THE FLIP AND FLOP OF TAXING ALIMONY

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Abstract

Since the dawn of income taxation in America, the tax treatment of alimony payments has flipped, flopped, and flipped again. The tax burden was first borne by the person paying alimony, then by the person receiving it. The burden has since shifted back to the alimony payor. This, we argue, was a flop.

The Tax Cuts and Jobs Act of 2017 eliminated a tax deduction for alimony payments that served to reduce the taxable income of the payor and shift the payments into the taxable income of the recipient. Congress justified this deviation from the longstanding deduction/income treatment based an old Supreme Court case that held alimony was to be taxed to husbands as part of their moral and legal obligations to support their wives. More likely, Congress was acting for its own benefit—eliminating the deduction is estimated to raise billions for the fisc.

In this Article, we argue that this change was a mistake. Treating alimony payments as income to the recipient better comports with the Tax Code's progressive rate structure and the concept of taxing a party based on "ability to pay." The argument proceeds in two parts. First, we argue that alimony payments do not constitute consumption by the payor. Thus, like gifts, alimony payments should only be taxed to one of the parties involved in the transfer. Existing scholarship seems to coalesce on this point. Still, this does not tell us whom to tax: the alimony payor or the recipient? Distinguishing the income tax treatment of alimony from that of gifts, we argue the latter.

As a theoretical matter, allowing a deduction for alimony payments aligns with our progressive rate structure by accounting for the payor's lower marginal "ability to pay" after making alimony payments. These payments represent future consumption by the recipient, not the payor, and thus reflect an increase in the recipient's "ability to pay" taxes on such sums. And, as a practical matter, allowing parties the flexibility to allocate the tax burden among themselves is a negotiating chip that may grease the wheels in other areas of the divorce settlement process. We recommend that Congress flip once more and return the tax treatment of alimony to what it was prior to the 2017 Act reform.

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I. INTRODUCTION

Since the dawn of income taxation in America, the tax treatment of alimony payments has flipped, flopped, and flipped again. The tax burden was first borne by the person paying alimony, then by the person receiving it. Most recently, as part of the Tax Cuts and Jobs Act of 2017,[1] the burden shifted back to the alimony payor. This, we argue, was a flop.

Specifically, the 2017 Act eliminated a deduction for alimony support payments made under any divorce or separation agreement executed after December 31, 2018. Prior to that change, the payor-spouse could take a federal tax deduction for the payment of alimony, and the recipient-spouse would have income from receiving the alimony payment.[2] A deduction for alimony, in some shape or form, had been a part of the Internal Revenue Code[3] since the early 1940s, so this revocation of the alimony deduction was a major shift in policy. And, unlike many provisions of the 2017 Act, the revocation is not subject to a sunset provision.[4] That is to say, the current state of nondeductibility for alimony payments is permanent unless Congress passes a new law bringing the deduction back.

This Article argues that the revocation was a mistake. Tax policy would be better served by returning the tax treatment of alimony to what it was immediately prior to the 2017 Act: allowing a deduction for the payor-spouse and including the payments as income to the recipient.

The Article proceeds in four Parts. Part II provides a brief history of the tax treatment of alimony. Part III reviews the current tax treatment of alimony and child support payments and their treatment prior to the 2017 Act. Part IV proposes the tax policy justifications for allowing a deduction for alimony payments. And Part V concludes.

II. HISTORY OF THE TAX TREATMENT OF ALIMONY

The concept of alimony far predates the American income tax. Spousal support payments were mandated by the Code of Hammurabi, and the first divorce in America can be traced to the mid-seventeenth century.[5] Our federal personal

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[1] An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017) [hereinafter TCJA].

[2] As the name suggests, the "payor-spouse" is the party that remits alimony or child support payments. The "recipient-spouse" is the party that receives such payments.

[3] The current tax system is governed by the Internal Revenue Code of 1986, as amended. However, we will sometimes refer to or cite older versions of the Internal Revenue Code.

[4] TCJA, *supra* note 1; *see also* Roger Wohlner, *These Tax Cuts Are Sunsetting in 2026. Are Your Clients Ready?*, ALM: THINK ADVISOR (Nov. 22, 2023, 11:49 AM), https://www.thinkadvisor.com/2023/11/22/these-tax-cuts-are-sunsetting-in-2026-are-your-clients-ready/ [https://perma.cc/44C5-9JRR].

[5] THE CODE OF HAMMURABI §§ 137-38 (L. W. King trans., 1910); Laura Clark, *The Second Divorce in Colonial America Happened Today in 1643*, SMITHSONIAN MAG. (Jan. 5, 2015), (citing WILLIAM H. WHITMORE, A BIBLIOGRAPHICAL SKETCH OF THE LAWS OF THE MASSACHUSETTS COLONY FROM 1630 TO 1686 99 (1890)), https://www.smithsonianmag.com/smart-news/second-divorce-colonial-american-history-happened-today-1643-180953799/ [https://perma.cc/PYZ8-396U].

income tax system was "born" in 1913.[6] Since then, the tax treatment of alimony has followed four arcs and a circular path as the 2017 Act returned the law to where it started.

From the inception of the income tax to the middle of World War II, the person paying alimony—almost invariably husbands of heterogeneous couples—bore the tax burden for alimony payments. But as the war picked up, so too did the income tax burden, and divorced men's payment obligations threatened to exceed their after-tax income. Thus, in 1942, Congress shifted the tax burden on alimony payments to the wives receiving them. In 1984, Congress made the corresponding deduction for alimony payments elective instead of mandatory, leaving the tax treatment of alimony at the parties' discretion. This tax regime persisted until 2017, when Congress shifted the burden back to the person paying alimony—this time, for the government's own benefit.

A. Initial Treatment (1917–1942)

In a single sentence, the Sixteenth Amendment provided the Constitutional authority for the federal personal income tax: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."[7] The Amendment left it to Congress to fill in the details. But the legislation imposing the first income tax did not account for the tax treatment of alimony.[8] It thus fell to the courts to decide how such payments would be taxed.

The question finally made its way to the Supreme Court in 1917 following the high-profile divorce of Howard from Katherine Gould.[9] Howard Gould was a well-known money man, a financier, and the son of the even more well-known railroad magnate and speculator Jay Gould. Howard had an affinity for women of the stage—over the course of his life he had been engaged to three women, all actresses, two of whom he married (and later divorced).[10]

This case arose from Howard's first marriage to then Katherine Clemmons. It had the makings of a great romance: the two had met in Europe and enjoyed a

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[6] Revenue Act of 1913, Pub. L. 63-16, 38 Stat. 114. This was, however, not the very first United States federal income tax as there was an income tax used to help finance the Civil War. That tax was repealed, however, in 1872. *See 16th Amendment to the U.S. Constitution: Federal Income Tax (1913)*, NATIONAL ARCHIVES: MILESTONE DOCUMENTS, https://www.archives.gov/milestone-documents/16th-amendment [https://perma.cc/P87M-HSYK].

[7] U.S. CONST. amend. XVI. Congress attempted to impose an income tax prior to 1913. Prior to the Sixteenth Amendment, Congress had the power impose a "direct" tax only if it was apportioned among the states according to population. U.S. CONST. art. I, § 2, cl. 3. In 1894, Congress instituted a federal income tax. This was challenged as unconstitutional by arguing that an income tax was a direct tax that was not apportioned by the population. The Supreme Court agreed and struck that act down as unconstitutional. Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 637 (1895). The Sixteenth Amendment avoided this issue by removing the proportional requirement for direct taxes.

[8] Revenue Act of 1913.

[9] Gould v. Gould, 245 U.S. 151 (1917). It is interesting that the case that set out the tax treatment of alimony did not involve the federal government.

[10] *Howard Gould May Marry Miss Tyler*, N.Y. TIMES, Nov. 9, 1894, at 12; *Howard Gould Marries*, N.Y. TIMES, Oct. 13, 1898, at 1; *Howard Gould, Son of Financier, Weds*, N.Y. TIMES, May 19, 1937, at 20.

long courtship.[11] Howard's family did not approve of his marrying—as they saw it—below his station and threatened to disinherit him.[12] But love prevailed and the two were wed in 1898.[13] Less than a decade later, the marriage was over.

The parties had been estranged for almost a year when Katherine sued for divorce in 1907, alleging charges of "desertion, nonsupport, and cruelty."[14] "A central issue in the trial was the amount of alimony that Howard would pay Katherine, and that, in turn, rested in part on whether he officially 'deserted' his wife or whether he was justified in leaving her due to her 'habits.'"[15] Howard had accused Katherine of heavy drinking and adultery with fellow actors Dustin Farnum and Buffalo Bill. This led to flashy headlines like "Mrs. Gould's Life at Home, Drunken Orgy"[16] and a deep dive into the couple's personal lives.

After much publicity, the divorce was finalized in 1909 and Howard was ordered to pay Katherine monthly alimony of $3,000 "for her support and maintenance."[17] The equivalent of around a million dollars annually today, it was said to be the largest alimony settlement ordered up to that time.[18] The question that made its way to the highest court in *Gould v. Gould* was not about the amount of the alimony, but rather, "whether such monthly payments during the years 1913 and 1914 constituted parts of Mrs. Gould's income."[19]

There were four ways the Court's decision could have come down. First, the Court could have held that the alimony payments were taxable to both parties: the husband pays alimony out of his gross income and the wife reports the alimony payments as income. Second, it could have held that only the husband would be taxed: the husband pays alimony out of his gross income and the wife takes the funds in full without having to report them as income. Third, only the wife would be taxed: the husband pays alimony out of his gross income but deducts the full amount while the wife reports the alimony as income. Or neither party would pay taxes on the alimony payments: the husband pays alimony out of gross income but deducts the full amount with no corresponding income to the wife.

The Court's short opinion adopted option two: to tax only the husband. Alimony payments from Howard were not deductible by him nor includible in Katherine's income.[20] It thus laid down the rule that the payor-spouse would earn income, pay taxes on that income, and then pay his spousal support obligations

[11] *Howard Gould Marries*, *supra* note 10.
[12] *Id.*
[13] *Id.*
[14] *Mrs. Gould to Ask Divorce on Desertion Plea*, L.A. HERALD, June 15, 1909, at 1.
[15] Michelle McClellan, *Katherine Gould's "Drunken Orgy" and the Perils of Social Climbing*, THE ATLANTIC (Feb. 24, 2012), https://www.theatlantic.com/health/archive/2012/02/katherine-goulds-drunken-orgy-and-the-perils-of-social-climbing/252427/ [https://perma.cc/Y2BB-S7UK].
[16] *Id.*
[17] Gould v. Gould, 245 U.S. 151, 152 (1917).
[18] *See Former Mrs. Gould Fears Poisoning*, N.Y. TIMES, Nov. 5, 1910, at 7.
[19] *Gould*, 245 U.S. at 152. Based on the opinion, it is not entirely clear why the issue mattered to the parties. Perhaps Katherine Gould believed she should receive a gross-up if the payments were subject to taxation.
[20] *Id.* at 154 ("The net income of the divorced husband subject to taxation was not decreased by payment of alimony under the court's order; and, on the other hand, the sum received by the wife on account thereof cannot be regarded as income arising or accruing to her within the enactment.").

from what was left over after tax; the recipient-spouse would receive those payments in whole without reduction for federal income tax.

The rationale behind this early tax treatment of alimony was based on the Court's understanding of the purpose of such payments. The Court's reasoning surely rung as soundly at the time as it does paternalistic today: "Alimony . . . is not founded on a contract, express or implied, but on the natural and legal duty of the husband to support the wife. . . . Permanent alimony is regarded rather as a portion of the husband's estate to which the wife is equitably entitled . . . ."[21] In that manner, the payment was treated for tax purposes like satisfying a loan obligation: the payor does not receive any deduction for paying off a loan and the recipient has no income on account of the payor satisfying the obligation.

As noted by Professor Deborah Geier in her article on the tax treatment of payments related to divorces, the Supreme Court looked at the divorced couple as a unit that should be taxed only once.[22] For comparison, if you look at the divorced couple as individuals, it may make sense to tax alimony payments to each.[23] The money used to pay alimony generally comes from the husband's salary, which is quintessential "income."[24] And, looking at the recipient in isolation, the alimony payments represent an "undeniable accession to wealth," bringing them under the income umbrella.[25] Thus, the payment would be taxed twice, much like, Geier noted, "amounts paid by an employee from his wages to his housecleaner."[26]

But the Court instead looked at the two taxpayers together. It assumed that whether the recipient-spouse has income on account of the payment and whether the payor-spouse gets a deduction for the payment are not independent issues. Any decision that determines the answer to one of those questions will also answer the other. Either the payor gets a deduction and the recipient has income, or the payor does not get a deduction and the recipient does not have income.

Viewed as a joint exercise, the resulting question becomes not whether the payment is income, but instead whose marginal tax rate should be used in determining the tax owed. If we allow a deduction for the alimony payment with

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[21] *Id.* at 153 (quoting Audubon v. Shufeldt, 181 U.S. 575, 577 (1901)); *see also* Douglas v. Willcuts, 296 U.S. 1, 8 (1935) ("Amounts paid to a divorced wife under a decree for alimony are not regarded as income of the wife but as paid in discharge of the general obligation to support, which is made specific by the decree."). As other commentators described it: "Justice Reynolds's paternalistic attitude toward women and wives permeates the *Gould* opinion: Women require protection, which is the responsibility of men." Tessa R. Davis, Amy H. Soled & Jay A. Soled, *Revisiting the Tax Treatment of Alimony*, 71 U. KAN. L. REV. 379, 386 (2023).

[22] Deborah A. Geier, *Simplifying and Rationalizing the Federal Income Tax Law Applicable to Transfers in Divorce*, 55 TAX LAW. 363, 369 (2002) ("Rather than analyzing the tax consequences to each of these taxpayers independently of each other, *i.e.*, determining whether the receipt qualifies as 'income' to the recipient and whether the payment qualifies as a deductible one to the payor under an 'income' analysis because it does not purchase discretionary personal consumption, we could view both taxpayers *together*.").

[23] As we will discuss later in Part IV, we disagree with this evaluation of the payor-spouse and even Professor Geier notes that, since there is no personal consumption with an alimony payment, it may be possible to justify a deduction for the payment. *Id.*

[24] *Id.* at 368.

[25] *Id.*

[26] *Id.* at 369. As we will elaborate later, the difference between an alimony payment and wages to a housekeeper is the lack of consumption for the payor in the alimony situation, unlike in consuming the services of a housekeeper. *See* discussion *infra* Section IV.A.

corresponding income to the recipient, then the marginal tax rate of the recipient-spouse will be used. Conversely, as applied by the Supreme Court, without a deduction and no income to the recipient-spouse, the marginal tax rate of the payor-spouse applies. This latter state of alimony taxation remained consistent until Congress stepped in during the early 1940s.

B. The Shift to the Recipient-Spouse's Rates (1942–1984)

Tax rates began climbing following the ratification of the Sixteenth Amendment, albeit slowly and focused largely on the very top earners.[27] However, as it became clear that America would become involved in World War II, Congress needed money to build up the military. The First Revenue Act of 1940 raised surtax rates—additional taxes charged to high-earning individuals—and lowered the exemption level, "dramatically increas[ing] the number of people paying the income tax."[28] The Revenue Act of 1941 further raised rates and lowered the next year's exemption level.[29] During the war, the overall marginal tax rate (combining "regular" and special surtax rates) was over 90 percent.[30]

That meant, as the war waged on, net incomes were decreasing, while existing alimony obligations remained the same. Under such a regime, alimony payments and increasing tax liabilities could exceed the annual income of some payors.[31] For example, in 1941, any individual making over $26,000 was taxed at a marginal rate of over 50 percent.[32] Thus, any individual making above $26,000 who had agreed to pay half of his income in alimony would not be able to meet both his annual tax obligation and his annual alimony obligation from the current year's gross income.[33]

Moreover, there was a growing concern that the approach was unfair, even if it did not bankrupt the payor. Certain Congressmen felt that alimony is "in reality not income to [the husband] at all since he has no control over it as the use to which

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[27] *See Historical U.S. Federal Individual Income Tax Rates & Brackets, 1862-2021*, TAX FOUND. (Aug. 24, 2021), https://taxfoundation.org/data/all/federal/historical-income-tax-rates-brackets/ [https://perma.cc/4F9D-P2R3].

[28] Joseph J. Thorndike, *Timelines in Tax History: From "Class Tax" to "Mass Tax" During World War II*, TAX NOTES (Sept. 19, 2022), https://www.taxnotes.com/tax-history-project/timelines-tax-history-class-tax-mass-tax-during-world-war-ii/2022/09/16/7f3s2 [https://perma.cc/5VXM-JTCN]; *see also* Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax during World War II*, 37 BUFF. L. REV. 685, 686 (1988) ("The result was that the income tax rolls increased from about 7 million taxpayers in 1940 to more than 42 million in 1945.").

[29] Thorndike, *supra* note 28.

[30] *See* TAX FOUND., *supra* note 27.

[31] *See* H.R. REP. NO. 77-2333, at 46 (1942) (noting that due to surtax rates, some divorced husbands would be unable to meet tax obligations after paying alimony); *see also* Russell v. Russell, 142 F.2d 753, 754 (D.C. Cir. 1944) (highlighting the same).

[32] TAX FOUND., *supra* note 27.

[33] $26k − [alimony ($26k × 50% rate)] − [tax burden ($26k × 51% rate)] = ($260).

it is to be put."[34] The more cynical viewed it as "an infernal racket" such that the receipt "ought at least to be taxed."[35]

This growing sentiment of perceived unfairness spurred Congress to shift the tax burden of alimony from the payor-spouse (usually the husband) to the recipient-spouse (usually the wife) as part of the Revenue Act of 1942.[36] Section 22(k) of the 1943 Internal Revenue Code defined "gross income" to include "periodic payments" from a "husband" to a "wife" made under a divorce decree or separation agreement.[37] And Section 23 included a corresponding deduction for, "[i]n the case of a husband . . . amounts includible under section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year."[38]

Again, the tax treatment of alimony was seen as a joint endeavor. Allowing a deduction for the payor-spouse for alimony while retaining the tax-free treatment for the recipient-spouse was never considered. Instead, this change simply shifted who would bear the tax incidence. Prior to 1942, the payor-spouse's tax rates applied. With this change, Congress shifted the income to the recipient-spouse and so her marginal rates would determine the ultimate tax burden.

Congress, however, did not allow this income shift to apply to all payments between divorced parties. Instead, Congress bifurcated the tax treatment—this new tax rule would apply to alimony payments, but it was not applicable to either property settlements between the parties or child support payments from the payor-spouse to the recipient-spouse.[39] Not surprisingly, this bifurcation led to significant tax litigation with the government and parties arguing over what qualified as alimony and what was either property settlements or child support payments.[40] Parties could whipsaw the government by having the payor-spouse treat the payment as alimony (and thus receive a tax deduction) while the corresponding

[34] 88 Cong. Rec. 6377 (1942) (statement of Rep. Wesley Disney); *see also* Lerner v. Comm'r, 195 F.2d 296, 298 (2d Cir. 1952) ("Such legislative history as is available stresses only the manifest fairness of charge to the wife and deduction by the husband of payments not only for alimony, but also for separate maintenance provisions 'in the nature of or in lieu of alimony or an allowance for support.'") (quoting H.R. REP. No. 77-2333, at 71 (1942)).

[35] Note, *Alimony Taxation of Indirect Benefits: A Critique and a Proposal*, 66 COLUM. L. REV. 1118, 1118 (1966) (quoting *Revenue Revision of 1942: Hearings Before the H. Comm. on Ways & Mean*s, 77th Cong. 2164 (1942) (statement of Rep. John D. Dingell, Member, H. Comm. on Ways & Means)).

[36] Revenue Act of 1942, Pub. L. 77-753, § 120, 56 Stat. 798, 816-17 (codified as amended at I.R.C. §§ 71, 215 (2012)).

[37] "In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband." I.R.C. § 22(k) (Supp. III 1943).

[38] I.R.C. § 23 (u) (1942). (Supp. III 1943).

[39] *See* I.R.C. § 22(k) (Supp. III 1943).

[40] *See, e.g.*, Beverly I. Moran, *Welcome to the Funhouse: The Incredible Maze of Modern Divorce Taxation*, 26 HARV. J. ON LEGIS. 117, 119-46 (1989).

recipient-spouse would treat the payment as either child support or a property settlement and thus not report the payment as income.[41]

Treating alimony differently from property settlements and child support necessitated rules to determine which side of the line a payment was on. The Code needed to provide guidelines on how to determine what would qualify as a deductible alimony payment and what would be considered a nondeductible child support payment or property settlement. This distinction was primarily made by looking to the divorce separation agreement—anything labeled as "child support" payments in the agreement would not qualify for a deduction.[42] The Code also provided that all payments made by the payor-spouse satisfied the child support payment obligation first.[43]

What if the divorce agreement was silent about what the payments were for? Somewhat surprisingly, the legislative history of the provision made it clear that unless a payment was specifically labeled as child support, it would be considered alimony and thus income to the recipient-spouse and deductible by the payor-spouse. So, for example, if a divorce agreement stipulated that the payor-spouse was required to pay $1,000 per month for general support, then the entire $1,000 would be considered alimony and thus income to the recipient-spouse.[44] This was true even if the agreement had some mechanism to reduce the payments owed should a child reach the age of majority or get married or die. Essentially, divorcing parties were in complete control over whether child support payments would be taxable to the payor-spouse (by not allowing the payor-spouse a deduction and not recognizing income to the recipient-spouse) or taxable to the recipient-spouse (by allowing the payor-spouse a deduction but also requiring the corresponding income inclusion by the recipient-spouse).[45]

C. Tax Election to Promote Settlements

In 1984, Congress significantly changed the alimony rules once again. Although the Tax Code continued to allow a deduction for alimony payments

[41] Davis, et al., *supra* note 21, at 392.

[42] I.R.C. § 22(k) (Supp. III 1943) ("This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband."). Note that the Code assumed the payor-spouse would be the husband.

[43] *See id.* Professor Geier provided an example of how this worked. Suppose Payor-Spouse owes $10,000 per year to Recipient-Spouse. Of that $10,000, $6,000 is for child support and $4,000 is for alimony support payments. If Payor-Spouse pays only $8,000 then the Code deems that the child support obligation is satisfied first. So, with this hypothetical, Payor Spouse is deemed to have paid the full $6,000 of child support and $2,000 of alimony. Geier, *supra* note 22, at 373.

[44] *See* Comm'r v. Lester, 366 U.S. 299, 303 (1961), where the Court relied on legislative history rather than apply a substance over form analysis. "This language [in the legislative history] leaves no room for doubt. The agreement must expressly specify or 'fix' a certain sum or percentage of the payment for child support before any of the payment is excluded from the wife's income. . . . We are obliged to enforce this mandate of the Congress.").

[45] Though, as Professor Geier noted, exercising this flexibility was easier for parties with sophisticated counsel than those going it alone. Geier, *supra* note 22, at 375.

included as income by the recipient,[46] it no longer mandated that the payments be taxed to the "recipient" (no longer to the "wife"). Assuming the other requirements were met,[47] the tax treatment of alimony payments was left up to the parties. The two sides could elect either of the tax treatments that applied to alimony payments before: (1) the payor-spouse receives a deduction for paying the alimony and the recipient-spouse has income for receiving the alimony or (2) the recipient-spouse does not report the alimony as income and the payor-spouse does not receive a deduction. Essentially, under this system, the parties could elect whose tax rates would apply to the alimony payments.[48]

Similar to their pre-1984 tax treatment, child support payments were not subject to this election. Anything deemed a child support payment was not deductible by the payor-spouse and not income to the recipient-spouse. Unlike in the old system, however, rules were added to attempt to classify some payments as child support even if the parties had not labeled them as such. As reviewed below, a substance-over-form analysis was applied to the payments made by the payor-spouse, and it was possible that some "alimony" payments would be reclassified as child support (thereby eliminating the payor deduction for such payment and the recognition of income for its receipt by the recipient-spouse).

Congress felt that the deduction/income tax treatment should apply only to support payments; it should not apply to property divisions between the former spouses. One way that Congress attempted to differentiate between the two was to include a requirement that, to qualify for the deduction treatment, the alimony payment must be made in cash.[49] Any property transfer would not be considered alimony for purposes of the Code and instead would be subject to the rules of property transfers. Under that treatment, any transfer between a couple incident to a divorce is treated as a nonrecognition event.[50] Thus, the recipient of the property has no income for receiving it and takes the same basis that the transferor had in the property.[51] The transferor recognizes no gain or loss for transferring the property to the former spouse and does not receive any deduction for the transfer. This tax treatment of property transfers between ex-spouses is still applicable today.

Congress was also concerned that large cash alimony payments in the initial years after the divorce were disguised property settlements and therefore inappropriate for the deduction/income treatment. Congress added a recapture provision to address this concern. Under former Code section 71(f), alimony

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46 I.R.C. §§ 71, 215 (Supp. III vol. 2 1985).

47 For example, the payments were required to be in cash, the ex-spouses were not members of the same household, and there was no liability to continue making payments after the death of the recipient spouse. *See* I.R.C. § 71(b)(1) (Supp. III vol. 2 1985); *see also* Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat. 494, 795.

48 We will review in Part III the reason why a recipient-spouse would be willing to be taxed on an alimony payment rather than receive the alimony payment without tax.

49 *See* I.R.C. § 71(b)(1) (Supp. III vol. 2 1985).

50 I.R.C. § 1041(a).

51 Essentially this treatment is the same as the rules that apply to gift transfers, although I.R.C. § 1015(a) imposes a limitation on a donee's loss basis that applies to gifts of property. This is inapplicable to property transfers between spouses or ex-spouses under I.R.C. § 1041. The basis for the transferee under I.R.C. § 1041 will always be the transferor's adjusted basis.

amounts paid in the "post-separation years"[52] were compared to the alimony amounts paid in previous post-separation years to determine if any amount should be recaptured.[53] If the amounts paid in the later years were greater than $10,000 less than the payments made in the previous post-separation years, the parties were required to "recapture" that difference.[54] Under the provision, recapture meant that the payor-spouse would have income (to offset the previous deduction) and the recipient-spouse would receive a deduction (to offset the previous income inclusion).[55]

A simple example illustrates the working of this recapture provision. Assume Payor spouse and Recipient spouse divorce on January 1, Year One. They agree that Payor will transfer $100,000 to Recipient in Year One as "alimony" but no further payments are required. In Year One, Payor transfers $100,000 to Recipient, but pays nothing to Recipient in the following five years. Under the old recapture provision, $90,000 of the $100,000 "alimony" will be recaptured and Payor will have $90,000 in income and Recipient will get a $90,000 deduction in Year Two.

As noted above, the policy basis for this treatment is that large reductions in payments during the first six years of the divorce likely signaled that the cash transfers were, in reality, a property settlement and not an alimony support payment. The idea is that, if the payments were truly support payments, they would continue in similar amounts each year for at least six years. If not, Congress felt the deduction/income treatment should not apply as such payments were property settlements and not support payments. The recapture mechanism would claw back the alimony support treatment by requiring the payor-spouse to recognize income and provide a deduction to the recipient-spouse.

Similar to the alimony tax treatment from 1942 to 1984, Congress again differentiated between alimony support and child support payments for tax purposes. Any payment labeled "child support" would not be deductible by the payor-spouse and would not be income to the recipient-spouse. However, unlike the previous period, Congress did not automatically accept the "alimony" label if the parties tried to disguise child support as alimony. Any payment that was reduced on account of a specific contingency relating to a child would be treated as child support rather than alimony and thus would not be deductible by the payor-spouse.[56] So, for example, if the Payor spouse agreed to pay the Recipient spouse $40,000 a year in "alimony" but the agreement also stated that the obligation would be reduced to $15,000 a year once a child turned eighteen years old, then $25,000

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[52] The term "post-separation year" was defined as "any calendar year in the 6 calendar year period beginning with the first calendar year in which the payor spouse paid to the payee spouse alimony." I.R.C. § 71(f)(4)(A) (Supp. III vol. 2 1985). This provision was amended in 1986 to liberalize the recapture rules. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1843, 100 Stat. 2085, 2853-54. For example, instead of six years, the post-1986 recapture rules applied only to a three-year period and the allowed reduction amount was increased to $15,000. I.R.C. § 71(f) (Supp. IV vol. 4 1987). This liberalized version of the recapture rule was in effect prior to the 2017 Act's elimination of the alimony deduction. I.R.C. § 71(f) (2012).

[53] I.R.C. § 71(f)(3) (Supp. III vol. 2 1985).

[54] I.R.C. § 71(f)(2) (Supp. III vol. 2 1985).

[55] *Id.*

[56] I.R.C. § 71(c)(2)(A)–(B) (Supp. III vol. 2 1985).

of the $40,000 payment would be treated as child support and not eligible for the deduction/income treatment.[57]

To avoid the reclassification, parties would reduce the payment obligation on a certain date without referencing a child. For example, rather than state that the alimony obligation would be reduced once a child turned eighteen, the agreement could state that the obligation would be reduced on a specific date that happened to be a week after the child's eighteenth birthday. The Treasury regulations attempted to deal with this workaround by providing that alimony reductions that occurred six months before or after a child's eighteenth or twenty-first birthday or the local age of majority would be presumed to be tied to the child and considered child support payments for tax purposes.[58] This presumption could be rebutted by the taxpayer if there was legitimate reason for the reduction on that date.[59] Otherwise, if the presumption held, the reduced alimony amount would be classified as child support instead of alimony.

To summarize, during this period, divorcing parties had significant flexibility to determine the tax consequences of alimony payments. It was up to the parties whether the original rules of no deduction for the payor-spouse and no income to the recipient-spouse should apply or whether the payor-spouse should receive a deduction for the alimony payment and the recipient-spouse should have income. Well-informed parties could elect the most efficient treatment which, in many cases, likely meant less tax revenue for the government but more after-tax income to the two divorced individuals. This period kept the rule that child support payments were not eligible for this election—the original rule of no-deduction/no-income applied to such payments. Unlike the prior period, however, the government added some substance-over-form analysis to determine whether something labeled as alimony was actually child support.

D. Taxing Payor-Spouses to Protect the Purse (2017–present)

Everything changed rather suddenly in 2017 with the passage of the Tax Cuts and Jobs Act.[60] For all divorces after 2018, the statute shifted back to the pre-1942 taxation of alimony under which there is no deduction for the payor and no income to the recipient.[61]

There is a dearth of legislative history on this provision. According to the conference report, "the intent of the provision is to follow the rule of the United States Supreme Court's holding in *Gould v. Gould*, in which the Court held that such payments are not income to the recipient."[62] However, recall that *Gould* held that alimony was not income to the recipient based on a husband's duty to provide for his wife—an unlikely rationale in 2017.[63] Indeed, alimony in 2017 bore little

[57] *Id.*
[58] Treas. Reg. § 1.71-1T(c), Q&A (18) (1984).
[59] *Id.*
[60] TCJA, *supra* note 1.
[61] *See id.* at 2089-90.
[62] H.R. REP. NO. 115-466, at 277 (2017) (Conf. Rep.) (citing Gould v. Gould, 245 U.S. 151 (1917)).
[63] Gould v. Gould, 245 U.S. 151, 153 (1917).

resemblance to alimony of the early twentieth century; the Supreme Court had since held that both husbands and wives may be entitled to alimony,[64] and states had largely moved away from lifetime spousal maintenance.[65]

The more likely reason for the change, commentators surmise, was practical on the part of the Treasury: the deduction for payment of alimony arguably had been a logistical nightmare for the Internal Revenue Service, and repealing the deduction was estimated to raise billions of dollars for the fisc.[66]

There's no question that the different tax treatments for different payments incident to divorce made the IRS's job more difficult. First, the alimony deduction made spousal support an outlier in how taxes were allocated in divorce. Child support payments and property settlements have always been treated as nondeductible and nonexcludable.[67] Second, the IRS had struggled for years with compliance. Alimony payors would classify payments as deductible while recipients would classify them as nontaxable child support or equitable distribution payments.[68] This inconsistent reporting is said to have cost the IRS billions in revenue.[69] The 2017 Act eliminated the IRS's need to distinguish between alimony and child support or alimony and property settlements. Everything was treated the same for tax purposes—admittedly a simpler system.

Money was also clearly a factor in this decision. Not only did the repeal reduce compliance costs, but repealing the deduction itself was expected to result in approximately $6.9 billion in revenue over a ten-year scoring period.[70]

Administrative challenges notwithstanding, we argue that the deduction/income treatment better comported with our progressive rate structure and urge a return to the pre-2017 tax treatment of alimony payments.

III. THE TWO CHOICES FOR THE TAX TREATMENT OF ALIMONY

As noted above, the 2017 Act returned the tax treatment of alimony to its origins. There is no denying that, between the two options, the current treatment is the administratively simpler choice. There is no tax deduction for the payor-spouse

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[64] *See* Orr v. Orr, 440 U.S. 268, 282-83 (1979).
[65] *See* Jennifer L. McCoy, *Spousal Support Disorder: An Overview of Problems in Current Alimony Law*, 33 FLA. ST. U. L. REV. 501, 506-13 (2005); *see also Alimony Laws and Forms: 50-State Survey*, JUSTIA, https://www.justia.com/family/divorce/alimony-forms-50-state-resources/ [https://perma.cc/E6Y5-AZWA].
[66] STAFF OF JOINT COMM. ON TAX'N, 115TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT" 3 (2017); TREASURY INSPECTOR GEN. FOR TAX ADMIN., U.S. DEP'T OF THE TREASURY, TIGTA NO. 2014-40-022, SIGNIFICANT DISCREPANCIES EXIST BETWEEN ALIMONY DEDUCTIONS CLAIMED BY PAYERS AND INCOME REPORTED BY RECIPIENTS 1-9 (2014) [hereinafter TIGTA ALIMONY REPORT].
[67] *See* Martin J. McMahon, Jr., *Tax Aspects of Divorce and Separation*, 32 FAM. L.Q. 221, 222-23, 227, 234-35 (1998).
[68] *See* TIGTA ALIMONY REPORT, *supra* note 66, at 5.
[69] *See id.* at 4, 8.
[70] STAFF OF JOINT COMM. ON TAX'N, *supra* note 66, at 3; *see also* Davis et al., *supra* note 21, at 396 (describing findings of TIGTA ALIMONY REPORT, *supra* note 66, at 5).

and there is no income for receiving alimony to the recipient-spouse. This applies to any transfer from one spouse to the other under a divorce agreement. It does not matter if the payment is for alimony support, child support, or a property settlement. The tax consequences are the same for all three types of transfers.

The pre-2017 Act tax treatment of alimony was more complex. Under those rules, if the requirements of Code section 71 were met, the payor-spouse would receive a tax deduction for the amount of alimony paid and the recipient-spouse would be required to report the alimony received as income. It is worth reiterating that this tax treatment was elective, not required. There would be no deduction for the payor-spouse and no income to the recipient-spouse if the parties agreed in the divorce agreement that alimony payments would not be income to the recipient-spouse and would not be deductible by the payor-spouse.[71] That is to say, the parties could elect out of the deduction/income system and instead apply the "old" rules (which are now the current rules). This meant that the pre-2017 Act system provided more flexibility than the current regime.

Of course, one might ask why any recipient-spouse would agree to treat alimony as income to them if they could elect to make the alimony payments nontaxable? The answer is tax arbitrage, which leads to more money for both parties (to the detriment of the government). Take a simple example—assume the Payor spouse is in the 30 percent tax bracket and the Recipient spouse is in the 10 percent tax bracket. Payor and Recipient agree that the alimony payments should be around \$20,000 per year. Recipient could demand that the parties elect to apply the pre-2017 Act treatment since that would mean Recipient would not have to report the \$20,000 alimony payments as income. However, such treatment also means no deduction to Payor.

Instead, it would be in both parties' interest to allow Recipient to take the deduction in exchange for a higher alimony payout. In a 30 percent tax bracket, a deduction is worth \$6,000 in tax savings to Payor. If the payment is income to Recipient, he will pay \$2,000 in taxes on the alimony received. Therefore, Payor can offer to pay Recipient \$25,000 in alimony if Recipient agrees to the deduction/income treatment. Payor has \$7,500 in tax savings so her total payout of \$17,500 is less than the \$20,000 it would be without the deduction. Recipient has an income of \$25,000, but, after paying \$2,500 in taxes, he still ends up with \$22,500—more than he would have if he had received \$20,000 tax-free.

This illustrates one normative reason why the pre-2017 Act system was preferable: it allowed the recipient spouses to receive more money, after tax, than under the current rules. The price of this, of course, is less tax dollars for the government. But this "cost" to the government is severely overstated. As recognized by Professor Geier, allowing divorced parties to shift alimony payments into the lower-income spouse's tax bracket merely extends the tax benefits of marriage into divorce.[72] Thus, the government is not really "losing" money—it is not recouping tax dollars paid by a couple who were once married and continue to live in part off of one spouse's higher income, as they did in marriage. In any event, as discussed in Part IV, any cost to the government is outweighed by the benefits

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[71] See I.R.C. § 71(b)(1)(B) (2012).
[72] See Geier, *supra* note 22, at 365.

of increased payments to recipient spouses and the progressivity served by allowing the deduction.

Still, some have argued that the current tax treatment is the appropriate approach for tax policy purposes. Professors Tessa Davis, Amy Soled, and Jay Soled have argued that shifting the tax burden back to the payor-spouse is the better approach.[73] Their argument proceeds in two parts. First, they contend that the Tax Code should affirmatively allocate the tax burden of alimony instead of leaving divorced couples the flexibility to allocate the burden among themselves to avoid lowering their overall tax burden.[74] Second, they argue that the payor-spouse is the proper party to bear the incidence of taxation.

The Code has long treated married couples as a single taxable unit to prevent tax avoidance collusion.[75] Additionally, as Professors Davis, Soled, and Soled suggest there is a similar incentive to work together in dividing assets after the marriage ends.[76] Because the parties continue to share a "common tax minimization agenda," the authors argue that the Tax Code should place the tax burden on one party to avoid collusion.

The authors realize that this argument does not end the discussion of how alimony and related payments should be taxed. The divorced parties were treated as a single economic unit under both the pre-1942 treatment (where there was no deduction for the payor-spouse and no income to the recipient-spouse) and the 1942–1984 system (where the payor-spouse received a deduction for alimony paid and the recipient-spouse had income). As previously noted, no one has seriously proposed that both parties should pay taxes on alimony payments (no deduction for the payor *and* the payments are included as income to the recipient). The authors, however, believe that the elective nature of the system was a problem as it allowed for structuring payments in a tax optimal way that hurt the public fisc.[77]

Once again, this is best illustrated by an example. If we assume each party in a divorce is trying to maximize their share of the marital assets, they will want to ensure that the pie is as big as possible. Imagine a husband with a marginal tax rate of 20 percent who wants to pay $100,000 of his gross income per year in alimony to his wife with a marginal tax rate of 10 percent. If taxed to the husband, he would be responsible for $20,000 in income tax on that amount, meaning that he would spend a total of $120,000 on alimony and taxes. The $20,000 spread between the $120,000 paid by the husband and the $100,000 received by the wife represents an opportunity for each party to improve their position at the expense of the fisc.

A couple willing to work together would assign the alimony as income to the wife in exchange for a higher alimony payment between $110,001 and $119,999, which would leave both parties better off. Take for instance alimony of $115,000, which would be $15,000 more than the original amount. Taxed to the

[73] *See* Davis et al., *supra* note 21, at 401-14.
[74] *See id.* at 402-05.
[75] *See, e.g.*, I.R.C. § 6013(a) (providing that spouses are broadly permitted to file a joint return); *id.* § 1041(a)–(c) (providing that no gain or loss is recognized on transfers of property incident to divorce).
[76] Davis et al., *supra* note 21, at 402-05.
[77] *Id.* at 404-05.

wife, $115,000 in alimony would have the following payout. The husband would pay only the $115,000 in alimony, thereby saving $5,000 in taxes from the $120,00 total he would pay at $100,000 of alimony taxed to himself. His wife would receive the higher alimony payment of $115,000, less $11,500 in taxes at her 10 percent rate, which would amount to a total payout of $103,500. Thus, she would gain $3,500 more than the original $100,000 of alimony taxed to her husband. The federal government, however, would lose $8,500 it would have received in taxes had the parties agreed to $100,000 of alimony taxed to the husband ($20,000 from the husband in scenario 1 versus $11,500 from the wife in scenario 2).

The government could prevent this kind of collusion by simply assigning the tax burden to one of the parties—the payor or the recipient—instead of allowing them to allocate it among themselves.[78] However, as the example illustrates, it's not the collusion that creates the tax problem for the government; it's the allowance of the deduction for alimony. Since the payor-spouse is generally in the higher tax bracket, allowing a deduction will always allow the parties to increase their respective share of the pie at the cost of the government's revenues. If the parties are in the same marginal tax bracket, there would be no cost to the government; it would merely be an issue of who bears the incidence of taxation.

So in many ways the collusion "problem" is misleading. If the only concern is government revenue, the current treatment (and the pre-1942 treatment) is the appropriate choice. Taxing the alimony at the payor-spouse's marginal rates should almost always lead to more revenue for the government, since it is likely the payor-spouse is in a higher tax bracket than the recipient-spouse.

Besides the increase in tax revenue, the authors set out three reasons why they believe the payor-spouse is the proper party to tax. First, they argue that alimony payments "represent a return on human capital that the erstwhile married couple had invested in one another."[79] By this they mean that, when two people decide to get married, they each implicitly agree to make economic investments in the relationship—many times, this means that one spouse sacrifices a career to support the spouse who pursues a career for the economic benefit of both.[80] The authors argue that the tax code should therefore treat alimony as nontaxable payments for lost or damaged human capital, as opposed to income to the recipient.[81]

Second, the authors argue that taxing the payor better aligns with the assignment of income doctrine, which holds that income should be taxed to the person who earned it.[82] "Failure to do so," they warn, "threaten[s] the integrity of the Code's progressive rate structure as taxpayers could strategically assign income to related taxpayers whose income was taxed at lower tax rates, thereby achieving significant tax savings."[83] Finally, the authors argue that taxing the payor better comports with the idea of declining marginal utility.[84]

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[78] *Id.* at 405.
[79] *Id.* at 408.
[80] *See id.* at 406-08.
[81] *Id.* at 408.
[82] *See id.* at 409-10.
[83] *Id.*
[84] *Id.* at 412-14.

We disagree with the authors' justifications and will discuss the counter arguments to each in turn.

A. Theory of Human Capital

Beginning with the theory of human capital, the idea that alimony is compensation for investments in human capital does not tell us whether the repayment of those investments should be taxed to the payor or recipient. The authors note that section 104(a)(2) of the Tax Code excludes from income payments related to damages for bodily injury, purportedly because they are considered a return of human capital as opposed to income.[85]

There are a few issues with this comparison. First, a return of "human capital" is not automatically nontaxable. What is important in determining tax gain or loss is not human capital, but instead the taxpayer's adjusted basis. For example, if a taxpayer buys wood, nails, and paint to make a bookcase, and if she is able to sell that bookcase for more than the cost of those items, she will recognize income on that gain even though it is a return of her human capital in the work she put into making the bookcase.

Aside from the basis issue, making shared contributions to a relationship by way of human capital is fundamentally different from being compensated for damages in a negligence action. For one thing, the authors assume a loss-centric view of the human capital theory in every case; that all returns of human capital represent compensation for a loss. This may in theory work for cases where an individual is injured by the negligence of another, but not for two people who, for at least a time, worked together to build a life. Under the author's loss-centric view, alimony is compensation to a spouse for losing out on investments she could have made in herself instead of her spouse. But there are other ways to view such intangible investments. More popular seems to be a gain-centric theory, under which both spouses' contributions to the economic relationship are recognized and under which alimony would represent the recipient spouse's share of the mutual returns on their investment. Under this view, it's not so clear that the tax burden should be borne solely by the partner who earned the income.[86]

There are other policy considerations that support the exclusion for the receipt of damages on account of physical injuries that do not support the same treatment for alimony payments. First, the tax system is primarily aimed at commercial transactions. Taxing transactions outside of the commercial sphere certainly can be appropriate but should be viewed with some caution. In the case of damages for physical injury, the noncommercial nature of the transaction supports the exclusion. Compare favorably the fact that if a taxpayer sells a body part (such as plasma or illegally sells a part of their body) then the tax system would tax that transaction. Although this transaction involves physical parts of the body, the

[85] *See id.* at 408 n.129.

[86] *See* Linda Sugin, *The Social Meaning of the Tax Cuts and Jobs Act*, 128 YALE L.J. F. 403, 413 (2018) ("Taxing alimony to the recipient is consistent with treating alimony as an earned amount, since earnings are always taxed to the earner. If we think about marriage as a partnership in which both spouses contribute inputs to produce shared returns, then the amounts earned in the market by one spouse are appropriately conceptualized as belonging jointly by both spouses.").

taxpayer, by selling, has entered the commercial space and so the taxation of that income is justifiable.

The noncommercial nature of a transaction alone, however, may not be enough to finalize the tax consequences. For example, medical expenses are deductible despite being personal in nature. Viewed in isolation, the noncommercial nature of personal injury damages might not be enough to support the exclusion. Other tax policy considerations also play a role in the exclusion. First, Congress has generally allowed taxpayers to avoid gain on involuntary conversions if they purchase something similar to replace the lost property.[87] Obviously, this replacement is not possible in the case of a physical injury and so Congress may have felt the exclusion was the right choice. Congress may also have been concerned that taxing physical injury damages awards would lead to higher payouts in order to gross up the injured party's recovery. Finally, Congress may have felt it was unseemly for the government to take a share of the recovery. There is an ick factor in having the government benefit from the physical injury of a taxpayer.

Do these policy considerations also support the nontaxation of alimony? Alimony appears to fit within the noncommercial realm of taxation. However, as noted, the noncommercial nature of a transaction on its own is not per se evidence of what the tax result should be. Other considerations can be at play to either support the exclusion or trump the presumption that the tax system should stay out of the noncommercial sphere. With physical injuries, it was (1) the inability to replace what was damaged, (2) the concern over higher and higher award amounts to compensate for the losses due to taxation, and (3) the unease at having the government take a share of the victim's compensation. The replacement element is not as strong for alimony. There is no involuntary-conversion-type provision that is inapplicable in the case of alimony payments. With damages, it is simple to compare damages paid for harm done to property with damages paid for physical injuries.

There also does not seem to be the same concern over increased amounts of alimony needing to be paid as there is with damage awards. In fact, because the recipient-spouse is usually in a lower bracket, the taxation of the award, combined with the alimony deduction, will usually mean more money for both parties after-tax. As we have noted, the fisc is the loser in this situation and so the concern for using the tax system to reduce alimony payments does not match the concern over increased award payments.

Finally, there was the unseemly argument—that is, the government should not benefit from the physical injury of a taxpayer. This factor is not nearly as strong in the case of alimony. While one could argue that the government should not share in the needed support of an ex-spouse, this sense is nowhere near the distaste the public would feel from having the government take a share from someone who has been physically injured. Therefore, while the noncommercial nature of alimony supports exclusion treatment, there are other exclusion-supporting factors in the case of damages that have little or no bearing on the tax treatment of alimony.

[87] I.R.C. § 1033(a)(1).

B. Assignment of Income Doctrine

The authors summarily state that taxing the alimony recipient instead of the payor better comports with the assignment of income doctrine because it taxes the person earning the income. But if, under a human capital theory, that income earned post-divorce was generated by the contributions of both spouses, the assignment of income doctrine does not so cleanly apply. As noted above, this payment may represent the gains that the recipient-spouse put into the joint exercise of the marriage. In that case, the recipient-spouse is appropriately taxed since the amount was "earned" by them.

And, as briefly mentioned above, there is no assignment of income concern in the marriage context because married couples are treated as a unit for purposes of the income tax system.[88] The Tax Code implicitly acknowledges the human capital contribution that a non- or lower-earning spouse makes to the salary of the higher earner. The tax rates and tax brackets take into account that a married household may have fewer expenses than two single individuals living separately. Once divorced, the question is what to do with the assignment of income doctrine. It does seem clear that the payor-spouse earned the income, but the authors stressed in their first justification that the alimony may just represent a return of human capital. If so, the payments are similar to deferred compensation and so the assignment of income doctrine may actually lead to the conclusion that the recipient-spouse is the one who earned the income and should therefore be taxed.

It boils down to this. Spouses who sacrifice their market participation for the benefit of a family unit that dissolves should be compensated for their investment. But what that partner is entitled to should not be determined by shifting tax burdens. Instead, the partner should be affirmatively allocated his or her share. If the parties know that the share will be treated as income on which the recipient will pay taxes, they can bargain around the tax burden and allocate alimony accordingly. Indeed, by placing the tax burden on the recipient, the recipient should receive more than she would because both parties would be able to share in the tax savings.

C. Ability to Pay

Finally, the authors argue that taxing the alimony payor better comports with the "ability to pay" concept. We will discuss this contention in detail in Part IV, but briefly, the more alimony a person receives, the higher their ability to pay taxes is, just as the inverse is true. The real issue is who should bear the incidence of taxation.

IV. REVOKING THE REVOCATION

Although the current tax treatment of alimony is easier to enforce and bolsters the fisc, we believe that the 2017 Act's alimony reform was a mistake. Congress should act to return to a flexible deduction/income regime for alimony

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[88] *See* I.R.C. § 6013(a).

payments. The major policy justification for our position is that the pre-2017 Act tax treatment of alimony payments better comports with the theoretical underpinnings of our income tax system and progressive taxation (particularly the purpose of graduated tax rates).

A. The Importance of Consumption

Our current federal tax system is "income" based. An income tax system was not the only option available. Theoretically, the government could have sought to tax the money used to consume[89] (a "consumption" tax), or it could have sought to use overall wealth as a measurement for taxation rather than the income earned in one tax year[90] (a "wealth" tax). So, when determining whether something like the receipt of alimony payments should be subject to taxation under an income tax system, it is imperative to begin with the question: what is income? Generally, academics have accepted the Haig-Simons measure of income. Under this measure, personal income is a mathematical equation:

> [t]he algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in value of the store of property rights between the beginning and end of the period in question.[91]

In other words, income for a period is the taxpayer's current consumption during that period plus the taxpayer's accumulation of wealth.

A simple example will illustrate. Assume Taxpayer has $50,000 in her non-interest-bearing bank account and she earns $10,000 from performing services for others. She spends exactly $10,000 to purchase and consume food and those groceries are her only purchases during the year. Taxpayer has $10,000 in income—all from current consumption. Her wealth accumulation is zero as she began the year with $50,000 and ended the year with the same amount. Therefore, Taxpayer will have $10,000 subject to federal taxation. Note that this result (in terms of the amount of dollars that Taxpayer would have subject to taxation) would be exactly the same under a pure consumption tax system.

Why does taxing consumption make sense as a policy matter? It is useful here to step back for a moment and consider how to define consumption for purposes of this theoretical definition. Professor Alvin Warren stated that "'consumption' means the ultimate use or destruction of economic resources."[92]

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[89] A sales tax is an example of a consumption tax system, but there are examples of more complex pure consumption taxes that could also introduce progressivity. *See, e.g.*, Daniel N. Shaviro, *Replacing the Income Tax with a Progressive Consumption Tax*, 103 TAX NOTES (TA) 91, 93-97 (Apr. 5, 2004) (describing four potential approaches to a progressive consumption tax).

[90] *See, e.g.*, David M. Schizer & Steven G. Calabresi, *Wealth Taxes Under the Constitution: An Originalist Analysis*, 77 FLA. L. REV. (forthcoming 2025) (manuscript at 11) (on file with authors).

[91] HENRY C. SIMONS, PERSONAL INCOME TAXATION 50 (1938).

[92] Alvin Warren, *Would a Consumption Tax be Fairer than an Income Tax?*, 89 YALE L.J. 1081, 1084 (1980). In that piece, Professor Warran defined "economic resources" as marketable goods or services. *Id.*

When a person uses their income to purchase and consume, they have taken that item (whether a good or a service) away from society.

Under our system, the federal government essentially has a right to some portion of everything that our society produces as the "price" of providing governmental services.[93] In a simple economy, the government could collect its share by collecting some percentage of everything produced at the source. If a farmer produced 100 apples, the government could collect 30 apples directly from the farmer as a tax.

In a more complex economy, collection at the source is neither administrable (how would the government collect 30 percent of a law professor's services?) nor desirable (the government prefers money to a percentage of goods and services produced). Instead of collecting taxation at the source, the government imposes a tax on income. This income represents the power to consume, that is, the power to take resources away from society. The income tax imposed on each taxpayer is a proxy for the government's share of the items or services that the taxpayer will consume.

As a policy matter, taxing income that will be used for current consumption is justifiable on the basis that the taxpayer is taking away goods and services from the common pool.[94] However, recall that the Haig-Simons definition of income also includes the accumulation of wealth. Returning to our example, assume the taxpayer earns $10,000 but does not purchase or consume anything during the year. The taxpayer has exactly the same amount of income as our original example: $10,000. Although her present consumption is zero, Taxpayer's accumulation of wealth is $10,000 (she started the year with $50,000 and she ended the year with $60,000). This of course is the difference between a pure consumption tax and an income tax. Under a consumption tax, the taxpayer in this example would not pay any income tax since there was no current consumption.

So, what is the justification for taxing accumulation of wealth when it is not used to remove goods or services from society (*i.e.*, the taxpayer does not actually consume anything with the income)? The answer is that the government is aware that the accumulation will be used at some point in the future to consume. Rather than imposing the tax when the person consumes in the future, our tax system chooses to tax the person in the present. Therefore, although consumption looks like only half of the formula of the Haig-Simons definition of income, it is actually on both sides of the equation. A taxpayer is taxed on both their current consumption and the present value of their future consumption.

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[93] As Supreme Court Justice Oliver Wendell Holmes stated, "Taxes are what we pay for civilized society . . . ." Compania General de Tabacos v. Collector, 275 U.S. 87, 100 (1927). This quotation is carved over the entrance of the IRS's national headquarters in Washington, DC.

[94] *See* Douglas A. Kahn & Jeffrey H. Kahn, "*Gifts, Gafts, and Gefts"—The Income Tax Definition and Treatment of Private and Charitable "Gifts" and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 454 (2003) ("When an individual uses an amount of income for consumption purposes in the year in which the income was received, the individual has removed the purchased goods or services from the common pool, and they are no longer available to anyone else in society. Those goods or services are captured by an individual to the exclusion of everyone else. It is an appropriate scheme to tax individuals in accordance with the amount of societal goods they have taken to themselves to the exclusion of others, and the income tax system does that in regard to current consumption.").

One more variation of our Taxpayer example may be helpful to illustrate how this concept works in practice. Recall that Taxpayer was taxed $10,000 because she accumulated wealth equal to that amount during the year (earning $10,000 but not spending any of it). Now assume that the taxpayer does not earn any income the following tax year. Instead, she uses $10,000 of her savings to purchase goods and services. Under this example, Taxpayer does not have any income and therefore she pays no income tax. Although her present consumption is $10,000, her accumulation of wealth is negative ($10,000). The consumption and accumulation-of-wealth elements of the Haig-Simons formula offset, and the Taxpayer's income comes out to zero. She is not taxed under the income tax system on her present consumption because she used money on which she had already paid income tax for her consumption. Once she paid the income tax on her accumulation of wealth, she could use that amount to consume in any future year without incurring additional income tax.

Of course, our tax system does not invariably follow the Haig-Simons definition of income, nor should it. Other policy considerations, including the administration of the tax system, come into play and may trump the presumed income tax treatment. For example, under the Haig-Simons definition of income, unrealized gains—such as increases in the value of one's stock portfolio—should be taxed each year as income. If a taxpayer buys a stock for $10 at the beginning of the tax year and it increases in value to $20 by the end of the tax year, the Taxpayer has accumulated wealth of $10. Yet, Congress has determined that the difficulty and cost imposed by implementing such a tax are greater than the policy justifications supporting including such amounts in income. Thus, in most cases, we do not tax the gain on property until the taxpayer realizes the gain—such as by selling the stock for $20.[95]

There are also deviations from the Haig-Simons definition when income stems from consumption. For example, the Tax Code excludes from income certain fringe benefits provided by employers to employees.[96] Qualified meals and lodging consumed by employees are not considered income, despite the destruction of resources (once the employee consumes the food, he takes it out of market, and his use of a lodging precludes its use by others). This exclusion violates the Haig-Simons definition of income but competing principles (such as valuation concerns) overtake the general policy of including that consumption in income.

Though our tax system does not follow the Haig-Simons definition of income in every case, it is seen as aspirational.[97] It can be thought of as the default rule to follow unless Congress has decided that contrary policy considerations lead to a different outcome.

The Haig-Simons definition is used not only as a policy device for determining whether something should be included in income for tax purposes, but also to begin the policy discussion and perhaps set the presumption of whether

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[95] *But see* I.R.C. § 475 (allowing mark to market accounting for securities dealers).

[96] I.R.C. § 119.

[97] *See, e.g.*, Majorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gift*s, 25 CONN. L. REV. 1, 28 (1992). The Haig-Simons definition of income is also used to apply the "Comprehensive Tax Base." *See* Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177, 1183 (1978).

something should be deductible. For example, the charitable contribution deduction is arguably supported by the Haig-Simons definition. If the taxpayer earns $10,000 and donates it all to a charity (assuming a full deduction without limitations or floors), that taxpayer will not pay any income tax (the $10,000 in income is fully offset by the $10,000 deduction). The Haig-Simons policy justification for this result is that the taxpayer did not consume any of society's resources by donating the money—she did not take anything away from the common good. Again, the Haig-Simons definition is not the end of our discussion, other policy considerations can come into play which Congress may determine are more important. For example, charitable contributions are subject to certain limitations in size and kind.[98]

Another example is the deduction for medical expenses. Although such expenses would normally constitute consumption, there are other policy justifications which Congress has determined outweigh the consumption element and it thus allows a deduction for such expenses.[99]

This leads back to our discussion of alimony. If alimony payments are deemed to be "consumption" under the Haig-Simons definition of income, then the default presumption should be that the payor-spouse should not receive a tax deduction for the transfer. And the corresponding accumulation of wealth to the recipient means that the recipient-spouse should have income. But, like contributions to charity, the alimony payor is not consuming any of society's assets by making the payment.

It seems then that alimony payments should not be considered consumption under the Haig-Simons definition of income. In other words, since the recipient-spouse will be the one consuming, he should be the one who is taxed. And since the payor-spouse did not consume with the transfer, she should receive a deduction to reflect that fact.

But determining that alimony payments are not consumption does not answer the question of whether the payor should get a deduction for the payment, it merely creates that presumption. Other policy considerations may outweigh the Haig-Simons treatment. For example, the same consumption analysis applies to the tax treatment of gifts. Such transfers are not consumption as they do not use up any of society's resources.[100] Therefore, the person who will do the consuming with the gift is the donee. Still, the Code does not provide a deduction for the transfer of gifts, nor does it tax the recipient of the gift under the income tax system.[101] Instead, the income tax treatment of gifts is the same as the treatment that currently applies to alimony payments—no deduction to the donor and no income to the donee.[102]

This does not mean that the policy consideration of consumption is pointless for either gifts or alimony payments. The fact that such a transfer is not

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[98] *See, e.g.*, I.R.C. § 170(b).

[99] *See* Jeffrey H. Kahn, *Personal Deductions – A Tax "Ideal" or Just Another "Deal"?*, 2002 L. REV. MICH. ST. UNIV. DET. COLL. L. 1, 25-29 (2002).

[100] Kahn & Kahn, *supra* note 94, at 462.

[101] *But see* I.R.C. § 2503 (application of the federal gift tax).

[102] Some have argued that gifts should be taxable (even without a deduction for the donor) but there are policy justifications for the current tax treatment of gifts. *See* Kahn & Kahn, *supra* note 94, at 461-62.

consumption supports the treatment of taxing only one party. For both gifts and alimony payments, such policy considerations support the conclusion that the appropriate tax treatment is either no deduction and no income or deduction to payor and income to recipient. The fact that only one person is or will be "consuming" counters any argument that such payments should be taxed to both parties. We will discuss and distinguish the tax treatment of gifts further in Part IV.C.

B. Marginal Rates of Taxation and Progressivity

So far, we have established that alimony payments represent consumption by only one party to a transfer and, like gifts, should only be taxed to one party to the transfer. Here we argue that party should be the alimony recipient. Taxing the alimony recipient better comports with our progressive rate structure and the concept of taxing a party based on her "ability to pay."

As discussed above, income is an appropriate measurement of taxation because it represents the power of the earner to consume society's assets whether in the current taxable year or in the future. However, that justification does not tell us what the tax rates should be. Under both a flat tax and a progressive tax, the more a person earns in income, the more they will pay in nominal taxes. The more difficult issue is how *much* more they should pay.

In the United States, progressive taxation has been a part of the federal income tax system since its adoption after the passage of the Sixteenth Amendment.[103] The main instrument used by Congress to implement progressivity has been graduated tax rates.

Although there have been several theoretical justifications for the graduated rate structure, in our opinion the strongest is the equal sacrifice theory. This theory accepts the general marginal utility idea, that the more of something that a person has, the less utility they derive from an additional unit.[104] Therefore, in order to equalize the sacrifice between two taxpayers, one with a significant amount of income and one with little income, it is appropriate to not only take more in nominal terms from the higher income taxpayer, but to also take a higher percentage of the total income earned.[105]

The graduated rate structure is essentially a rough guide to the marginal utility of the income earned by a taxpayer. The first dollars that a person earns are the most important; they pay for food and shelter. The more income that the person earns, the less marginal utility that they derive from those additional dollars, and thus a higher tax rate applies as income increases. This creates what is known as the marginal utility curve, representing the value a taxpayer gleans from each additional dollar earned—a visual representation of the law of diminishing marginal utility.

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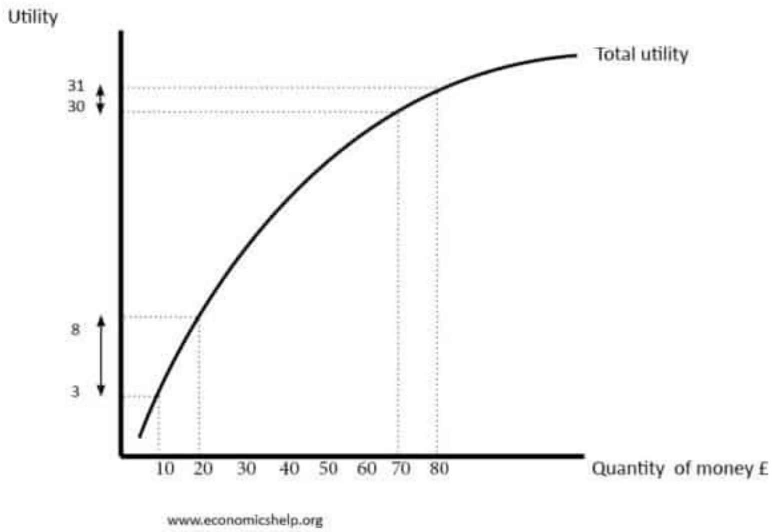
[103] The first revenue act passed after the adoption of the Sixteenth Amendment "imposed a normal tax of one percent (subject to certain exemptions) and a surtax of one percent to six percent on net income over $20,000." Douglas A. Kahn & Jeffrey H. Kahn, FEDERAL INCOME TAX 2 (8th ed. 2019).
[104] Kahn, *supra* note 99, at 21-23.
[105] *Id.*



[106]

Further justification for this theory derives from the fact that the lower tax rate brackets still apply even when a taxpayer earns enough to put them in a higher bracket. It is a common misconception that earning a dollar that places the taxpayer in a higher bracket means that all of their income is taxed at the new higher rate. Even the wealthiest taxpayers benefit from the lower tax rates applied to the lower income brackets. They too receive the most utility out of the first earned dollars and therefore the government applies the lowest tax rates to that bracket, no matter how much more income they have that year.

Many deductions can be justified as an adjustment to the rough utility curve set out by the graduated rate structure. Returning to the medical expense deduction, recall that such a deduction is not supported under the Haig-Simons definition of income. Such expenditures are clearly consumption. However, a deduction for medical expenses is supported by the progressive tax structure of our graduated rates.[107] Consider a simple example. Taxpayer A and Taxpayer B each earn $100,000 in income in a taxable year. A is perfectly healthy and does not have any medical expenses. B has a serious illness which requires him to spend $25,000 on medical treatment. Without a medical expense deduction, A and B would be taxed the same—that is, the system would believe that they have roughly the same utility curve for their income. It is clear however that B is in a significantly different position than A. For the utility curve to treat them the same would not properly take into account B's situation. Thus, the medical deduction is allowed to provide an additional zero-rate bracket since Congress is aware of how important those expenditures are.

Thus, the graduated rate structure is Congress's attempt to roughly apply a marginal utility curve to each individual taxpayer. That curve assumes that everyone has some medical expenditures, since there is a floor that a taxpayer must

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[106] Tejvan Pettinger, *Diminishing Marginal Utility of Income & Wealth*, ECON. HELP (Jan. 18, 2018), https://www.economicshelp.org/blog/12309/concepts/diminishing-marginal-utility-of-income-and-wealth/ [https://perma.cc/R2TQ-TKVS].
[107] *See* Kahn, *supra* note 99, at 25-35.

reach before they can begin deducting medical expenses.[108] Congress is aware however that taxpayers may have more medical expenses than the default curve assumes and thus an adjustment is made through the use of a deduction—essentially an increase in the zero-rate bracket.

Of course, this argument could be used to justify a deduction for any expense. If A had spent $75,000 on a luxury vacation, the remaining $25,000 will provide more utility than if A had not spent the money on travel. Should Congress provide a deduction for all expenditures? The answer of course is no—this adjustment to the utility curve argument applies only to expenditures that Congress has decided should require an adjustment to the graduated-rate progressive tax structure. Unsurprisingly, luxury travel is not something that Congress has felt justifies the need to increase a taxpayer's zero-rate bracket to accommodate.[109]

Let us then return to the alimony deduction. Should a deduction be provided to the payor-spouse for the payment of alimony? As we have stated, we believe that is the correct result and that an adjustment to the payor-spouse's graduated rate utility curve is appropriate in this situation. Return to our previous example with Taxpayers A and B, but this time B does not have medical expenses. Instead, B pays $25,000 in alimony to his ex-spouse. Do A and B have the same rough utility curve for the income that they earn that year? Without a deduction for the alimony payment, the tax system is treating them the same.

We believe that the system should account for that payment by providing a deduction, thereby adjusting the utility curve of Taxpayer B. Indeed, the argument for a deduction in the case of alimony is even stronger than the one for the medical expense deduction because in the alimony situation, there is no consumption by the payor-spouse. It is fairer to tax B similar to a taxpayer who makes $75,000 rather than a taxpayer who makes $100,000 and does not have to make any alimony payments. The tax system should adjust the payor-spouse's brackets by applying a zero-rate bracket to the alimony paid.

Note that this argument does not apply to child support payments and thus such payments do not warrant a deduction under this line of reasoning. It is the payor-spouse's obligation to support his or her children, and the graduated rate structure builds such support into the rates and brackets. No adjustment should be made for such payments since they are already baked in the cake, as it were. If A (who is still married) and B (who is divorced) each make $100,000 and each spend $25,000 on their children (A spending directly and B making a child support

[108] *Id.* at 28 ("Since most individuals suffer minor illnesses from time to time, a certain amount of medical expense is accommodated in the rate schedule as part of ordinary living expenses."). The current floor for medical expenses is 7.5% of a taxpayer's adjusted gross income (AGI). I.R.C. § 213(a). An AGI percentage floor (rather than a flat amount) allows for the fact that wealthier taxpayers may have more disposable to spend on medical expenses and that some medical expenses may have pleasurable aspects and so the wealthy are more likely to use them. Kahn, *supra* note 99, at 29.

[109] Kahn, *supra* note 99, at 29 ("Adjustments are made only for those events or conditions that elicit the view that the application of the standardized curve in those circumstances would be grossly inappropriate.").

payment to the ex-spouse), there is no reason to provide B a deduction. It is fair to treat A and B the same for tax purposes in this scenario.[110]

Thus, our proposal continues the admitted administrative difficulty of determining what are legitimate alimony payments and what are hidden child support payments. In our opinion, this is a worthwhile price to pay in order to satisfy the superior tax policy result that alimony payments should be deductible and child support payments should not be deductible. Others have disagreed. In her piece, Professor Geier argued that the parties should be able to elect the desired tax treatment for any type of transfer.[111] She felt that there was no justified policy reason for the different treatment between alimony and child support.[112] We have provided that justification. However, we concede that distinguishing between the two raises administrative costs and can understand why one might conclude that the cost of such administrative difficulty exceeds the benefit of following the theoretically preferable treatment. Between the current treatment of alimony and allowing the parties to elect the treatment for any divorce support transfer (whether alimony or child support), we would also support the latter.

C. Alimony and Gifts

As discussed above, the current tax treatment of alimony payments is identical to the tax treatment of gifts: no deduction to payor-spouse or donor and no income to the recipient-spouse or donee. We have argued that, for the tax treatment of alimony payments, this treatment is inconsistent with both the consumption element of the Haig-Simons definition of income and the equal sacrifice/marginal utility argument justifying progressive tax rates. Does this mean that we also support a change to the tax treatment of gifts (allowing the donor a deduction for transferring a gift)?

The answer is no. Despite being similar in that neither transfer should be considered consumption, the differences between alimony payments and gifts illustrate why the appropriate tax treatment for each is not identical, as we will discuss. The current tax treatment of gifts is appropriate, while the tax treatment of alimony should return to what it was before the 2017 Act.

At first blush, it might appear that the same treatment should apply to both transfers. Under the Haig-Simons definition of income, one could argue that the donor should receive a deduction since the donor is not consuming any of society's

[110] Only one of the divorced spouses may claim a child as a dependent and only one may use the child tax credit on their tax return. Treas. Reg. § 1.152–4 (as amended in 2008); I.R.C. § 24.
[111] *See generally* Geier, *supra* note 22, at 364.
[112] Geier, *supra* note 22, at 364 ("The reason underlying the different tax treatment applicable to alimony and child support has never been adequately articulated, though it is often difficult to distinguish between the two."). Professor Geier conceded that there was justification for differentiating between alimony and property settlements. *Id.* ("The reasons underlying the different tax treatment applicable to alimony and many cash property settlements can, in contrast be articulated as a theoretical matter . . . ."). However, she felt the administrative cost of distinguishing the two was not worth it. *Id.* In our opinion, although imperfect, both the former Code section 71(a) cash requirement and the recapture rules of former Code section 71(f) provide a workable system to distinguish between alimony and property settlements.

assets and the donee should report the gift as income since the donee is the party that will use the gift to consume. When we dig further, however, we see that important counter policy considerations come into play that justify the current tax treatment.

First, consider the definition of gifts for tax purposes. In *Commissioner v. Duberstein*, the Supreme Court held that the primary test for what should be considered a gift for income tax purposes is whether the donor held the appropriate intent when making the transfer.[113] That intent, according to the Court, should be "detached and disinterested generosity."[114] When that test is met, the tax treatment of gifts applies—no deduction to the donor and no income to the donee.

As discussed, under our income tax system, people are taxed when they earn income, whether they use that money for current consumption or save it to consume later. Should a taxpayer decide that he would prefer to wait until a later tax year to use the money to consume something, he would not be taxed again under the income tax system for that future consumption. So, for example, if a taxpayer earns $10,000 in Year One and puts that money in the bank, he will be taxed on it under the income tax system despite not using it for present consumption. If the taxpayer decides to use the $10,000 to consume something in Year Two, that consumption will not trigger the income tax again.[115]

In a sense, the tax system provides that once a person has been taxed on income once, he is allowed to use that income to consume at any time without being subject to another incidence of income taxation. Under an income tax system, it does not matter if the income occurs in the present year or in a future tax year, either way the taxpayer gets to consume with that income one time without paying any additional income tax.

In short, the system does not care when the consumption occurs. The next question is, does it care who does the consumption? For gifts, the answer is no. By transferring a gift, the donor signals that he would get more utility from the money by having the donee do the consumption in his place.[116] The system is essentially treating the donor and donee as one taxpayer for this limited purpose.[117] The trite slogan of one-tax/one-consumption is met, it's just the donee doing the consumption instead of the donor.

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[113] Comm'r v. Duberstein, 363 U.S. 278, 285-86 (1960).

[114] *Id.* at 285 (citing Comm'r v. LoBue, 351 U.S. 243 (1956)).

[115] Using an unrealistic numerical example for demonstration purposes, if Taxpayer had no wealth at the start of Year One and earned $10,000 which they put under their mattress for safekeeping, they would have $10,000 of income under the Haig-Simons definition. As set out in the formula—0 (present consumption) + $10,000 (accumulation of wealth) = $10,000 income. If Taxpayer earns nothing in Year Two but uses the $10,000 to consume something, then Taxpayer would not have any income despite the consumption. Again, as set out in the formula—$10,000 (present consumption) + ($10,000) (accumulation of wealth since Taxpayer went from $10,000 wealth to zero) = $0 (zero).

[116] Kahn & Kahn, *supra* note 94, at 466-67.

[117] *Id.* at 469-74.

Since the donee is the one doing the consumption, should she be the party that pays the income tax? That is, should we allow a deduction for the donor to reflect the fact that he has not consumed anything and income to the donee to reflect the fact that she is the one who will be doing the consumption? As noted above, it would appear that should be the presumptive tax treatment in this situation. In this case, however, the counter policy considerations outweigh that presumption.

First, as noted, gifts are a special subgroup of transfers. They require a specific intent that the transferor has determined that he would get more utility from his money by vicariously enjoying the consumption made by another taxpayer. This supports the treatment of continuing to impose the tax burden on the donor.

Perhaps more importantly, allowing a deduction for gifts would be too easily abused for tax purposes. Wealthy taxpayers could easily engage in tax arbitrage and transfer money and assets to individuals in lower tax brackets. The loser with these transfers would be the federal government. Protecting the fisc in this case makes sense and so the tax treatment of gifts should remain the same.

Does the same reasoning apply to alimony payments? Clearly such payments can be used for tax arbitrage purposes—usually the higher-income spouse is paying alimony to the lower-income spouse. The loser once again is the federal government. But as discussed, this "loss" is overstated because the parties are simply mirroring the tax treatment they enjoyed in marriage into their divorce. There is thus no divorce bonus at all. Indeed, as it stands, allocating all of the income into the higher-earning spouse's bracket, even those dollars used solely to support the lower-earning spouse, results in a divorce penalty, shrinking the pie for both parties and their children.

And, in any event, alimony payments are different in ways that make them far less prone to abuse. First, alimony payments are not nearly as readily available to abuse as gifts. As noted, gifts can be transferred to anyone as long as the appropriate intent is met. While it is true that if two individuals used a "gift" to engage in tax arbitrage, the appropriate detached-and-disinterested test would not be met. This would be incredibly difficult for the government to detect and prove. Without a smoking gun, it would be nearly impossible to prove that a taxpayer transferred gifts to family members only for tax savings. Alimony payments are much more limited. They must be made to an ex-spouse.[118] People do not marry and then divorce to engage in tax arbitrage.[119] Therefore, the concern over abuse is significantly less than in the case of gift transfers.

As discussed, the tax treatment of gifts is justified because in this limited situation, it makes sense to treat the two parties as one person. By making valid gifts, donors signal that they would prefer the donee use the one "free" consumption rather than the donor using it. Alimony payments do not have the same justification.

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[118] I.R.C. § 71 (Supp. III vol. 2 1985) (repealed 2017). Recall as well that to qualify for the deduction treatment such payments must also be in cash, the ex-spouses are not members of the same household, and there is no liability to continue making payments after the death of the recipient spouse. *Id.*

[119] Geier, *supra* note 22, at 364-65.

Alimony payments are not gifts—they are not made out of detached and disinterested generosity but rather in accordance with a binding divorce decree or separation agreement. Unlike gifts, the transfer of alimony is not a one-time payout. And, unlike gifts, the alimony payor does not make alimony payments out of a desire that the recipient get to use the consumption rather than the payor. In most cases, the opposite is likely true. Therefore, this justification for taxing gifts to the donor clearly does not apply to alimony payments.

D. Mandating Fairness or Allowing Flexibility

Though we are alimony-deduction apologists, we think that that the deduction should be elective. Recall that from 1942 to 1984, Congress imposed the deduction/income treatment of alimony on divorcing parties. Divorce settlements are often emotional affairs. There can be bad feelings on both sides of the negotiations. Allowing parties to structure alimony payments in tax advantageous ways could clear a path for agreement in other areas of the divorce settlement process. If the lawyers can show the two parties how they can both benefit (to the detriment of the federal government) by working together, this may help the two sides reach an agreeable settlement in areas outside of tax.[120] We believe this flexibility is a net positive when you consider its positive external effects.

V. CONCLUSION

The appropriate tax treatment of alimony is not easy to determine. There are valid considerations on both sides of the debate that lead to opposite tax treatments. The current system is clearly simpler, easier to administer for the government, less subject to abuse, and raises more money for the federal fisc. Still, countervailing considerations lead us to believe that the 2017 Act change was a mistake: the prior tax treatment was more aligned with several tax policy considerations and the former treatment created positive externalities allowing parties to advantageously structure alimony payments in divorce settlements. Tax reform is likely to be a major element of the 2025 legislative session.[121] Prospects for our recommended change to the alimony rules, however, are low as President Trump and the Congressional Republicans were the group responsible for the 2017 Act that made the alimony rule change we suggest was a mistake. Still, even if the short-term prospects are poor, our hope is that some future Congress will reinstate the option for divorcing parties to allocate the tax burden of alimony payments among themselves.

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[120] *See generally* Geier, *supra* note 22.

[121] Andrew Duehren, *Washington Prepares for the 'Super Bowl of Tax'*, N.Y. TIMES (July 31, 2024), https://www.nytimes.com/2024/07/31/us/politics/tax-code-congress.html.