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INSIGHT: Marriage and the 2017 Tax Reform Law

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The Tax Cuts and Jobs Act of 2017 made significant changes to tax deductions for individuals. The new restrictions on itemized deductions may favor unmarried couples in some cases, particularly two lawyers or other high income professionals, who live in a high tax state like New York, New Jersey, or California.

The Act generally limited a taxpayer's federal deduction for state and local income and property taxes to $10,000 per taxpayer per year for 2018 through 2025. The same $10,000 limit applies to a single individual and to a married couple filing a joint return. In other words, a married couple who is subject to the $10,000 limit would effectively double the limit, to $20,000 of aggregate deductible state and local taxes per year, by not being married. The Joint Committee on Taxation emphasized the $10,000 limit for married couples in a 400-word footnote in its year-end law summary, presumably to dispel any doubts.

Prior to the Act, a taxpayer may deduct home mortgage interest generally on up to $1.1 million of debt on a primary residence and a secondary residence. The Act reduced the allowed principal debt balance to $750,000 for 2018 through 2025, with some grandfathering for up to $1 million of pre-existing mortgages. The same $750,000 limit applies to a single individual and to a married couple filing jointly. The U.S. Court of Appeals for the Ninth Circuit held in *Voss v. Commissioner* that two unmarried taxpayers may each have his or her own deductible debt limit for residences that they co-owned. As a result, a married couple who is subject to the new $750,000 debt limit may effectively double their limit to $1.5 million by being unmarried co-owners of the same property.

The Act roughly doubled the standard deductions in 2018 (through 2025), to $12,000 for a single individual and $24,000 for a married couple filing jointly. An unmarried couple may benefit from having one person claiming the standard deduction and another person claiming itemized deductions.

For example, if a married couple has $10,000 of local property taxes and $10,000 of charitable contributions, their best choice is the $24,000 standard deduction. Two unmarried persons in the same situation may have one person claiming the $12,000 standard deduction and the other person paying and claiming the $20,000 of itemized deductions ($10,000 local property tax deduction plus $10,000 charitable contributions), for an aggregate deduction of $32,000. Cases such as *Powell v. Commissioner* and *Milgroom v. Commissioner* have held that a co-owner of a property may pay more than his or her pro rata share of property taxes and deduct the entire amount paid (up to any applicable limits).

The Act changed the graduated federal income tax rates at various income brackets, with the bracket for a married couple generally equal to twice a single individual's bracket. For example, the 35 percent federal income tax rate applies to a single individual's taxable income above $200,000 and to a married couple's taxable income above $400,000 in 2018. However, the highest 37 percent federal income tax rate has a marriage penalty, in that it applies to a single individual's taxable income above $500,000 and a married couple's taxable income above only $600,000 in 2018.

For couples who found themselves married in 2018 and were reconsidering the situation, the Act helpfully eased any transition into unmarried status by providing that alimony is still deductible by the payor and includible in the payee's gross income as long as the alimony is paid pursuant to a divorce or separation instrument executed on or before Dec. 31, 2018. Alimony that does not qualify for this grandfathering rule is not deductible

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by the payor or taxed to the recipient anymore, similar to child support and other non-business payments.

Despite some comments from media reports and divorce lawyers that may have led to the Great Divorce Rush of 2018, couples could enter into a separation instrument in 2018, without necessarily getting divorced by that year's end, and still preserve the ability to deduct alimony for the rest of their lives. In *Dato-Nordurft v. Commissioner*, the U.S. Tax Court held that a separation instrument, for two spouses that were physically separated but not legally separated, did not even have to be enforceable under state law, as long as the document was signed by both spouses and contained some terms of support.

The tax law does favor married couples in some cases, such as better federal gift and estate tax exemptions for individuals with more than around $11 million of assets. Marriage may also have some non-financial benefits. Nevertheless, the Act's marriage penalty effects may be costly for a married couple compared to two unmarried persons in otherwise identical circumstances.

Congress took around 48 years to eliminate the marriage penalty in the lower income tax rate brackets that existed between 1969 and 2017, and future legislation may address the current marriage penalties. In the meantime, the Act may have a significant monetary influence on a couple's decision to get married, at least before 2026, particularly if the couple consists of two working professionals who live in a city with high housing costs and state and local taxes.

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