New alimony tax rules and your retirement savings

"'Til death do us part" is a famous phrase from traditional marriage vows. Yet for many older adults, divorce has been on the rise. According to a March 2017 Pew Research study entitled, "Led by Baby Boomers, divorce rates climb for America's 50-plus population", divorce rates for adults ages 50 and older have roughly doubled in the past twenty-five years. The climbing divorce rate for adults ages 50 and older is linked in part to the aging of the Baby Boomers, who now make up the bulk of this age group. (As of 2015, Baby Boomers ranged in age from 51 to 69.) During their young adulthood, Baby Boomers had unprecedented levels of divorce. That, in turn, has led to higher levels of remarriage among the Baby Boomer population, and remarriages tend to end in divorce more frequently than first marriages, Pew says.

It's not exactly a lighthearted topic, but it's one that is impact a growing number of people. As detailed in a CNBC.com com article from August 2018, "Two surprising ways the new alimony tax rules affect your retirement savings," changes from the Tax Cuts and Jobs Act that take effect January 1st, 2019 will introduce different tax rules for alimony payments. That could mean big changes for your retirement accounts. Under the new regulations, the individual who pays alimony to an ex-spouse will no longer be able to deduct those payments. And the recipient of the money will no longer pay taxes on that income. This will only impact you if you divorce after December 31st, 2018.

If one spouse makes alimony payments through an individual retirement account, for example, they are giving money that they otherwise would have had to pay tax on if they had withdrawn it. Once a receiving spouse takes money from the IRA, they will pay tax on that money. If the receiving spouse is younger than fifty-nine and a half, they will have to pay a 10 percent penalty in addition to the income taxes on that withdrawal. Any transfer from an IRA would be considered a one-time transaction. Of course, any such alimony agreement would need to be outlined in the divorce agreement. This is where working with Financial Services Professional can be useful. They can work with you to examine the most efficient and financially secure way to potentially utilize your IRA as part of your alimony payments.

In addition, the new alimony rules in the Tax Cuts and Jobs Act of 2017 could impact the way that alimony recipients save for retirement. Because alimony funds will no longer be considered taxable earned income, it will not be possible to invest that money in an individual retirement account. This could impact individuals who are not working and only receiving alimony. Those individuals would need to invest any alimony funds into a taxable account.

These new alimony rules will impact any divorce after December 31st, 2018. According to the Pew Research Study we cited earlier, of all adults 50 and older who divorced in 2015, 48% had been in their second or higher marriage. Pew also notes that divorce at this stage of life can have more downsides. Gray divorcees tend to be less financially secure than married and widowed adults, particularly among women. And living alone at older ages can be detrimental to one's financial comfort and, for men, their satisfaction with their social lives.

Regardless of new tax rules for alimony from the Tax Cuts and Jobs Act of 2017, it is vitally important for any newly divorced spouse to create a financial plan to understand how their retirement savings may be impacted or have to be adjusted due to their divorce. Lifestyles and expenses are likely to change and doing that sooner rather than later can have a positive impact on your financial security in retirement.

Sources:

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