A Primer on Alimony

In family law/divorce practice, one of the most often expressed words is "alimony", and along with that, often "support" – whether that be spousal or child support. On one level, alimony is rather simple – it is deductible by the one paying it, and taxable to the one receiving it. On the other hand, it's not that simple – because the response to the preceding is "sometimes" (even if that sometimes is "usually"). Also, like so many other things in the tax world, as well as in the legal world, there are fine points, nuances, exceptions, and all other sorts of disruptive concepts, altering what would otherwise be the calm veneer of the tax issues revolving around alimony. The purpose of this article is to briefly address some key tax issues.

- Must be in writing – a simple idea, but a critical one. In order to qualify as alimony for tax purposes, there must be an obligation to pay same, and that obligation must be expressed in some form of a writing. Typically, you will see it in an MSA/PSA or judgment for divorce, etc. Of course, a *pendente lite* order qualifies as a written document;

- Unallocated – if payments are not allocated (part to alimony/spousal support and part to child support) – that is they are unallocated – they are alimony. We understand the illogic in the wording that says for instance "payments are for the support of the spouse and the children" in that clearly the intent is that part of these payments are the economic equivalent of child support. However, from a tax point of view, if there is no specific allocation on behalf of the children, if the payments are "unallocated", then they are deductible/taxable alimony payments;

- It's your choice – virtually unique in the Tax Code, payments that would otherwise qualify as deductible/taxable alimony, can be elected to be not deductible/taxable. It takes nothing more than a simple writing for that to be effective. There is no need to justify same, or to otherwise support that treatment. All that needs to be done is there be wording in the written document establishing alimony that says that some part, or all, of the alimony is non-deductible by the payor and non-taxable to the recipient;

- Life insurance premiums and other expenses – in order for payments to qualify as deductible/taxable alimony, they need to be paid to the recipient (think former spouse), or paid on behalf of that former spouse. Thus, if as part of the MSA there is a provision that the payor spouse, besides perhaps alimony directly, will also pay for the car

lease of the now to be ex-spouse, that too qualifies as deductible/taxable alimony. Similarly of course with paying the rent expense of that former spouse. Life insurance is a little more complicated – if the payor of the life insurance premiums is the owner of the policy, then payments are not deductible, and thus of course also not taxable to the beneficiary. On the other hand, if the former spouse owns the policy, and the payor is simply obligated to make the payments of the premiums, then those payments are deductible/taxable as alimony;

- Cash – in order to qualify as alimony, payments must be in the form of cash – defined for this purpose as a check, money order, real actual green cash, etc.; or, as described immediately preceding, payments for the benefit of the ex-spouse, as per an agreement. Giving a note to a former spouse – for instance, "I promise to pay you $50,000 of alimony in 15 months" – is not alimony for tax purposes, it is not payment in cash. Similarly, giving an ex-spouse a car is not alimony;

- Death – okay, I got your attention with that nasty word. In order for payments to qualify as alimony from a tax perspective, they must cease at the death of the recipient, and that cessation must be either stated in writing in the divorce agreement or equivalent; or, it must be state law. In New Jersey, because such cessation is state law, you need not go out of your way to state that it stops at the death of the recipient – though there's no harm in doing so. Interestingly, and for some perhaps ironically, there is no such requirement that alimony stops at the death of the payor – in fact, it's well established that the obligation to pay alimony can reach into the grave, or perhaps more accurately, into the estate of the deceased;

- Child support – if payments are specifically designated as for the support of one or more children, those payments are not deductible to the payor, and not taxable to the recipient. It doesn't matter that the recipient is typically the ex-spouse, and that the payments are used for general support and maintenance of the spouse, the household and, yes, incidentally, the children;

- Child support electing – unlike as to alimony, the tax law is nowhere near as flexible in respect to child support. That is, while you have the right to opt-out of the normal taxable/deductible treatment of alimony (see above), there is no such reverse right in regards to child support. If, under the tax rules, the payments are child support, you do not have the ability to change the tax treatment and call it alimony – unless you actually change the terms, and get away from it being child support;

- Event or contingency related to a child – a trap for the unwary where alimony is reduced at some point – if there are children involved. If alimony is reduced at any time and it is connected to a contingency related to a child, then from day one, ab initio, to the extent of such reduction, that amount is considered to have been child support, not alimony. This is regardless of what language you might put in the agreement. To oversimplify, if the agreement reads that alimony shall be $3,000 a month, but when the child enters college, the alimony is reduced to $2,500 a month, then that $500 reduction is considered to have been child support from the very beginning – never deductible as alimony. If you try to be coy with the language, and instead say that alimony shall be reduced by this referenced $500, say on June 4, 2014 – and if the child happens to turn 18 on that date (or nearby that date), the result is the same. There are exceptions – this is a complex area – particularly if more than one child is involved. If there are any such reductions in alimony, and there are children involved, by all means, make sure that you coordinate this issue using a tax expert. Note that this is only a concern where there is a reduction in the alimony – it is not a concern if the alimony is increased.

As with so many other things that involve professional/technical knowledge and judgment, we urge our readers to make sure they (their clients) engage a CPA tax professional, expert in the divorce arena, in order to properly address any but the simplest situations. Many times, particularly for those of you who have solid relationships with such a qualified CPA, you can quickly get an answer as a courtesy – or at least be told that the issue is not as simple, not as black and white, as you thought.