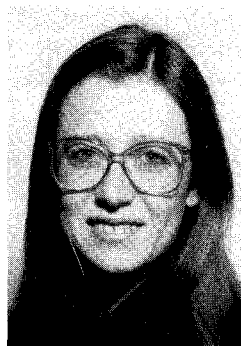
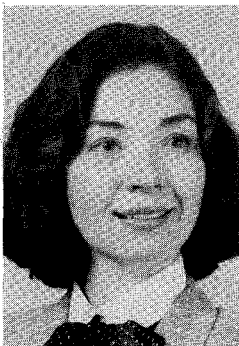


Tax Consequences as a Factor in Judicial Awards of Alimony and Property

by *Fernande R. V. Duffly and
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This article addresses the extent to which the tax consequences of a support order or judicial property assignment must be considered, if at all, by the trial court in a divorce matter.

As divorce practitioners, most of us have, in our daily practice of divorce law, labored under the admonition to be aware of the tax consequences of divorce. In the negotiation and drafting of a sound Separation Agreement, we do not fail to address the potential tax consequences of alimony versus child support; we raise the specter of deferred original basis where sole title to the marital abode is transferred to one spouse; provisions respecting includability and deductibility, child dependency exemptions, and joint filing are on our computer



EDITORS' NOTES

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master forms. Indeed, this may be our obligation; courts in other jurisdictions have held that attorneys who fail to consider tax consequences may be held liable to their clients.¹

But, when negotiations fail and a trial on the merits ensues, must the trial judge — who now is responsible for entering orders for support and division of property — address tax consequences? While a number of states have statutory schemes that provide for judicial consideration of tax consequences,² Massachusetts at present does not.³

Massachusetts General Laws chapter 208, section 34, which sets forth all the factors which a judge must consider in determination of alimony and property division, makes no reference to tax consequences.⁴ The Supreme Judicial Court in *Rice v. Rice*, 372 Mass. 398 (1977), notes that the statute requires a judge to consider all the criteria enumerated in the third sentence of section 34 and none other: “[S]ince §34, third and fourth sentences ... define the scope of a trial judge’s discretion ... his consideration of factors not enumerated in §34 would constitute an error of law.” *Rice, supra* at 401, citing *Bianco v. Bianco*, 371 Mass. 420 (1976) and *Putnam v. Putnam*, 5 Mass. App. Ct. 10 (1977). The SJC went on to state that “in future cases under this statute we wish to have findings, whether or not requested by a party . . . , showing that the judge below weighed all the statutory factors in reaching his decision and considered no extraneous factors.” *Rice, supra* at 402-403.

However, while not directly addressing the issue, the SJC, commenting in a footnote that there was no evidence of any kind in the record concerning the tax consequences to the husband of the judge’s property assignment, stated that “consequently, the judge’s order cannot be plainly wrong, as alleged, for failure to consider such tax consequences.” *Rice, supra* at 402 n. 4. The implication of this statement is that, had such tax consequences been raised, the judge’s failure to consider them might have constituted error.⁶

The SJC has not, in the decade since the *Rice* decision was rendered, expanded on the implication contained in its footnote. However, the Massachusetts Appeals Court, in several cases since the *Rice* decision, has addressed the issue of the extent to which a trial court must consider tax consequences. An analysis of these decisions offers some guidance to the Massachusetts divorce practitioner. As set forth more fully in the following discussion, taken together these cases suggest that if counsel makes a timely request that the issue of tax consequence be considered, and presents adequate evidence relevant to the tax issues, the trial court *must* consider it.

In *Wolfe vs. Wolfe*, 21 Mass. App. Ct. 254 (1985), the Court refused to consider the issue of tax consequences raised for the first time in oral argument on appeal and not previously presented to the trial judge or argued in the briefs. However, the Court in a footnote to the opinion referred to "the importance of consideration of the tax consequences of divorce and of the division of property and payments incident thereto Such issues should be raised in timely form in the trial court and supported by appropriate evidence in the record." *Wolfe, supra* at 258 n. 7, citing *Bennett v. Bennett*, 15 Mass. App. Ct. 999, 1000 (1983), *Sheskey v. Sheskey*, 16 Mass. App. Ct. 159, 160-162 (1983) and *Cabot v. Cabot*, 18 Mass. App. Ct. 903, 905-906 (1984).

In *Bennett v. Bennett, supra*, the defendant husband cross-examined the wife's expert accountant about various tax and valuation issues, but presented no evidence of his own on such issues, and made no request that the probate judge consider the tax effects of his order upon the parties. The Court of Appeals held that the trial court's findings of fact and conclusions were not clearly erroneous, although they did raise questions about the husband's ability to meet the judicially imposed obligations without incurring significant federal and state tax liabilities. The court suggested that it would be appropriate for the trial court, pursuant to a request for revision because of changed circumstances or in contempt proceedings, to "give attention to whether the original awards may have been made without sufficient consideration of possible tax consequences." *Bennett, supra* at 1000. However, the court went on to state: "We intend no suggestion whether or to what extent this need be done." *Id.* See also, *Angelone v. Angelone*, 9 Mass. App. Ct. 728, 732 (1980) and *Langerman v. Langerman*, 9 Mass. App. Ct. 869, 870 (1980), where the failure to introduce any evidence on the issue of tax consequences was cited as the basis for the appellate court's determination that the judge's failure to consider such consequences could not be plainly wrong (both citing *Rice, supra* at 402, n.4).

In *Sheskey v. Sheskey, supra*, unlike the circumstances found in either *Bennett* or *Wolfe*, the husband's lawyer in a divorce action made a timely request that the probate court consider the tax effects of borrowing or making distributions from a pension plan and presented evidence, through expert witnesses, on this issue. The trial judge made no findings on the issue of tax consequences, and the Appeals Court remanded the matter "for reconsideration of the awards, in light of the income tax consequences to Dr. Sheskey . . . with a view to minimizing unnecessary adverse income tax consequences." *Sheskey, supra* at 189. The court also

stated that the trial court could, in its discretion, receive evidence (if offered by the parties) from tax and estate planning specialists. The Appeals Court in *Robbins v. Robbins*, 16 Mass. App. Ct. 576, 453 N.E.2d, 1058 (1983) and *Cabot v. Cabot, supra*, noted with approval that the trial judge had apparently taken tax consequences into account.

In *Doe v. Doe*, 16 Mass. App. Ct. 499 (1983), the Court of Appeals remanded with instructions that the trial court make specific findings to support a property distribution, and determine the value of the husband's profit sharing and savings plan. Although it does not appear that the parties raised the issue of tax consequences, either on appeal or at the divorce trial, the court suggested, in a footnote, that on remand it might be appropriate for the court to take tax issues into consideration in assigning the value of the profit sharing plan. *Doe, supra*, at 506, citing *Sheskey*.

Based on the foregoing, it appears that Massachusetts courts will consider the tax consequences of orders regarding support and property division, in cases where: 1) at least some evidence is presented on the issue of possible tax consequences and 2) a request is made prior to the entry of judgment that the court consider the tax consequences to the parties.

The cases to date provide little guidance, however, as to the nature of the evidence which must be presented, and whether or in what cases the evidence must be presented by an expert, such as a certified public accountant or pension specialist. The Court in *Sheskey* suggests that tax and estate planning specialists may be appropriate, at least where complex tax questions arise in connection with, for example, pension valuation and distribution issues. Where the tax question is relatively straightforward, no expert may be required. For example, in a case in which the issue is whether payments of cash should be alimony (which is taxable) or property (which is not) the parties themselves are competent to present evidence as to their own incomes; the court may take judicial notice of applicable tax laws and IRS rulings, raised in oral or written argument, to enable it to make conclusions as to the relative tax impact to the parties.

Further, even assuming that the court will entertain the evidence with respect to tax consequences, a question remains as to the degree to which this consideration must be reflected in the Court's property assignment or support order. For example, can or should tax consequences be found too speculative or remote to be considered in the judge's final determination? Arguably, fixing the amount of a potential tax liability is no less exact or speculative than determining the fair market value

of a business which cannot be sold, or the present value of a contributory benefits pension plan — and a failure to recognize tax liabilities which will occur, although not in the immediate future, may make facially equal awards of property, unequal.⁷ On the other hand, it can be argued that tax laws can and do change, assets need never be sold, and taxes on capital gains may be deferred or offset by future tax losses. These and similar questions have been addressed to some extent by courts in other jurisdictions,⁸ but await further development in Massachusetts.

NOTES

1. *Bronstein v. Kalcheim, Ltd.*, 90 Ill. App.3d 957, 414 N.E.2d 96 (1980); *Wright v. Wright*, 92 Wis.2d 246, 284 N.W.2d 894, 900 (1979); *Philips v. Giles* 620 S.W.2d 750 (Tex. Civ. App. 1981); *Graham v. Harlin, Parker & Rudloff*, 664 S.W.2d 945 (Ky. App. 1983).

2. The following states have statutes which require judicial consideration of tax consequences in determining both support, and division of property: Iowa (Iowa Code Ann., §598.21(j) (West 1986); New York (N.Y. Dom. Rel. Law §236(B)(5)(2)(10) and (B)(6)(a)(7) (Consol. 1986); Virginia, West Virginia and Tennessee require such consideration only in connection with support orders: Va. Code Ann. §§20-107.1 (1983); W. Va. Code §48-2-16(b)(12)(1986); Tenn. Code Ann. §36-5-101 (1984). States requiring consideration of tax consequences in connection with division of property only are: Wisconsin (Wisc. Stat. Ann. §767.255(10) (West 1986); North Carolina (N.C. Gen. Stat. §50-20(c)(11) (1984); Oregon (Or. Rev. Stat. §107.105(f) (1986); Illinois (Ill. Marr. & Diss. Act §503(d)(11) (West 1986); Delaware (Del. Code Ann. tit. 13 §1513(a)(11) (1981) and Arkansas (Ark. Stat. Ann. §34-1214(A)(9) (1985).

3. The Senate Judiciary Special Commission on Divorce has this year proposed legislation which would require the Court to consider tax consequences in ordering support or assigning property in an action for divorce.

4. M.G.L. ch. 208 §34 provides: "Upon divorce or upon a complaint in an action brought at any time after a divorce, whether such a divorce has been adjudged in this commonwealth or another jurisdiction, the court of the commonwealth, provided there is personal jurisdiction over both parties, may make a judgment for either of the parties to pay alimony to the other. In addition to or in lieu of a judgment to pay alimony, the court may assign to either husband or wife all or any part of the estate of the other. In determining the amount of alimony, if any, to be paid, or in fixing the nature and value of the property, if any, to be so assigned, the court, after hearing the witnesses, if any, of each party, shall consider the length of the marriage, the conduct of the parties during the marriage, the age, health, station, occupation, amount and sources of income, vocational skills, employability, estate, liabilities and needs of each of the parties and the opportunity of each for future acquisition of capital assets and income. The court may also consider the contribution of each of the parties in the acquisition, preservation or appreciation in value of their respective estates and the contribution of each of the parties as a homemaker to the family unit"

5. The rationale for this suggestion, taken up by the Appeals Court in subsequent decisions, is not made clear. It could be argued that, in spite of the statute's silence, the trial court's discretionary authority to consider tax consequences is inherent in its power to fix "the nature and value of the property to be assigned."

It would also be argued that the court's power to consider tax consequences is implicit in the requirement that the trial court consider the "amount and sources of income, ... estate, liabilities and needs of the parties" This might be true, for example, to the extent that a party incurs an immediate and ascertainable tax liability as a direct consequence of an order for support or property assignment.

6. Assume, for example, that parties' shares of stock in a closely held corporation are the sole asset and are valued at \$1 million; further assume that the tax basis for the stock is very low—next to nothing, in fact. If the judge, intending to divide assets equally, ignores tax consequences as being too remote and speculative, and awards the other party a cash distribution of \$500,000, the distribution, while equal on its face, in fact awards to the party receiving the cash the lion's share of assets. Under the current tax laws, the cash distribution is a non-taxable transfer, while any gain recognized in connection with a sale of the shares is taxable.

7. See, e.g., *Kelley v. Kirk*, 391 N.W.2d 652, 658-659 (S.D., 1986) (unless liquidation is required by the judgment, property valuation may not take tax consequences into account, and husband held liable for all tax consequences of sale of his pathology practice which took place prior to divorce trial); *Rosenberg v. Rosenberg*, 497 A.2d 485 (Md. App. 1985) (tax liability for imputed interest on prior loans was immediate and specific and was therefore appropriately considered, future tax liability in retirement plans and the sale of other assets was speculative and need not have been considered by the trial court); *Majauskas v. Majauskas*, New York (94 A.D.2d 913, 464 N.Y.S.2d 913 (1983), aff'd 61 N.Y.2d 481, 474 N.Y.S.2d 699, 463 N.E.2d 15 (1984) (On appeal, formula to distribute to the wife a portion of each pension payment, upon receipt from the husband was modified to subtract the taxes from each payment before applying the formula); *Aaron v. Aaron*, 281 N.W.2d 150 (Minn. 1979), (Trial court's refusal to consider the potential tax consequences of a future sale, because it was too speculative, was not an abuse of discretion.) See also *Brockman v. Brockman* 373 N.W.2d 664 (Minn. 1985) *In re Marriage of Johnson*, 106 Ill. App.3d 502, 436 N.E.2d 228 (1982); *Wallahan v. Wallahan*, 284 N.W.2d 21 (SD 1979); *In re Marriage of Emken*, 86 Ill.2d 164, 427 N.E.2d (1981); *Corliss v. Corliss*, 107 Wis. 2d 388, 320 N.W.2d 219 (Wis. Ct. App. 1982); *Marriage of Marx*, 97 Cal. App.3d 552, 159 Cal. Rptr. 215 (1979).