

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

PATRICIA M. JANES)	
)	DOCKET NO.: IT-2001-2
Appellant,)	
)	
-vs-)	
)	FACTUAL BACKGROUND,
)	CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,)	<u>FOR JUDICIAL REVIEW</u>
)	
Respondent.)	

Oral argument on the above-entitled appeal was held on November 6, 2003, in the City of Helena, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was duly given as required by law.

By mutual agreement of the parties, the matter was submitted on briefs and an agreed statement of facts. At oral argument held on November 6, 2003, Appellant was represented by her counsel, Patrick Dougherty, and the Department of Revenue was represented by Stephen R. McCue, tax counsel. Ms. Janes is the appellant in this proceeding and, therefore, has the burden of proof.

The record remained open for a period of time for the purpose of submitting post-hearing briefs from both parties. Said briefs were timely received by this Board.

Based on the record, the Board finds that the decision of the Department of Revenue shall be overruled. The Appellant's Motion for Leave to Amend Complaint, Set Hearing, and Compel Additional Discovery is hereby denied. As this Board has found previously, it lacks jurisdiction to impose sanctions.

STATEMENT OF THE ISSUE

After filing suit for Dissolution of Marriage, and alleging the existence of a common law marriage with Dr. Frank Gustafson, voluntary settlement was reached between the Petitioner (Patricia M. Janes) and the Respondent (Dr. Frank Gustafson) in that action. The parties agreed that Gustafson would pay to Janes the sum of \$211,250 in exchange for the dismissal of the Petition and the execution of a mutual release of all claims. The settlement did not provide for the entry of a Decree of Dissolution by the District Court and none was ever entered. The issue in this case concerns the treatment, for tax purposes, of the amount of \$211,250 that Janes received in the settlement.

STATEMENT OF FACTS

The matter came before this Board with the following statement of facts stipulated to by both parties:

1. Patricia Janes, the taxpayer in this appeal, and Dr. Frank Gustafson cohabited for eighteen years.

2. In 1995, Appellant filed a Petition for Dissolution of Marriage in the Montana Third Judicial District Court, Cause Number DR-96-01.

3. In that Petition she alleged that the parties were married by operation of law and requested both Maintenance (Alimony) and a Property Settlement from Dr. Gustafson.

4. Dr. Gustafson opposed the Petition with the contention that there never was a marital relationship.

5. Appellant thereafter filed a Motion with the Court for Temporary Maintenance under a theory that she was a putative spouse under Montana law and that she was, therefore, entitled to temporary maintenance pursuant to sections 40-1-404, 40-4-121, and 40-4-203, MCA.

6. The District Court, Judge Mizner, agreed and issued an Opinion and Order dated August 16, 1996, that Appellant would "remain the putative spouse of Dr. Gustafson until such time as knowledge of the fact terminated her status" and ordered temporary maintenance payments of \$1,626.00 per month be paid to by Dr. Gustafson.

7. All temporary maintenance payments received by Appellant under this Opinion and Order were reported as alimony income on her income tax returns.

8. The parties thereafter executed a settlement agreement on September 4, 1997, whereby Ms. Janes agreed to accept cash in the amount of \$191,250.00 and a motor vehicle equal in value to \$20,000.00, or \$211,250.00 in total, in exchange for dismissing the Petition with prejudice and executing a release of all claims.

9. Cash in the total sum of \$224,258.00 was paid to Appellant on September 15, 1997.

10. Of this sum, \$13,008.00, representing eight months of unpaid temporary maintenance payments was reported as

alimony income by Appellant on her 1997 Montana and federal income tax returns. The balance of \$211,250.00 was not reported as income on her Montana and federal income tax returns and is disputed in this action by the parties.

11. Patricia Janes declared a filing status of single on all Montana income tax returns during the years that she and Dr. Gustafson cohabited. She was advised by an income tax preparer that this was the correct status to claim unless a court determined that she was married.

12. Thereafter, pursuant to the settlement executed on September 4, 1997, the Petition for Dissolution was dismissed with prejudice by an Order of the District Court dated November 17, 1998.

13. The Order of the District Court dated November 17, 1998, does not contain a Decree of Dissolution of Marriage.

14. The Montana Department of Revenue has adjusted Appellant's 1997 income tax return claiming that the entire \$224,258.00 was income and assessed additional income tax for tax year 1997 in the amount of \$22,509.00 together with penalties and interest.

15. Appellant disputed the adjustment and assessment claiming that the \$211,250.00 amount in dispute, and received in 1997, was the result of a property settlement pursuant to the divorce petition and was not taxable income.

16. On July 28, 1999, the Department issued a Final Notice of Assessment to Appellant.

17. By letter dated March 2, 2000, the Department asserted that Internal Revenue Code section 61 provides that any accession to wealth not specifically exempted is classified as income and subject to tax; therefore, the 1997 settlement payment of \$211,250.00 was an accession to wealth and taxable income.

18. On May 5, 2001, the Final Decision of the Department was issued upholding the Department's determination that the 1997 settlement payment of \$211,250.00 was an accession to wealth and taxable income.

19. The Internal Revenue Service was placed on notice of the Department's assessment and action by Appellant's

attorney in November of 1999, but has not assessed any additional income taxes against Appellant for 1997 for the \$211,250.00 settlement payment received by her in that year.

APPELLANT'S CONTENTIONS

Patricia Janes contends that the payment made to her by Dr. Frank Gustafson was a property settlement in response to the petition she filed to terminate their 18-year common law marriage. Property settlements incident to the separation of a marital estate are not taxable to either party under IRC sec. 215.

Petitioner further contends that the amount could not be construed as maintenance, since it fails the test set forth in IRS section 71. Specifically, Section 71 requires that for an amount to be considered as maintenance it must provide that there is "no liability to make any such payment for any period after the death of the payee spouse". Since there was no such provision in this settlement, the settlement would not qualify as alimony.

The Appellant points to federal "origin of the claim" doctrine to determine, for tax purposes, the character of the amount in question. "Origin of the claim" doctrine holds that where the character of a settlement is in dispute and is not clear by reference to the settlement documents, it is necessary to refer to the underlying claim. **Hort v. Comm.,**

313 U.S. 28, 61 S. Ct. 757, 85 L. Ed 1168 (1941) and U.S. v. Gilmore, 372 U.S. 39, 83 S. Ct 623, 9 L. Ed 2d 570 (1963).

During oral argument before this Board, DOR counsel characterized the disputed payment as alimony. This stance is directly opposite the previous DOR position in which it was conceded that the subject amount was NOT alimony, but still taxable as an accession to wealth. (Taxpayer's Exhibit A to Appellant's Supplemental Brief on Alimony Income, dated November 18, 2003: May 26, 1999 Scott Payton letter, DOR auditor, to Gregg Olson, Janes' accountant).

The Appellant also requests the finding that the \$13,008 amount (eight monthly payments of \$1,626.00 each under Judge Mizner's Opinion and Order dated August 15, 1996) that Ms. Janes actually reported as alimony income on her 1997 Montana Income Tax Return is also not taxable alimony income to her, because there was no provision in that Opinion and Order to provide that, if she died before the payment was in fact made to her, that Dr. Gustafson would be relieved from any further liability to make the payment to her or to her estate. Section 71 of the Internal Revenue Service code requires that, for an amount to be considered as maintenance, or alimony, it must provide that there is "no liability to make any such payment for any period after the death of the payee spouse". Since there was no such provision in these payments

as well, the \$13,008 amount would also not qualify as alimony.

DEPARTMENT OF REVENUE CONTENTIONS

The \$211,250 payment received by Janes is ordinary income taxable to her and does not escape taxation under Internal Revenue Code section 1041 as made incident to a divorce since no dissolution of marriage was ever entered by the court. Alternatively, the DOR argues that the payment is alimony or maintenance under Internal Revenue Code section 71 and is taxable as ordinary income to Janes under Internal Revenue Service code section 61.

BOARD'S DISCUSSION

The Board finds merit in the Appellant's argument regarding the origin of the claim doctrine and will grant her appeal accordingly. This federal legal doctrine is relied upon in disputes where there has been a settlement and, therefore, no determination about what has been alleged by the parties or what has been asserted either as facts or legal theory. The presumption would then be that, if a party is receiving compensation, or a settlement amount, then they have prevailed on their original claim being asserted.

Under this doctrine, the Appellant is deemed to have prevailed in the divorce action and her request for a property settlement, without the need for a divorce decree

or court order, or even an order that the parties were ever married. The origin of the claim doctrine dictates that, if the case had not been settled, and she had successfully established her claim that she and Dr. Gustafson were married, the proceeds would have been excludible as a property settlement. Therefore, the payment in question is excludible from income under Internal Revenue Service code section 1041.

The Board will not exclude from income the \$13,008 amount (eight monthly payments of \$1,626.00 each under Judge Mizner's Opinion and Order dated August 15, 1996) that Ms. Janes actually reported as alimony income on her 1997 Montana Income Tax Return. This amount was characterized as *temporary maintenance* in Judge Mizner's order and the Board will treat it as such.

The DOR seems to want to operate under whatever assumption will result in taxation for this Appellant: either that the Appellant was married to Dr. Gustafson and therefore entitled to alimony, which is taxable, or that she was not married, because there was no divorce decree, and therefore could not possibly receive either alimony or a property settlement if she was never married, but that the payment is still taxable as an accession to wealth.

CONCLUSIONS OF LAW

1. **§15-2-302, MCA. Direct appeal from department decision to state tax appeal board - hearing.** (2)(a) Except as provided in subsection (2)(b), the appeal is made by filing a complaint with the board within 30 days following receipt of notice of the department's final decision.

2. **IRC §71 and IRC §1041.**

3. **§40-1-403, MCA (Common Law) and §40-1-404, MCA (Putative Spouse).**

4. **Hort v. Comm.**, 313 U.S. 28, 61 S. Ct. 757, 85 L. Ed 1168 (1941) and **U.S. v. Gilmore**, 372 U.S. 39, 83 S. Ct 623, 9 L. Ed 2d 570 (1963).

5. The appeal of the taxpayer is hereby granted, in part, and the decision of the Department of Revenue is overruled.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the \$211,250 payment in question is not taxable income to the Appellant.

Dated this 29th day of January, 2004.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

GREGORY A. THORNQUIST, Chairman

JERE ANN NELSON, Member

JOE R. ROBERTS, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 29th day of January, 2004, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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