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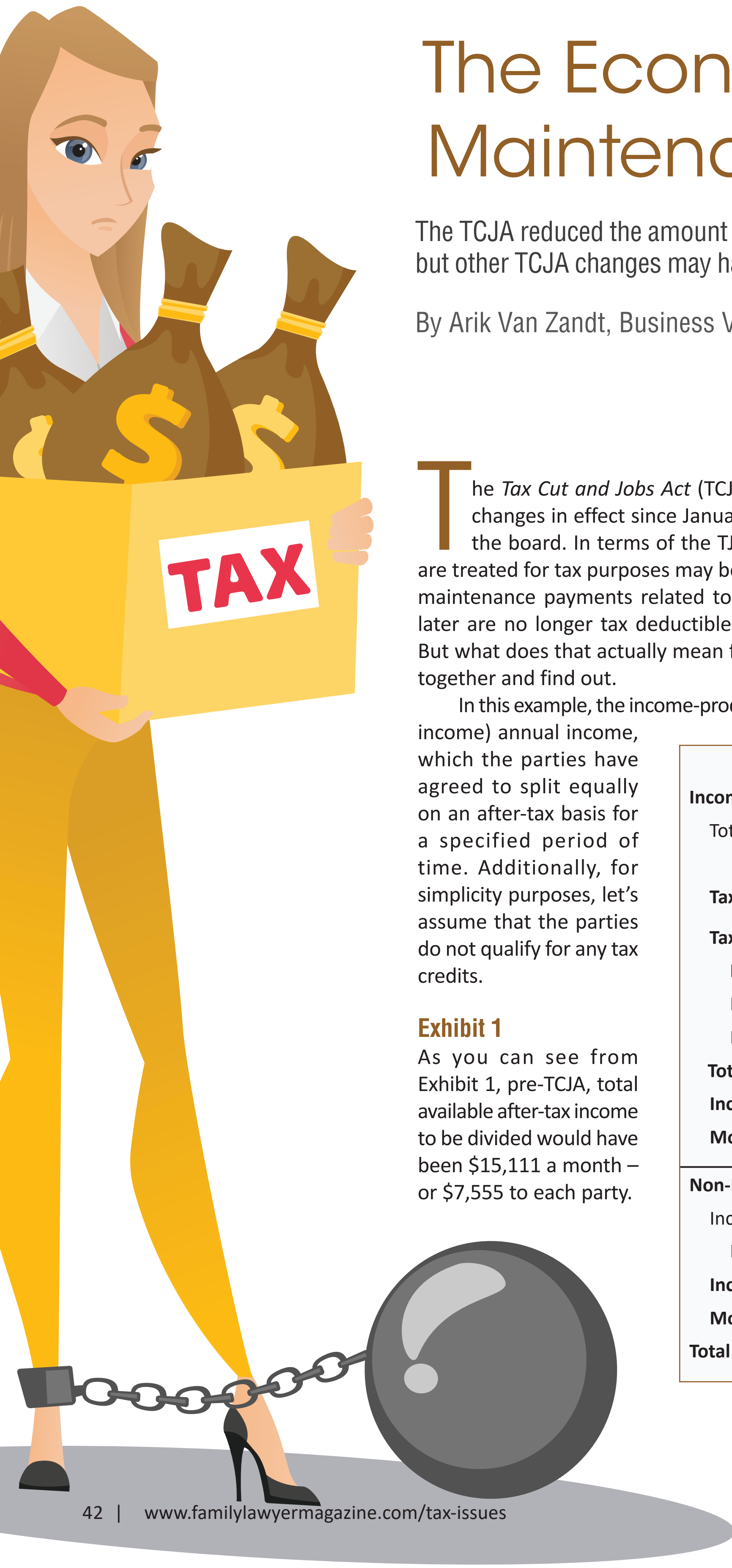

The Economic Reality of Maintenance Post TCJA

The TCJA reduced the amount of after-tax income available to pay maintenance, but other TCJA changes may have positively impacted the marital balance sheet.

By Arik Van Zandt, Business Valuator

The *Tax Cut and Jobs Act* (TCJA) – signed into law on December 22, 2017, with most changes in effect since January 2018 – has resulted in significant tax changes across the board. In terms of the TJCA's impact on family law, how maintenance payments are treated for tax purposes may be one of the most significant. As you likely already know, maintenance payments related to separation agreements signed on January 1, 2019, or later are no longer tax deductible for the payor and no longer taxable for the recipient. But what does that actually mean for the divorcing parties? Let's walk through an example together and find out.

In this example, the income-producing spouse generates $250,000 in pretax (adjusted gross income) annual income, which the parties have agreed to split equally on an after-tax basis for a specified period of time. Additionally, for simplicity purposes, let's assume that the parties do not qualify for any tax credits.

Exhibit 1

As you can see from Exhibit 1, pre-TCJA, total available after-tax income to be divided would have been $15,111 a month – or $7,555 to each party.

Exhibit 1: Pre-TCJA

Income Producing Spouse		
Total Income		$ 250,000
Less: Maintenance		(116,173)
Taxable Income		**$ 133,827**
Taxes		
Less: Federal Income Tax	*22.8%*	$ (30,453)
Less: Social Security Tax	*3.2%*	(7,961)
Less: Medicare Tax	*1.9%*	(4,750)
Total Taxes	*32.3%*	**$ (43, 163)**
Income After Maint. & Taxes		**$ 90, 664**
Monthly Income		**$ 7,555**
Non-Income Producing Spouse		
Income from Maintenance		$ 116,173
Less: Federal Income Tax	*22.0%*	(25,510)
Income After Taxes		**$ 90,664**
Monthly Income		**$ 7,555**
Total Available After-Tax Monthly Income		**$ 15, 111**

Exhibit 2

Post-TCJA, excluding any changes related to maintenance, the reduction in personal income tax rates that were part of the TCJA would have resulted in more after-tax income: approximately $615 more (see Exhibit 2, below).

Exhibit 2: Post-TCJA, ex. Maintenance Changes		
Income Producing Spouse		
Total Income		$ 250,000
Less: Maintenance		(116,638)
Taxable Income		**$ 133,362**
Taxes		
Less: Federal Income Tax	*19.7%*	$ (36,396)
Less: Social Security Tax	*3.2%*	(7,961)
Less: Medicare Tax	*1.9%*	(4,750)
Total Taxes	*39.2%*	**$ (39,007)**
Income After Maint. & Taxes		**$ 94,356**
Monthly Income		**$ 7,863**
Non-Income Producing Spouse		
Income from Maintenance		$ 116,368
Less: Federal Income Tax	*19.1%*	(22,282)
Income After Taxes		**$ 94,356**
Monthly Income		**$ 7,863**
Total Available After-Tax Monthly Income		**$ 15, 726**

However, after considering all the TCJA's applicable changes, the benefit that resulted from changes made to the personal income tax rate tables is more than offset by the changes made to how maintenance is treated for tax purposes, resulting in overall less after-tax income available to pay maintenance; in this example, $603 (or 4%) less is available, as shown in Exhibit 3 (right, above).

Exhibit 3

In the case of our example, a 4% reduction in total income available to pay maintenance may not sound significant. However, when considering that the total income is already being split between two households post-divorce, even a 4% reduction in total income available can be significant.

Exhibit 4

As can be seen in Exhibit 4 (right), if we assume that the non-income producing spouse has an inflexible monthly budget of $7,555, an amount equivalent to monthly after-tax income that would have been available pre-TCJA as shown in Exhibit 1, $602 (or 8%) less after-tax income is available to the income-producing spouse. Therefore, in this scenario, the negative impact of the TCJA as it relates to maintenance fully becomes the burden of the income-producing spouse. That said, the economic reality is, more often than not, that the income-producing spouse's wages will increase over time and any negative inequity on the part of the income-producing

Exhibit 3: Post-TCJA		
Income Producing Spouse		
Total Income		$ 250,000
Less: Maintenance		*Not Allowed*
Taxable Income		**$ 250,000**
Taxes		
Less: Federal Income Tax	*25.3%*	$ (63,188)
Less: Social Security Tax	*3.2%*	(7,961)
Less: Medicare Tax	*1.9%*	(4,750)
Total Taxes	*39.2%*	**$ (75,889)**
Income After Maint. & Taxes		**$ 87,050**
Monthly Income		**$ 7,254**
Non-Income Producing Spouse		
Income from Maintenance		$ 87,050
Less: Federal Income Tax	*0.0%*	*Not Taxed*
Income After Taxes		**$ 87,050**
Monthly Income		**$ 7,254**
Total Available After-Tax Monthly Income		**$ 14,508**

Exhibit 4: Post-TCJA		
Income Producing Spouse		
Total Income		$ 250,000
Less: Maintenance		*Not Allowed*
Taxable Income		**$ 250,000**
Taxes		
Less: Federal Income Tax	*25.3%*	$ (63,188)
Less: Social Security Tax	*3.2%*	(7,961)
Less: Medicare Tax	*1.9%*	(4,750)
Total Taxes	*39.2%*	**$ (75,889)**
Income After Maint. & Taxes		**$ 83,437**
Monthly Income		**$ 6,953**
Non-Income Producing Spouse		
Income from Maintenance		$ 90,664
Less: Federal Income Tax	*0.0%*	*Not Taxed*
Income After Taxes		**$ 90,664**
Monthly Income		**$ 7,555**
Total Available After-Tax Monthly Income		**$ 14,508**

spouse's available after-tax income is temporary and will disappear (and even invert) with wage growth.

The Trend Away from Maintenance and Towards Transfer Payments

While the TCJA did reduce the amount of after-tax income available to pay maintenance, other TCJA changes may have positively impacted the marital balance sheet through an increase in the value of private business interests or public equity interests held due to reduced corporate tax rates, creating an alternative source from which to transfer value from one spouse to another[1]. At Alvarez & Marsal Valuation Services, we've noticed a trend over the last five years away from maintenance payments and towards using transfer payments as a vehicle to transfer cash between the parties, primarily because transfer payments are generally lower risk for the recipient and result in a cleaner break between the parties. Given that the TCJA eliminated any tax benefits previously associated with maintenance payments, this is a trend we expect to continue with even greater velocity. ■

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[1] *Martin v. Martin*, 1D18-2546 in the advance sheets For more information related to how the TCJA impacted the value of business interests, please refer to Arik Van Zandt's May 10th, 2018 article, entitled "How the Tax Cuts & Jobs Act Will Impact Corporate Taxes", available at www.familylawyermagazine.com/articles/how-the-tax-cuts-jobs-act-will-impact-corporate-taxes.