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Spousal maintenance: when are the tax consequences considered?

When it comes to the division of property, we have some guidance.

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In *Maurer v. Maurer*, the Supreme Court had to decide whether the district court abused its discretion by considering tax consequences in valuing the husband's retirement assets as part of the division of property. 623 N.W.2d 604, 605 (Minn. 2001). In affirming the district court, *Maurer* clarified that consideration of tax consequences was not limited to situations where the sale of assets was required by the dissolution judgment or certain to occur in the near future. Instead, taxes could be considered in any scenario so long as the district court has a "reasonable and supportable basis for making an informed judgment as to [the] probable liability." *Id*. at 608 (quotation omitted). But is the district court ever required to consider tax consequences?

When it comes to the division of property, we have some guidance. In *Aaron v. Aaron*, the Supreme Court stated that tax consequences "should" be considered "where sale of real estate is required or is likely to occur within a short time after the dissolution." 281 N.W.2d 150, 153 (Minn. 1979). This has been interpreted to require consideration of the tax consequences which are triggered by the division of property itself or are likely to occur soon after the dissolution. *Reynolds v. Reynolds*, 498 N.W.2d 266, 271 (Minn. Ct. App. 1993) (reversing district court for not considering capital gains taxes that owner of apartment building would incur where building was in foreclosure with a balloon payment fast approaching); *Archer v. Archer*, No. A10-1465, 2011 WL 2672231, at *3 (Minn. Ct. App. July 11, 2011) (reversing district court for not considering income taxes that would be triggered by transfer of real estate required by dissolution judgment). Putting this all together, while district courts have broad discretion in dividing property to consider tax consequences in any situation so long as there is a reasonable and supportable basis for making an informed judgment as to the probable liability, *Maurer*, 623 N.W.2d at 608, this discretion is abused by ignoring tax consequences which result from the division of property or are likely to occur shortly after the dissolution. *Reynolds*, 498 N.W.2d at 271. In those instances, consideration of tax consequences is required. But what about spousal maintenance? Is consideration of the tax consequences of the spousal maintenance award ever required?

The answer, to date, has been a resounding no. One obligee after another has tried and failed to persuade the Court of Appeals that the district court erred by not considering that spousal maintenance payments are taxable to the obligee and deductible by the obligor. Some of

those decisions are based on the obligee's failure to present evidence of the tax impact. *See, e.g., Ostrosky v. Ostrosky*, No. A10-389, 2011 WL 1004572, at *7 (Minn. Ct. App. Mar. 22, 2011) (rejecting obligee's challenge to maintenance award because she presented no evidence at trial of tax consequences). Those decisions make sense because, without evidence of the tax consequences, the district court would lack the "reasonable and supportable basis" required by *Maurer* and would be engaging in improper speculation. However, other decisions interpret *Maurer* to mean that, as a matter of law, the district court can never abuse its discretion by not considering the tax consequences of spousal maintenance because consideration of tax consequences is entirely discretionary under *Maurer*. *See, e.g., Benshoof v. Benshoof*, No. C0-02-525, 2002 WL 31655155, at *1 (Minn. Ct. App. Nov. 26, 2002); *Mullenbach v. Mullenbach*, No. A11-2010, 2012 WL 4052516, at *5 (Minn. Ct. App. Sept. 17, 2012); *Doyle v. Klein*, Nos. A14-0989, A14-1280, 2015 WL 2456983, at *3 (Minn. Ct. App. May 26, 2015). But can this really be the law? Does *Maurer* mean that a district court can choose to ignore the tax impact of its spousal maintenance award even if there is ample evidence in the record of the impact? The answer from the Court of Appeals seems to be yes.

This reading of *Maurer* does not make a whole lot of sense. In *Maurer*, the Supreme Court was called upon to review a district court's decision to consider tax consequences, not a district court's decision to ignore tax consequences. Thus, the circumstances in which a district court might abuse its discretion by ignoring tax consequences was not addressed in any way by *Maurer*.

Interpreting *Maurer* to never require consideration of tax consequences on a spousal maintenance award leads to some odd results when the standard of review is applied. If a district court's exercise of discretion to consider tax consequences results in an overstatement of the obligee's liability, then a reversal would make sense. *See, e.g., Brooks v. Brooks*, No. A12-0553, 2013 WL 869670, at *6 (Minn. Ct. App. May 21, 2013) (reversing district court because it calculated obligee's taxes at a rate higher than both parties' estimates without explaining basis for doing so). But in a recent decision, the Court of Appeals reversed a district court for failing to make sufficient findings explaining its calculations of the parties' respective income tax liabilities and because the district court apparently had "significantly underestimated" the taxes the obligee would incur on her maintenance award. *Gribble v. Gribble*, No. A14-0184, 2015 WL 3648843, at *7 (Minn. Ct. App. June 15, 2015). Similarly, in another case, the district court was reversed for calculating taxes on remand at a rate lower than the original rate: "Because the district court did not explain its reasoning or set forth any evidence supporting the decrease to the spousal maintenance taxes from 25% to 7.5%, and because such a decrease has a substantial effect upon the maintenance calculation, we conclude the district court abused its discretion in its calculation of appellant's tax liability." *Doyle v. Klein*, No. A12-0751, 2013 WL 2922755, at *9 (Minn. Ct. App. June 17, 2013). If *Maurer* means then a district court is not required to consider taxes on spousal maintenance, how can a district court's understatement of those taxes constitute an abuse of discretion? Stated otherwise, how can a district court abuse its discretion by underestimating tax liabilities it had no obligation to consider in the first place?

We do not believe *Maurer* means that a district court is never required to consider the tax consequences of its spousal maintenance award. Since under *Aaron* and *Reynolds*, district courts are obligated to consider the tax impact of divisions of property which are required by the dissolution judgment or which are likely to occur soon after the dissolution, why are they not similarly obligated to consider the tax consequences of spousal maintenance? In the property context, the rationale for not speculating about tax consequences which are not required by the dissolution judgment or likely to soon occur is based on the fact that those consequences are often difficult to predict, both because they are driven by events in the future and also because they are subject to manipulation because the owner can choose when and how to structure a sale. But spousal maintenance awards do not entail this same uncertainty. For one thing, the tax event occurs instantly and not in the future. Entry of the dissolution judgment gives rise to an income stream that is immediately taxable to the obligee and deductible by the obligor. The obligee's liability and the benefit to the obligor are relatively straightforward to determine because the amount of spousal maintenance is known, and the amounts of their respective incomes are known. And unlike owners of property who may have a choice about when and how to sell the property awarded to them, spousal maintenance obligors and obligees have no choice because they are bound by the spousal maintenance award set forth in the dissolution judgment.

Ignoring the tax consequences of the spousal maintenance award conflicts

with the notion articulated in *Erlandson v. Erlandson* that the essence of determining spousal maintenance is balancing the obligee's need against the obligor's ability to pay. 318 N.W.2d 36, 39-40 (Minn. 1982). Failing to consider taxes shortchanges obligees in this analysis because it leaves them without enough money to pay the taxes on their income. And ignoring the deductibility of payments to the obligor results in an understatement of the obligor's actual cash flow. This is not so critical in cases where the obligor has the ability to pay the maintenance award and the only issue is the obligee's need, but it makes a big difference if there is not enough money to go around. In those cases, failing to account for taxes is a double-whammy for the obligee—not only are the obligee's needs understated but the obligor's ability to pay is understated. This unfairness is further magnified in cases involving traditional homemakers, where the spousal maintenance award may well comprise the majority of their income. Take, for example, an obligee awarded $4,000 per month in permanent maintenance. Ignoring the taxes which will have to be paid is akin to slicing the obligee's monthly budget by perhaps $1,000 or $1,500. A district court which reduced a budget so dramatically without findings would easily be reversed on appeal. Yet the law seems to allow district courts to—without any rhyme or reason—simply choose to ignore the tax consequences of spousal maintenance without making any findings of fact explaining the rationale for doing so.

The one-sidedness of this state of affairs is self-evident. It is only the obligees, not the obligors, who are hurt by not accounting for the tax impact of spousal maintenance. This unfairness is especially apparent considering that the law is very clear that the obligor's ability to pay maintenance must be analyzed using the obligor's net income and not gross income. *Kostelnik v. Kostelnik*, 367 N.W.2d 665, 670 (Minn. Ct. App. 1985) (holding that district court must use net income in determining obligor's ability to pay under Minn. Stat. § 518.552, subd. 2(f)). How can the law demand caution to avoid overestimating the obligor's ability to pay but not care one iota about underestimating the obligee's need? Mandating a calculation of taxes on the obligor's earnings while in the same breath, leaving entirely to the whim of the district court the decision on whether to account for the taxes on the obligee's spousal maintenance is asymmetrical and unfair to obligees.

Spousal maintenance is a tough issue for many reasons and the uncertainty surrounding whether tax consequences are considered makes it even more challenging. The next time the Court of Appeals affirms a district court which has shortchanged an obligee by not awarding enough spousal maintenance to pay the obligee's income taxes, we hope that the Supreme Court will accept review to clarify whether *Maurer* really means that a district court is never required to consider the tax consequences of its spousal maintenance determination.

(Alan C. Eidsness represented the obligee in the two Doyle decisions referenced in this article.)

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