OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **E. DUNBAR-SHERRILL**	OTA Case No. 21017111

OPINION

Representing the Parties:

For Appellant: E. Dunbar-Sherrill

For Respondent: Brian C. Miller, Tax Counsel III

For Office of Tax Appeals: Oliver Pfost, Tax Counsel

A. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, E. Dunbar-Sherrill (appellant) appeals an action by the Franchise Tax Board (respondent) proposing additional tax of $55,510, and applicable interest, for the 2015 tax year.

Appellant waived the right to an oral hearing and the matter is being decided based on the written record.

ISSUE

Whether appellant's receipt of $500,000 in 2015 is alimony.

FACTUAL FINDINGS

1. Appellant and her former husband (Former Husband) married in 1991 and divorced in 2002.
2. Appellant and Former Husband executed a Marital Settlement Agreement (MSA), which was incorporated into an August 27, 2002 Judgment of Dissolution.
3. Under the heading titled "5. SPOUSAL SUPPORT," the MSA provides the following:

> 5.02 [Former Husband] will pay to [appellant], as and for spousal support, the sum of three thousand ($3,000.00) dollars per month, payable in advance, on or before the first day of every month, commencing May 1, 2002, and continuing until either party's death or the remarriage of

> [appellant], whichever occurs first, at which point spousal support will terminate absolutely. Neither the amount nor the duration of spousal support will be modifiable under any circumstances.
>
> 5.03 [Former Husband] agrees that upon his death [appellant] shall receive the sum of five hundred [sic] ($500,000.00) dollars from his estate. To accomplish this, [Former Husband] agrees to establish an irrevocable trust for the benefit of [appellant] in the sum of five hundred [sic] ($500,000.00) dollars. [Former Husband] shall provide [appellant] within thirty days of the execution of the [MSA] or the hand-written Agreement between the parties executed May 17, 2001, with documentation showing that said Trust has been established. The agreement to establish the Irrevocable Trust shall be enforceable directly against [Former Husband's] estate if [Former Husband] does not make proper provisions in his Will or Trust.

4. Former Husband died in September 2015.

5. In November 2015, a law firm contacted appellant by letter (the Law Firm Letter). The Law Firm Letter states, in part, the following:

> Pursuant to the terms of your Judgment of Dissolution entered on August 27, 2002, and amended by stipulation pursuant to a court order dated January 14, 2004 […], the payment of Five Hundred Thousand Dollars ($500,000.00) is due to you, [appellant], if you survive [Former Husband]. The terms of the [MSA] were reflected in *The Elizabeth Mary 1990 Living Trust*, as restated on December 10, 2008 […], in lieu of a separate irrevocable trust referenced in said court order.

6. Included with the Law Firm Letter were three separate checks totaling $497,000 (the Payment), which appellant accepted.[1] Appellant and Former Husband were not members of the same household when the Payment was made.

7. The Elizabeth Mary 1990 Living Trust (the Trust) references the $500,000 payment identified in Section 5.03 of the MSA. Under Division VIII, titled "DEBTS," the Trust states the following:

> E. Dissolution Payment. Trustee is authorized to comply with the latest terms of the Marital Settlement Agreement attached to the Judgment of Dissolution entered August 27, 2002 and amended by stipulation pursuant to a court order dated January 14, 2004[…]; the current provisions of said Judgment [of Dissolution] as amended direct payment of Five Hundred

[1] Appellant states that she is unclear why the records show that she only received checks totaling $497,000 and not $500,000. Regardless, appellant does not dispute that she received $500,000.

> Thousand Dollars ($500,000) to [appellant], if she survives [Former Husband], in satisfaction of [Former Husband's] obligation to her.

8. Appellant filed an amended 2015 California Resident Income Tax Return (amended return) and did not include the Payment in her reported California taxable income. In the explanation of changes portion of the amended return, appellant states: "[P]lease note that [appellant] received life insurance payment of $500,000. This was not alimony (and is not taxable)."
9. Respondent examined appellant's amended return and determined that the Payment was alimony. It issued a Notice of Proposed Assessment that increased appellant's California taxable income by $522,334, and proposed additional tax of $55,510, plus interest.[2] Respondent later issued a Notice of Action affirming the Notice of Proposed Assessment in its entirety.
10. This timely appeal followed.

DISCUSSION

It is well settled that deductions and exclusions are a matter of legislative grace and are allowable only where the conditions established by the legislature have been satisfied. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440; *Appeal of Head and Feliciano*, 2020-OTA-127P.) Respondent's determination is presumed correct, and taxpayers bear the burden of proving such determinations erroneous. (*Appeal of Head and Feliciano*, *supra*.) To overcome the presumed correctness of respondent's finding as to issues of fact, taxpayers must introduce credible evidence to support their assertions. (*Ibid.*)

Pursuant to Internal Revenue Code (IRC) section 71(a), gross income includes amounts received as alimony or separate maintenance payments.[3] IRC section 71(b) provides the following:

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[2] Respondent added $500,000 to appellant's California taxable income because it determined the Payment she received was alimony. Respondent also disallowed $26,378 of itemized deductions. In lieu of appellant's itemized deductions, respondent applied the standard deduction, which resulted in a $4,044 credit. Based on these adjustments, respondent increased appellant's California taxable income by $522,334. The disallowance of itemized deductions is not at issue in this appeal.

[3] R&TC section 17081 incorporates IRC section 71. The United States Congress repealed IRC section 71 effective December 22, 2017. Congress's repeal of IRC section 71 does not affect California law, however, because the R&TC conforms to the IRC in effect on January 1, 2015, for the tax year at issue in this appeal. (R&TC, § 17024.5(a)(1)(P).)

> (1) In general.—The term "alimony or separate maintenance payments" means any payment in cash if—
>
> > (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 [IRC] 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.

The parties agree the Payment satisfies subparagraphs (A), (B), and (C) of IRC section 71(b)(1). Appellant received the Payment pursuant to an MSA, the MSA does not designate the payment as a payment which is not includible in gross income under IRC section 71 and not allowable as a deduction under IRC section 215, and appellant and Former Husband were not members of the same household at the time the Payment was made.

The parties disagree, however, whether subparagraph (D) of IRC section 71(b)(1) is satisfied, which is whether Former Husband remained liable under the terms of the MSA to make the Payment if appellant should predecease him. Respondent contends the MSA does not require the Payment if appellant were to predecease Former Husband. In support of this contention, respondent points to Section 5.02 of the MSA, which expressly provides that spousal support terminates on the death of either party or the remarriage of appellant, whichever occurs first. Respondent also points to the Law Firm Letter and the Trust, both of which state that the Payment is to be made if appellant survives Former Husband. Respondent argues, in sum, the Payment satisfies all statutory requirements to be alimony, and its determination must be upheld.

Appellant argues that the Payment is distinct from spousal support, which the MSA provided for separately. Appellant contends that the Payment was a testamentary gift upon the death of her Former Husband because Former Husband had no liability to make the payment after his death in accordance with Family Code section 4337 and MSA section 5.02.

In instances where federal law and California law are the same, federal rulings dealing with the IRC are persuasive authority in interpreting the conforming state statute. (*J.H.*

McKnight Ranch v. Franchise Tax Board (2003) 110 Cal.App.4th 978, fn. 1, citing *Calhoun v. Franchise Tax Board* (1978) 20 Cal.3d 881, 884; *Appeal of Akhtar*, 2021-OTA-118P, at p. *6.) Federal courts, including the United States Tax Court, have applied a three-step approach to determine whether IRC section 71(b)(1)(D) is satisfied. (*DeLong v. Commissioner* (2013) T.C. Memo. 2013-70.) The court first looks for an unambiguous termination provision in the divorce instrument. (*Ibid*.) If there is no termination provision in the divorce instrument, then the court looks to whether the payments would terminate at the payee's death by operation of state law. (*Ibid*.) If state law is unclear or silent in this regard, then the court will look solely to the divorce instrument to determine whether the payments would be terminated at the payee's death. (*Ibid*.) If after applying this three-step approach it is determined the payment or payments do survive the death of the payee spouse, the payment or payments are deemed a disguised property division, neither taxable to the payee nor deductible by the payor. (*Johanson v. Commissioner* (9th Cir. 2008) 541 F.3d 973, 976-977.) The requirement that the obligation to make payments terminates immediately on the death of the payee spouse is fundamental to Congress's intended distinction between alimony and property settlements. (*Hoover v. Commissioner* (6th Cir. 1996) 102 F.3d 842, 845-846; *Leslie v. Commissioner* (2016) T.C. Memo. 2016-171.)

Turning to the first step, it must first be determined whether there is an unambiguous termination provision in the divorce instrument. Section 5.02 of the MSA provides an explicit termination provision, stating the monthly payments of $3,000 to appellant from Former Husband will continue "until either party's death or the remarriage of [appellant], whichever occurs first, at which point spousal support will terminate absolutely." Section 5.03 of the MSA, the section regarding the Payment at issue, does not contain an explicit termination provision.

It is evident, however, that the MSA submitted into the record is not the final agreement between appellant and Former Husband. The Trust references an amended MSA dated January 14, 2004 (amended MSA), but the MSA in the appeal record is dated August 27, 2002. Appellant was given the opportunity to provide a copy of the amended MSA but did not do so. Appellant's failure to provide such evidence that is within her control gives rise to the presumption that the document is unfavorable to her appeal. (*Appeal of Bindley*, 2019-OTA-179P.)

The Trust and the Law Firm Letter both reference that the amended MSA directs the Payment be made to appellant only if she survives Former Husband in satisfaction of Former Husband's obligation to her. This revision expressly states that Former Husband provide monetary support to continue even after Former Husband's death. A contrary reading of this amended provision would be rendered meaningless if it was interpreted that the amended MSA terminated upon Former Husband's death. (See *Lucas v. Elliott* (1992) 3 Cal.App.4th 888, 894.) Moreover, appellant does not dispute that the terms purporting to be references to the amended MSA stated in the Trust and the Law Firm Letter are accurate. OTA finds, therefore, that the terms of the amended MSA referenced in the Trust and the Law Firm Letter are likely an accurate recitation of appellant and Former Husband's final agreement in the amended MSA. (See Evid. Code, § 1521.)[4] Accordingly, we find that the terms of the amended MSA required alimony be made to appellant and alimony terminated upon appellant's death in accordance with IRC section 71(b)(1)(D).

California Law

For the sake of argument, even if the Law Firm Letter and the Trust did not suggest the possibility that the Judgment of Dissolution was amended, the Payment would terminate upon appellant's death by operation of California law.

Spousal support, also called a "support order" or an "order of support," under the California Family Code (Family Code) is analogous to alimony under California Personal Income Tax Law, but spousal support is only alimony for income tax purposes if the statutory requirements of IRC section 71(b)(1) are satisfied. (Family Code, § 4300 et seq.; *Johanson v. Commissioner*, *supra*, 541 F.3d at p. 974.)

Regarding the termination of spousal support by operation of law, Family Code section 4337 provides the following:

> Except as otherwise provided by the parties in writing, the obligation of a party under an order for the support of the other party terminates upon the death of either party or the remarriage of the other party.

A written agreement to waive Family Code section 4337 must be proved by clear and convincing evidence. (*Johanson v. Commissioner*, *supra*, 541 F.3d at p. 977.) Clear and

[4] Rules relating to evidence contained in the California Evidence Code do not apply to any proceedings before OTA, but the OTA panel may rely on the Evidence Code when evaluating the weight to give the evidence. (Cal. Code Regs., tit. 18, § 30214(e).)

convincing evidence requires a high probability such that the evidence is so clear as to leave no substantial doubt. (*In re Z.K.* (2011) 201 Cal.App.4th 51, 65.) The written agreement must be "specific and express," and while particular words are not required, the mere failure to include death as a terminating event does not constitute a waiver. (*Johanson v. Commissioner*, *supra*, at p. 977.) It is well established that the label the parties attach to a payment in a divorce instrument is not conclusive as to whether a payment is in the nature of spousal support or a property settlement, or whether a payment qualifies as alimony under IRC section 71. (*Davidson v. Commissioner* (2018) T.C. Memo. 2018-38; *Poole v. Commissioner* (1998) T.C. Memo. 1988-147; *Daugharty v. Commissioner* (1997) T.C. Memo. 1997-349.) Here, there is nothing in the record, and appellant has not provided any argument, that suggests that she and Former Husband waived Family Code section 4337.

Appellant argues that Section 5.03 of the MSA merely reflects appellant's and Former Husband's wishes and contends that it is not binding upon the appellant. Appellant reasons that the language stating that the Payment was "for the benefit of" appellant and directing appellant to enforce Section 5.03 directly against Former Husband's estate if the provisions are not met suggest that the Payment was intended as a testamentary gift and not a court-ordered spousal support.

It is a well-settled principle in California to "construe agreements as to carry into effect the reasonable intentions of the parties if that can be ascertained." (*Cal. Lettuce Growers v. Union Sugar Co.* (1955) 45 Cal.2d 474, 481.) The law disfavors holding agreements unenforceable because of uncertainty. (*Ibid.*) Section 5.03 indicates that Former Husband intended to bind his estate if his desire for appellant to receive the Payment was not carried out. When Former Husband's Trust is read in connection with the MSA, by including the Payment under Division VIII DEBTS instead of under Division IV Disclaimer Trusts (which lists the beneficiaries of the Trust), it shows that Former Husband considered the Payment as an obligation to appellant.

Moreover, appellant erroneously focuses on the intent of what she and Former Husband considered as alimony. Although California law establishes the property interest in the divorcing parties, IRC section 71 controls the tax treatment of those interests. (*Okerson v. Commissioner* (2004) 123 T.C. 258, 264.) "Congress eliminated any consideration of intent in determining the deductibility of a payment [for the payee] as alimony in favor of a more straightforward,

objective test that rests entirely on the fulfillment of explicit requirements set forth in section 71." (*Id.* at 264-265.) Appellant has not provided any evidence that shows the parties agreed in writing alimony payments to appellant would continue past her death. Absent such evidence, OTA finds that the Payment was received under a divorce instrument that did not require Former Husband to make such payments after appellant's death.

HOLDING

The $500,000 payment appellant received in 2015 is alimony.

DISPOSITION

Respondent's action is sustained.

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Andrea L.H. Long
Administrative Law Judge

We concur:

DocuSigned by:
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Asaf Kletter
Administrative Law Judge

DocuSigned by:
8A4294817A67463...
Andrew Wong
Administrative Law Judge

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