Current Federal Tax Developments

Week of August 8, 2022

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INFLATION ADJUSTED PREMIUM TAX CREDIT AMOUNTS ISSUED FOR 2023

Revenue Procedure 2022-34, 7/29/22

Although much of it rendered may be rendered moot by law changes Congress may enact as part of the reconciliation process, the IRS did release the inflation adjusted percentage table that would apply for plan years beginning after 2022 in Revenue Procedure 2022-34.[1]

At the time this was written, Congress was considering extended the treatment that expanded eligibility for the premium tax credit in 2021 and 2022 to cover 2023 and some future years.

Applicable Percentage Table

Reg. §1.36B-3(g)(1) explains the use of this table as follows:

> (1) **In general.** The applicable percentage multiplied by a taxpayer's household income determines the taxpayer's annual required share of premiums for the benchmark plan. The required share is divided by 12 and this monthly amount is subtracted from the adjusted monthly premium for the applicable benchmark plan when computing the premium assistance amount. The applicable percentage is computed by first determining the percentage that the taxpayer's household income bears to the Federal poverty line for the taxpayer's family size. The resulting Federal poverty line percentage is then compared to the income categories described in the table in paragraph (g)(2) of this section.[2] An applicable percentage within an income category increases on a sliding scale in a linear manner and is rounded to the nearest one hundredth of one percent.

The table for tax years beginning in 2023 is:[3]

[1] Revenue Procedure 2022-34, July 29, 2022, https://www.taxnotes.com/research/federal/irs-guidance/revenue-procedures/irs-makes-adjustments-for-calculating-premium-tax-credit/7dtqb (retrieved August 5, 2022)

[2] This is referring to the applicable percentage table.

[3] Revenue Procedure 2022-34, July 29, 2022

Household income percentage of Federal poverty line:	Initial percentage	Final percentage
Less than 133%	1.92%	1.92%
At least 133% but less than 150%	2.88%	3.84%
At least 150% but less than 200%	3.84%	6.05%
At least 200% but less than 250%	6.05%	7.73%
At least 250% but less than 300%	7.73%	9.12%
At least 300% but not more than 400%	9.12%	9.12%

Required Contribution Percentage

Reg. §1.36B-2(c)(3)(v)(B) describes the use of the required contribution percentage as follows:

> An eligible employer-sponsored plan is affordable for a part-year period if the employee's annualized required contribution for self-only coverage under the plan for the part-year period does not exceed the required contribution percentage of the applicable taxpayer's household income for the taxable year. The employee's annualized required contribution is the employee's required contribution for the part-year period times a fraction, the numerator of which is 12 and the denominator of which is the number of months in the part-year period during the applicable taxpayer's taxable year. Only full calendar months are included in the computation under this paragraph (c)(3)(v)(B).

For plan years beginning in calendar year 2023, the required contribution percentage is 9.12%.[4]

[4] Revenue Procedure 2022-34, July 29, 2022

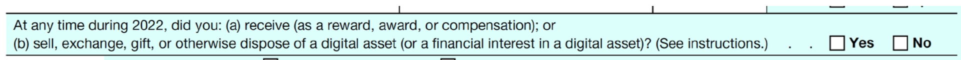
IRS REVISES FORM 1040 QUESTION ON DIGITAL ASSETS ON 2022 FORM DRAFT

Draft 2022 Form 1040, 7/29/22

The IRS has issued a draft 2022 Form 1040[5] which contains a revised question regarding digital assets.

Revisions

The revised portion of Form 1040 appears like this:


At any time during 2022, did you: (a) receive (as a reward, award, or compensation); or
(b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) . . ☐ Yes ☐ No

The question now specifically asks if the taxpayer has received as a reward, award or compensation any digital asset or financial interest in a digital asset. As well, the IRS added to the list of dispositions to be required a yes answer whether the taxpayer has gifted any digital asset or financial interest in a digital asset.

The reference to "digital asset" rather than "virtual currency" is also new for 2022. Although the related instructions to the form are not yet issued in draft form (and likely won't be until much later in the year if the IRS follows the same schedule they have in the past), presumably this change is meant to include coverage of NFTs and other forms of digital assets in addition to virtual currencies.

Why the Changes?

This will be the fourth tax return on which the IRS has asked a digital asset question, and third one for which the question appears on the first page of Form 1040.

The change in wording to "digital assets," in addition to clearly bringing in nonfungible tokens (NFTs) and whatever else similar might be developed, also brings the terminology in line with the terminology added to the Internal Revenue Code in the Infrastructure Investment and Jobs Act in late 2021. The term was added to the IRC as part of the new information reporting requirements that will go into effect after December 31, 2023.

The new question also focuses on various manners in which taxpayers could receive such assets in at least a potentially taxable transaction (such as rewards and awards, in addition to compensation for services performed).

[5] Draft 2022 Form 1040, July 27, 2022, https://www.irs.gov/pub/irs-dft/f1040--dft.pdf (retrieved August 5, 2022)

The IRS also subtly broadened what must be reported by moving beyond the actual digital asset to include any financial interest in a digital asset.

$51 MILLION OF PAYMENTS RULED NOT TO BE DEDUCTIBLE ALIMONY BY LOOKING TO STATE LAW

Redleaf v. Commissioner, CA6, Cases No. 21-2209 and No. 21-2224, 8/5/22

Even though the alimony deduction/taxation issue for divorced couples is no longer an issue in divorces finalized today, the issue of exactly what is federal income tax law alimony continues to be an issue for pre-2019 divorces. In the case of *Redleaf v. Commissoner*[6] the former spouses were disputing the treatment of payments totaling $51 million.

As is normal in a case like this, the IRS also has a protective assessment issued against the recipient spouse so the agency does not get whipsawed should the payor prevail in the court challenge, even though the agency had determined that the payments did not qualify as alimony. Thus, both former spouses were actively involved in this matter.

Pre-2019 Definition of Alimony for Federal Tax Purposes

Prior to being removed from the law effective for divorces entered into after December 31, 2018, IRC §71(b)(1) created a four-pronged test to determine if payments between divorcing spouses were or were not alimony, taxable to the recipient under IRC §71 and deductible by the payor under IRC §215. The opinion cites the rule as follows:

> Under revised § 71(b)(1), an alimony or separate maintenance payment deductible under § 215(a) 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,

[6] *Redleaf v. Commissioner,* CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/eighth-circuit-affirms-denial-of-alimony-deductions/7dvny (retrieved August 7, 2022)

> 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."[7]

Congress enacted this test in 1984 to provide for what Congress hoped would be a clear test to determine what was alimony, one that could be easily incorporated into divorce agreements. One of the key provisions of the four is the requirement that, for a payment to be alimony, the liability of the payor to make any payments must end if the recipient spouse dies. As the opinion notes:

> In making the statute more objective, Congress adopted criteria that would distinguish deductible alimony payments from property settlements:
>
>> In order to prevent the deduction of amounts which are in effect transfers of property unrelated to the support needs of the recipient, the bill provides that a payment qualifies as alimony only if the payor . . . has no liability to make any such payment for any period following the death of the payee spouse.
>
> H.R. Rep. No. 98-432, Part II at 1496, 1984-3 U.S.C.C.A.N. 697, 1138.[8]

Thus, if a payor wants the payment stream to be taxable as alimony, the payor could insist a clause providing that liability for payments will cease upon the death of the recipient be added to the document to eliminate any question regarding whether state law would otherwise have the liability continue after the recipient's death with payments going to the recipient's estate or heirs.

While not enough by itself to ensure a payment stream is taxable as alimony, it makes sense to include it if the payments are intended to be treated as alimony. Normally the first test (the payment received under a written decree or order) is no problem to meet, and it's unlikely the third test is going to be a problem in many cases as the last party the potentially warring spouses may want to share a household with is each other.[9]

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[7] *Redleaf v. Commissioner,* CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

[8] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

[9] There are other provisions that a payor would need to deal with to insure a payment stream is taxable as alimony, avoiding the front end loading rules or the provisions meant to surface disguised child support found in old Section 71.

The second test offers up a way for the recipient spouse, who does not want to have the amounts taxed as alimony, to eliminate that possibility by insisting upon a clause that requires the payments be designated as not taxable under IRC §72 and not deductible under IRC §215. If that clause is in the agreement, the recipient spouse can be sure that the amounts will not be taxable alimony.

So you might think that the issue of whether a payment stream was or wasn't alimony would simply not arise on decrees covered by the 1984 law. But you would be wrong—quite a few divorce decrees simply ignored dealing with the tax implications of any payments, despite having methods available to ensure that the tax treatments of the payments would be clear to all parties.

There are numerous reasons why these issues were ignored, perhaps simply because they were overlooked by the parties and their counsel or those involved recognized that adding one more issue to be resolved could torpedo the potential resolution of the disputes in the divorce. But, in any event, in a number of cases that have made it to the courts the decree standing alone did not contain language that could resolve the question—so the courts then had to turn to how state law would interpret what was in the decree.

Payments with Tax Treatment in Dispute Among the Former Spouses

The key payments in dispute in this case involve the following:

> Andrew received a piano, at least three pieces of art, his personal effects, the fifth vehicle, and — most importantly in this case — his entire 84.5% ownership interest in Whitebox Advisors, LLC ("Whitebox"), a hedge fund asset management firm Andrew founded in 1999. Andrew proposed this property settlement on the day that business-valuation appraisers were scheduled to meet with Andrew and Whitebox employees to prepare a business valuation of this principal marital asset.
>
> To reflect Elizabeth's interest in the Whitebox marital asset, Part VI, Paragraph 23 of the MTA, entitled "Property Settlement," provided that Andrew would pay Elizabeth some $140 million over the next five years:
>
>> A. On or before February 15, 2008, [Andrew] shall pay to [Elizabeth], as a cash property settlement, $750,000;
>>
>> B. On or before February 15, 2008, [Andrew] shall pay to [Elizabeth], as a cash property settlement, $20,000,000;

> C. Commencing March 15, 2008, [Andrew] shall pay to [Elizabeth] $1,500,000 per month . . . for sixty (60) months; and
>
> D. On March 15, 2013, [Andrew] shall pay to [Elizabeth] $30,000,000.[10]

I'm sure some readers will immediately object that the document called this a property settlement and so this could not be alimony. While that sounds convincing, in fact it's not necessarily determinative for the *federal* tax law treatment of these payments. If they meet the four tests found in IRC §71, they will be treated as alimony for tax purposes (assuming neither the front-end rules nor disguised child support provisions get in the way).

But, as will become clear, while what the payments are called under state law isn't, on its own, determinative of whether the payments are federal tax alimony, it may impact the rights and obligations under the agreement under state law, and those determinations could impact the four tests, especially the liability to make payments after the death of the recipient spouse.

The document contained other provisions that will be important in this case, mainly from the perspective of how the state in question (Minnesota here) will decide what are the rights and obligations under the agreement:

> The MTA also contained additional provisions relevant to this appeal in Parts V and VI:
>
> > Paragraph 15.b. provided that Elizabeth "is not employed outside the home . . . [and she] has adequate income and financial resources from the property settlement to meet her needs and the needs of the minor child when she is in her care."
> >
> > Paragraph 17 provided that each party "is capable of self support and . . . waives any right to receive temporary and/or permanent spousal maintenance . . . now or in the future. . . . The consideration for said waivers is the property division as herein described, the award of income-producing assets, and both party's ability to provide adequate self support after considering the standard of living established during the marriage. . . . [T]he parties intend to divest the Court of jurisdiction to award spousal maintenance to either party now or in the future."

[10] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

> Paragraph 35 provided: "The parties have entered into the division of property . . . intending it to be an equitable division of marital property, which they believe to be co-owned by virtue of the actual contributions of each party to the acquisition of the whole and by virtue of the co-ownership property interest granted to spouses by law. Both parties accordingly agree not to take any position . . . which is inconsistent with the concept of an equitable division of jointly owned property with regard to any filing, audit, or report required by any state or federal taxing authority."
>
> Part VI listed terms that "shall be incorporated into the Judgment and Decree," including in addition to the above-quoted Property Settlement:
>
>> 11. Spousal Maintenance. . . .
>>
>>> B. [Andrew] shall pay no temporary or permanent spousal maintenance to [Elizabeth], [Elizabeth] having absolutely waived any right to have [Andrew] pay temporary or permanent spousal maintenance now or in the future.
>>>
>>> C. The Court is divested of, and shall have no jurisdiction, over spousal maintenance, therefore prohibiting the Court from modifying the [parties'] agreement at a later [date], as this right was waived pursuant to Minn. Stat. § 518.552, Subd. 5, and Karon v. Karon, 435 N.W.2d 501 (1989).
>>
>> 20. Business Interests. [Andrew] is awarded all right, title, interest and equity in and to Whitebox . . . [Elizabeth] waives all right, title and interest she may have in [Andrew's] business interests, including Whitebox. . . .

Appeals Court Panel's Analysis and Decision

The panel starts its analysis by questioning why this case exists rather than having been dealt with when the divorce was entered into:

> Rather surprisingly, given the overall sophistication of the document and the substantial state court litigation between the parties that followed, the MTA contained no provision clarifying (designating) that the payments in question were not includable in Elizabeth's gross

> income and allowable as a deduction to Andrew, § 71(b)(1)(B)4; and no provision unambiguously stating that Andrew had no liability to make payments for a period after Elizabeth's death, § 71(b)(1)(D).[11]

This is not the first time this author has seen this sentiment stated in court opinions on these cases over the years, though I suspect that adding this issue to a divorce that already had "substantial state court litigation between the parties" would have likely caused even more litigation. As well, it is possible that one or both parties believed that once the analysis moves to rights under state law they will get the result they prefer without needing to drag out the process of finalizing the divorce. In fact, one of the two parties would be correct in that belief.

In any event, the parties did not take up Congress's offer to have this solved in their agreement for whatever reason, so the panel now turned to applying Minnesota state law to what was in the agreement. As the Court noted:

> In general, "the property interests of divorcing parties are determined by state law [but] federal law governs the federal income tax treatment of that property." *Id*. at 844 (quotation omitted). Thus, the court in *Hoover* paid close attention to the role to be played by state law in applying § 71(b)(1)(D). The Tax Court has summarized the test adopted in Hoover and followed by other courts:
>
>> To determine whether a payor has liability to continue payments after the payee's death, we apply the following sequential approach: (1) the Court first looks for an unambiguous termination provision in the applicable divorce instrument; (2) if there is no unambiguous termination provision, then the Court looks to whether payments would terminate at the payee's death by operation of State law; and (3) if State law is ambiguous as to the termination of payments upon the death of the payee, the Court will look solely to the divorce instrument to determine whether the payments would terminate at the payee's death."
>
> *Logue v. Comm'r*, 114 T.C.M. (CCH) 599 (2017), citing Hoover, 102 F.3d at 847-48.

The panel notes that all parties agree that the agreement is ambiguous on the key issues, so the question moves to state law:

> The Tax Court concluded, and the parties agree, that the MTA "does not plainly state" whether the payments at issue would have survived

[11] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

> Elizabeth's death. Therefore, applying the sequential analysis adopted in *Hoover*, we turn to Minnesota state law.[12]

Andrew (the payor) argues that these payments qualify as maintenance under Minnesota state law and, under that state law, the payments would terminate at Elizabeth's (the recipient) death:

> Under Minnesota's Marriage Dissolution law, "'Maintenance' means an award made in a dissolution . . . proceeding of payments from the future income or earnings of one spouse for the support and maintenance of the other." Minn. Stat. § 518.003, Subd. 3a. The statute further provides that, "[u]nless otherwise agreed in writing or expressly provided in the degree, the obligation to pay future maintenance is terminated upon the death of either party. . . ." Minn. Stat. § 518A.39, Subd. 3.[13]

Andrew argued that the payment should qualify for the following reasons:

> In a Minnesota dissolution proceeding, the Hennepin Country District Court could grant a maintenance order if Elizabeth:
>
> > (a) lacks sufficient property, including marital property apportioned to the spouse, to provide for reasonable needs of the spouse considering the standard of living established during the marriage . . . or
> >
> > (b) is unable to provide adequate self-support, after considering the standard of living established during the marriage and all relevant circumstances. . . .
>
> Minn. Stat. § 518.552, Subd. 1. Conceding as he must that Elizabeth could not satisfy condition (a), Andrew argues that she satisfied condition (b) because "tens of millions of dollars" were needed to self-support her extravagant international lifestyle, established during the marriage and further enhanced in the years after their divorce.[14]

But the panel agrees with the Tax Court that the payment stream does not qualify as maintenance under Minnesota law:

> This argument simply ignores controlling Supreme Court of Minnesota precedent. In *Lyon v. Lyon*, 439 N.W.2d 18, 22 (Minn.

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[12] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

[13] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

[14] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

1989), decided well before Andrew and Elizabeth entered into the MTA, the Court held:

> Because maintenance is awarded to meet need, maintenance depends on a showing of need. [Citation omitted.] This dependence on need is implicit in the second threshold requirement dealing with unemployability of the spouse seeking maintenance. Indeed, what is implicit becomes explicit when the statute goes on to state that, in awarding maintenance, the factors to be considered include 'the financial resources of the party seeking maintenance including marital property apportioned to the party, and the party's ability to meet needs independently' [citing § 518.552, Subd. 2(a)].
>
> . . . . Here . . . there has been an equal division of a substantial marital estate amassed over 32 years which enables the wife to continue her established high standard of living.
>
> We hold, therefore, that the award of spousal maintenance must be reversed.

More recently, the Court has reaffirmed that, "[o]nce a spouse has made a sufficient showing of need, only then will a court consider the amount and duration of a maintenance award. . . ." *Curtis v. Curtis*, 887 N.W.2d 249, 252 (Minn. 2016) (emphasis added).

We therefore conclude that Minnesota law unambiguously establishes that the MTA was not a spousal maintenance agreement. Rather, it was a contractual division of marital property. Contractual obligations under a divorce agreement fall under the general rule that causes of action survive their personal representatives. Minn. Stat. § 573.01. That being so, Minnesota law unambiguously provides that the payments in question were not deductible because Andrew's liability to make the payments would survive Elizabeth's death. This is consistent with the stated purpose of § 71(b)(1)(D) "to prevent the deduction of amounts which are in effect transfers of property *unrelated to the support needs of the recipient*" *(emphasis added)*.[15]

[15] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

And, frankly, the taxpayer had attempted to get his payments reduced which lead to a Minnesota court not finding a claim that the payments were maintenance credible given the language in the divorce settlement:

> Approximately eight months after the Hennepin County District Court approved the MTA and entered the divorce decree, Andrew advised Elizabeth that the 2008 financial crisis negatively impacted Whitebox and he could not continue to make the $1.5 million monthly payments. Elizabeth declined to reopen the MTA. Andrew stopped making payments in January 2009 and moved to "reopen[ ] the property division" in the decree on the ground that it was no longer equitable. See Minn. Stat. § 518.145, Subd. 2(5).The District Court denied the motion because Andrew failed to present an unforeseen development, only that his "prediction about the market proved inaccurate." *Redleaf v. Redleaf*, No. 27 FA 07 3480 (D. Ct. 2009), citing *Thompson v. Thompson*, 739 N.W.2d 424, 430-31 (Minn. Ct. App. 2007). One year later, the District Court for the same reason denied Andrew's renewed motion to amend the decree, observing, "This Court is at a loss . . . as to how one can construe the 'property settlement' to be 'spousal maintenance' given the clear language in paragraph seventeen (17) of the [MTA] and paragraph nineteen (19) [of the decree]." *Redleaf v. Redleaf*, No. 27 FA 07 3480, Order at 4 (D. Ct. June 22, 2010). The Minnesota Court of Appeals affirmed. Nos. A09-1805, A09-2360, A10-10, 2010 WL 3543458 (Minn. Ct. App. Sept. 14, 2010). The Court of Appeals observed that:
>
> > [Elizabeth] was entitled to one-half of the value of Whitebox. But in lieu of establishing that value based on an appraisal of the business, she agreed to [Andrew's] proposed cash settlement without any reference to Whitebox. Id. at *4.[16]

Ultimately, the panel agreed with the Tax Court's conclusion that the payments were *not* alimony as there would be a liability to continue to make the payments even if Elizabeth died before all payments were made.

[16] *Redleaf v. Commissioner*, CA6, Cases No. 21-2209 and No. 21-2224, August 5, 2022

FINAL REGULATIONS ISSUED REMOVING REQUIREMENT FOR SIGNING AN ELECTION UNDER §754

TD 9963, 8/4/22

The IRS issued final regulations[17] that adopt proposed regulations originally issued in October 2017[18] without making any changes eliminating the requirement that the election under IRC §754 included with a partnership income tax return be signed by a partner of the partnership.

An election under IRC §754, once made, requires that the basis of partnership property be adjusted:

- For distributions, as provided in IRC §734 and
- For transfers of a partnership interest, as provided in IRC §743.

This election cannot be revoked except as provided for in regulations issued by the IRS.[19]

Prior Regulations

Before this change, Reg §1.754-1(b)(1) provided, in its fourth sentence, the following requirements for the content and form of the election under IRC §754:

> The statement required by this subparagraph shall (i) set forth the name and address of the partnership making the election, *(ii) be signed by any one of the partners, (emphasis added)* and (iii) contain a declaration that the partnership elects under section 754 to apply the provisions of section 734(b) and section 743(b).[20]

The signature requirement generally meant that the partnership needed to scan a copy of the election signed by a partner as a PDF to attach to an electronically filed partnership tax return.

[17] TD 9963, August 5, 2022 *Federal Register* publication date, announced August 4, 2022, https://public-inspection.federalregister.gov/2022-16271.pdf (retrieved August 4, 2022)

[18] REG-116256-17, 82 FR 47408, October 12, 2017

[19] IRC §754

[20] Reg. §1.754-1(b)(1) before being revised by TD 9963

Revised Regulations

The only change found in the new regulations is to replace the fourth sentence of Reg. §1.754-1(b)(1) with the following:

> The statement required by this paragraph (b)(1) must set forth the name and address of the partnership making the election and contain a declaration that the partnership elects under section 754 to apply the provisions of section 734(b) and section 743(b).[21]

The clause that required the partners' signature has been removed from this version.

Effective Date

The new fourth sentence will apply to taxable years ending on or after August 5, 2022. However, taxpayers may apply the fourth sentence (that is, not having to have a partner sign the election to the return) for taxable years ending before that date, duplicating what had been temporary relief granted when the proposed regulations were issued back in 2017.

[21] Reg. §1.754-1(b)(1) after being revised by TD 9963