STATE OF WISCONSIN

TAX APPEALS COMMISSION

SUSAN CARRAN	**DOCKET NO.**	**05-I-132**
and		
JOSEPH CARRAN	**DOCKET NO.**	**05-I-134**
JOSEPH AND PATRICIA CARRAN,	**DOCKET NO.**	**05-I-135**

Petitioners,

vs. **DECISION AND ORDER**

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

JENNIFER E. NASHOLD, COMMISSIONER:

These matters come before the Commission on a Stipulation of Facts, attached exhibits, and briefs filed by the parties, as well as additional exhibits petitioners filed with their briefs. Petitioner Susan Carran appears by Attorney Lisa L. Derr. Petitioners Joseph and Patricia Carran appear by Dennis Kinyon, CPA. Respondent, Wisconsin Department of Revenue ("respondent" or "Department"), appears by Attorney Michael J. Buchanan.

Having considered the entire record before it, the Commission finds, decides, concludes, and orders as follows:

FINDINGS OF FACT

The facts below are taken from the Stipulation of Facts and the exhibits incorporated therein.

Jurisdictional Facts

1. By Notice dated October 25, 2004, respondent issued an assessment against petitioner Susan Carran ("Susan") for the years 2000 through 2003 ("the years at issue").[1]

2. By letter dated December 28, 2004, Susan petitioned respondent for a redetermination of the assessment.

3. By Notice of Action dated June 28, 2005, respondent informed Susan that her petition for redetermination had been denied.

4. On August 15, 2005, Susan filed a petition for review with the Commission (Docket No. 05-I-132.)

5. By Notice dated October 25, 2004, respondent issued an assessment against petitioner Joseph Carran ("Joseph") for the years 2000 through 2002.

6. By Notice dated October 25, 2004, respondent issued an assessment against petitioners Joseph and Patricia Carran for the year 2003.

7. By letter dated November 3, 2004, Joseph petitioned respondent for redetermination of both assessments he received.

8. By Notice of Action dated June 28, 2005, respondent informed Joseph that his petition for redetermination for the years 2000 through 2002 had been denied.

9. By Notice of Action dated June 28, 2005, respondent informed Joseph and Patricia that their petition for redetermination for the year 2003 had been

[1] All facts refer to the years at issue, unless otherwise noted.

denied.

10. On August 22, 2005, Joseph filed a petition for review with the Commission (Docket No. 05-I-134.) On that same date, Joseph and Patricia filed a petition for review with the Commission (Docket No. 05-I-35.)

Additional Facts

11. Joseph and Susan were granted a divorce in Dodge County, Wisconsin, in 2000.

12. The divorce judgment refers to and incorporates by reference the Final Stipulation of the parties. The Final Stipulation states, *inter alia*, as follows:

> II. FAMILY SUPPORT
>
> Joseph Carran is to pay a fixed sum of $1,500 per month as nonmodifiable family support through and including the earlier of June 1, 2006 or the death of either party. Susan Carran is permanently waiving maintenance in reliance on the agreement to pay $1,500 per month until June 1, 2006 as well as the parties' agreement to each equally divide the costs of tuition, room and board of Luther Prep and St. Stephen's for both children through and including Steven's graduation from Luther Prep which is expected on or about June 1, 2006. If for any reason Steven does not graduate on that timetable, the family support payments shall nevertheless terminate with the last payment on June 1, 2006 or the death of either party whichever occurs first.

(Exh. J, p. 4.) The Final Stipulation further states that "[f]amily support will not terminate or be adjusted upon the graduation of either child but shall continue until the earlier of June 1, 2006 or the death of either party." (Exh. J, p. 5.)

13. Joseph made payments to Susan in the amount of $18,000 for each of the years at issue pursuant to the divorce judgment.

14. During each of the years at issue, Joseph deducted from his gross income the $18,000 yearly payments that he made to Susan.

15. Susan did not report any amount of the $18,000 payments that she received from Joseph as gross income on her tax returns.

16. At the time of their divorce, Joseph and Susan had two minor children, Jennifer Carran, born on December 31, 1983, and Steven Carran, born on December 16, 1987 (Exh. J, p. 2.)

17.[2] At the time of the divorce, Joseph and Susan's youngest child, Steven, was expected to graduate from Luther Prep School on or about June 1, 2006.

18. Susan received an assessment from the I.R.S. for calendar year 2002.

19. In response to the assessment, Susan wrote a letter to the I.R.S., dated September 17, 2004, stating that the $18,000 she received in payments from Joseph for 2002 were child support payments and not alimony, and therefore not includible in her taxable income.

20. Susan received a "No Change Letter" from the I.R.S., dated April 1, 2005, which informed her that the I.R.S. did not make any changes to the tax Susan reported on her 2002 tax return and that she could disregard any Notice of Deficiency she received for that year (Exh. M.)

21. Joseph received a Notice of Tax Deficiency from the I.R.S. in the

[2] The parties did not stipulate to Findings of Fact Nos. 17-23. Rather, they stipulated that if the cases proceeded to hearing, Susan or Joseph would have moved to introduce testimony and exhibits related to these findings. Respondent asserts that any evidence related to the partial transcript of the divorce proceeding or the actions of the I.R.S. for 2002 and 2003 are irrelevant. The Commission admits the evidence but addresses its significance in the Decision, *infra*.

amount of $4,329, dated November 1, 2004, for calendar year 2002.

22. Joseph filed a written objection to the I.R.S.'s assessment, dated November 16, 2004, stating that the amounts at issue were alimony payments, and therefore properly deductible from his gross income.

23. Joseph received a "No Change Letter" from the I.R.S., dated April 22, 2005, which stated that the I.R.S. did not make any changes to the tax reported on Joseph's 2002 tax return, and that he could disregard any Notice of Deficiency he received for that year (Exh. P.)

24. A "Final Hearing Partial Transcript" in the divorce between Joseph and Susan was prepared by a court reporter and includes the following testimony by Susan:

> Q [By Ms. Derr] And I'm also asking you now to sign the last page of the marital settlement agreement, all right? Although we have made these changes this morning, do you believe that you had adequate time to review and discuss this document with me?
>
> A Yes, I have.
>
> Q And you understand the impact of this document?
>
> A Yes, I do.
>
> Q You understand that with family support, you have agreed to take a sum which is going to be completely considered taxable income to you, do you understand that?
>
> A Yes, I do.
>
> Q And you're going to have to talk to an accountant about how to make payments in order to not be surprised every year?
>
> A Right, I understand. (Exh. Q, pp. 6-7.)

CONCLUSION OF LAW

The payments in "family support" for the years at issue constituted child support under Section 71 of the Internal Revenue Code and, as such, were not deductible by Joseph and were not includible in Susan's gross income.

OPINION

The parties have stipulated that, if any or all of the payments from Joseph to Susan constitute alimony, then Joseph and Patricia Carran (hereinafter, collectively referred to as "Joseph") may deduct from their gross income the amounts paid for each of the years at issue and Susan must include those amounts in her gross income for those same years. If, however, any or all of the payments constitute child support, then Joseph may not deduct the amounts from his gross income and Susan is not required to include the amounts in her gross income.

Alimony is deductible by the payor under Internal Revenue Code (I.R.C.) § 215 and includible in gross income by the recipient under I.R.C. § 71(a). I.R.C. § 215 provides:

> Sec. 215. ALIMONY, ETC., PAYMENTS
>
> (a) GENERAL RULE. — In the case of an individual, there shall be allowed as a deduction an amount equal to the alimony or separate maintenance payments paid during such individual's taxable year.
>
> (b) ALIMONY OR SEPARATE MAINTENANCE PAYMENTS DEFINED. — For purposes of this section, the term "alimony or separate maintenance payment" means any alimony or separate maintenance payment (as defined in section 71(b)) which is includible in the gross income of the recipient under section 71.

I.R.C. § 71 provides:

> Sec. 71. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS
>
> (a) GENERAL RULE. — Gross income includes amounts received as alimony or separate maintenance payments.
> (b) ALIMONY OR SEPARATE MAINTENANCE PAYMENTS DEFINED. — For purposes of this section —
>
> > (1) IN GENERAL. — The term "alimony or separate maintenance payment" 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 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.

Susan concedes that the payments satisfy the requirements of § 71(b)(1). The marital settlement agreement is a divorce or separation instrument; the payments terminate upon Susan's death; Susan and Joseph were not members of the same household at the time the payments were made; and nothing in the divorce judgment or

marital settlement agreement designates the payments as not includible in Susan's gross income or not deductible to Joseph.

Susan asserts, however, that the payments are nonetheless child support payments under § 71 (c), which states:

> (c) PAYMENTS TO SUPPORT CHILDREN −
>
> (1) IN GENERAL. − Subsection (a) shall not apply to that part of any payment which the terms of the divorce or separation instrument fix (in terms of an amount of money or a part of the payment) as a sum which is payable for the support of children of the payor spouse.
>
> (2) TREATMENT OF CERTAIN REDUCTIONS RELATED TO CONTINGENCIES INVOLVING CHILD. − For purposes of paragraph (1), if any amount specified in the instrument will be reduced −
>
>> (A) on the happening of a contingency specified in the instrument relating to a child (such as attaining a specified age, marrying, dying, leaving school, or a similar contingency), or
>>
>> (B) at a time which can clearly be associated with a contingency of a kind specified in subparagraph (A),
>>
>> an amount equal to the amount of such reduction will be treated as an amount fixed as payable for the support of children of the payor spouse.

Temporary Regulations § 1.71-1T (Alimony and separate maintenance payments) provides further clarification for contingencies relating to a child. Question 17 asks, "When does a contingency relate to a child of the payor?" The Answer instructs:

> A-17 − For this purpose, a contingency relates to a child of the payor if it depends on any event relating to that child, regardless of

> whether such event is certain or likely to occur. Events that relate to a child of the payor include the following: the child's attaining a specified age or income level, dying, marrying leaving school, leaving the spouse's household, or gaining employment.

Susan asserts that the cessation of payments on June 1, 2006 related to two contingencies involving a child, namely, Steven Carran's anticipated graduation from Luther Prep School on June 1, 2006 and Steven's eighteenth birthday, which was December 16, 2005, five and one-half months prior to the June 1, 2006 termination of payments. We address these arguments in turn.

A. Steven's Graduation

The Final Stipulation, incorporated into the divorce judgment, states:

> II. FAMILY SUPPORT
>
> Joseph Carran is to pay a fixed sum of $1,500 per month as nonmodifiable family support through and including the earlier of June 1, 2006 or the death of either party. Susan Carran is permanently waiving maintenance in reliance on the agreement to pay $1,500 per month until June 1, 2006 as well as the parties' agreement to each equally divide the costs of tuition, room and board of Luther Prep and St. Stephen's for both children through and including Steven's graduation from Luther Prep which is expected on or about June 1, 2006. If for any reason Steven does not graduate on that timetable, the family support payments shall nevertheless terminate with the last payment on June 1, 2006 or the death of either party whichever occurs first.

(Exh. J, p. 4.) This language supports Susan's position that the termination of payments related to Steven's graduation. The divorce instrument states that Susan is "permanently waiving maintenance" in exchange for Joseph's payment of $1,500 per month until June 1, 2006, a date which, as the divorce instrument makes clear, was chosen not at random, but precisely because it was Steven's anticipated graduation

date.

Joseph, however, relies on the following language from the Final Stipulation, which he states supports his claim that the payments were not contingent upon Steven's graduation: that payments would terminate even if "Steven does not graduate on that timetable," and that "[f]amily support will not terminate or be adjusted upon the graduation of either child but shall continue until the earlier of June 1, 2006 or the death of either party." (Exh. J, pp. 4-5.)

This language does not negate that the payments constitute child support under I.R.C. § 71(c). "[A] contingency relates to a child of the payor if it depends on any event relating to that child, *regardless of whether such event is certain or likely to occur*." (Emphasis added.) Temporary Regulations § 1.71-1T(c), A−17. The fact that the divorce instrument accounted for the possibility that Steven might graduate earlier or later than the anticipated graduation date of June 1, 2006 and identified that date as the date certain for both the continued payment and receipt of $1,500 monthly amounts does not mean that the payments were unrelated to the contingency of Steven's graduation. As stated, the Final Stipulation specifically referred to Steven's graduation date of June 1, 2006, and such reference was made in the very sentence ordering payment of $1,500 per month until June 1, 2006. Cessation of the monthly payments was clearly related to Steven's anticipated graduation date.

Our conclusion that the award constituted child support rather than separate maintenance is further supported by the Final Stipulation's statement that Susan was "waiving maintenance," without stating that she was waiving child support.

See In re Marriage of Tyson v. Tyson, 162 Wis. 2d 551, 554 (1991) ("divorce judgment provisions waiving maintenance take precedence over other provisions which arguably award or reserve maintenance payments").

Joseph also relies on the Final Stipulation's statement that payments would terminate upon Susan's death, arguing that this demonstrates the payments were not tied to Steven's age or graduation date. The Commission has previously rejected this argument. *See Oehler et. al. v. Dep't. of Revenue,* Wis. Tax Rptr. (CCH) ¶ 400-114 n.1 (WTAC 1995) ("Even though the divorce instrument also provides that the payments will cease upon the death of either party, that contingency has no direct bearing on the applicability of I.R.C. § 71 (c).") The Commission's conclusion in *Oehler* is consistent with I.R.C. § 71. One of the four requirements defining "alimony or separate maintenance payment" under I.R.C. § 71(b)(1) is that there be no liability for payments upon the death of the payee. As is the situation here, payments may fit the definition of "alimony or separate maintenance payments" under § 71(b)(1), but nevertheless be characterized as child support payments due to the operation of § 71(c). It is clear, therefore, that payments may constitute child support under subsection (c) even where the payments terminate upon the payee's death.

Accordingly, we hold that termination of the monthly payments related to a contingency involving a child under I.R. C. § 71(c)(2)(A).

B. Steven's Eighteenth Birthday

Even if we were to conclude that termination of the payments was not contingent upon Steven's graduation, the payments would nonetheless constitute child

support payments because their termination "can clearly be associated with a contingency" relating to a child of the payor under I.R.C. § 71(c)(2)(B), namely, Steven turning 18 years old. Temporary Regulations 1.71 − 1T outlines when payments are considered reduced at a time related to a child:

> Q-18 When will a payment be treated as to be reduced at a time which can clearly be associated with the happening of a contingency related to a child of the payor?
>
> A-18 There are two situations, described below, in which payments which would otherwise qualify as alimony or separate maintenance payments will be presumed to be reduced at a time clearly associated with the happening of a contingency relating to a child of the payor. In all other situations, reductions in payments will not be treated as clearly associated with the happening of a contingency relating to a child of the payor.
>
> The first situation referred to above is where the payments are to be reduced not more than 6 months before or after the date the child is to attain the age of 18, 21, or local age of majority . . . . [The second situation is inapplicable to this case.]

Temporary Regulations § 1.71 - 1T. The presumption may be rebutted by showing that the time at which the payments are to be reduced was "determined independently of any contingencies relating to the children of the payor." *Id*.

Steven's date of birth is December 16, 1987. He turned 18 on December 16, 2005, approximately five and a half months prior to the June 1, 2006 cessation of payments. Because payments terminated "not more than 6 months before or after" Steven attaining the age of 18, there is a presumption that the payments were child support. Temporary Regulations § 1.71 − 1T. Joseph has failed to offer any evidence indicating that the termination date was determined "independently of" Steven's

attaining the age of 18. Indeed, from the record, it appears that the only possible evidence Joseph could have offered would be to show that the June 1, 2006 date was arrived at by consideration of Steven's graduation date, which, as stated above, would render the payments child support under I.R.C. § 71(c)(2)(A).

Joseph further asserts that he paid "family support," which is deductible from gross income by the payor and includable in gross income by the payee. In support of this contention, he relies on Wis. Stat. § 767.261, which states that "[t]he court may make a financial order designated 'family support' as a substitute for child support orders under s. 767.25 and maintenance payment orders under s. 767.26 . . . . " Joseph further relies on the Legislative Council Note regarding § 767.261, which states:

> The Divorce Reform Act specifically empowers the court to make a financial order for "family support" as a substitute for the maintenance payments and child support orders, and based upon the same criteria applicable to those separate orders. Under Commissioner v. Lester (1961), 366 U.S. 299, there are significant federal income tax advantages to the payer under such a consolidated order, which may exceed the tax disadvantages to the payee in certain situations. . .

Legislative Council Note - 1977, Wis. Stat. Ann. § 767.261 (West 2001). This Legislative Council Note was drafted in 1977, prior to the Tax Reform Act of 1984, which sharply limited *Lester*:

> The legislature originally created the family support option to allow parties to take advantage of "significant federal income tax advantages" under *Commissioner of Internal Revenue v. Lester* [citation omitted]. Legislative Council Note, 1977, Wis. Stat. Ann. § 767.261 (West 2001). *Lester* was superseded by I.R.C. § 71, as amended by the Deficit Reduction Act of 1984, Pub.L. No. 98-369, § 422(a), 98 Stat. 795 (1984), which provides that child support is not

> taxable to the payee or deductible to the payer if it is "fixed" (set as a specific amount) by the support order. *See* I.R.C. § 71(c). . . .

Vlies v. Brookman, 2005 WI App. 158, 285 Wis. 2d 411, 701 N.W. 2d 642 (footnote omitted). Courts from other jurisdictions have made the same observation:

> Prior to the Tax Reform Act of 1984 [part of the Budget Deficit Reduction Act], Publ.L. 98-369, I.R.C. § 71 (1984), an award of undifferentiated alimony and child support afforded the payor spouse maximum flexibility, i.e., the payor spouse could treat the entire payment as alimony, deductible from the payor spouse's income. The rule that a payor spouse might do so was announced in *Commissioner v. Lester*, [citation omitted], and the process of allowing divorcing spouses to allocate income tax burdens between themselves to maximize tax benefits became known as "lestering." Lestering was sharply limited by the 1984 tax amendments. Under I.R.C. § 71(c), as amended, even if a payment has not been fixed in the divorce or separation instrument as child support, there are instances (e.g., if a payment is reduced upon a child's attaining a certain age) where the payments will be treated as [child] support).

Griffith v. Griffith, 509 N.E.2d 38, n.1 (Mass. App. Ct. 1987). We are therefore unpersuaded by any argument that payments denominated as "family support" are necessarily deductible by the payor. *See also Oehler, et al., supra* (payments termed "family support" by divorce instrument properly characterized as child support).

Joseph also refers to the excerpt from the transcript of the final divorce hearing, quoted in Finding of Fact 24, in which Susan acknowledged that the monthly payments would be taxable income to her. We agree with the Department that the excerpt is irrelevant. Pursuant to I.R.C. § 71, whether payments are "alimony or separate maintenance" or "child support" is determined solely by reference to a divorce or separation instrument. *See also Linton v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶400-598 (WTAC 2002); *Boerner and Legler v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶400-239

(WTAC 1996). Thus, we do not consider statements that were made during the divorce hearing. Even if we were to consider these statements, however, the Commission has previously held that payments may be deemed child support even where the divorce instrument itself stresses that the payments are deductible to the payor and taxable to the payee. *See Oehler, e. al., supra.* Accordingly, a party's verbal statements regarding the tax consequences are certainly not determinative.

Moreover, both Joseph and respondent note that the divorce instrument did not reduce Joseph's payments upon Joseph and Susan's older child, Jennifer, turning 18 or upon her graduation. This fact, they assert, indicates the payments were not child support. For payments to be considered child support under I.R.C. § 71(c), there is no requirement that the contingency relate to an event involving all (or more than one) of the payor's children, only that the contingency relate to an event involving *a child* of the payor. It is inconsequential, therefore, that the divorce instrument did not provide for reduction of payments upon Jennifer's turning 18 or upon her graduation, but, instead, waited until the parties' youngest child, Steven, was to graduate and/or attain a certain age before terminating payments. *See also Oehler, e. al., supra* (payments considered child support under I.R.C. § 71(c), despite fact that parties had four minor children at time of divorce and divorce instrument did not reduce payments until youngest child turned 18 years old).

Finally, both Susan and Joseph rely on proceedings before the I.R.S., in which both parties were assessed by the I.R.S. for the payments at issue during 2002 but

were ultimately issued No Change Letters.[3] This evidence, which only addresses one of the four years at issue, is a wash as both parties use the same type of No Change Letter issued for 2002 to support their own positions and undermine the other party's position. Further, a decision by the I.R.S. is not binding on the Department. Wisconsin Statutes § 71.01(4) provides that "federal adjusted gross income" means "adjusted gross income as determined under the internal revenue code or, if redetermined by the department, as determined by the department under the internal revenue code . . . . " Therefore, the Department may redetermine an individual's "federal gross income" as long as the Department makes that determination based on the Internal Revenue Code, which the Department did in these cases. The fact that the I.R.S. apparently permitted Joseph to characterize the 2002 payments as deductible alimony, while simultaneously characterizing those payments as child support not includible in Susan's taxable income, does not bind the State of Wisconsin to the same inexplicable and inconsistent result.

Based on the foregoing, the Commission concludes that the payments for the years at issue were child support payments, neither deductible from Joseph's gross income nor includible in Susan's gross income.

IT IS ORDERED

1. The Department's actions on the petitions for redetermination in Docket Nos. 05-I-134 and 05-I-135 are affirmed.

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[3] Joseph also attaches to his brief "Exhibit E" pertaining to tax year 2003. That document was not part of the Stipulation of Facts, and appears to be a settlement agreement between Joseph and the I.R.S., to which the Department was not privy. Accordingly, the Commission will not consider it.

2. The Department's action on the petition for redetermination in Docket No. 05-I-132 is reversed.

Dated at Madison, Wisconsin, this 8th day of September, 2006.

WISCONSIN TAX APPEALS COMMISSION

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Jennifer E. Nashold, Chairperson

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Diane E. Norman, Commissioner

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David C. Swanson, Commissioner

ATTACHMENT: **"NOTICE OF APPEAL INFORMATION"**