

What Are the Tax Implications of Paying or Receiving Alimony?

Article Highlights:

- Definition of Alimony
- When Is It Income, and When Is It Deductible?
- IRA Qualification
- Effect of Child Support
- Need for Estimated Payments
- IRS Matching Program

Recently divorced individuals may pay or receive alimony. If this is your situation, here are some tips for how to correctly treat the payments on your tax return.

The first consideration is the definition of alimony. There are actually two definitions of alimony—one for payments made under divorce decrees and separation agreements established before 1985 and another for agreements established since that time. For the purposes of this article, only the rules for post-1984 decrees and agreements will be discussed.

For post-1984 decrees and agreements, alimony has the following requirements:

- The payments must be in cash paid to a spouse, ex-spouse or third party on behalf of a spouse or ex-spouse, and the payments must be made after the divorce decree is finalized. If made under a separation agreement, the payments must be made after the execution of that agreement.
- The payments must be required by a decree or instrument incident to divorce, a written separation agreement, or a support decree.
- The payments cannot be designated as child support. Child support payments are neither income for the recipient nor a deduction for the payer.
- Payments made while spouses or ex-spouses share the same household don't qualify as alimony. This is true even if the spouses live separately within a dwelling unit.
- The payments must end upon the death of the payee.
- The payments cannot be contingent on the status of a child. This is to prevent child support from being disguised as deductible alimony.

If payments you receive from or make to a spouse or former spouse meet the definition of alimony, those payments are taxable for the recipient and deductible for the payer. There is one exception to this rule, however: A divorce decree or separation agreement can designate that alimony payments are neither deductible nor taxable. If this is the case, the payments are not reportable on either party's tax return.

Here are some additional issues that should be considered.

- The IRS requires that a taxpayer deducting alimony include the payee's Social Security Number (SSN) on his or her tax return. Thus, the recipient must provide his or her SSN to the payer.
- The IRS has noted that a significant number of taxpayers incorrectly report their alimony by either understating the income or overstating the amount paid. As a result, the IRS computer compares the amounts listed on the payer's and recipient's tax returns, and it will initiate a correspondence audit where there is a discrepancy.

- The recipient of alimony payments may treat alimony payments as compensation even if those payments are that person's only income. This allows alimony recipients to save for their retirement by making either Traditional or Roth IRA contributions, the rules for which require the contributor to have earned income or compensation. Alimony income satisfies this requirement.
- If a divorce decree or other written instrument or agreement calls for both alimony and child support, and the person making the payments pays less than the total required, the payments apply first to child support. Any remaining amount is then considered alimony.
- There is no income tax withholding from alimony payments, so the recipient may need to consider making estimated tax payments.

Other complications can occur that are not addressed here. If you have such complications or wish to discuss alimony as it applies to your circumstances, please give this office a call.