

Here's the New Tax-Advantaged Way to Pay Alimony

- The Tax Cuts and Jobs Act will **eliminate the tax deduction for alimony** for divorce agreements executed after Dec. 31, 2018.
- Under the old law, these spousal payments were deductible to the payer and taxable to the payee.
- IRAs are now a bargaining chip in alimony discussions, as long as your ex can wait to withdraw money.

As the tax advantages of alimony payments disappear in 2019,

expect the individual retirement account to feature more prominently in divorce discussions.

That's a prediction from Ed Slott, CPA and founder of Ed Slott and Co. He hosted a discussion on IRA planning at the American Institute of CPA's Engage conference in Las Vegas.

Today, and under the old tax law, one spouse pays alimony and collects a benefit in the form of an above-the-line deduction on his income tax return.

"It's almost always the case that the spouse paying the alimony was in a higher tax bracket than the one receiving it," Slott said. "The payer gets a big deduction, and the other spouse picks it up as income in a lower tax bracket."

The calculus of divorce has changed under the Tax Cuts and Jobs Act.

Alimony will **not be available** as a deduction for couples who finalize their divorce and separation *after* Dec. 31, 2018. *Existing divorces and separations aren't affected by this.*

IRAs can provide divorcing couples an alimony planning opportunity under the new law, provided the conditions are just right, according to Slott.

A Bargaining Chip

Money is usually the one thing that most people worry about when getting divorced.

Under the old law, in order to collect a deduction for alimony, the payment must be made in cash.

Since the payments are no longer deductible starting in 2019, a divorcee can give the recipient spouse an IRA as a lump-sum payment of alimony.



In this move, the higher-earning spouse is shipping off an account that would have saddled them with income taxes if they withdrew cash from it.

“When the husband gives the IRA to his ex-wife, he’s giving money he would have paid taxes on,” Slott said. “He is in effect getting a deduction.”

The recipient spouse, who is presumably in a lower tax bracket, is responsible for income taxes once they take a distribution from the account.

They may be also be subject to a 10 percent penalty for withdrawing from the account before age 59½.

The actual transfer of the account from one spouse to the other is tax-free.

Be careful, however. This strategy is not suitable for divorced people who need spousal support immediately.

Since the recipient spouse can face taxes and penalties for early withdrawals from the IRA, **this strategy won’t work if they need cash in hand to sustain a living.**

“If the receiving spouse is under 59½, this may not be the best deal since any withdrawals will be subject to the 10 percent penalty,” Slott said. *“There is no exception for this.”*

Still, an ex-spouse who can afford to wait to make withdrawals will enjoy the benefit of tax-deferred growth inside of the IRA over time.

Further, once the recipient can tap the account free of penalties, the IRA can provide them with retirement income.

ALIMONY?

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