ELMER A. & PEGGY Y. NUSS 23757 CHADWICK DRIVE ATHENS, AL 35613,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 12-846
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Elmer and Peggy Nuss (together "Taxpayers") for 2009, 2010, and 2011 income tax. The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on January 31, 2013. The Taxpayers attended the hearing. Assistant Counsel Keith Maddox represented the Department.

Elmer Nuss (individually "Taxpayer") retired from the military in June 1989. He began receiving his monthly military retirement pay at that time.

The Taxpayer and his wife divorced in November 1998. The divorce decree provided that the ex-wife "shall receive one-half (1/2) of the Husband's military retirement pay" beginning in December 1998. The decree also specified that the retirement pay constituted a non-modifiable property settlement, "and shall continue payable to the Wife until the death of the Husband."

In May 2006, the Taxpayer was diagnosed with prostate cancer. He subsequently began received VA medical benefits, which by federal law correspondingly reduced his military retirement pay. That is, the Taxpayer's military retirement pay was reduced dollar for dollar by the amount of VA benefits he began receiving in 2006. Because his military retirement was reduced to approximately $60 per month, the Taxpayer began paying his

ex-wife one-half of that amount, or $30 a month, pursuant to the 1998 divorce decree.

The ex-wife subsequently garnished the Taxpayer's bank account to receive the difference between what she had received in military retirement pay before the Taxpayer began receiving the VA benefits, and the reduced amount she had received after he began receiving the VA benefits.

The Taxpayer filed a motion in Madison County Circuit Court to quash the garnishment. The Court ruled that the ex-wife had a vested interest in one-half of the Taxpayer's military retirement pay, and that as a property settlement it could not be reduced. The Court accordingly ordered the Taxpayer to pay his ex-wife the difference between the reduced military retirement she received after the Taxpayer began receiving VA benefits and the amount she would have received but for the VA benefits. The Taxpayer paid those amounts to the ex-wife during the years in issue. He also deducted the amounts as alimony on his Alabama returns in those years.

The Department disallowed the deductions because it determined that the payments were part of a nondeductible property settlement. This appeal followed.

Alimony paid to an ex-spouse pursuant to a divorce or separation agreement can be deducted by the payor spouse. Code of Ala. 1975, §40-18-15(a)(17). But a payment or payments in the nature of a property settlement for the purpose of dividing the couple's assets at the time of divorce are not deductible. *Schatten v. U.S.*, 746 F.2d 319 (6th Circuit 1984).

Alabama law on the subject adopts by reference the federal alimony provisions at 26 U.S.C. §§71 and 215. See, Code of Ala. 1975, §40-18-15(a)(17). Payments qualify as

alimony under §71(b)(1) if the following four requirements are satisfied:

> (A) such payment is received by (or on behalf of) a spouse under a divorce or separation agreement,
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> (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,
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> (C) in the case of an individual legally separated from his spouse under a decree of divorce or separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and
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> (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 payment after the death of the payee spouse.

It is undisputed that subparagraphs (A) and (C) are satisfied in this case. Concerning subparagraph (B), the divorce decree specifies that the payment of one-half of the Taxpayer's military retirement to his ex-wife constituted a property settlement. The Alabama Court of Civil Appeals has held on several occasions, however, that the substantive nature of an award given in a divorce decree takes precedence over the label applied in the decree.

> Both parties concede that the divorce judgment refers to the military-retirement benefits as "assets" divided pursuant to the property settlement incorporated into the parties' divorce judgment. However, it is well settled that "the substance of the award takes precedence over the form or label."

> *Kenchel v. Kenchel*, 440 So.2d 567, 569 (Ala. Civ. App. 1983); see also *Kelley v. State Dep't of Revenue*, 796 So.2d 1114, 1117 (Ala. Civ. App. 2000) (labels are not controlling on the question of the true nature of the obligation; to be a property settlement, the amount and time of payment must be certain and the right to payment must be vested and not subject to modification). Therefore, we must look at the true nature of the award to the former wife of a share of the former husband's military-retirement benefits to determine into which category it falls.

Rose v. Rose, 70 So.3d 429, 432 (Ala. Civ. App. 2011).

The U.S. Tax Court held in *Proctor v. CIR*, 129 T.C. 92 (2007), that subparagraph (B) is satisfied if there is not specific language in the divorce decree stating that the payments are not to be treated as alimony.

> Section 71(b)(1)(B) requires that the divorce instrument "not designate such payment as a payment which is not includible in gross income under this section and not allowed as a deduction under section 215." Respondent contends that this prong is not met because the divorce decree refers to the payments as part of a division of the marital property. The classification of a payment as part of the division of marital property does not, however, preclude the payment from being alimony. See *Benedict v. Commissioner*, 82 T.C. 573, 577 (1984) (stating that "labels attached to payments mandated by a decree of divorce or marriage settlement agreement are not controlling"). While the designation need not mimic the statutory language of sections 71 and 215, the requirements of subparagraph (B) will generally be met if there is no "clear, explicit and express direction" in the divorce decree stating that the payment is not to be treated as alimony. See *Estate of Goldman v. Commissioner*, 112 T.C. 317, 323 (199), affd. without published opinion sub nom. *Schutter v. Commissioner*, 242 F.3d 390 (10th Cir. 2000). The divorce decree does not contain such language. Accordingly, the retirement payments meet the requirements of section 71(b)(1)(B).

Proctor, 129 T.C. at 95.

The above rationale also applies in this case. Because the Taxpayer's divorce decree does not specify that the payments to the ex-wife are not alimony, subparagraph (B) is satisfied.

The Tax Court in *Proctor* also addressed the applicability of §71(b)(1)(D) as it relates to military retirement pay paid to an ex-spouse.

> Section 71(b)(1)(D) provides that there must be no liability for the payor to make such payments, or for the payor to make substitute payments, after the death of the payee spouse. Respondent contends that the retirement payments fail to meet the requirements of section 71(b)(1)(D) because the divorce decree does not state whether such payments will terminate upon the death of Ms. Holdman. In 1986, Congress amended section 71(b)(1)(D), specifically to remove the requirement that a divorce instrument expressly state that the liability terminates upon the death of the payee spouse. See Tax Reform Act of 1986, Pub. L. 99-514, sec. 1843(b), 100 Stat. 2853 . Consequently, section 71(b)(1)(D) is satisfied if the liability ceases upon the death of the payee spouse by operation of law. Cf. Notice 87-9, 1987-1 C.B. 421.
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> The divorce decree provides that the retirement payments were ordered pursuant to the USFSPA, which states that
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> > Payments from the disposable retired pay of a member pursuant to this section shall terminate in accordance with the terms of the applicable court order, but not later than the date of the death of the member or the date of the death of the spouse or former spouse to whom payments are being made, whichever occurs first.
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> 10 U.S.C. sec. 1408(d)(4) (2000). Accordingly, the retirement payments will terminate, by operation of law, on the date that either petitioner or Ms. Holdman dies, whichever occurs first. (footnote omitted) Moreover, the USFSPA provides that "Notwithstanding any other provision of law, this section does not create any right, title, or interest which can be sold, assigned, transferred, or otherwise disposed of (including by inheritance) by a spouse or former spouse". 10 U.S.C. sec. 1408(c)(2)(2000). Petitioner has no liability to make such retirement payments after the death of Ms. Holdman. Thus, the retirement payments meet the requirements of section 71(b)(1)(D).

Proctor at 6 – 8.

As in *Proctor*, subparagraph (D) is also satisfied in this case because the payments in issue will cease by law with the death of either the Taxpayer or his ex-wife.

Because all four elements of §71(b)(1) are satisfied, the payments in issue constitute deductible alimony. The final assessments are accordingly voided.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered July 19, 2013.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Mark Griffin, Esq.
Elmer & Peggy Nuss
Kim Peterson