

STATE OF ALABAMA §  
DEPARTMENT OF REVENUE, §

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DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

v. §

DOCKET NO. INC. 92-113  
INC. 92-115

BARBARA J. BLYTHE §  
417 Auburn Drive §  
Alexander City, AL 35010, §

Taxpayer. §

JOHN C. & RUTH R. BLYTHE §  
Route 1, Box 370A §  
Alexander City, AL 35010, §

Taxpayers. §

FINAL ORDER

The Department of Revenue assessed additional income taxes against Dr. John C. and wife Ruth R. Blythe for the years 1987, 1988, and 1989. The assessment resulted from the deduction of certain payments made by Dr. Blythe for the benefit of his former wife, Barbara J. Blythe, pursuant to a divorce decree. Additional income taxes were also assessed by the Department of Revenue against Barbara J. Blythe [hereinafter referred to as Mrs. Blythe] for the years 1988, 1989, and 1990. This assessment resulted from her failure to include as income certain payments made for her benefit by her former husband, Dr. John C. Blythe. The taxpayers appealed the assessment to the Administrative Law Division. Upon agreement of all the parties, the cases, which involve common questions of law and fact, were consolidated and heard on July 21st 1992.

Jay Hare, certified public accountant, represented Dr. John C.

and Ruth R. Blythe. William P. Cobb II, attorney-at-law, represented Barbara J. Blythe.

Findings of Facts

A final decree of divorce was granted to John C. Blythe and Barbara J. Blythe by the Tallapoosa County Circuit Court on August 26, 1983. The decree provided for alimony payments made by Dr. Blythe to Mrs. Blythe in paragraph four of the decree entitled "Alimony". Paragraph seven A of the decree entitled "Property Settlement" provided as follows:

7. PROPERTY SETTLEMENT:

A. The home of the parties on Auburn Drive and the contents thereof, except for the items hereinafter enumerated, are awarded to the wife. The husband is ordered to execute a warranty deed conveying his undivided one-half interest in the said home to the wife. It is further ordered that the husband shall continue to pay the mortgage payments in the amount of \$501.37 per month to Alex City Bank and the liability on the mortgage to Alex City Bank of the said home shall be solely that of the husband and he shall protect and indemnify the wife of any liability thereon.

Paragraph eight of the decree entitled "Insurance" provided in pertinent part, "8. INSURANCE: The husband shall procure and maintain, at his own expense, health insurance on behalf of the wife."

On March 24th, 1988 the Circuit Court of Tallapoosa County rendered an order clarifying its previous decree with respect to the provision on Dr. Blythe's obligation to pay the mortgage on the family home conveyed to Mrs. Blythe. The decree of clarification enunciated Dr. Blythe's continuing liability for full payment of

the mortgage balance and provided that in the event of Dr. Blythe's death, his estate would assume liability. Dr. Blythe was given an option by the court to pay off the mortgage balance in full or continue monthly payments.

It is the deduction of the mortgage payments and health insurance payments as alimony that resulted in the Department of Revenue's assessment for additional income taxes against Dr. Blythe. The Department contended in its initial assessment that these payments were part of a property settlement rather than alimony, and therefore were not deductible.

On the other hand, the Department initially took a contradictory position against Mrs. Blythe, contending that the mortgage and insurance payments were alimony, and thus should have been included as income to Mrs. Blythe. Failure to make this inclusion resulted in an assessment against her.

At the administrative law hearing on this matter certain facts previously submitted in writing were stipulated by the parties. These facts included the following. (1) Mrs. Blythe surrendered valuable property rights in exchange for the mortgage payments made on her behalf. Mrs. Blythe was awarded the family home and Dr. Blythe received other substantial assets to which Mrs. Blythe otherwise had a claim. (2) No condition subsequent, including the death of Dr. Blythe, extinguished his obligation for making the mortgage payments. (3) The mortgage payments were secured in that

the divorce court included an indemnity provision in its decree for Mrs. Blythe's protection. (4) The divorce decree contained separate sections for alimony and property settlement with the mortgage payment provision being listed under "Property Settlement". (5) With regard to the health insurance payments both taxpayers stipulated that these payments were in the nature of alimony.

#### Conclusions of Law

Alimony is generally deductible by the payor and income to the payee. In the tax years under consideration in the instant cases, as well as currently, Alabama allows a deduction for alimony in the same amount as is allowed by federal law. Ala. Code §40-18-15(a)(18)(1975). Although federal law tax treatment of alimony changed substantially with the Tax Reform Acts of 1964 and 1986, divorce decrees executed prior to December 31, 1984 are generally controlled by pre-1985 law. Act of 1984, §422(e) of Pub.L. 98-369 as amended by Pub.L. 99-514, §2, October 22, 1986, 100 Stat. 2095.

The Blythe's divorce decree, rendered in 1983, falls into this category.

Federal courts applying law also applicable to the instant cases have ruled that property settlements in contrast to alimony are not deductible by the payor, and thus not income to the payee.

See, e.g., Boucher v. Commissioner of Internal Revenue, 710 F. 2d 507 (9th Cir. 1983); White v. United States, 550 F. Supp. 96 (M.D. Ala. 1982). The key issue in the instant cases is, therefore,

whether or not payments made by Dr. Blythe for Mrs. Blythe's benefit constitute deductible alimony or a non-deductible property settlement.

With regard to the health insurance premiums paid by Dr. Blythe for Mrs. Blythe's benefit, both taxpayers have stipulated that these payments are in the nature of alimony. The Internal Revenue Department has taken the position that such payments are deductible alimony. Rev. Ruling 62-106. Thus, the Department's assessment against Dr. Blythe for deduction of health insurance premiums is not correct and should be withdrawn. The Department's assessment against Mrs. Blythe for failure to include these amounts should stand.

Turning to the issue of deductibility of the mortgage payments, an analysis of the nature of the payments indicates that these payments are a property settlement. In Schatten v. United States, 746 F. 2d 319 (6th Cir. 1984), several factors were identified as useful in analyzing whether or not a particular payment is a non-deductible property settlement or deductible alimony. Factors indicative of a property settlement include (1) valuable property rights are surrendered in exchange for payments, (2) the payments do not terminate upon death or remarriage, (3) the payments are secured, and (4) there is a separate provision for support and division of property in the decree. See, Id. at 322-323. Applying the law to the facts of the instant cases, the

correct conclusion is that mortgage payments made by Dr. Blythe on Mrs. Blythe's behalf are a property settlement.

Additionally, Alabama law indicates that Dr. Blythe's mortgage payments are a property settlement. To qualify as a property settlement, an award must meet at least two requirements. First, the amount and time of payment must be certain; and second, the right to it must be vested and not subject to modification. Bender v. Bender, 560 So. 2d 1053 (Ala. Civ. App. 1989); Thomas v. Thomas, 392 So. 2d 233. The obligation of Dr. Blythe to pay the balance on the mortgage constitutes an amount that is certain. Time of payment, which is monthly, is certain. Although, Dr. Blythe was given an option to pay the mortgage balance off in full at any time in the future, this fact alone would not change the certain character of the payment. The right of Mrs. Blythe to have the mortgage paid on her behalf is subject to no contingencies and is therefore vested. Thus, the Department's assessment against Dr. Blythe with regard to his incorrect deduction of mortgage payments should stand. The assessment against Mrs. Blythe for failure to include the amounts as income should be withdrawn.

Dr. Blythe argues that if he is denied a deduction as alimony for mortgage payments made for the benefit of Mrs. Blythe, he should still be allowed to deduct the interest portion of the payment. In 1987, the first year of Dr. Blythe's assessment by the Department, Alabama law allowed "[a]ll interest paid or accrued

within the taxable year on indebtedness . . ." as a deduction. Ala. Code §40-18-15(a)(2)(1975). Thus, any deduction for interest paid on the mortgage in question should be allowed for 1987 and the assessment of the Department of Revenue for this amount should be withdrawn. A change in Alabama law provided, "[b]eginning with all tax years or periods beginning after December 31, 1987, the interest deductions allowed in each of such tax years or periods shall be limited to the amount allowable as an interest deduction for federal income tax purposes in the corresponding tax year or period pursuant to the provisions of 26 U.S.C. §163." Ala. Code §40-18-15(a)(2)(Supp. 1991). Thus, with regard to the interest payments made in 1988 and 1989, an analysis of federal law is required.

Dr. Blythe's payment of interest on the mortgage is personal interest under 26 U.S.C §163(h)(2). Personal interest deductions are disallowed under 26 U.S.C. §163(h). The disallowance was phased in over a five year period beginning in 1987 when 35% of personal interest was non-deductible and ending in 1991 when 100% of personal interest was non-deductible. For 1988, 1989, and 1990, the amounts of non-deductible personal interest were 60%, 80%, and 90% respectively. 26 U.S.C. §163(d)(6)(B).

An exception to the non-deductibility of personal interest is given for "qualified residence interest" 26 U.S.C. §163(h)(3). The term "qualified residence" is defined by federal law as meaning the

principal residence of the taxpayer and one other residence of the taxpayer . . . which is used by the taxpayer as a residence . . ."

26 U.S.C. §163(h)(4) emphasis added. Dr. Blythe does not reside in or use the family home occupied by Barbara Blythe. He does not have any interest in the home. It is probable that Dr. Blythe claims the home in which he does reside as a "qualified residence". The interest payments made by Dr. Blythe do not fit the "residence" exceptions regarding disallowance of personal interest deductions. Therefore, Dr. Blythe should not be allowed a full interest deduction for 1988 and 1989. The phased in amount of non-deductible interest applicable for 1989 and 1989 under 26 U.S.C. §163 should be applied by the Department of Revenue to properly adjust the assessment against him.

In summary, with regard to taxpayer Barbara J. Blythe, the Department's assessment against her for failure to include as income payments made for her benefit by Dr. Blythe should be made final as it applies to health insurance payments and withdrawn as it applies to mortgage payments. The Department's assessment against taxpayer, John C. Blythe, with regard to health insurance payments and interest on mortgage payments for 1987 should be withdrawn. The Department's assessment against Dr. Blythe with respect to mortgage interest payments for 1986 and 1989 should be withdrawn in part and made final in part in accordance with applicable state and federal law as outline in this order. The



Department's assessment against Dr. Blythe for deduction of mortgage payments, excluding the interest portion, should be made final.

DONE the 20th day of August, 1992.

SARAH C. BOWERS  
Acting Administrative Law Judge