



Are Alimony Payments Deductible – Or not?

By Ann G. Grubbs, CPA

Alimony payments are tax deductions for the payer and taxable income to the recipient. But, if the settlement is not structured properly, alimony could be treated as either child support or a division of marital property. The bad news is that neither of these is tax deductible. The good news, for the receiving party, is that they are both tax-free income.

According to the Internal Revenue Service, tax-deductible alimony must meet the following tests:

1. The payment must be specified in a written instrument.
2. It must be made to an ex-spouse.
3. The divorce document cannot state that it is not alimony.
4. The ex-spouses cannot live in the same household or file a joint return.
5. The payment must be made in cash or a cash equivalent.
6. The payment cannot be fixed or deemed child support.
7. The payment(s) must stop if the spouse receiving it dies. However, it is permissible for the payer's estate to continue making payments after the payer dies.
8. The payer's return is required to include the payee's social security number.

There are several of these requirements that commonly cause taxpayers trouble.

The payment must be specified in a written instrument. Payments made before signing a written agreement and before the date of the court order are not deductible - they are considered voluntary. The same is true for any payment in excess of the required amount.

The payment must be made in cash or a cash equivalent. If the payment is in a form other than cash it is considered a division of marital property. For example, a decree transfers one-third of Ronald's company's stock to Mary. This transfer is designated as alimony in the divorce, but is not deductible because it is not a cash payment.

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The payment cannot be fixed (child support) or deemed child support. A fixed child support payment is one that is classified as child support in the divorce decree. *Deemed* means that it wasn't really intended to be child support, but the IRS interprets it that way. A *deemed* child support payment would be one that ends or is reduced when your child reaches a certain age or achieves some milestone (graduation, marriage, employment, etc.).

For example, Ted and Anna divorce, and Anna agrees to pay Ted \$2500.00 per month until their son William reaches age 18. After that Anna will pay Ted \$1000.00 per month. In this situation, \$1500.00 of the monthly payment will be considered child support.

The obligation to make payments must cease if the recipient dies. If the divorce papers are unclear about whether or not payments should continue after the recipient's death, state law controls. However, relying on state law to support the deductibility of alimony is risky. Rather, the divorce papers should always state whether a payment continues after the death of the receiving party.

In addition to these rules, divorcing taxpayers should be aware of the "Alimony Recapture" rule. This rule could be a problem if alimony payments decrease substantially in the second or third year, or if they terminate during the first three calendar years. When this situation occurs, the payer will have to include in income in the third calendar year part of the alimony payments previously used as a tax deduction. The recipient of the alimony will be able to deduct from income the amount included in the payer's income.

The moral is this: look at the rules before finalizing the negotiations on the divorce in order to determine what part of your alimony Uncle Sam will pay.

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