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Breaking Up Is Harder to Do

A new maintenance formula, the repeal of the alimony deduction, and other changes that divorcing couples and their attorneys need to know.

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FOR THE PAST 70 YEARS, FAMILY LAW ATTORNEYS HAVE UTILIZED THE ALIMONY deduction to help ease the financial burden divorcing families face as they transition to two households. The elimination of the alimony-payments deduction is a major casualty of the federal Tax Cuts and Jobs Act of 2017 ("TCJA").[1] This change will be costly for divorcing couples and may make settling divorce cases more difficult.

Currently, the Internal Revenue Code treats alimony—more commonly referred to as spousal maintenance—as a deduction for the paying spouse and as income for the recipient spouse. The payor's tax-free spousal maintenance payments are taxed as ordinary income to the (likely) lower-tax-bracket recipient resulting in the overall payment of less income tax. The transfer of tax liability to the spouse with lower income allows the divorced couple to receive a significant overall tax savings.

1. Tax Cuts and Jobs Act of 2017, § 11051(c)(2).

For divorce cases completed after Dec. 31, 2018, spousal support payments will no longer be tax deductible to the payor and included as ordinary income to the recipient. This means the divorced couple will pay more income tax and have less disposable family income. The loss of the alimony deduction on new or pending divorce cases as of Jan. 1, 2019, will have an immediate financial impact on families having to deal with the cost of two households on the same amount of income previously used for one household.

This article will address questions on the minds of many family law attorneys regarding changes taking effect Jan. 1 for divorcing couples.

What about pre-2019 divorce cases?

The repeal of the alimony deduction only applies to new divorce and legal-separation cases filed as of Jan. 1, 2019, and those filed before this date, but without having completed a divorce or separation instrument (such as a marital settlement agreement) or having received a judgment. For existing spousal maintenance judgments and court orders entered prior to Jan. 1, 2019, parties will continue to enjoy favorable tax treatment as the TCJA has grandfathered deductibility and includability provisions for those existing judgments and orders.

Will orders entered prior to 2019 and subsequently modified after 2019 retain favorable tax treatment?

Yes. Section 11051(c)(2) of the TCJA states that the repeal of the alimony deduction applies to:

> [A]ny divorce or separation instrument (as so defined) executed on or before such date [Dec. 31, 2018] and modified after such date [Dec. 31, 2018] if the modification expressly provides that the amendments made by this section apply to such modification.[2]

Although the language in this section is somewhat vague, the TCJA provides that the parties can retain favorable tax treatment upon modifications of pre-2019 maintenance judgments and orders—unless the parties expressly provide otherwise in the modification. Of course, it is unlikely that parties who have been enjoying the financial benefits of tax-deductible spousal maintenance will wish to switch to non-deductible spousal maintenance when modifying the amount or duration of spousal support. Therefore, for modifications to pre-2019 orders or judgments, assuming the parties do not opt out and all tax code requirements are met, deductibility/includability of spousal maintenance will continue despite the repeal of the alimony deduction.

What should family practitioners do?

Before the repeal of the alimony deduction takes effect on Jan. 1, 2019, family law attorneys should attempt to finalize their pending cases involving the payment of spousal maintenance or unallocated family support so that parties paying or receiving spousal maintenance may benefit from favorable tax treatment and the additional income created by the alimony deduction. Family law attorneys should discuss the new tax legislation with their clients, who may wish to benefit from the soon-to-expire deduction in cases where the possibility of paying or receiving spousal maintenance or unallocated ("family") support exists.

2. *Id.*

TAKEAWAYS >>

- The elimination of the alimony-payments deduction is a major casualty of the federal Tax Cuts and Jobs Act of 2017. This change will be costly for divorcing couples and may make settling divorce cases more difficult.

- The loss of the alimony deduction on new or pending divorce cases after Jan. 1, 2019, will have an immediate financial impact on families having to deal with the cost of two households on the same amount of income previously used for one household.

- The Illinois legislature also clarified a number of maintenance provisions that have caused confusion and uncertainty for litigants, the bench, and bar.

FOR EXISTING SPOUSAL MAINTENANCE JUDGMENTS AND COURT ORDERS ENTERED PRIOR TO JAN. 1, 2019, PARTIES WILL CONTINUE TO ENJOY FAVORABLE TAX TREATMENT AS THE TCJA HAS GRANDFATHERED DEDUCTIBILITY AND INCLUDABILITY PROVISIONS FOR THOSE EXISTING JUDGMENTS AND ORDERS.

Jeffrey W. Brend of Levin & Brend, PC, suggests asking the court to bifurcate a case if a full property settlement cannot be reached before Dec. 31, 2018, and to enter a judgment with spousal maintenance provisions. However, practitioners should be aware that courts may not agree to bifurcation and that any assets acquired after a bifurcation judgment would be non-marital, including year-end bonuses and 401(k) contributions.

The definition of taxable alimony in the Internal Revenue Code section 71 requires the alimony to be set forth in a divorce or separation instrument. This is defined in section (2) as:

> Divorce or separation instrument. The term "divorce or separation instrument" means—
>
> A) a decree of divorce or separate maintenance or a written instrument incident to such a decree,
>
> B) a written separation agreement, or
>
> C) a decree (not described in subparagraph (A)) requiring a spouse to make payments for the support or maintenance of the other spouse.[3]

The authors strongly recommend seeking an entry of a judgment of dissolution or legal separation.

Will the amended 750 ILCS 5/504 contain two guideline formulas?

Yes. Elimination of the alimony deduction required Illinois and other states using formulas to rewrite their spousal maintenance statutes. Until the TCJA, spousal maintenance ("formulas") have been based on gross income because the alimony deduction transferred the income tax liability from one spouse to the other spouse. The TCJA delayed the repeal of the alimony deduction by one year to give states the opportunity to rewrite and align their statutes with the TCJA's repeals and its elimination of the alimony deduction beginning in 2019.

For cases filed in and after 2019, Illinois' new formula will be based on *net*, not *gross*, income.[4] However, because the TCJA grandfathers or retains the deductibility/future includability of pre-2019 maintenance judgments and orders and subsequent modifications, it was necessary to retain the original formula that is based on *gross* income for pre-2019 judgments and orders.

The result is two concurrent maintenance-guideline formulas: One for pre-2019 maintenance modification cases (with tax advantages, unless the parties opt out of deductible/includible treatment); the other, for cases filed or determined on or after Jan. 1, 2019 (and which will not receive favorable tax treatment). It is anticipated that the pre-2019 formula will continue to be used for many years in modifications for spousal maintenance awards entered prior to Jan. 1, 2019.

When may I use the pre-2019 spousal maintenance formula?

The pre-2019 formula is based on tax-deductible maintenance payments by payor and includible as income to the recipient for tax purposes. The formula may be used for modifications of pre-2019 maintenance judgments and orders that continue to be tax deductible and includible—unless the parties opt out. The statutory formula is applicable to families with a combined gross income of less than $500,000 per year and if the payor has no obligation to pay child support or maintenance or both from a prior relationship. Spousal maintenance amounts are determined by taking 30 percent of the payor's gross annual income minus 20 percent of the recipient's gross annual income. However, the formula provides that spousal maintenance payments plus the recipient's own income cannot exceed more than 40 percent of the parties' combined gross annual income. For maintenance purposes, gross income means all income from all sources within the scope of that phrase in 750 ILCS 5/505. Due to the change in the taxability of spousal maintenance created by the TCJA that repeals the alimony deduction, an amendment to the formula becomes necessary for all new maintenance cases filed on or after Jan. 1, 2019, or those still pending but not finalized.

Considerations when determining the formula applicable for post-2018 cases

While it was not possible to retain the existing formula and achieve a similar result in the maintenance amount after the repeal of the alimony deduction, the new formula attempts to align with the existing one. With the loss of deductibility/includability, the new formula would cause spousal maintenance awards to be effectively higher or lower than they

ISBA RESOURCES >>

- Rhys Saunders, *A Separate Peace*, 106 Ill. B.J. 10 (Sept. 2018), law.isba.org/2AsYVue.
- James Arogeti, Tony Garvy, & Justin Pelock, *Personal Goodwill: Can We Limit the Subjectivity?,* Family Law (Apr. 2018), law.isba.org/2yxs0D5.
- Adam B. Whiteman, *Doing the Deed: Some Property-Related Tips for Divorcing Couples*, Real Property (Nov. 2017), law.isba.org/2OT5GhO.

3. I.R.C. § 71(2) (2018).
4. 750 ILCS 5/504.

would have been under the existing formula, causing unintended and negative consequences for the parties. A revision to the formula became necessary. Equitable adjustments had to be made to take into consideration the loss of the tax savings and to share the reduction in available cash between the parties.

Is the new formula based on net income?

Yes. The new formula will no longer be based on the parties' gross income. Any percentage computation would have had to be adjusted and aligned with the numerous and ever-changing federal and state tax brackets as well as the respective filing statuses of the parties. It was determined that the new formula must be based on net income. It was quickly realized that when using a net-income formula, the guideline's income percentages must increase to achieve results similar to the pre-2019 formula.

What is the new formula?

The ultimate result is a new guideline formula based on the net income of both parties. The new formula is 33 1/3 percent of the payor's annual net income minus 25 percent of the recipient's annual net income (the recipient's own net income plus maintenance is not to exceed 40 percent of the parties' combined annual net income).[5] This formula continues to be applicable to families with a combined annual gross income of less than $500,000—and if the payor has no obligation to pay child support, maintenance, or both from a past relationship.

How to determine net income when calculating spousal maintenance

When calculating spousal maintenance for new spousal maintenance cases on or after Jan. 1, 2019, "net income" has the meaning provided in 750 ILCS 5/505 for child support as amended in 2017. Recently revised section 505 includes an expanded and more concise methodology for calculating net income by relying on either the standardized or individualized tax amount. The standard tax amount means the total of all federal and state taxes for a single person claiming the standard tax deduction, one personal exemption, and the applicable number of dependency exemptions for the minor children of the parties (this includes Social Security and Medicare tax calculated at the Federal Insurance Contribution Rate). Parties may use the Gross to Net Income Conversion Table Using Standardized Tax Amounts provided by the Illinois Department of Healthcare and Family Services on its website (law.isba.org/2OaX7cY).

While the standardized tax amount may be appealing in its relative simplicity, it is unlikely to reflect the actual net income of a party who has numerous tax deductions or substantial capital-gain income. In those cases, it is best to use the individualized tax amount to determine net income, which in turn requires properly calculated state and federal taxes using actual filing status, deductions, tax deductions, and credits.

Is the amendment to 750 ILCS 5/504 a basis for modifying an existing maintenance order?

No. New language in the statute states: "The enactment of this amendatory act of the 100th General Assembly itself does not constitute a substantial change in circumstances warranting a modification."[6] Therefore, the amendment itself is not a basis for modification of an existing spousal maintenance order.

Additionally, language in section 510 (a-5) was added to permit a modification or termination of an order

> "only upon a showing of a substantial change in circumstances. The court may grant a petition for modification that seeks to apply the changes made to section 504 by this amendatory Act of the 100th General Assembly to an order entered before the effective date of this amendatory Act of the 100th General Assembly only upon a finding of a substantial change in circumstances that warrants application of the changes."[7]

This may now resolve the absence of specific direction noted by the appellate court in the *Carstens* case.[8]

FAMILY LAW ATTORNEYS SHOULD DISCUSS THE NEW TAX LEGISLATION WITH THEIR CLIENTS, WHO MAY WISH TO BENEFIT FROM THE SOON-TO-EXPIRE DEDUCTION IN CASES WHERE THE POSSIBILITY OF PAYING OR RECEIVING SPOUSAL MAINTENANCE OR UNALLOCATED ("FAMILY") SUPPORT EXISTS.

Are there any other changes to 750 ILCS 5/504?

Yes. The legislature clarified a number of provisions that have caused confusion and uncertainty for litigants, the bench, and bar. Below is a list of the other changes in the statute:

1. There is now language that requires the court, after considering all relevant facts, but before determining spousal maintenance, to first make a finding as to whether spousal maintenance is appropriate.[9]
2. A provision was included in the statute that permits the court to bar maintenance after finding maintenance is not appropriate, regardless of the length of the marriage at the time the action was commenced.[10]
3. Language was added to 504(b-1) to allow awards of both guideline- and non-guideline-maintenance in cases only when the court finds a maintenance award is appropriate.[11]

5. *Id.*
6. *Id.* at § 5/510.
7. *Id.* at § 5/510(a-5).
8. *In re Marriage of Carstens*, 2018 IL App (2d) 170183.
9. 750 ILCS 5/504(a).
10. *Id.* at § 5/504(b-1).
11. *Id.*

4. Many courts and practitioners encountered instances over the past few years where the child support and maintenance awards far exceeded 50 percent of the payor's net income. Language was added to allow the court to deviate if the application of the guidelines results in combined awards in excess of 50 percent of the payor's net income.[12] The deviation may be from maintenance, child support, or both. Previously, courts were deviating from the child-support formula, which worked to a family's benefit when maintenance was tax deductible. Now, since both maintenance and child support are based on after-tax dollars, the court may choose where the deviation will be taken. However, note that such a deviation is at the discretion of the court and is not a cap on payments.
5. Previously, the statute obliquely referred to reviewable maintenance and directly referred to fixed-term and indefinite (formerly "permanent") maintenance without clarifying or defining these terms. Now, these terms are specifically referenced and defined in the statute.[13] Definitions include:

A. Fixed-term maintenance. If a court grants maintenance for a fixed term, the court shall designate the termination of the period during which this maintenance is to be paid. Maintenance is barred after the end of the period during which fixed-term maintenance is to be paid.

B. Indefinite maintenance. If a court grants maintenance for an indefinite term, the court shall not designate a termination date. Indefinite maintenance shall continue until modification or termination under section 510.

C. Reviewable maintenance. If a court grants maintenance for a specific term with a review, the court shall designate the period of the specific term and state that the maintenance is reviewable. Upon review, the court shall make a finding in accordance with subdivision (b-8) of this section, unless the maintenance is modified or terminated under section 510.

The court must now designate which form of maintenance it is awarding. For practitioners, the best practice will be to use those defined terms in marital settlement agreements and designate which type of maintenance is being paid.[14]

6. Formerly, the statute provided a "fixed-term" spousal maintenance in a marriage under 10 years and an "indefinite" maintenance in a marriage over 20 years. Nothing was stated as to reviewability, and marriages between 10 and 20 years required no attribution of the type of maintenance that should or could be awarded. This led to confusion and disagreement, with some contending that "inclusion of one excludes all others." This led to the conclusion that marriages of 10 to 20 years had to be reviewable. For others, the durational guidelines for maintenance made no sense if they were only going to be reviewable. This has now been clarified. Any "kind" of maintenance can be applied to any length of marriage. The former permission for fixed-term maintenance in marriages under 10 years has been deleted.
7. Minor revisions also were made to the definitions of income in section 505, with corresponding reference in section 504 to account for the non-taxable nature of maintenance after Dec. 31, 2018. IBJ

12. *Id.*
13. *Id.* at § 5/504(b-4.5).
14. *Id.* at §§ 5/504(b-1), (b-3), (B-4.5).