ELVIN D. BITTNER 2801 PINE TREE STREET MOODY, AL 35004,	§	STATE OF ALABAMA ALABAMA TAX TRIBUNAL
Taxpayer,	§	DOCKET NO. INC. 13-1385
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER ON TAXPAYER'S APPLICATION FOR REHEARING

This appeal involves a final assessment of 2009 Alabama income tax entered against the above Taxpayer. A Preliminary Order was entered directing the Taxpayer to review the Revenue Department's Answer and notify the Administrative Law Division, now the Tax Tribunal, by June 6, 2014 if he disagreed with the Department's position. The Order further stated that if the Taxpayer failed to respond by the above date, the final assessment would be affirmed. The Taxpayer failed to respond by the above date, and a Final Order affirming the final assessment was entered on June 11, 2014.

The Taxpayer timely applied for a rehearing. After numerous preliminary orders on rehearing were entered in the case, the Tribunal conducted a hearing on July 28, 2016. The Taxpayer attended the hearing. Assistant Counsel Ralph Clements represented the Revenue Department.

The issue is whether monthly payments of $1,500 paid by the Taxpayer to his ex-wife in 2009 pursuant to a May 21, 2007 divorce decree constituted deductible alimony or a nondeductible property settlement.

Paragraph 1 of the 2007 divorce decree directed the parties to sell the marital residence and split the net proceeds. Paragraph 1 also specified that the Taxpayer "shall

continue to access his IRA to pay, . . ., the household utilities, monthly mortgage payments, mortgage taxes and insurance, automobile insurance for both parties' vehicles, $1,500 per month to the (ex-wife), $1,000 per month to the (Taxpayer). . . ." The Taxpayer made the $1,500 per month payments to his ex-wife during 2009, the year in issue.

Paragraph 9 of the 2007 divorce decree also ordered the Taxpayer to pay his ex-wife $1,000 per month in alimony, beginning on the first day of the month after the house is sold and closed, "and each month thereafter until one of the parties dies, or the (ex-wife) remarries or cohabitates."

Paragraph 12 of the divorce decree specified that once the marital residence was sold, the Taxpayer's remaining IRA balance shall be added to the ex-wife's IRA balance, and the total split evenly between the parties.

The parties were unable to sell the marital residence, and by agreement, the circuit court modified the original divorce decree in January 2010. The modification awarded the marital residence to the ex-wife. The Taxpayer was also required to transfer his remaining IRA balance to the ex-wife. The modification also reaffirmed that the Taxpayer was to begin paying his ex-wife $1,000 in monthly alimony in January 2010.

The Taxpayer deducted the $1,500 monthly payments to his ex-wife in 2009 as alimony on his 2009 Alabama return. The Department determined that the payments were in the nature of a nondeductible property settlement. It consequently disallowed the deduction, and also a portion of the medical expenses claimed by the Taxpayer on his 2009 return. It assessed the Taxpayer accordingly. This appeal followed.

The Department explained the governing law that distinguishes between deductible alimony and a nondeductible property settlement in its Post-Hearing Brief, as follows:

Alimony vs. Property Settlement

Payments made by one divorced spouse to his or her ex-spouse can, for tax purposes, be either "alimony" or a property settlement. Alimony is deductible by the payor, and includible in the taxable income of the payee; whereas property settlements are neither.

It is an unfortunate reality that divorcing parties and judges in Alabama are inconsistent when describing the various transactions that the parties may enter into when undergoing a divorce. Alabama law recognizes two very different types of relief to which divorcing spouses may be entitled, both of which have the word "alimony" in their name, but only one of which is treated as alimony for purposes of federal (and therefore Alabama) income tax law.

These types of relief are "periodic alimony," and "alimony in gross." As explained in further detail, below, "alimony in gross" is in the nature of a property settlement, representing compensation for marital assets the ex-spouse has a claim to out of his or her ex-spouse's current estate. On the other hand, "periodic alimony" represents support for the ex-spouse, payable out of his or her ex-spouse's future income. (footnote omitted) Alimony in gross is considered a property settlement, whereas only periodic alimony may qualify as deductible "alimony" for tax purposes. (footnote omitted)

Unfortunately, not all divorce decrees will use these terms correctly, as even lawyers and judges themselves appear to be confused at times regarding the use of the word "alimony." Taxpayers, especially, will often assume that "alimony in gross" is deductible, simply because it contains the word "alimony." (footnote omitted) However, what label has been placed upon a payment by the parties or by the court is usually not controlling. (footnote omitted) Rather, it is "the effect of the [judgment] that determines what it is that has been prescribed by that judgment." (footnote omitted)

As stated above, the labels attached to payments between divorcing spouses by the parties or the court are not controlling. This is true for purposes of local, Alabama divorce law, and it is especially true for tax law. Payments of alimony are deductible from the payor spouse's Alabama taxable income pursuant to *Ala. Code* (1975) § 40-18-15(a)17, which incorporates by reference I.R.C. § 215. (footnote omitted) Section 215, in turn, defers to the definition of "alimony or separate maintenance payment" contained in the provision requiring such amounts to be included in the federal taxable income of the payee spouse, which is § 71(b). (footnote omitted)

Section 71(b) attempts to set forth a bright-line test for defining an "alimony or separate maintenance payment." Prior to 1984, whether a payment

qualified as alimony was determined by reference to a number of subjective factors regarding the parties' intent and the nature of the payments. (footnote omitted) In 1984, Congress rewrote §71(b), imposing an objective, four-factor test that payments had to meet in order to be considered "alimony" for tax purposes. (footnote omitted) To be alimony under the 1984 revision, payments must have met the following four criteria:

> (A) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument,
>
> (B) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under this section and not allowable as a deduction under section 215,
>
> (C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and
>
> (D) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse (and the divorce or separation instrument states that there is no such liability). (footnote omitted)

As quoted above, the fourth paragraph (§ 71(b)(1)(D)) contained a requirement that the termination of payments upon the payee spouse's death had to have been explicitly stated. Unfortunately, this caused a number of unintended results, and so very shortly afterwards, § 71(b)(1)(D) was amended by striking the parenthetical requirement for express termination-by-death language. (footnote omitted) This technical change in 1986 was intended "to provide that alimony payments under certain support decrees . . . will not be disqualified solely because the decree does not specifically state that the payments will terminate at the payee's death." (footnote omitted) Therefore, payments may continue to meet the termination-upon-death requirement of § 71(b)(1)(D), even where there is no explicit requirement that the payments end upon the death of the payee spouse, so long as the payments would cease in any event by operation of applicable state law. (footnote omitted)

Payments that meet the criteria of § 71(b)(1)(A)-(D) may be deducted by the payor ex-spouse, and must be included in the taxable income of the payee ex-spouse (unless they elect otherwise pursuant to § 71(b)(1)(B)). However,

because § 71(b)(1)(D) allows operation of state law to suffice in creating a termination-upon-death requirement, the inquiry into whether any stream of payments does or does not meet the above criteria cannot be answered without reference to state law, at least where the termination upon death is not clearly and explicitly stated in the agreement or court decree.

There is significant case law in Alabama on the distinction between alimony-in-gross (i.e., a property settlement) and periodic alimony. This question matters to divorced spouses for more reasons than merely income tax. For example, periodic alimony remains modifiable by the court for the duration of the payments, whereas alimony-in-gross, as a final judgment, becomes un-modifiable once the 30-day period for an appeal lapses. (footnote omitted) Periodic alimony is also subject to being eliminated if the payee ex-spouse remarries or cohabits with a member of the opposite sex, (footnote omitted) whereas alimony in gross is not. (footnote omitted)

> "'Alimony in gross' is considered 'compensation for the [recipient spouse's] inchoate marital rights [and] . . . may also represent a division of the fruits of the marriage where liquidation of a couple's jointly owned assets is not practicable.'" (footnote omitted) "Periodic alimony, on the other hand, 'is an allowance for the future support of the [recipient spouse] payable from the current earnings of the [paying spouse].' Its purpose 'is to support the former dependent spouse and enable that spouse, to the extent possible, to maintain the status that the parties had enjoyed during the marriage, until that spouse is self-supporting or maintaining a lifestyle or status similar to the one enjoyed during the marriage.'" (footnote omitted)

A payment must meet two characteristics in order to be considered alimony in gross. First, the "time of the payment and the amount must be certain." (footnote omitted) Second, "the right to alimony must be vested." (footnote omitted) The term "vested," in this context, "simply signifies that an award of 'alimony in gross' is not subject to modification." (footnote omitted) As further clarification, the court has stated an award of alimony in gross "must also be payable out of the present estate of the paying spouse as that estate exists at the time of the divorce." (footnote omitted) An award that fails to meet either or both of these two criteria may be periodic alimony; an award that meets both criteria must be considered alimony in gross.

Further, with respect to an award that could conceivably be either periodic alimony or alimony in gross, it would be a mistake to presume that the payment must be alimony in gross. Rather, "[b]ecause an award of alimony in gross cannot be modified, the intent to give such an award should be

clearly expressed, or necessarily inferred, from the language used. [citation omitted] The source of payment and its purpose are of prime importance." (footnote omitted) Therefore, in cases of ambiguity or uncertainty, it would be better to begin by assuming that a stream of payments constitute periodic alimony, unless the parties clearly state otherwise, or unless the particular facts of the case clearly establish that the payments meet both the criteria set out above for alimony in gross.

The general rule posited above has several known exceptions. One exception concerns a divorcing spouse who is ordered to continue making payments on debts that encumber marital property, or property of the payee spouse, such as a home mortgage or a car note. Especially where the divorce decree or agreement has other provisions relating to periodic alimony (or where periodic alimony has been waived or omitted), this has been found to be a property settlement, even where the order is silent regarding the payor's obligation to continue making payments in the event of the payee's death. (footnote omitted)

Application to Mr. Bittner's Facts

The Taxpayer claims that the payments he made are alimony, and thus deductible. This claim is incorrect. According to the Paragraph 1 (entitled "Marital Residence") of the Final Judgment of Divorce, entered May 21, 2007, (footnote omitted) the Taxpayer was ordered to use his IRA account to pay utilities, the mortgage on the marital home, taxes and insurance on the home, automobile insurance, $1,500 per month to his ex-wife and $1,000 to himself. These IRA distributions were ordered to continue during the pendency of the sale of the marital residence. Under paragraph 12 of that order, following the sale of the marital residence, whatever amount was left in the Taxpayer's IRA would be added to his ex-wife's IRA, and the total amount divided between them equally. Regarding alimony, paragraph 9 (entitled "Alimony") provided that, following the sale of the marital residence, the Taxpayer would pay his ex-wife $1,000 per month, until the death of either party or his ex-wife's remarriage. (footnote omitted)

As events unfolded, the Taxpayer and his ex-wife were unable to sell the marital residence as easily as they had expected. On December 21, 2009, the Court entered that certain Order on Rule Nisi and Petition to Modify. (footnote omitted) That order modified the original divorce decree in several respects. First, the procedure by which the Taxpayer was ordered to pay certain expenses relating to the marital residence and also a cash amount to his ex-wife and himself was eliminated. Instead, the ex-wife was awarded the marital home outright, with the Taxpayer being required to continue making payments on an equity line of credit associated with the home. Second, the Taxpayer was ordered to transfer 100% of his remaining IRA balance to his

> ex-wife. The requirement of $1,000 per month periodic alimony was reaffirmed, with the alimony set to begin on January 1, 2010 (that is, the first day of the first month following the entry of the modification order).
>
> Clearly, the law as elucidated above indicates that the payments that the Taxpayer attempted to deduct were in the nature of a property settlement and not periodic alimony, despite the periodic nature of such payments. The payments were fixed in amount, and were intended to be for a short duration of time, and for a particular purpose; that is, to maintain the marital home while it was being sold. Further, each payment made from the IRA necessarily reduced the amount the Taxpayer's ex-wife received when the account was finally transferred to her. Whether she received the Taxpayer's IRA in a series of 30 $1,500 payments and a lump sum consisting of what was left, or else one lump sum at the beginning (or at the end, for that matter), she was receiving one and the same property, and had no right to receive more. Further, the Taxpayer's ex-wife's right to receive these payments was not stated in the Divorce Decree to be contingent upon her remaining alive, or her subsequent remarriage. That is, the Taxpayer was required to make these payments, even had his ex-wife remarried or died in the interim. This clearly marks this stream of payments as a property settlement and not alimony. Further, the divorce decree <u>did</u> provide for alimony, elsewhere in the decree, strengthening the argument that these payments were not alimony. Also, the divorce decree required not only that he distribute $1,500 per month to his ex-wife, but also that he distribute $1,000 per month to himself. Surely, there can be no argument that the amounts distributed to himself were somehow deductible; yet those payments spring from the very same source as the distributions to his ex-wife.
>
> Finally, under the rule set forth in the *Lacey* case, (footnote omitted) because the payments were tied to the mortgage on and the sale of an encumbered marital asset, the presumption must be that the payments represent part of a scheme to dispose of that asset as between the parties. Again, this is indicative of a property settlement and not alimony.

I agree with the above analysis. The payments were alimony in gross or a property settlement because they were fixed in duration, i.e., they were to be paid until the house sold. Importantly, they were "payable out of the present estate of the paying spouse (Taxpayer) as that estate exist(ed) at the time of the divorce" because the Taxpayer was required to make the payments from his preexisting IRA. See generally, *Lacey v. Lacey*,

126 So.3d 1029, 2031 (Ala. Civ. App. 2013). The IRA was also a part of the overall property settlement because the decree provided that after the house sold, the Taxpayer's IRA and his ex-wife's IRA would be comingled and then evenly split. The $1,500 monthly payments to the ex-wife in 2009 were thus in substance a division of the Taxpayer's existing IRA.

The above is supported by the fact that the decree separately provided for monthly alimony payments to the ex-wife, and specified that such alimony would begin only after the sale of the marital residence.

The Taxpayer was also required by the divorce decree to pay for his ex-wife's COBRA health insurance in 2009. The Taxpayer has presented evidence that he paid $4,964 to Golden Rule, a United HealthCare Company, for that purpose in 2009. That amount, less the four percent of adjusted gross income floor, should be allowed.

The Department is directed to recompute the Taxpayer's liability as indicated above and notify the Tribunal of the adjusted amount due. A Final Order will then be entered in the case.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2B-2(m).

Entered November 15, 2016.

_____
BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Gwendolyn B. Garner, Esq.
Elvin D. Bittner