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THE TAX COST OF DIVORCE HAS RISEN FOR MANY

Are you divorced or in the process of divorcing? If so, it's critical to understand how the Tax Cuts and Jobs Act (TCJA) has changed the tax treatment of alimony. Unfortunately, for many couples, the news isn't good — the tax cost of divorce has risen.

WHAT'S CHANGED?

Under previous rules, a taxpayer who paid alimony was entitled to a deduction for payments made during the year. The deduction was "above-the-line," which was a big advantage, because there was no need to itemize. The payments were included in the recipient spouse's gross income.

The TCJA essentially reverses the tax treatment of alimony, effective for divorce or separation instruments executed after 2018. In other words, alimony payments are no longer deductible by the payer and are excluded from the recipient's gross income.

WHAT'S THE IMPACT?

The TCJA will likely cause alimony awards to decrease for post-2018 divorces or separations. Paying spouses will argue that, without the benefit of the alimony deduction, they can't afford to pay as much as under previous rules. The ability of recipients to exclude alimony from income will at least partially offset the decrease, but many recipients will be worse off under the new rules.

For example, let's say John and Lori divorced in 2018. John is in the 35% federal income tax bracket and Lori is a stay-at-home mom with no income who cares for John and Lori's two children. The court ordered John

to pay Lori $100,000 per year in alimony. He's entitled to deduct the payments, so the after-tax cost to him is $65,000. Presuming Lori qualifies to file as head of household, and the children qualify for the full child credit, Lori's net federal tax on the alimony payments (after the child credit) is approximately $8,600, leaving her with $91,400 in after-tax income.

Suppose, under the same circumstances, that John and Lori divorce in 2019. John argues that, without the alimony deduction, he can afford to pay only $65,000, and the court agrees. The payments are tax-free to Lori, but she's still left with $26,400 less than she would have received under pre-TCJA rules.

The pre-2019 rules can create a tax benefit by reducing the divorced couple's overall tax liability (assuming the recipient is in a lower tax bracket). The new rules

WHAT IF YOU'RE ALREADY DIVORCED?

Existing divorce or separation instruments, including those executed during 2018, aren't affected by the TCJA changes. The previous rules still apply unless a modification expressly provides that the TCJA rules must be followed. However, spouses who would benefit from the TCJA rules — for example, because their relative income levels have changed — may voluntarily apply them if the modification expressly provides for such treatment.

eliminate this tax advantage. Of course, if the recipient is in a higher tax bracket than the payer, a couple is better off under the new rules.

WHAT TO DO?

If you're contemplating a divorce or separation, be sure to familiarize yourself with the post-TCJA divorce-related tax rules. Or, if you're already divorced or separated, determine whether you would benefit by applying the new rules to your alimony payments through a modification of your divorce or separation instrument. (See "What if you're already divorced?" above.) We can help you sort out the details. ■

DOUBLE UP ON TAX BENEFITS BY DONATING APPRECIATED ARTWORK

From a tax perspective, appreciated artwork can make one of the best charitable gifts. Generally, donating appreciated property is doubly beneficial because you can both enjoy a valuable tax deduction and avoid the capital gains taxes you'd owe if you sold the property.

The extra benefit from donating *artwork* comes from the fact that the top long-term capital gains rate for art and other "collectibles" is 28%, as opposed to 20% for most other appreciated property.

REQUIREMENTS

The first thing to keep in mind if you're considering a donation of artwork is that you must itemize deductions to deduct charitable contributions. Now that the Tax Cuts and Jobs Act has nearly doubled the standard deduction and put tighter limits on many itemized deductions (but not the charitable deduction), many taxpayers who have itemized in the past will no longer benefit from itemizing.

For 2019, the standard deduction is $12,200 for singles, $18,350 for heads of households and $24,400 for married couples filing jointly. Your total itemized deductions must exceed the applicable standard deduction for you to enjoy a tax benefit from donating artwork.

Something else to be aware of is that most artwork donations require a "qualified appraisal" by a "qualified appraiser." IRS rules contain detailed requirements about the qualifications an appraiser must possess and the contents of an appraisal.

IRS auditors are required to refer all gifts of art valued at $50,000 or more to the IRS Art Advisory Panel. The panel's findings are the IRS's official position on the art's value, so it's critical to provide a solid appraisal to support your valuation.

Finally, note that, if you own both the work of art and the copyright to the work, you must assign the copyright to the charity to qualify for a charitable deduction.

DEDUCTION TIPS

The charity you choose and how the charity will use the artwork can have a significant impact on your tax deduction. Donations of artwork to a public charity, such as a museum or university with public charity

status, can entitle you to deduct the artwork's full fair market value. If you donate art to a private foundation, however, your deduction will be limited to your cost.

For your donation to a public charity to qualify for a full fair-market-value deduction, the charity's use of the donated artwork must be related to its tax-exempt purpose. If, for example, you donate a painting to a museum for display or to a university's art history department for use in its research, you'll satisfy the related-use rule. But if you donate it to, say, a children's hospital to auction off at its annual fundraising gala, you won't satisfy the rule.

CAREFUL PLANNING

To reap the maximum tax benefit of donating appreciated artwork, you must plan your gift carefully and follow all applicable rules. Contact us for assistance. ■

HOW BUSINESSES CAN ASSESS RISK OF WORKER MISCLASSIFICATION

Classifying a worker as an independent contractor frees a business from its portion of payroll tax liability and allows it to forgo providing overtime pay, unemployment compensation and other employee benefits. It also frees the business from responsibility for withholding income taxes and the worker's share of payroll taxes.

For these reasons, the federal government looks unfavorably on misclassifying a bona fide employee as an independent contractor. If the IRS reclassifies a worker as an employee, your business could be hit with back taxes, interest and penalties.

KEY FACTORS

When assessing worker classification, the IRS typically looks at the:

Level of behavioral control. The more control the company exercises, the more likely the worker is an employee. So, the IRS looks at the extent to which the company instructs a worker on when, where and how to work; what tools or equipment to use; where to purchase supplies and so on.

Level of financial control. Independent contractors are more likely to invest in their own equipment or facilities, incur unreimbursed business expenses, and market their services to other customers. Employees are more likely to be paid hourly, weekly or bimonthly; independent contractors are more likely to receive a flat fee.

Relationship of the parties. Independent contractors are often engaged for a specific project, while employees are typically hired permanently (or at least for an indefinite period). Also, workers who serve a key business function are more likely to be classified as employees.

The IRS examines a variety of factors within each category, as well as the totality of facts and circumstances.

PROTECTIVE MEASURES

When in doubt, reclassify questionable independent contractors as employees. This may increase your tax and benefits costs, but it will eliminate reclassification risk.

From there, modify your relationships with independent contractors to better ensure compliance. For example, you might exercise less behavioral control by reducing your level of supervision or allowing workers to set their own hours or work from home.

Also, consider using an employee-leasing company. Workers leased from these firms are employees of the leasing company, which is responsible for taxes, benefits and other employer obligations.

HANDLE WITH CARE

Taxes, interest and penalties aren't the only possible negative consequences of a worker being reclassified as an employee. Your business also could be liable for employee benefits that should have been provided but weren't. Contact us if you have questions about worker classification. ■