



TAX TRENDS AND DEVELOPMENTS

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House Ways and Means Committee Proposes “Tax Reform” Legislation that Provides (1) Alimony Would No Longer Taxable or Deductible and (2) Deductions for Personal Exemptions Would Be Eliminated. “Tax Cut and Jobs Act”, H.R. 1

In late October, 2017, the House Ways and Means Committee introduced the “Tax Cut and Jobs Act” (Act) which would, if enacted, provide sweeping changes to federal taxation of individuals and businesses. For the most part, if passed, the new provisions would take effect on January 1, 2018.

The Act has numerous, significant revisions to current tax law. The following are some of the most notable for family law practitioners.

Alimony Proposal

As noted, among the many changes in the Act is the provision that spousal support payments would be non-deductible/non-taxable, similar to the treatment of child support payments.

This would apply to divorce judgments and separation agreements executed after 2018, and to any such documents amended after 2018 which expressly provide for tax treatment under the Act to apply.

Comments on the Alimony Proposal

Tax Subsidy Eliminated

Often the spousal support payer is in a meaningfully higher tax bracket than the payee spouse. This affords the opportunity to obtain a “tax subsidy” from Uncle Sam.

For example, if W, the payer, is in a 40% federal tax bracket and H is in a 20% bracket, it costs Uncle Sam twenty cents on the dollar of spousal support paid:

	<u>W</u>	<u>H</u>	Uncle <u>Sam</u>
Spousal Support Payment	(1,000)	1,000	-
Tax Saving (Tax Cost)	<u>400</u>	<u>(200)</u>	<u>(200)</u>
After-Tax	<u>(600)</u>	<u>800</u>	<u>(200)</u>

Under the Act, such tax subsidies would no longer be available.

Advantageous Use of Section 71 Payments Also Eliminated

When there is a significant disparity in brackets, what have become known as Section 71 payments have often provided an effective, tax saving tool when structuring:

1. A buy-out of one spouse’s marital interest in the other’s business or professional practice.
2. A division of non-qualified retirement or executive benefits for which a QDRO cannot be used.
3. A payment of the other spouse’s professional fees on a tax deductible basis.
4. A “global” settlement taking advantage to the bracket disparity.

These and other uses of Section 71 payments would be unavailable under the Act.

Planning Consideration

As noted, the current taxable/deductible tax treatment of spousal support can be used to advantage. If such is the case and subject divorce is in a position to conclude before year-end, consider the merits of doing so.

Other Selected Highlights of Proposed Changes

Individual Tax Changes

- **Tax Brackets**—The current 7 tax brackets ranging from 10% to 39.6% would be replaced by 4 brackets – 12%, 25%, 35%, and 39.6%. The top bracket would apply taxable income of singles exceeding \$500,000, and marrieds’ taxable income over \$1,000,000.

- **Alternative Minimum Tax (AMT)**—Eliminated
- **Deduction for Personal Exemptions**—Eliminated.
- **Standard Deduction**—Increased substantially - \$12,000 for single; \$18,000 for single with qualifying child; \$24,000 for married.
- **Certain Itemized Deductions Eliminated**—State & local income taxes; medical expenses; casualty losses; tax preparation fees; unreimbursed business expenses; all interest expense except for mortgage interest on principal residence.
- **Child Tax Credit**—Increased from \$1,000 to \$1,600.

Business Tax Changes

- **Tax Brackets**— Corporate tax rate would be a flat rate of 20%; 25% for personal service corporations.
- **Alternative Minimum Tax (AMT)**—Eliminated
- **“Pass-Through” Entities**—Generally, the tax rate on S Corporation and LLC pass-through income would be 25% on 30% of the income; the balance of 70% - subject to individual tax rates.

Will the Act Become Law?

The Senate Finance Committee will next prepare its version of the tax reform bill. Then a Joint Conference Committee will iron out differences and the resulting bill will be presented to the House and Senate for approval.

Due to the failure to enact any significant GOP platform item to date, there will be considerable pressure to pass tax reform legislation this year. The House bill provides a foundation for moving it forward.

About the Author

Joe Cunningham has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy, though his practice is statewide.

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