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Spousal Support Modification: Calling It Alimony Under New Tax Law

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When the Tax Cuts and Jobs Act was passed in 2017, Congress eliminated the longstanding treatment of alimony and separate maintenance payments under the tax code as a deduction to the payor spouse and as income to the recipient spouse. For any agreement or order executed after Dec. 31, 2018, alimony, spousal support and alimony pendente lite (APL) are not treated the same way as before and payments made to support a spouse are no longer deductible to the payor spouse and are not includable as income to the recipient spouse.

While the stated rationale for the change in the law was to bring the treatment of alimony in line with case law that predated the Revenue Act of 1942, most commentators believe that the reason for the change was to increase tax revenue as normally the payor spouse is in a higher tax bracket than the recipient spouse and also to eliminate the problems with the enforcement of recipient spouses not reporting alimony as income.

There is no doubt that this change in the law makes things easier and popular opinion will always be in favor of simplifying the process of paying taxes and complying with the law, however, some practitioners are now looking for ways to apply the old law to their cases where it makes sense to do so. While every individual situation is different, when alimony is deducible to the payor and taxed to the recipient, it usually results in more money in both parties' pockets. One way to do this is to argue that the new code allows for modification of spousal support and APL agreements that predate the change in the law to alimony awards agreed to or modified after the new law has taken effect. The support for this course lies in the interpretation of the language of the amendments, see 26 U.S.C. Section 71.

The new tax law defines a "divorce or separation agreement" as, "a decree of divorce or separate maintenance; a written instrument incident to such a decree; a written separation agreement; and a decree requiring a spouse to make payments for the support of the other spouse." The law goes on to collectively define "alimony and separate maintenance payments" as, "cash payment(s) received by a spouse under a divorce decree or separate instrument." It would seem that the collective definitions of a "divorce or separation agreement" and "alimony and separate maintenance" under the code mean that APL and alimony are the same thing for tax purposes.

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The new law will allow the previous tax treatment of alimony and support to apply to current modifications of divorce or separation instruments executed on or prior to Dec. 31, 2018, unless they "expressly provide" that the treatment of alimony and support under the new law apply to the modification. Some practitioners and commentators have argued that because the new law treats divorce and separation agreements as one in the same and treats alimony and separate maintenance payments as one in the same, then the new law clearly allows for the transformation of spousal support or APL to an award of alimony as long as the first agreement or order predated the new law; the post divorce alimony becoming a modification of the existing spousal or APL order.

While it is clear that the IRS Code believes that alimony and separate maintenance, as well as the decrees, orders and agreements implementing them are one in the same the Pennsylvania Divorce Code provides very distinct definitions alimony and APL. Pennsylvania law distinguishes between alimony, APL and spousal support and makes it clear that they are very different, especially with respect to alimony and APL, see 23 Pa.C.S. Section 3103. They are all defined as follows:

- "Alimony." An order for support granted by this commonwealth or any other state to a spouse or former spouse in conjunction with a decree granting a divorce or annulment.
- "Alimony pendente lite." An order for temporary support granted to a spouse during the pendency of a divorce proceeding.
- "Spousal support." Care, maintenance and financial assistance.

Under Pennsylvania law, APL is meant to be temporary support to a spouse "before" a divorce decree is entered and alimony is support for the spouse upon entry of a divorce decree or, clearly, "after" the divorce. 23 Pa.C.S. Section 3701 provides for alimony only when a divorce decree has been entered, and because only "married persons are liable for the support of each other," 23 Pa.C.S Section 4321(1), spousal support necessarily stops upon entry of a divorce decree. Furthermore, reported case law and the procedural rules describe the purposes and policy behind alimony and APL as very different things. Indeed, both are calculated differently, with APL and spousal support being derived from a guideline formula and alimony being based upon need. Again, they are two totally different concepts needing to be separately ordered.

When matched up with the collective definitions of alimony and support in the new tax code, some practitioners see no trouble in modifying APL and spousal support to an alimony award, especially when their particular case may dictate that treatment of alimony to a recipient spouse is a better deal "tax wise" for both parties. The problem with this interpretation of what may be allowed under the new law is that there is no universal agreement on whether this is or will be permitted by the IRS and certainly no one right answer.

In the absence of any reported Pennsylvania cases, federal cases, or IRS regulations, interpreting modifications of "old law" APL and spousal support awards to "new law" post divorce alimony, it is hard to determine how practitioners can be sure whether such a course of action is legal or will be permitted, no matter how much sense it makes to the attorneys and the parties to a separation and divorce. Further, should the real goals of the new law of increased revenue be applied in a contested federal or Pennsylvania case that says that APL and alimony are two different things and cannot be transformed by agreement to manipulate the payment of taxes, one wonders what that does to any such modifications transforming support and APL to alimony. In the absence of any real guidance, can a recommendation to a client to modify in such a way be considered malpractice?

Should an IRS regulation be published disallowing the practice or modifications be found to be invalid, the corrective work that will need to be done will be tedious and expensive. Alimony will need to be recalculated, orders will need to be changed and accountants will likely have to be employed to determine the correct amounts of taxes that will need to be paid and the forms and amendments that will need to be filed. Also, what is the responsibility of both the attorneys and accountants who were involved in recommending such a modification from the standpoint of correcting the situation? Will it be the responsibility of attorneys and accountants to notify the non-compliant parties of the error or will it only become relevant if individual or former spouses get audited? One wonders, in the absence of a regulation or not, whether the IRS in the current administration or the next will be interested in policing such a situation.

Such questions should be on the minds of every divorce attorney and accountant who may be in the position of how to decide to structure a new alimony order or modification of spousal support or APL to alimony. The instant situation is very much up for debate but unfortunately we are now at a point in time where the new law has taken effect and the only real way to advise your clients that they are without a doubt in compliance, is to refrain from modifying APL and spousal support to deductible alimony.

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