatly from the *pendente lite* support award because that resolution constitutes the path of least resistance for overburdened family court judges. With the new tax treatment of alimony, the intended temporary term of *pendente lite* will, in practice, more than likely become open duration support from the commencement of the case. From a tax policy perspective this state of affairs compounds the collection risk to the fisc by protracting the period where an alimony-paying individual may fall into tax arrears.

With that background, there is no reason to expect that in the absence of express legislative guidance the current practices in the New Jersey family courts that govern the award of spousal support (whether its *pendente lite* or alimony) will change overnight in response to the change in the federal tax code. Tax and social policy considerations compel a prompt and comprehensive legislative response in New Jersey.

**D. Proposed Legislative Action.** We expect that the New Jersey legislature will enact changes to the New Jersey tax laws that will mirror the federal tax treatment of alimony at some point prior to December 31, 2018. The loss of the alimony deduction unfairly shifts the entire tax burden of divorce onto the wage earner paying alimony, makes the negotiation of marital settlements more difficult, presents the potential of unduly and unfairly burdening social services and puts the timely collection of tax revenue at risk. We propose the following changes (which are intended to be considered as a menu of alternative legislative solutions) for New Jersey to mitigate adverse tax and social policy outcomes anticipated by the changes in tax law:

1. **Emphasize Tax Considerations.** Require judges to make tax considerations paramount in making an alimony award, such as requiring judges to use net income in determining the amount of alimony and replacing maintenance of the marital lifestyle with economic sustainability as the principal governing metric for the amount of the alimony award.

2. **Cap Income Available for Alimony.** Impose a cap on the amount of income available for alimony. In New Jersey, there has long been an informal “rule of thumb” capping the amount of an alimony award at 1/3 of the difference between the gross incomes of the alimony payer and the recipient. This “rule of thumb” could be enacted as law.

3. **Guidelines.** Establish guidelines for alimony below a certain income threshold (say, \$550,000) as is presently done with similarly non-deductible child support so that income is preserved for the payer to have the ability to both pay taxes and maintain a lifestyle that is at least roughly commensurate with their personal labor and income. After December 31, 2018, alimony will receive the same tax treatment as child support and in New Jersey child support is determined by a legislated formula and guidelines; consequently, analogous policy considerations should inform the use of guidelines for the award of alimony. Child support guidelines ensure that there is a basic level of income set aside to meet the direct needs of the children of the marriage, while preserving sufficient income to maintain a household. In the same way, alimony guidelines would ensure that there is sufficient income available to satisfy tax obligations. Many other states, including the border states New York and Pennsylvania, already have spousal support guidelines

4. **Durational Limits.** Impose stricter durational limitations on alimony awards to reduce the time-frame in which a spouse receives tax free income to reduce the potential burdens on means-tested programs and ameliorate the incentive to ‘hold-out’ during the settlement phase of a divorce to maximize tax-free income.

5. **Applicability to Alimony Modifications.** Make any caps, guidelines or durational limitations available when alimony is modified after December 31, 2018 so that current payers seeking a modification get the same treatment under the law that takes into account the non-deductibility of alimony after the effective date of the changes in federal law.

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