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# I.R.C. Section 71: Breaking Up is Hard to Do

*John A. Lynch, Jr.\**

If it is true that an unhappy marriage is a zero sum game, it is no less true that the financial arrangements incident to the marriage's dissolution perpetuate that game. And when a marriage made in heaven plummets to earth, the postlapsarian ceremonies are presided over by that most fallen of angels, the Commissioner of Internal Revenue.<sup>1</sup>

## I. INTRODUCTION

It is difficult to imagine provisions of the Internal Revenue Code which demand simplicity in statement and application more than those which control the tax treatment of payments incident to separation and divorce: I.R.C. section 71, and its companion provision, I.R.C. section 215.<sup>2</sup> Such payments, whether pursuant

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1. *Stock v. Commissioner*, 551 F.2d 614, 615 (5th Cir. 1977).

2. I.R.C. § 71 (1976) determines whether payments are income to the recipient:

Alimony and separate maintenance payments

(a) General Rule

(1) Decree of divorce or separate maintenance

If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

(2) Written separation agreement

If a wife is separated from her husband and there is a written separation agreement executed after the date of the enactment of this title, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such agreement is executed which are made under such agreement and because of the marital or family relationship (or which are attributable to property transferred, in trust or otherwise, under such agreement and because of such relationship). This

to judicial decree or settlement agreement, are often arranged in

paragraph shall not apply if the husband and wife make a single return jointly.

(3) Decree for support

If a wife is separated from her husband, the wife's gross income includes periodic payments (whether or not made at regular intervals) received by her after the date of the enactment of this title from her husband under a decree entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance. This paragraph shall not apply if the husband and wife make a single return jointly.

(b) Payments made to support minor children

Subsection (a) shall not apply to that part of any payment which the terms of the decree, instrument, or agreement fix, in terms of an amount of money or a part of the payment, as a sum which is payable for the support of minor children of the husband. For purposes of the preceding sentence, if any payment is less than the amount specified in the decree, instrument, or agreement, then so much of such payment as does not exceed the sum payable for support shall be considered a payment for such support.

(c) Principal sum paid in installments

(1) General rule

For purposes of subsection (a), installment payments discharging a part of an obligation the principal sum of which is, either in terms of money or property, specified in the decree, instrument, or agreement shall not be treated as periodic payments.

(2) Where period for payment is more than 10 years

If, by the terms of the decree, instrument, or agreement, the principal sum referred to in paragraph (1) is to be paid or may be paid over a period ending more than 10 years from the date of such decree, instrument, or agreement, then (notwithstanding paragraph (1)) the installment payments shall be treated as periodic payments for purposes of subsection (a), but (in the case of any one taxable year of the wife) only to the extent of 10 percent of the principal sum. For purposes of the preceding sentence, the part of any principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be treated as an installment payment for the taxable year in which it is received.

(d) Rule for husband in case of transferred property

The husband's gross income does not include amounts received which, under subsection (a), are (1) includible in the gross income of the wife, and (2) attributable to transferred property.

*Id.*

I.R.C. § 215 (1976) makes payments deductible by the paying spouse if they are income to the recipient:

Alimony, etc., payments

(a) General rule

In the case of a husband described in section 71, there shall be allowed as a deduction amounts includible under section 71 in the gross income of his wife, payment of which is made within the husband's taxable year. No deduction shall be allowed under the preceding sentence with respect to any payment if, by reason of section 71(d) or 682, the amount thereof is not includible in the husband's gross income.

*Id.*

an atmosphere of strident adversariness and can have longstanding tax and other consequences.

Unfortunately, the body of tax law concerning divorce-related payments is not simple or predictable for the average taxpayer, and undoubtedly, in many cases, the processes of divorce and separation are the participants' first personal experience with litigation or legal negotiations. While a casual review of the classified advertising pages of many newspapers demonstrates an increasing availability of moderately priced legal assistance in domestic relations matters, at least two decisions indulgently indicate that, in some respects, the law is too complicated for lawyers.<sup>3</sup> This article examines the structure of the tax law with respect to divorce-related payments and considers the rationality of its development in light of Congress's intent in three specific areas: (1) the definition of an obligation of support; (2) the differentiation between a support obligation and a property interest; and (3) the periodic payment requirement. Finally some suggestions are made to simplify the code with respect to such payments.

## II. THE DEVELOPMENT OF THE TAX LAW WITH RESPECT TO DIVORCE-RELATED PAYMENTS

Section 71 originated with earnest congressional good intentions. Before 1942, alimony or separate maintenance payments paid by a taxpayer to his spouse or former spouse were not deductible by the payor or income to the recipient.<sup>4</sup> The cash flow problems caused by not permitting spouses paying alimony to deduct such payments were exacerbated by the substantial increases in federal taxes necessary to finance World War II.<sup>5</sup> As

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3. See *Karageorgevitch v. Commissioner*, 38 T.C.M. (CCH) 1003, 1006 (1979) (attorney's characterization in a divorce decree of payments held not binding because attorney was not a tax specialist); *Tracy v. Commissioner*, 70 T.C. 397, 398 (1978) (an attorney unfamiliar with tax law handles his own divorce). In these cases, the Tax Court took pains to note that attorneys involved were not tax attorneys.

In *Warnack v. Commissioner*, 71 T.C. 541, 551 n.7 (1979), the court hinted that the law under I.R.C. § 71 is not now clear enough to make tax planning by the parties feasible.

4. *Gould v. Gould*, 245 U.S. 151 (1917).

5. Sections 102 and 103 of the Revenue Act of 1942 substantially increased the rates of the normal tax and surtax on personal incomes, respectively, and section 172 imposed an additional victory tax. Ch. 619, 56 Stat. 802, 884 (1942).

Representative Disney, a House sponsor of the Revenue Act of 1942, remarked in floor debates:

The present law does not permit the husband any deduction on account of alimony or separate maintenance payments to the wife and does not treat such payments as income to the wife. With the increased rates applicable to individuals, many husbands compelled to make large alimony payments will not have enough income left to pay their income tax.

The amount of a husband's income which goes to the wife as alimony under a court order is in reality not income to him at all since he has no control over it as to the use to which it is put.<sup>6</sup>

This concern led to the enactment of section 120 of the Revenue Act of 1942<sup>7</sup> which added sections 22(k) and 23(u) to the Internal Revenue Code of 1939. These sections were subsequently renumbered as sections 71 and 215 respectively, in the 1954 Code.<sup>8</sup>

I.R.C. section 71(a) provides that periodic payments received by a wife<sup>9</sup> who is divorced or legally separated from her husband, whether under a decree or agreement, are included in the wife's gross income if such payments are in discharge of a legal

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6. 88 CONG. REC. 6575 (1942).

7. See *supra* note 5.

8. Internal Revenue Code of 1939 §§ 22(k) and 23(u), ch. 619, § 120, 56 Stat. 816, were renumbered I.R.C. sections 71 and 215 respectively in the 1954 Code. Section 22(k) of the 1939 Code is essentially the same as section 71(a)(1), (b), (c), and (d) of the 1954 Code. See *supra* note 2. Section 23(u) of the 1939 Code is essentially the same as section 215 of the 1954 Code. Section 71(a)(2) and (3) were added in the 1954 codification, 68A Stat. 19, to apply I.R.C. section 71 to payments made under a written separation agreement or under any type of decree, whether or not they are called separate maintenance payments. STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 83D CONG., 2D SESS., SUMMARY OF THE NEW PROVISIONS OF THE INTERNAL REVENUE CODE OF 1954, at 7 (Comm. Print 1955).

9. By virtue of I.R.C. § 7701(a)(17), when payments are made by or on behalf of the wife, the term "husband" in the statute is read "wife" and the term "wife" is read "husband." Even in 1942, Rep. Disney was concerned about public reaction to the use of gender in the statute:

So I know the press will have a lot of fun over a rather ridiculous looking paragraph in the bill, but it cannot be done in any other way, so that we will have to take our medicine for having willfully drafted an amendment that looks ridiculous. If there was any other way of doing it, of course, out of deference to the ladies, we would not have drafted the bill in this way, because it is a fact that wives do sometimes settle money on their husbands.

88 CONG. REC. 6575 (1942).

obligation imposed upon or incurred by the husband because of the marital or family relationship.<sup>10</sup> The meaning of "periodic payments" is not clearly set forth by the statute, and while there is case law support for defining "periodic" as indefinite in duration and amount,<sup>11</sup> the term has taken on other connotations.<sup>12</sup>

Under I.R.C. section 215 a paying spouse may deduct, in the year in which they are paid, amounts includible in the gross income of the recipient.<sup>13</sup> Thus, a shifting of income is permitted in the situations specified in section 71 based on the recognition that the paying spouse lacks control over amounts paid to the recipient.

I.R.C. section 71(c) is generally concerned with payments representing installments on a principal sum. The terms "installments" and "principal sum" are not defined in the statute or in the committee reports.<sup>14</sup> Under I.R.C. section 71(c)(1), installment payments are not periodic and therefore are neither gross income to the recipient nor deductible by the payor. Under I.R.C. section 71(c)(2), however, if the principal sum is to be paid over a period that exceeds ten years, installment payments are deemed periodic and, hence, income to the recipient and deductible by the payor. Deductibility is limited to ten percent of the principal sum in any one year.

The Treasury Department has promulgated a regulation contradicting this apparent meaning of the statute.<sup>15</sup> Under the regulations, if payments are to be made over a specified period of ten years or less and may be terminated on the occurrence of certain contingencies, such as the death of either spouse or remarriage of the recipient, or the payments may be modified upon a change in the economic circumstances of the parties, the payments are deductible by the payor. The contingencies need

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10. I.R.C. § 71(a). *See supra* note 2.

11. *See, e.g.,* Warnack v. Commissioner, 71 T.C. 541, 554 (1979).

12. In neither the House nor the Senate Reports accompanying the Revenue Act of 1942 was the term "periodic" defined. *See* H.R. REP. NO. 2333, 77th Cong., 2d Sess. 72-74 (1942); S. REP. NO. 1683, 77th Cong., 2d Sess. 83-87 (1942).

13. I.R.C. § 215. *See supra* note 2.

14. Both the House and Senate Reports accompanying the Revenue Act of 1942 generally regarded such installments as not periodic. *See* H.R. REP. NO. 2333, *supra* note 12; S. REP. NO. 1683, *supra* note 12.

15. Treas. Reg. § 1.71-1 (d)(3) (1960).

not be specified in the agreement or decree; if they are imposed by local law, they may transform what appear to be payments that are not covered by section 71 into periodic payments.<sup>16</sup> Whether this amplification of the statute is consistent with Congress's intent, or is sensible, is examined below.

Divorce-related payments, in order to fall within I.R.C. section 71, must not only be periodic, but must also be made "in discharge of a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation."<sup>17</sup> In other words, payments representing compensation for a property interest of the recipient are not deductible by the payor or income to the recipient.<sup>18</sup> The regulations promulgated pursuant to section 71 provide further explanation of what constitutes payments pursuant to a legal obligation of support. Such payments must be "in the nature of or in lieu of alimony or an allowance for support."<sup>19</sup> Congress used the description of a support obligation in section 71 in order to

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16. Treas. Reg. § 1.71-1 (d)(3)(ii)(a) (1960).

17. I.R.C. § 71(a)(1).

18. This is clear in both the House and Senate Reports, H.R. REP. NO. 2333, *supra* note 12, at 72; S. REP. NO. 1683, *supra* note 12, at 84.

19. Treas. Reg. § 1.71-1(a) (1960). Section 1.71-1(b)(4) of the regulations provides guidance as to what constitutes a property interest rather than support: *Scope of section 71(a)*. Section 71(a) applies only to payments made because of the family or marital relationship in recognition of the general obligation to support which is made specific by the decree, instrument or agreement. Thus, section 71(a) does not apply to that part of any periodic payment which is attributable to the repayment by the husband of, for example, a bona fide loan previously made to him by the wife, the satisfaction of which is specified in the decree, instrument, or agreement as a part of the general settlement between the husband and wife.

Treas. Reg. § 1.71-1(b)(4) (1957).

Section 1.71-1(c)(4) is also instructive:

Section 71(a)(1) or (2) does not apply to that part of any periodic payment attributable to that portion of any interest in property transferred in discharge of the husband's obligation under the decree or instrument incident to the divorce status or legal separation status, or transferred pursuant to the written separation agreement, which interest originally belonged to the wife. It will apply, however, if she received such interest from her husband in contemplation of or as an incident to the divorce or separation without adequate and full consideration in money or money's worth, other than the release of the husband or his property from marital obligations.

Treas. Reg. § 1.71-1(c)(4) (1957).

provide uniform treatment for payments in the nature of alimony regardless of the variance in state law with respect to alimony.<sup>20</sup> Whether this language has been construed to achieve this objective is examined below.

It is apparent that a citizen of average intelligence would not be able to look at section 71 and determine much about the tax consequences of divorce.<sup>21</sup> If the average citizen might have trouble navigating the terminology of section 71, the courts have not had much success applying it in a manner that fosters predictability and planning. The remainder of this article considers the tortuous development of the case law under section 71 in three very difficult areas.

### III. THE DEFINITION OF AN OBLIGATION OF SUPPORT

It is clear that the major congressional objective with respect to enactment of the predecessor of section 71 was to tax payments that represented a diversion of disposable income to the recipient of such payments regardless of variations in local law.<sup>22</sup>

Immediately prior to enactment of the Revenue Act of 1942, the sole tax benefit available in the domestic relations area was the ability of divorced taxpayers in some jurisdictions to set up a

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20. H.R. REP. NO. 2333, *supra* note 12, at 72.

21. Perhaps the parties to most divorces need not worry much about distinguishing deductible support payments from nondeductible payments representing a property settlement. As one judge stated: "In the vast majority of cases the trial judge has the problem of dividing the meager loaves and fishes without the aid of a miracle." *Comer v. Comer*, 110 N.H. 505, 507, 272 A.2d 586, 587 (1970). Certainly, however, the law of taxation in the area of domestic relations should be simple enough for unsophisticated taxpayers to understand.

22. As Randolph Paul, Tax Advisor to the Secretary of the Treasury, testified:

Generally speaking, alimony payments are not subject to tax in the hands of a divorced wife. Even where irrevocable trusts have been established, and the husband has no further interest in the trust property, the income of the alimony trust is nevertheless taxable to him because it is used to pay an alimony obligation. Rising tax rates have in some cases absorbed the entire income of the husband required to pay the tax on his income and that of his divorced wife. At the same time, divorced wives receiving tax-free alimony possess a privileged status under our tax laws which relieves them of any share of the tax burden.

*Revenue Revision of 1942: Hearings Before the House Committee on Ways and Means*, 77th Cong. 2d Sess. 92 (Part I 1942) (statement of Randolph Paul, Tax Advisor to the Secretary of the Treasury).



trust, the income of which was payable to the grantor's former spouse, and have the income taxed to the recipient. The income, used to support the former spouse, was taxed to the former spouse as long as under state law no legal obligation of support survived the divorce decree.<sup>23</sup> This was an exception to the rule in *Douglas v. Willcuts*,<sup>24</sup> that income used to pay a support obligation of a divorced grantor was taxable to the grantor. Thus, in jurisdictions where a legal obligation of support survived the divorce decree, the trust income paid to the grantor's former spouse was attributed to the grantor.<sup>25</sup>

The Senate Finance Committee recognized the unfairness not only of taxing a payor on income used to support his divorced spouse but also of the variations entailed in determining the incidence of taxation on the basis of state law. In 1941, the Committee proposed a provision, as part of the Revenue Act of 1941,<sup>26</sup> which was substantially the same as the predecessor to I.R.C. section 71 enacted in the Revenue Act of 1942.<sup>27</sup> The reports accompanying the 1941 and the enacted 1942 proposals indicate that Congress intended to eliminate the reference to state law to determine the existence of a support obligation.<sup>28</sup> The clear dichotomy drawn by Congress in the predecessor to

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23. See *Helvering v. Fuller*, 310 U.S. 69 (1940).

24. 296 U.S. 1, 9 (1935).

25. See *Helvering v. Leonard*, 310 U.S. 80 (1940); *Helvering v. Fitch*, 309 U.S. 149 (1940). See also, Gornick, *Taxation of Alimony Trusts: A Need for Congressional Reform*, 20 TAXES 529 (1942).

26. 55 Stat. 687 (1941).

27. This provision was deferred by agreement of the House and Senate committees for later consideration. See H.R. REP. NO. 1203, 77th Cong., 1st Sess. 11 (Conference Report). See also *supra* note 8.

28. See H.R. REP. NO. 2333, *supra* note 12, at 72; S. REP. NO. 1683, *supra* note 12, at 83. See also S. REP. NO. 673, 77th Cong., 1st Sess. 32 (1941):

[T]he amended sections will produce uniformity in the treatment of amounts paid in the nature of or in lieu of alimony regardless of the variance in the laws of different States concerning the existence and continuance of any obligation to pay alimony. In this respect the amendments are designed to remove the uncertainty as to the tax consequences of payments made to a divorced spouse out of the net income of so-called irrevocable alimony trusts, arising from the recent Supreme Court decisions in *Helvering v. Fitch*, ((1940) 309 U.S. 149), *Helvering v. Fuller* ((1940) 310 U.S. 69), and *Helvering v. Leonard*, ((1940) 310 U.S. 80), which decisions made the test of whether such income is taxable to the husband the existence of a continuing legal obligation under State law.

*Id.*

section 71 was between payments representing a support obligation of the payor and those representing a property interest of the recipient. This intent has been recognized by the Tax Court:

A review of the cases in the "support" area reveals that the courts have not focused merely on whether the payments are for "support"—rather the approach has been to determine whether the payments are for support in contradistinction to being in exchange for the wife's release of some property interest. The question of whether a payment is in recognition of the husband's obligation of support (and is, therefore, made because of the marital or family relationship) is meaningful only if it is considered in connection with the question of whether the payments are in recognition of and for the extinguishment of some property interest of the wife. If the payments are of the former sort, they are probably periodic and hence section 71 income to the wife.<sup>29</sup>

#### A. *Payments After Divorce*

Whether payments represent a support obligation or a property interest can be a difficult inquiry.<sup>30</sup> Unfortunately, recent Tax Court decisions have further clouded section 71 by creating a class of payments which, though not attributable to any demonstrable property interest of the recipient, are not deductible because they are not attributable to an obligation of support arising out of the marital or family relationship. The Tax Court has created this class of payments by examining whether, under state law, an obligation of support survives the divorce. This flies in the face not only of the congressional intent that payments constituting or resembling alimony be treated uniformly, but also of several earlier decisions of the Tax Court<sup>31</sup> and a well-reasoned opinion of the Court of Appeals for the Fifth Circuit in *Taylor v. Campbell*,<sup>32</sup> the leading case involving tax treatment of support payments after an absolute divorce in states that do not permit an order of permanent alimony following an absolute divorce.

In *Taylor*, the taxpayer husband appealed from an adverse

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29. *Warnack v. Commissioner*, 71 T.C. 541, 550-51 (1979). See also *Salapatas v. Commissioner*, 446 F.2d 79, 82 (7th Cir. 1971); *Taylor v. Campbell*, 335 F.2d 841, 845 (5th Cir. 1964); *Bardwell v. Commissioner*, 318 F.2d 786, 789 (10th Cir. 1963).

30. See *infra* Part III of the text.

31. See *infra* notes 41 & 43 and accompanying text.

judgment in a suit for a tax refund. The refund suit was based on the Commissioner's denial of deductions for payments to the taxpayer's former wife under a property settlement incorporated in their 1950 divorce decree.<sup>33</sup> Under this settlement, which also divided personal property, the wife was to receive irrevocable payments of \$200 per month until 1954 and thereafter \$200 per month until she died or remarried.<sup>34</sup> The court noted that there was nothing in the record to indicate that the former wife had any interest in property beyond that for which she was compensated in the division of the personal property.<sup>35</sup> Finding that, one might reasonably assume, therefore, that the monthly payments represented fulfillment of a support obligation arising out of the marital relationship. The Commissioner contended, however, that because there was no obligation to pay permanent alimony in Texas,<sup>36</sup> and because the Texas courts would consider these payments to be permanent alimony, they would not be in discharge of a legal obligation of support.<sup>37</sup> In essence, the Commissioner contended that any obligation of support must spring from state law in order for payments pursuant to it to be deductible by the paying spouse.

Referring to the legislative history of sections 71 and 215,<sup>38</sup> the court of appeals rejected the Commissioner's limited view of the support obligations under section 71. The question, according to the court, was not whether the obligation arose under state law, but whether the payments were in lieu of or in the nature of alimony:

This is not a case in which a spouse is seeking to deduct voluntary gratuitous payments. The payments here were hammered out by attorneys representing the husband and wife as an indispensable preliminary to the divorce proceedings. The vagaries

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32. 335 F.2d 841 (5th Cir. 1964).

33. Parties to a divorce in Texas seeking section 71 treatment must use property settlement terminology because alimony is against the public policy of Texas. *McBride v. McBride*, 256 S.W.2d 250 (Tex. Civ. App. 1953).

34. 335 F.2d at 844.

35. *Id.* at 845.

36. *Id.* (citing *Lodge v. Lodge*, 368 S.W.2d 40 (Tex. Civ. App. 1963)).

37. 335 F.2d at 845. Actually, Texas courts are sympathetic with its citizens who make their property settlements resemble alimony in order to qualify payments under section 71. See *Nordstrom v. Nordstrom*, 515 S.W.2d 14 (Tex. Civ. App. 1974).

38. See *supra* note 12.

of Texas marital law cannot operate to defeat the obvious intent of the statute that it be uniformly applied.<sup>39</sup>

The court thus reversed the district court judgment for the Commissioner.<sup>40</sup>

The interpretation of an obligation of support relied upon in *Taylor* was established by the Tax Court in *Commissioner v. Hesse*.<sup>41</sup> *Hesse*, which arose under section 22(k) of the 1939 code, involved a taxpayer who sought to exclude from her income support payments received from her former husband. She contended that the payments were not income because the law of Pennsylvania, where the divorce decree was granted, did not permit the ordering of alimony for a spouse who received an absolute divorce. Referring to the legislative history, the court determined that Congress intended that there be uniform treatment of payments in the nature of alimony regardless of differences in state law. With that established, the court held:

The payments in question here were in the nature of alimony, and they were in lieu of alimony. Petitioner desired at all times to receive support from her husband, and the record shows clearly that the respective agreements of petitioner and [her husband] (on her part to get an absolute divorce; and, on his part, to execute an agreement to provide for her support until she might remarry, with security of various kinds to secure payment to her) were made in connection with a contemplated divorce, and were made to take care of the lack of any provision under the law which would require the payment of alimony to the petitioner if she sued for and obtained an absolute divorce.<sup>42</sup>

The quoted language is particularly interesting in that it acknowledges that the parties created a right to payments in the wife *in spite of* state law. What is most significant, however, is

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39. 335 F.2d at 846 (footnote omitted). The court distinguished a case where a paying spouse was denied a deduction for paying an amount more than was specified originally in the divorce decree, although the taxpayer later obtained a decree in state court increasing the payments of the original decree *nunc pro tunc* to the amount he had actually paid. *Id.* at 846 n.20. See *Van Vlaanderen v. Commissioner*, 175 F.2d 389 (3d Cir. 1949). The court relied upon *Daine v. Commissioner*, 168 F.2d 449 (2d Cir. 1948), to refuse to give effect for tax purposes to the belated state sanction of the payments. 175 F.2d at 390. This is consistent with the refusal in *Taylor* to require state sanction when the agreement is made.

40. 335 F.2d at 846.

41. 7 T.C. 700 (1946).

42. *Id.* at 704.

that payments which, on the basis of the evidence are clearly intended as support, are treated as such for tax purposes regardless of state law. This was reaffirmed on several occasions by the Tax Court.<sup>43</sup>

Unfortunately for tax planning and predictability, there has been some movement away from the uniformity, embraced by *Taylor* and *Hesse*, for defining support obligations. There are several relatively recent reported and memorandum Tax Court decisions in which the court has examined support obligations incurred in separation agreements or divorce decrees in light of state law.

In *Knobler v. Commissioner*,<sup>44</sup> a divorced wife sought to exclude from her income support payments received from her former husband. The payments were made pursuant to an order of the Pennsylvania Quarter Sessions Court, empowered to enforce quasi-penal support laws,<sup>45</sup> following the issuance of a criminal information for nonsupport and desertion obtained by the wife in 1964.<sup>46</sup> In 1966, the husband obtained an absolute divorce, which the Tax Court noted is not usually accompanied by an award of alimony.<sup>47</sup> The husband continued to make support payments by agreement through 1967, the tax year at issue. Although the wife continued to accept the payments, which the court noted were covered by section 71(a)(3),<sup>48</sup> the court, without benefit of a brief on behalf of the taxpayer, determined that her filing of a petition in the Tax Court was tantamount to a contention that the husband did not make the payments pursuant to an obligation of support because such obligation was terminated by the absolute divorce in 1966.<sup>49</sup>

The Tax Court rejected the contention it deemed the taxpayer to have made. While conceding that the absolute divorce terminated the jurisdiction of the quarter sessions court,<sup>50</sup> the court

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43. See *Newbury v. Commissioner*, 46 T.C. 690 (1966); *Nathan v. Commissioner*, 19 T.C. 865 (1953); *Campbell v. Commissioner*, 15 T.C. 355 (1950); *Hogg v. Commissioner*, 13 T.C. 361 (1949).

44. 59 T.C. 261 (1972).

45. Act of March 31, 1860, ch. 427, § 32 Pa. Laws (repealed 1978).

46. 59 T.C. at 262.

47. *Id.* (citing *Commonwealth v. Petrosky*, 168 Pa. Super. 232, 77 A.2d 647 (1951)).

48. 59 T.C. at 263.

49. *Id.* at 264.

50. *Id.* at 262 (citing *Heilbron v. Heilbron*, 158 Pa. 297, 27 A. 967 (1893)).

noted that it was well-established that a husband, following an absolute divorce, must continue to observe the decree until he has it vacated by the quarter sessions court.<sup>51</sup> Because the husband did not seek post-divorce relief from the quarter sessions court, leaving the original decree in effect, the Tax Court held that the payments were for the support of the taxpayer.<sup>52</sup> Thus, it was not the alimony-like quality of the payments or the lack of relationship to any demonstrable property interest of the wife that led to characterization of the payments by the husband as arising under a support obligation. Rather, the payments were deemed to be support because the paying spouse had not taken procedural steps under state law to terminate the support obligation. Such voyages into state law seemingly had been rejected in cases such as *Taylor* and *Hesse*. Reaching a result that was appropriate in light of congressional intent as discerned in *Taylor*, the Tax Court in *Knobler* laid a foundation which could lead it and other courts far afield of Congress's intent with respect to uniform treatment of alimony-like payments.<sup>53</sup>

In *Wolman v. Commissioner*,<sup>54</sup> the Tax Court rejected an attempt by a payor to use *Knobler* to deduct payments that were clearly child support. In *Wolman*, the husband, while the parties were separated, was ordered by the Family Court of the State of New York to pay \$604 per month to his wife for her support and for the support of their daughter. He regularly made the payments from April 1968 until February 1969.<sup>55</sup>

On February 20, 1969 the husband was granted a divorce

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51. 59 T.C. at 263 (citing *Commonwealth v. Cieply*, 162 Pa. Super. 346, 57 A.2d 910 (1948)).

52. The court held that the original support decree was within the ambit of section 71, requiring the recipient to take payments thereunder into income, because of a congressional purpose "to embrace all support payments made pursuant to judicial sanction where the spouses are in fact living apart." 59 T.C. at 263.

53. In support of its assertion that the Internal Revenue Service (IRS) position was that payments received under support orders of states are deductible unless and until such orders are vacated or declared invalid, the court included in its citations Revenue Ruling 58-321, 1958-1 C.B. 35. This is surprising because that ruling stated that the IRS was not precluded from making its own analysis of payments under a divorce decree that the Florida Supreme Court had characterized as a property settlement.

54. 64 T.C. 883 (1975).

55. *Id.* at 884-85.

which did not provide for support for his former wife.<sup>56</sup> The decree itself did not provide for support payments for the minor child, but the husband continued to make payments to his wife throughout 1969 and 1970, the tax years involved, following the divorce. These payments were made on what approximated a monthly basis, but they were usually in an amount substantially less than the original family court support order.

The Tax Court in *Wolman* rejected the application of *Knobler* to the facts before it. While noting that the divorce decree superseded the prior support order,<sup>57</sup> the court also stressed that following the divorce decree, the husband "made no attempt to conform to the prior support order."<sup>58</sup> The court viewed the former wife's receipt of the payments as serving as a conduit for child support payments. What is significant about *Wolman* is the court's analysis of the substance of the payments to determine whether an obligation of support survived the divorce. Examination of the payments themselves revealed that they did not represent support to the wife. The court did not rely solely on the procedural intricacies of state law to determine whether the payments were pursuant to a support obligation.

The *Knobler* approach was followed by the Tax Court in *Schaer v. Commissioner*,<sup>59</sup> which involved an attempt by a recipient of payments to exclude from gross income eighty percent of payments received from her former husband after their absolute divorce. The parties, upon their separation in 1973, executed a written separation agreement under which the husband was to pay "\$600 per month for the support of [his wife] and their children . . ."<sup>60</sup> Contemporaneously, the Court of Common Pleas of Allegheny County, Pennsylvania entered an order com-

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56. The order included a recitation finding the [husband] from the obligation [of matrimony] except, and only except, those obligations owed by him to DANIELLE WOLMAN the infant child of the parties, and the obligation, if any, of the plaintiff to pay any of the defendant's counsel fees, with respect to which exceptions decision is reserved.

*Id.* at 885.

57. 64 T.C. at 888 (citing *Marshall v. Marshall*, 380 A.D. 814, 113 N.Y.S.2d 602 (1952), *aff'd*, 304 N.Y. 956, 110 N.E.2d 889 (1953) and *Sacknoff v. Sacknoff*, 203 Misc. 86, 115 N.Y.S.2d 414 (Sup. Ct. Bronx County 1952)).

58. 64 T.C. at 889.

59. 38 T.C.M. (CCH) 1191 (1979).

60. *Id.* at 1192.

elling the husband to pay the support into the court every month. In 1976, the same tribunal entered a divorce decree that did not refer to its earlier support order.<sup>61</sup> The taxpayer's former husband paid her in accordance with the 1973 order through 1976 and until it was modified by a court order of November 28, 1977.<sup>62</sup>

The Tax Court determined that the payments prior to the 1977 modification and after the grant of an absolute divorce in 1976 were income to the recipient although, under Pennsylvania law, the husband's duty to support his former wife was terminated by the absolute divorce. The court emphasized the importance of the husband's failure to have the agreement modified immediately after the divorce. As in *Knobler*, the husband's inertia in exercising a procedural right under Pennsylvania law, rather than the nature of the payments themselves, was seized upon by the court in determining whether such payments are pursuant to a legal obligation of support arising from the marital or family relationship.<sup>63</sup>

The analyses in *Knobler* and *Schaer* yielded results that essentially disregarded the state substantive law with respect to alimony. This is consistent with section 71. To reach such results, however, the Tax Court analyzed state *procedure*, an analysis that seems less than consistent with Congress's intention that there be uniform treatment of payments representing a support obligation.

The *Knobler* analysis was not the sole basis of the decision in *Schaer*. The court also rested its decision on section 71(a)(2) of the Code,<sup>64</sup> which provides that payments under a written separation agreement made because of a marital or family rela-

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61. *Id.*

62. *Id.* The modification reduced the original \$600 per month to \$400 and provided that these payments represented child support. *Id.*

63. The court was not impressed by the distinction that in *Knobler* the original support order and the divorce decree were entered by different courts, the quarter sessions and the court of common pleas, respectively. While the same court, the court of common pleas, entered both the support and divorce decrees in *Schaer*, the Tax Court determined the earlier support order would remain in effect, thus providing the legal obligation of support necessary for section 71, until the paying spouse specifically obtained its modification. *Id.* at 1193.

64. *See supra* note 2.



tionship are includable in the recipient's gross income. The court determined that because the former husband's obligation to make payments was contractual, it survived the divorce decree under Pennsylvania law.<sup>65</sup> In finding a support obligation in the taxpayer's former husband by determining the viability of the pre-divorce agreement under state law, the court relied upon a prior Tax Court decision in *Engelhardt v. Commissioner*.<sup>66</sup>

*Engelhardt*, like *Schaer*, involved an attempt by a recipient spouse to exclude payments from her gross income. The taxpayer and her husband, in 1961, entered into a separation agreement that provided for support payments. This agreement stated that it would survive any decree of divorce and would be independent thereof. Later in 1961, the taxpayer and her former husband obtained a Mexican divorce which provided that the earlier separation agreement survived the divorce. The separation agreement provided for a reduction rather than a termination of payments in the event of the recipient's remarriage.<sup>67</sup> In 1964, the taxpayer remarried and her former husband made reduced payments as provided in the separation agreement. In March, 1969, in an action instituted by the taxpayer's former husband, the Chancery Division of the New Jersey Superior Court held that payments after the wife's remarriage were "considered as child support and hence were neither income to the wife nor a deduction from income to the husband."<sup>68</sup> The taxpayer argued that payments she received in 1965, 1966, 1967, and 1968 were thus not pursuant to any legal obligation of support to *her* and were not includible in her income.

The court in *Engelhardt* decided against the taxpayer for two reasons: first, it refused to give effect to the *nunc pro tunc* recharacterization of the payments by the New Jersey court;<sup>69</sup> and second, it found that the support agreement fell within the

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65. 38 T.C.M. (CCH) at 1193 (citing *Commonwealth v. Jones*, 216 Pa. Super. 1, 260 A.2d 809 (1969)).

66. 58 T.C. 641 (1972).

67. *Id.* at 642-43.

68. *Id.* at 644. See I.R.C. § 71(b) (1976).

69. 58 T.C. at 649 (citing *Van Den Wymelenberg v. United States*, 397 F.2d 443 (7th Cir. 1968); *Turkoglu v. Commissioner*, 36 T.C. 552 (1961); *Segal v. Commissioner*, 36 T.C. 148 (1961), *Van Vlaanderen v. Commissioner*, 10 T.C. 706 (1947), *aff'd*, 175 F.2d 389 (3d Cir. 1949), *Daine v. Commissioner*, 9 T.C. 47 (1947), *aff'd*, 168 F.2d 449 (2d Cir. 1948)).

ambit of section 71(a)(2). The court's reliance on section 71(a)(2) would seem to require a rather tenuous interpretation of the statute and its legislative history.<sup>70</sup> Contrary to *Schaer* and *Engelhardt*, payments after divorce in jurisdictions that do not permit alimony after an absolute divorce need not be made pursuant to a pre-divorce separation agreement under section 71(a)(2) in order to be covered by section 71. If they are intended and used as support, they are covered by section 71 for divorced spouses regardless of whether there is any support obligation under state law. The 1954 revision<sup>71</sup> was intended to extend treatment under section 22(k) of the 1939 Code to payments under separation agreements, not to make payments made under an agreement more easily deductible than those made pursuant to a divorce decree. The answer as to whether divorce-related payments are covered by section 71 is not contained in the laws of the various states; it is contained in the Internal Revenue Code and its legislative history. If such payments do not represent a recipient's property interest then presumptively, if incident to a divorce, they represent an obligation of support.<sup>72</sup> To the extent that the Tax Court looks to state law in cases such as *Knobler*, *Schaer*, and even *Wolman* to determine the applicability of section 71, the court is looking in the wrong place.

### B. *Payments After Remarriage*

A second area where judicial decisions have become plagued with the niceties of state substantive and procedural law in determining the presence *vel non* of a legal obligation of support

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70. The statute itself does not purport to cover situations where the parties, after executing a separation agreement, have then obtained a divorce. It would seem that section 71(a)(1) would apply to that situation. The Senate Report, S. REP. NO. 1622, 83d Cong., 2d Sess. 171 (1954), quoted by the court, does not purport to apply that subsection to payments made after a divorce decree; neither does the House Report. See H.R. REP. NO. 1337, 83d Cong., 2d Sess. A20-21 (1954). Interestingly, both the House and Senate Reports indicate that payments are covered by the subsection whether or not they are enforceable in a court of law. This appears consistent with Congress's intent in enacting the predecessor of section 71(a)(1) in 1942.

71. Ch. 1, § 71(a)(2), 68A Stat. 19 (1954).

72. Assuming, of course, they do not represent child support, in which case they are not income to the recipient under I.R.C. § 71(b) or deductible by the payor under I.R.C. § 215.

involves continued payment of maintenance or support after a recipient has remarried. Rigid adherence to state law in such instances, that is, not permitting a deduction by a paying spouse when state law would terminate any obligation of support, often results in determinations that payments appearing to be support, and which are used for support, are not covered by section 71. The law of many states terminates alimony upon remarriage of the recipient.<sup>73</sup>

Initially, the decisions under section 71 and its predecessor involving alimony-like payments after remarriage did not look to state law to determine whether such payments were deductible by the payor or were income to the recipient.<sup>74</sup> Unfortunately,

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73. See *Estate of Kuhns v. Kuhns*, 550 P.2d 816 (Alaska 1976); *Martin v. Martin*, 267 N.C. App. 506, 216 S.E.2d 456 (1975); *Martin v. Martin*, 46 Wis. 2d 218, 174 N.W.2d 468 (1970); ARIZ. REV. STAT. ANN. § 25-327(B) (Supp. 1980); CAL. [CIVIL] CODE § 4801 (West Supp. 1980); COLO. REV. STAT. § 14-20-122 (1973); DEL. CODE ANN. tit. 13, § 1519(b) (Cum. Supp. 1978); GA. CODE ANN. § 30-209 (1980); ILL. ANN. STAT. ch. 40, § 510(b) (Smith-Hurd 1980); KY. REV. STAT. ANN. § 403.250(2) (Baldwin Repl. 1979); LA. CIV. CODE ANN. art. 160 (West Supp. 1980); MD. ANN. CODE art. 16, § 5(b) (Repl. 1981); MINN. STAT. ANN. § 518.64 (3) (West Supp. 1980); MO. ANN. STAT. § 452, 370 (2) (Vernon 1977); MONT. CODE ANN. § 40-4-208(b)(4) (1979); NEB. REV. STAT. § 42-365 (Supp. 1980); NEV. REV. STAT. § 125.50(5) (1979); N.Y. [DOM. REL.] LAW § 247 (McKinney Supp. 1980); 23 PA. CONS. STAT. ANN. § 501(e) (Purdon Supp. 1980); R.I. GEN. LAWS § 15-5-16 (Supp. 1980); UTAH CODE ANN. § 30-3-5 (Supp. 1979); VA. CODE § 20-109, 110 (Supp. 1980); WASH. REV. CODE ANN. § 26.07.170 (Supp. 1981).

However, the parties may provide otherwise by agreement under the above authorities in Alaska, Arizona, California, Colorado, Delaware, Georgia, Maryland, Minnesota, Missouri, Montana, Nebraska, New York, Virginia and Washington. In Nevada and Utah the court may decree otherwise.

74. See *Hollander v. Commissioner*, 248 F.2d 523 (9th Cir. 1957). See also *Blate v. Commissioner*, 34 T.C. 121 (1960). In *Blate*, the issue of whether support payments were deductible after remarriage of the recipient was not directly considered, but the payments were determined to be deductible on the finding that they constituted support rather than a property settlement.

If the obligation of support is not created by the divorce decree, it must be incurred by "a written instrument incident to such divorce or separation." I.R.C. § 71(a) (1976). The most serious problem concerning whether payments made pursuant to such an obligation incurred by agreement are covered by section 71 involves agreements made at some time after the divorce. In such cases there is a question as to whether the agreement is "incident to" the divorce or separation.

Determining whether an agreement executed after a divorce is "incident to such divorce or separation," a statutory prerequisite to deductibility of an obligation incurred by the paying spouse, may be a difficult inquiry. In *Cox v. Commissioner*, 176 F.2d 226 (3d Cir. 1949), the court held that an agreement reached eight months after a Florida divorce was not incident to the divorce

the Tax Court has increasingly resorted to state law in cases involving payments after remarriage of a recipient to determine whether a support obligation incurred by agreement incident to a divorce has validity after remarriage for purposes of section 71. Distinctions drawn in such cases have been rather fine and not all of the cases can be easily reconciled with each other.

In *Brown v. Commissioner*,<sup>75</sup> the Service sought to tax to the taxpayer payments made by her former husband after the taxpayer had remarried. The court noted that under Virginia law, the taxpayer's right to alimony ceased upon remarriage.<sup>76</sup> The Commissioner asserted that the enactment of section 22(k) of the 1939 Code was "intended to end distinctions based upon variations between the laws of different states" and that therefore the provisions of the divorce decree should control despite the provisions of Virginia's laws.<sup>77</sup>

The court, however, agreed with the taxpayer that the payments were taxable only during the existence and continuance of an obligation to pay alimony. The court held that since there was no agreement accompanying the divorce upon which the payments might be based, the payments were not alimony.<sup>78</sup> Later

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and, thus, payments to the former spouse were not deductible. The taxpayer and his former wife had been New Jersey residents. The taxpayer quickly remarried after the Florida divorce but there apparently was a serious question whether the Florida court had jurisdiction over the taxpayer's former wife. The taxpayer agreed to make support payments and the former wife agreed not to contest the Florida divorce as long as the taxpayer made his payments under the agreement. The court, in denying deduction for payments pursuant to that agreement, held that such agreement was not incident to the divorce, but rather "to preserve his divorce status as to his former wife, and his married status as to his second wife." 176 F.2d at 230. *But cf.* *Newton v. Pedrick*, 212 F.2d 357 (2d Cir. 1954) (opinion of Harlan, J.). In *Newton*, the court permitted deduction of payments under an agreement made six years after the taxpayer and his wife were divorced. This agreement modified an earlier agreement made in contemplation of their divorce. The court determined that when a later agreement adjusts an obligation imposed by decree or incurred by agreement at the time of the divorce, the decree is incident to the divorce.

75. 50 T.C. 865 (1968), *aff'd per curiam*, 415 F.2d 310 (4th Cir. 1969).

76. 415 F.2d at 311 (VA. CODE § 20-110 (1950)).

77. 50 T.C. at 867-68.

78. *Id.* at 869. The court distinguished cases such as *Hesse v. Commissioner*, 7 T.C. 700 (1946), and *Hogg v. Commissioner*, 13 T.C. 361 (1949), where agreements to make payments accompanied the divorces. As the court stated: "We find them all inapposite, for they all involve *property settlement agreements* (a written instrument incident to such divorce, i.e., a contract) between the parties." 50 T.C. at 869 (emphasis added). The use of the term "prop-

cases have made it clear that even the presence of an agreement at the time of the divorce will not ensure that payments after remarriage will fall within section 71.

In *Hoffman v. Commissioner*,<sup>79</sup> the Service again sought to include in the taxpayer's income payments she received from her former spouse after her remarriage. As Virginia law did in *Brown*, Illinois law in *Hoffman* terminated the recipient's right to alimony upon remarriage.<sup>80</sup> Unlike those in *Brown*, however, the payments to the taxpayer in *Hoffman* were made pursuant to an agreement entered into with her former husband at the time of the divorce. Not surprisingly in view of *Brown*, the Commissioner contended that the agreement "had a separate existence apart from the decree and that the obligations the agreement imposed continued to be binding on the parties after remarriage of the parties."<sup>81</sup> Such a position was consistent with the language of section 71, noted in *Brown*,<sup>82</sup> stating that the husband's obligation may arise "under the decree or under a written instrument. . . ."<sup>83</sup>

Although the Tax Court in *Brown* specifically left open the question as to whether an obligation of support after remarriage might be created by agreement,<sup>84</sup> and although recognition of agreements as an alternative source of a legal obligation of support would diminish the slavish adherence to state law in deter-

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erty settlement agreement" can be troublesome. If the payments are actually compensation for the recipient's property interest, they are not deductible. If the agreement provides for payments which are indefinite in duration or amount, they are of the sort that are dependent on the decree for their existence. To be independent of a decree, payments must generally be fixed in time and amount. See *infra* notes 290 & 291 and accompanying text.

If they are fixed in time and amount, and hence, are not dependent on state law or a court decree for the necessary obligation for support, and their fixed term is less than ten years, then they would often not be deductible because they would not be subject to contingencies or modification. See I.R.C. § 71(c)(2) (1976).

The channel that one must navigate to insure deductibility—steering between no agreement, which means no obligation for support, and an agreement which precludes contingencies or modification—is obviously very narrow.

79. 54 T.C. 1607 (1970), *aff'd per curiam*, 455 F.2d 161 (7th Cir. 1972).

80. See 1949 Ill. Laws 729 § 1 (current version at ILL. ANN. STAT. ch. 40, § 510(b) (Smith-Hurd 1980)).

81. 54 T.C. at 1612.

82. 50 T.C. at 871.

83. I.R.C. § 71(a) (1976).

84. 50 T.C. at 869.

mining tax consequences,<sup>85</sup> the court in *Hoffman* determined that because the agreement of the parties was incorporated into the divorce decree, it lost its contractual nature and became part of the decree.<sup>86</sup> The court determined that the obligation was created by the decree partly because the agreement between the taxpayer and her former husband provided that it would be applicable only if a divorce was awarded and the agreement was incorporated in the divorce.<sup>87</sup> While the agreement clearly was the basis of the decree, the agreement, according to the court, was no longer the basis of the legal rights of the parties once it was merged into a decree.

The court held that under Illinois law there could be no agreement in derogation of the statutory provision requiring a cessation of alimony payments upon remarriage of the wife.<sup>88</sup> Further, the Tax Court stated that an Illinois court could not, in a decree, establish provisions that are contrary to the statute.<sup>89</sup> The only sort of decree in which the Illinois court could create an obligation that would survive the remarriage would be a settlement in lieu of alimony—one ordering lump sum alimony or alimony in gross, such alimony becoming vested and not terminable or modifiable.<sup>90</sup>

The decision in *Hoffman* created much potential for confusion. Although a holding that alimony is not deductible after remarriage in a jurisdiction that terminates a right to alimony upon remarriage of the recipient would be inconsistent with congres-

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85. Indeed the Commissioner plaintively urged that the court, in turning to state law to determine the tax consequences of divorce-related payments, was placing "an insurmountable legal and factual burden on the Internal Revenue Service" because of the need to keep abreast of the law in 50 jurisdictions. 54 T.C. at 1611. The court gave this argument short shrift: "In view of our discussion above, it is clear that [the IRS] has the burden of knowing the divorce law of all the States." *Id.*

It is easy to sympathize with the Commissioner in this case because it had been "whipsawed." An IRS auditor had previously allowed the taxpayer's former husband a deduction for the amounts that the Commissioner was attempting to make the taxpayer take into income in *Hoffman*.

86. 54 T.C. at 1612.

87. *Id.*

88. *Id.* (citing *Miller v. Miller*, 317 Ill. App. 447, 46 N.E.2d 102 (1943)).

89. 54 T.C. at 1612-13 (citing *Balasa v. Balasa*, 11 Ill. App. 2d 103, 136 N.E.2d 594 (1956)).

90. 54 T.C. at 1613.

sional intent, such a holding would provide at least a measure of certainty. The court in *Hoffman* did not so hold; rather, its decision was based on whether, under Illinois law, the parties' agreement merged with the decree and whether the decree took a form which created an obligation that survived remarriage. Fortunately, given the court's analytical predilection, there was precedent in Illinois on those two issues. At a time when there are many congressional and scholarly drums beating for abolishment of federal diversity jurisdiction and its nettlesome choice of law or *Erie* problems,<sup>91</sup> it seems strange indeed that federal tribunals would require such a descent into the morass of state domestic relations law to resolve this federal taxation question.<sup>92</sup>

Two Tax Court decisions that have considered the *Hoffman* decision, *Suarez v. Commissioner*,<sup>93</sup> and *Sherwood v. Commissioner*,<sup>94</sup> have treated *Hoffman* as holding that only a settlement in lieu of alimony<sup>95</sup> will create an obligation which survives remarriage.<sup>96</sup> Both cases involved divorces granted in Illinois.

In *Suarez*, in which the Commissioner proceeded alternatively against both taxpayers who had been parties to a divorce, the recipient asserted that payments she received were not includible in her gross income because the duration of the payments specified in the agreement was only five years. The agreement provided for 61 monthly payments, 59 in the amount of \$500 and two in the amount of \$250, or a total of \$30,000. The total amount specified in the agreement was \$60,000, however, which could have been liquidated by 119 payments of \$500 and two in the amount of \$250, or 121 monthly payments from the date of the

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91. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938). See Rowe, *Abolishing Diversity Jurisdiction: Positive Side Effects and Potential for Further Reforms*, 92 HARV. L. REV. 963 (1979). See also H.R. REP. NO. 9622, 95th Cong., 2d Sess. 1(b) (1978); *Hearings on S. 2094, S. 2389 and H.R. 9622 Before the Subcommittee on Improvements in Judicial Machinery of the Judiciary*, 95th Cong., 2d Sess. 10 (1978).

92. In relying on federal rather than state law in a federal gift tax case, Judge Frank caustically expressed relief: "[W]e are not compelled by *Erie R. Co. v. Tompkins* . . . to play the role of ventriloquist's dummy to the courts of some particular state; as we understand it, 'federal law,' not 'local law,' is applicable." *Richardson v. Commissioner*, 126 F.2d 562, 567 (2d Cir. 1942) (citation and footnote omitted).

93. 68 T.C. 857 (1977).

94. 38 T.C.M. (CCH) 660 (1979).

95. Also referred to in *Hoffman* as lump sum alimony. 54 T.C. at 1613.

96. 68 T.C. at 866; 38 T.C.M. (CCH) at 663.

agreement. The court was guided by the total sum, \$60,000, in concluding that the five-year payment period implied by the agreement was a mathematical error.<sup>97</sup> In addition to the factual finding that the payments extended over a period longer than ten years and, hence, were periodic,<sup>98</sup> the court found in the alternative that they were subject to the contingency of reduction upon the wife's remarriage; therefore, the payments had no determinable principal sum and thus were not installment payments.<sup>99</sup> The court summarily concluded that the agreement fell within the *Hoffman* exception that a settlement in lieu of alimony creates an obligation surviving remarriage.<sup>100</sup>

In light of *Hoffman's* construction of Illinois law with respect to the continuation of an obligation to make support payments after remarriage, the Service should have been required, in order to make the wife include the payments after her remarriage in her income, to demonstrate that they were pursuant to a settlement in lieu of alimony, that is, one that created an amount of payments that could not be modified. The court made no such finding. No attempt was made to reconcile the *Suarez* opinion's conclusory finding of a settlement in lieu of alimony with the contingent nature of the payments under the agreement of the parties. In *Hoffman*, payments after remarriage were not income to the recipient because of their uncertainty.<sup>101</sup> In *Suarez*, the payments after remarriage were income to the recipient because of their uncertainty. Both *Hoffman* and *Suarez* cannot be consistent with Illinois law in that respect.

This confusion was glossed over in *Sherwood*, which also involved payments after remarriage to a party to an Illinois divorce. In *Sherwood*, which, like *Suarez*, involved Tax Court petitions by both parties to the divorce, the recipient wife contended that payments to her after her remarriage were not income because they were not in discharge of an obligation imposed on the husband because of the marital or family relationship.<sup>102</sup>

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97. 68 T.C. at 863. The court was reinforced in its belief by a provision that called for a 25% reduction in remaining payments upon the wife's remarriage within five years and a 50% reduction upon her remarriage after five years. *Id.*

98. *Id.* at 864.

99. *Id.* See Treas. Reg. § 1.71-1(d)(3)(ii) (1960).

100. 68 T.C. at 866.

101. See *supra* text accompanying note 90.

102. 38 T.C.M. (CCH) at 662.



The court cited *Hoffman*,<sup>103</sup> but then noted the possibility under Illinois law that a settlement in lieu of alimony, "to be paid in installments without regard to either party's death or remarriage,"<sup>104</sup> would create an obligation that would survive the recipient's remarriage. Peculiarly enough, the court cited *Suarez* for that proposition. In the next sentence, the court held: "In order to qualify as a settlement in lieu of alimony, the award must, among other things, be for a definite amount of money payable over a definite length of time."<sup>105</sup> The agreement of the parties in *Sherwood* provided that the payments to the wife were to be reduced in the event of her remarriage. It was because of this provision that the court decided that the agreement lacked the definiteness needed to constitute a settlement in lieu of alimony under Illinois law.<sup>106</sup>

This holding is difficult to reconcile with *Suarez*. It is also difficult to reconcile with the court's alternative holding that even if Illinois law had provided that alimony obligations could survive remarriage of the recipient, the court would have found that the payments constituted an exchange for the wife's interest in marital property.<sup>107</sup> The Tax Court so found, though it could only speculate as to what property interest was involved, because the fixed amount of the payments after remarriage prevented them from resembling support.<sup>108</sup> Thus, the payments were too indefinite in amount to constitute a lump sum settlement in lieu of alimony, but too definite to constitute support.

Clearly, a comparison of *Hoffmen*, *Suarez*, and *Sherwood*, involving the law of one jurisdiction, demonstrates the difficulty of determining on the basis of state law the support characterization of payments that represent no identifiable interest in property.

Unfortunately, it appears that the Commissioner, who saw the difficulties involved in *Brown*<sup>109</sup> and resisted this divergence

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103. *Id.* at 663.

104. *Id.*

105. *Id.* (citing *Robin v. Robin*, 57 Ill. App. 2d 193, 206 N.E.2d 850 (1965); *Jacobson v. Jacobson*, 50 Ill. App. 2d 244, 200 N.E.2d 379 (1964); *Walters v. Walters*, 341 Ill. App. 561, 94 N.E.2d 726 (1950)).

106. 38 T.C.M. (CCH) at 663.

107. *Id.* at 663-64.

108. *Id.* at 664.

109. *See supra* note 85.

from the legislative intent of section 71, has now accepted the position of the Tax Court that the applicability of section 71 to payments made after remarriage of the recipient is determined by reference to state law. In Revenue Ruling 81-8,<sup>110</sup> the IRS held that if under state law the payor's obligation to make payments terminates upon the recipient's remarriage, payments made after remarriage are not deductible by the payor.

The Commissioner added an interesting twist to the inquiry however. Relying on the case of *Joss v. Commissioner*,<sup>111</sup> the ruling states that the payments were nonetheless income to the recipient. This is, of course, one way of dealing with the anomaly created by payments which do not represent an obligation of support because of state law and which cannot be tied to any property interest in the recipient. Such treatment flies in the face of the obvious symmetry of sections 71 and 215, the latter of which provides that the husband may deduct only what the wife must take into income. It is not a matter of logical necessity that the recipient may exclude any divorce-related payment that the husband may not deduct. Nevertheless, *Joss* does not provide much support for a proposition so apparently contradictory to the structure of sections 71 and 215.

In *Joss*, the taxpayer was the third husband of a woman who received support from her second husband in a taxable year in which she filed a joint return as a taxpayer. The taxpayer's wife received this support under an agreement which provided that support would terminate upon her remarriage. She did not tell her second husband about the remarriage and thus continued to receive support until the second husband learned of her remarriage. Because of the joint return, the "support" was income to the taxpayer if it was income to his wife.<sup>112</sup>

The taxpayer attempted to rely on *Brown*<sup>113</sup> in contending that the support received by his wife was not income. The court held that if the payments were not support for the recipient or child support, they were income unless excludable under some other section of the Code.<sup>114</sup> Finding no donative intent on the part of

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110. Rev. Rul. 81-8, 1981-2 I.R.B. 6.

111. 56 T.C. 378 (1971).

112. By the time of trial, the taxpayer, perhaps not surprisingly, was divorced from the recipient of the support payments. *Id.* at 380.

113. See *supra* text accompanying notes 75-78.

114. 56 T.C. at 384-85.

the payor, the court held that the payments could not constitute a gift.<sup>115</sup> The court concluded, quite appropriately, that the payments were income to the recipient on the basis of *James v. United States*,<sup>116</sup> a case in which the Supreme Court held that the proceeds of embezzlement were taxable to the embezzler in the year of the embezzlement. The court held that the taxpayer's receipt carried with it no stronger obligation to repay than would be the "obligation of an embezzler to repay the person from whom he had embezzled."<sup>117</sup> Holding that one who has received money under false pretenses in a divorce context has received income is a far cry from holding that all payments not received pursuant to an obligation created by state law and not attributable to a property interest must be taken into income. The court did not state whether its holding would be different if the parties had created an obligation of support by agreement.

The Tax Court's development by reference to state law of a class of nondeductible support or alimony-like payments and the Commissioner's responsive creation of nonexcludable payments constitute a scheme of double taxation outside of section 71, unwarranted in light of the legislative intent.

#### IV. DIFFERENTIATING BETWEEN SUPPORT PAYMENTS AND PAYMENTS REPRESENTING A PROPERTY INTEREST.

##### A. *The Role of the Separation Agreement in Characterizing Payments*

If the parties to a divorce are so inclined, they may determine the division of property and even support obligations through an agreement. Such agreements, at least for purposes of state law, promote planning and judicial economy. It is not as clear that such agreements foster certainty and judicial economy for federal tax purposes. The case law indicates that the courts have considerable latitude in characterizing payments made pursuant to an agreement notwithstanding their description in an agreement. Courts ostensibly characterize divorce-related payments as

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115. *Id.* at 385 (citing *Commissioner v. Duberstein*, 363 U.S. 278 (1960)). The court in *Brown* posited that the payments which were not deductible by the payor were gifts to the wife. 50 T.C. at 871.

116. 366 U.S. 213 (1961).

117. 56 T.C. at 385-86.

representing support or an interest in property on the basis of the facts and circumstances surrounding execution of the divorce agreement.<sup>118</sup> In that spirit, the form of nomenclature of an agreement is not permitted to control, absolutely, the tax consequences of payments it provides. Thus, the ability of the parties to control the tax consequences of a divorce is limited.

The cases indicate that patent attempts to fix tax consequences of a divorce by mischaracterization of payments in an agreement, whatever effect such attempts may have for state law purposes, will not be successful if challenged by the IRS. One of the leading cases demonstrating the courts' ability to look behind the terminology of divorce agreements is *Bardwell v. Commissioner*.<sup>119</sup> In that case, the agreement between the parties to the divorce provided for monthly payments to the taxpayer of temporary alimony of \$425 for seven months and, thereafter, for monthly payments in the same amount until she died or remarried.<sup>120</sup> The agreement also provided that the husband was to place several life insurance policies in trust for the benefit of the taxpayer, and that in the event of the paying spouse's death, the taxpayer was to receive payments of \$600 per month until she died or remarried. Because the payments would terminate only upon unpredictable contingencies, it was not possible to compute the total amount of payments. Although the payments of indefinite duration were in the same amount as the earlier seven payments, which were designated as temporary alimony, the agreement recited: "[T]hese payments not to be alimony but as part of a property settlement."<sup>121</sup> Since the payments were designated as a property settlement, the recipient omitted them from her gross income in the tax years at issue.<sup>122</sup>

The United States Court of Appeals for the Tenth Circuit, in rejecting the recipient's reliance upon the terminology of the agreement, held that the payments were taxable to the recipient. The court conceded that the courts of Colorado, where the divorce was granted, might decline to characterize the payments

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118. See *Bardwell v. Commissioner*, 38 T.C. 84 (1962), *aff'd*, 318 F.2d 786 (10th Cir. 1963); *Ryker v. Commissioner*, 33 T.C. 924 (1960).

119. 38 T.C. 84 (1962), *aff'd* 318 F.2d 786 (10th Cir. 1963).

120. 38 T.C. at 87.

121. *Id.*

122. See *id.* at 89.

as alimony.<sup>123</sup> The court insisted: "[W]e are not, however, bound by the labels which the parties attach to the payments in their agreement, especially when its other provisions make it equivocal, any more than we are bound by the rules of state law."<sup>124</sup>

The description of the facts by the Tax Court discloses that according to the husband, the parties described the payments as a property settlement to foreclose the possibility of subsequent amendment under Colorado law.<sup>125</sup> Unfettered by the terms of the agreement, the court of appeals examined the circumstances of the parties in their entirety. It determined that the parties intended that these payments be used for support,<sup>126</sup> that the agreement otherwise disposed of the property of the parties, and that "there [was] nothing in the record to indicate that the wife surrendered any property interests or gave up anything other than her right to alimony in exchange for these payments."<sup>127</sup> In *Bardwell*, the Commissioner and the courts cut through the terminology and characterized the payments on more essential grounds.<sup>128</sup>

It is equally true that characterization of payments as alimony in a divorce agreement when such payments patently represent a property settlement will not in itself create a deduction for the

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123. 318 F.2d at 789.

124. *Id.* (citing *Riddell v. Guggenheim*, 281 F.2d 836 (9th Cir. 1960); *Landa v. Commissioner*, 206 F.2d 431 (D.C. Cir. 1953); *Scofield v. Greer*, 185 F.2d 551 (5th Cir. 1950)).

125. 38 T.C. at 91. The husband also testified that it was the parties intention that the recipient wife pay federal taxes on all amounts she received. *Id.*

126. The Tax Court had noted that the taxpayer, in her divorce petition, had specifically asked for alimony. *Id.*

127. 318 F.2d at 790.

128. The Commissioner, whose responsibility, after all, is to preserve the revenue, does not always accept the consequences of the apparent substance of the transaction. In *Phinney v. Mauk*, 411 F.2d 1196 (5th Cir. 1969), the District Director contended that payments made by the taxpayer to his former wife were not deductible by the taxpayer merely because they were labeled as a property settlement. The court, in reversing a summary judgment for the taxpayer, held that to determine the true nature of the payments it was necessary to determine the intent of the parties to the agreement. *Id.* at 1198. *Phinney* indicates that the IRS is capable of asserting a deficiency consistent with or in disregard of the terms of a divorce agreement. In either case, the burden is on the taxpayer, whether he files suit for a refund, see *United States v. Anderson*, 269 U.S. 422 (1926), or petitions the Tax Court.

paying spouse. In *Coker v. United States*,<sup>129</sup> the taxpayer's executors sought to overturn the Commissioner's deficiencies for years in which the taxpayer had deducted payments of \$30,000 each to his former spouse. The divorce agreement provided that the taxpayer was to pay \$1000 per month for his divorced wife's life and that in the year of the divorce, 1960, and the following year, he was to make payments of \$30,000 each year. All payments provided by the agreement were designated as "permanent alimony."<sup>130</sup> As is discussed below, when payments made at or near the time of the divorce are disproportionately large with respect to other payments provided in a divorce agreement, it is quite likely such payments will not be viewed as periodic.<sup>131</sup>

The district court in *Coker* indicated that the agreement provided for payments of \$1000 per month indefinitely.<sup>132</sup> The taxpayer's executor attempted to buttress the justification for the deduction of the \$30,000 payments by reference to a provision that would terminate all payments in the event of the death of the husband or remarriage of the wife.<sup>133</sup> The executors argued that the large payments were contingent, that they did not represent a principal sum and, thus, were deductible. The district court held that the contingency provision applied only to the \$1000 payments and that the \$30,000 payments therefore constituted a property settlement. The court so held because the contingency provision was found in the same section of the agreement as the \$1000 payments and a different section from the \$30,000 payments, and because the contingency provision did not refer specifically to the section containing the \$30,000 payments, while other provisions in the section containing the \$1000 payments did so refer.<sup>134</sup>

Such solicitude for determining the parties' true intent from the agreement must be viewed in contrast to the disregard by both the district court and the United States Court of Appeals for the Eighth Circuit of the clear designation of all payments as "permanent alimony." It is difficult to quarrel with the refusal by

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129. 456 F.2d 676 (8th Cir. 1972).

130. *Id.* at 676-77.

131. *See infra* notes 214-24 and accompanying text.

132. 327 F. Supp. 169, 172 (D. Neb. 1971).

133. *Id.*

134. *Id.* at 175-76.

both courts in *Coker* to permit the taxpayer to pass off as support payments the disproportionately large payments by making them contingent. It is quite clear from *Coker* that disingenuous designation of payments as alimony will not guarantee their deductibility to the payor.

Undoubtedly, the ability of a court to recharacterize divorce payments can prevent an unrepresented or inadequately represented party from being overreached on issues of taxation. A spouse entitled to substantial property from the other spouse may not be cognizant of the consequences of denoting installments representing such payments as alimony. In *Karageorgevitch v. Commissioner*,<sup>135</sup> the parties by the divorce initially made an agreement dividing their community property. Among other things, the taxpayer was to receive \$386,000 in savings deposits and other cash assets.<sup>136</sup> Just before the divorce decree was entered, the attorneys of the parties conferred "on the courthouse steps." The husband, short of cash at the time, wished to give the wife \$55,000 less than the sum to which they had agreed and to pay it over twenty-one months in payments of \$1500 per month.<sup>137</sup> The amended agreement described these deferred payments as "maintenance and support."<sup>138</sup>

Clearly, the deferral of the \$55,000 was caused by the husband's shortage of cash rather than the wife's need for support. The hasty changes *in limine* were not permitted to rebound to the husband's advantage tax-wise. The court refused to tax the payments to the wife on the basis of the "inept" words, "maintenance and support."<sup>139</sup> The court relied heavily on the above circumstances, the absence of contingencies and a provision stating that the agreement was binding on the heirs and executors of the parties, in determining that the deferred payments were in the nature of a property settlement.<sup>140</sup> The

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135. 38 T.C.M. (CCH) 1003 (1979).

136. *Id.* at 1004.

137. *Id.* at 1004-05.

138. *Id.* at 1005.

139. *Id.* at 1006. The court noted that the wife's attorney was not a tax specialist. The Commissioner had assessed deficiencies against both the recipient and the payor, but took a neutral position before the Tax Court. *Id.* at 1005-06. See also *Martin v. Commissioner*, 73 T.C. 255 (1979) (description "additional alimony" does not control characterization of payments deemed to be in the nature of a property settlement).

140. 38 T.C.M. (CCH) at 1005-06.

ability of the court to reach a just result by looking behind an agreement, as in *Karageorgevitch*, should not obscure the fact that such ability may detract from the potential for predictable tax consequences of such agreements.

If transparently inaccurate characterization to fix tax consequences of divorce-related payments has been resisted by the courts, so too has use of strategic ambiguity in agreements, that is, ambiguous characterization designed to achieve inconsistent, favorable tax treatment for both parties. For example, an agreement might designate installment payments as a property settlement but provide that they are contingent.<sup>141</sup> Such characterization would provide some basis for the paying spouse to deduct and for the recipient to exclude the payments and to argue in favor of such characterization during an audit of his or her return.<sup>142</sup>

In *Hoeme v. Commissioner*,<sup>143</sup> the court confronted what it regarded as an attempt by the taxpayers to shift adverse tax consequences to each other by leaving the divorce agreement ambiguous. The agreement provided, *inter alia*, that the husband was to pay the wife \$25,000 in monthly payments over a period that exceeded ten years. These payments were not specifically characterized either as alimony or as a property settlement and a general paragraph describing the purposes of the agreement was ambiguous.<sup>144</sup> In resolving the ambiguity, the court noted the sensitivity of the parties and their attorneys to tax conse-

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141. See, e.g., *Riddell v. Guggenheim*, 281 F.2d 836, 838 (9th Cir. 1960).

142. Perhaps calculated ambiguity creates more of an advantage to the payor, because he or she must have taken the amount paid into his or her gross income before deducting it. Therefore, the special six-year limitation on assessments by the Commissioner for substantial omissions from gross income, see I.R.C. § 6501(e) (Supp. 1978), would not ordinarily be applicable against a paying spouse. The six-year limitation might often affect adversely recipient spouses who do not have other substantial sources of income, as amounts erroneously excluded would not ordinarily be disclosed anywhere on the return of such spouse and might easily be detected in an audit.

143. 36 T.C.M. (CCH) 880 (1977).

144. *Id.* at 883. The agreement provided:

[T]his agreement is intended as a fair, just and equitable settlement as to the property rights of each of the parties hereto and shall constitute a complete and final settlement of all obligations, rights, claims and duties of every kind and nature arising out of their marriage relation; shall constitute and be a full and complete settlement as to all claims for all rights to alimony, support money, property division, attorneys' fees and costs . . .

*Id.*



quences: "Both petitioners wanted to avoid tax liability and have the other assume it. The agreement was specifically drafted to leave the nature of the payments (as support or a property settlement) unclear."<sup>145</sup> The court wryly noted: "This was perhaps unwise because the parties are now presumably incurring additional legal fees to have the question decided by this Court."<sup>146</sup> Faced with an inconclusive agreement, the court looked to the facts and circumstances surrounding it. The court found that the payor did not have a net worth anywhere near the \$25,000 payments provided in the agreement. Thus, there was very little property that could have been the basis of a property settlement. Consequently, the payments were held to represent a support obligation.<sup>147</sup>

Realistic and candid consideration of the tax incidents of an agreement among the parties is probably the most effective strategy in providing predictable tax consequences. Nevertheless, the inconsistency which the courts have displayed in evaluating the terminology of a separation agreement as a factor in characterizing divorce-related payments makes realistic negotiations difficult. The willingness of the courts to look behind the form of an agreement has not prevented them from simply refusing to do so when substantial considerations might have otherwise warranted it. At times, a form of estoppel has been applied to prevent the parties to divorce agreements from impeaching their terms.

In *Campbell v. Lake*,<sup>148</sup> the United States Court of Appeals for the Fifth Circuit reversed the judgment of the district court for the taxpayer. The taxpayer had deducted monthly payments to his former spouse under a Texas divorce judgment which incorporated a contract settlement between the parties. The agreement provided for transfer of real estate and \$50,000 cash to the wife and for 125 monthly payments of \$1000. While the distinction between immediate and deferred payments may have suggested a dichotomy between a property settlement and support, the agreement itself specified that the payments constituted "the value of . . . one-half of the the community estate and . . . the

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145. *Id.* at 883-84.

146. *Id.* at 885.

147. *Id.*

148. 220 F.2d 341 (5th Cir. 1955) (involving the 1939 Code).

most equitable manner of partitioning [the] community estate between [the] parties.”<sup>149</sup>

The district court found the monthly payments to be “periodic support payments,” in spite of the designation of the agreement as a settlement of property rights. The court of appeals, in reversing the judgment below, refused to look behind the agreement or to evaluate the substance of the payments.<sup>150</sup> The taxpayer contended that the terminology of the agreement represented an attempt to state that no permanent alimony was being paid, to avoid contravention of Texas public policy. The court held that this was without support in the record:

The lawyers representing the parties were highly competent draftsmen. If they had desired to say this, they could and would have said it simply and directly with no beating about the bush. What they did say was said simply and directly, and there is no evidence in this record contradicting what they said. It will, therefore, not do, as appellee undertakes at this late date to do, to subject the facts and figures used in the settlement and decree to an analysis, in the nature of higher criticism, designed to read into and extract from them an entirely different meaning and effect from that which the parties had in precise terms ascribed to them.<sup>151</sup>

The discussion of *Lake* does not imply an incorrect result therein. What is remarkable, however, is the implication by the court that the agreement of the parties is controlling unless there is evidence of a contrary intention in the record. Clearly, the proffered testimony of the taxpayer as to the parties' intention constituted such evidence, whatever its credibility. In view of the foregoing discussion of case law, it is surprising that the terminology of the agreement in *Lake* should have carried such weight. Nevertheless, there is substantial authority that would permit a court to refuse to look behind the terms of an agreement in order to re-characterize divorce-related payments.<sup>152</sup> The Tax Court has

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149. *Id.* at 342 n.4.

150. The taxpayer cited *Scofield v. Greer*, 185 F.2d 551 (5th Cir. 1950), to the effect that the terms of the agreement were not conclusive and that parol evidence might be considered. The court distinguished *Greer* on the basis that the payments therein were “clearly intended” to be support payments. 220 F.2d at 343.

151. 220 F.2d at 343.

152. See *Syndes v. Commissioner*, 577 F.2d 60 (8th Cir. 1978), *aff'd*, 68 T.C. 170 (1977); *Warnack v. Commissioner*, 71 T.C. 541 (1979); *Collins v. Commissioner*, 39 T.C.M. (CCH) 757 (1979).

recently indicated a willingness to respect a tax bargain apparently struck by the parties to a divorce agreement.<sup>153</sup> The weight to be accorded to an agreement and, hence, the degree of incentive to parties to a divorce to say what they mean, is an imponderable. It is perhaps safe to say that an agreement will be one circumstance among many that the court will consider in characterizing payments for tax purposes.

If an agreement is ambiguous, the court will make an attempt to construe it.<sup>154</sup> Interpretation of an ambiguous agreement may be based on the surrounding circumstances discussed above or on an analysis of the terms of the agreement itself, or both. The location of a provision in an agreement may play a significant role in the court's characterization of payments for tax purposes. In *Newbury v. Commissioner*,<sup>155</sup> the court was required to determine the tax effect, *inter alia*, of monthly payments on a note to the taxpayer's former spouse. The payment period exceeded ten years, making them potentially periodic under I.R.C. section 71(c). The court found, however, that because the provision for these payments was grouped with provisions that more clearly represented a property settlement, and was apart from a provision for payments that the court construed as support, the payments were part of a property settlement and were not deductible.<sup>156</sup>

The unexpected prior drafts of an agreement may provide a basis for interpreting it. In *Estate of Thoda v. Commissioner*,<sup>157</sup> the payor sought to deduct payments designated in the divorce agreement as "alimony in solido." In determining whether or not the payments represented a property settlement, the court noted that two prior drafts of the agreement called these payments alimony and provided that they be terminated upon the occurrence of certain contingencies. Because the final agreement described the payments as alimony in solido, an ambiguous term,

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153. See *Shane v. Commissioner*, 40 T.C.M. (CCH) 1308, 1312 (1980) (terms of an agreement are persuasive evidence of the parties' intent, particularly where the agreement is not structured to take advantage of the tax laws).

154. See *Thorsness v. United States*, 260 F.2d 341 (7th Cir. 1958).

155. 46 T.C. 690 (1966).

156. *Id.* at 697. See also *Pierce v. Commissioner*, 66 T.C. 840 (1976).

157. 38 T.C.M. (CCH) 880 (1979).

and provided for no contingencies, the court determined that the payments represented a property settlement.<sup>158</sup>

The presence of items specifically designated as support of a property settlement in an agreement or decree may, by reverse inference, be used to characterize undesignated items as the opposite for tax purposes. If particular payments are designated as representing the recipient spouse's property interest, then other undesignated or ambiguously designated payments may be regarded as support. Several cases demonstrate this sort of analysis. In *Bardwell v. Commissioner*,<sup>159</sup> as indicated earlier,<sup>160</sup> the court determined that monthly payments specifically designated as a property settlement were nevertheless deductible by the payor. A factor in re-characterizing the payments as support was the presence elsewhere in the agreement of several provisions disposing of the property of the parties.<sup>161</sup> This reasoning is probably sensible, particularly if the recipient is unable to demonstrate any particular interest to which the payments are attributable.

Consistent with this method of characterization is *Van Orman v. Commissioner*,<sup>162</sup> where the taxpayer was required by a property settlement agreement to pay to his former spouse alimony varying from \$1300 to \$900 per month for ten years and one month. These payments were to cease upon the recipient's remarriage. The taxpayer also agreed to purchase a home for his former spouse. The payments on the new home were not to be terminated by the recipient's remarriage.<sup>163</sup> The taxpayer sought to deduct the payments on the home as periodic payments. In holding that the payments on the home represented a property settlement rather than a support obligation the court noted the presence of a provision for support elsewhere in the agreement.<sup>164</sup>

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158. *Id.* at 885. Likewise, when a party requests alimony in an initial pleading, and a provision for payments is not specifically designated as such in the decree or agreement, the payments may be regarded as a property settlement. See *Gammill v. Commissioner*, 73 T.C. 921, 929 (1980).

159. 38 T.C. 84 (1962), *aff'd*, 318 F.2d 786 (10th Cir. 1963).

160. See *supra* text accompanying notes 119-28.

161. 318 F.2d at 790. See also *Tracy v. Commissioner*, 70 T.C. 397, 401 (1978); *Appling v. Commissioner*, 39 T.C.M. (CCH) 50, 52-53 (1979).

162. 418 F.2d 170 (7th Cir. 1969).

163. *Id.* at 171.

164. *Id.*

The court also contrasted the requirement of the purchase of the home with the specifically designated alimony provision by noting that the former was not contingent while the latter was.<sup>165</sup> If an agreement expressly applies contingencies to specifically characterized support payments, a court may refuse to apply them to undesignated payments.<sup>166</sup>

It is clear that characterization of payments in a divorce agreement may provide an important indication of how they will be treated for tax purposes. Such characterizations, however, have not been binding on the courts.

*B. Characterization of Divorce-Related Payments  
in the Absence of or in Spite of Characterization  
in an Agreement or Decree*

When a divorce agreement or decree does not characterize some divorce-related payments, or if it does but the court is unwilling to accept its characterization, the court must examine the circumstances surrounding the divorce to determine the tax consequences of the payments. In deciding whether payments represent support or a property interest the courts have considered a myriad of factors. The decisions involving these factors are not always easily reconcilable. There has been refreshing consistency with respect to the tax treatment of disproportionately large payments which are roughly contemporaneous with the divorce. Such payments are usually regarded as not deductible by the payor because they are not regarded as periodic.<sup>167</sup> With payments that are structured such that they could meet the periodic requirement, it is nonetheless necessary to determine

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165. Also important in the court's characterization of the house payments as a property settlement was the fact that they could be characterized as a lump sum, a capital transaction "in convenient payments." *Id.* at 172.

166. See *Watkins v. Commissioner*, 53 T.C. 349, 360 (1969). In *Biddle v. Commissioner*, 38 T.C.M. (CCH) 1361 (1979), a judgment provided for the taxpayer to make payments to his former spouse of \$200 per month and also to make monthly payments of \$126 per month on their mobile home. When the taxpayer suffered financial reverses, the parties modified their agreement. The \$200 monthly payments were reduced, but the loan payments were not. The absence of the contingency with respect to the loan payments, in part, led the court to conclude that the loan payments represented a property settlement rather than support. *Id.* at 1364-65.

167. See *infra* notes 237-48 and accompanying text.

whether they represent a support obligation of the payor or a property interest of the recipient. When a deduction by the payor is challenged, he often must prove the nonexistence of a property interest of the recipient. When exclusion by the recipient is challenged, the recipient must demonstrate the existence of such a property interest.

In order to demonstrate a property interest to which payments pertain, it is not always necessary that a recipient point to an identifiable interest in specific assets. *United States v. Davis*,<sup>168</sup> although it did not involve section 71, demonstrates that a very limited, qualified or inchoate form of ownership may result in characterization of a divorce-related transfer as a property settlement. In *Davis*, the husband transferred 1000 shares of stock to his wife in connection with their divorce. The Commissioner asserted that this was a taxable transaction for the husband, contending that he had realized gain to the extent of the difference between the stock's basis and its fair market value at the time of the transfer.<sup>169</sup> Although the stock had been the husband's separate property before the divorce, he contended that his transfer of the stock represented a division of property among co-owners, analogous to a division of property by the divorcing parties in a community property state. In holding that the husband had a capital gain on his transfer of the stock, the Court found, in essence, that he had sold the stock, exchanging it for extinguishment of his wife's marital rights in his property.<sup>170</sup> To find the consideration necessary to support a taxable exchange the Court relied upon the relatively evanescent rights which Delaware law provided a spouse in the property of another spouse. It is clear from the Court's description of such rights why it did not regard them as sufficient basis for a division of property among co-owners:

[T]he inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership. The wife has no interest—passive or active—over the management or disposition of her husband's personal property. Her rights are not descendable, and she must survive him to share in his intestate estate. Upon dissolution of the marriage she

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168. 370 U.S. 65 (1962).

169. *Id.* at 68.

170. *Id.* at 69-70.

shares in the property only to such extent as the court deems "reasonable."<sup>171</sup>

What is significant about *Davis* for purposes of section 71 is that it demonstrates the very limited degree of ownership by the recipient spouse that will sustain property settlement treatment. As *Davis* implies, it is sometimes more difficult for a divorced spouse receiving payments in a common law property jurisdiction to demonstrate that such payments represent a property interest than it is in a community property jurisdiction.<sup>172</sup>

If sole or joint ownership of specific assets from among the cumulative assets of the parties is not required to sustain property settlement treatment for a recipient of divorce-related payments, it is nevertheless true that the parties must possess assets at the time of the divorce for there to be a property settlement. This may sound simplistic, but the question of whether payments are attributable to a property interest may arise many years after a divorce has been entered.<sup>173</sup> Under such circumstances it may be quite difficult to determine whether the parties possessed, jointly or cumulatively, any property that might have been divided.

If the recipient is to receive an amount in payments which exceeds the net worth of the parties or is grossly disproportionate with respect to such net worth, even with respect to interest over the payment period, it is likely that such payments will be deemed to pertain to a support obligation. This may be seen in *Hoeme v. Commissioner*,<sup>174</sup> wherein the husband agreed to make payments to his former wife in a total amount of \$25,000 payable over a period exceeding ten years.<sup>175</sup> As noted earlier, these

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171. *Id.* at 70 (citing DEL. CODE ANN. tit. 13, § 1531(a) (1953), ch. 221, § 15, 25 Del. Laws (1907) (current version at DEL. CODE ANN. tit. 13, § 1513 (Supp. 1980))).

172. For an excellent comparison of the position of taxpayers in common law and community property states with respect to support payments, see Harris, *The Federal Income Tax Treatment of Alimony Payments—The "Support" Requirement of the Regulations*, 22 HASTINGS L.J. 53, 78-79 (1970).

173. See, e.g., *Bernatschke v. United States*, 364 F.2d 400 (Ct. Cl. 1966). *Bernatschke* involved the tax treatment of payments in taxable years 1956 through 1959 under an agreement made in 1940.

174. 36 T.C.M. (CCH) 880 (1977). See *supra* notes 143-47 and accompanying text.

175. The payments were to be made as follows: \$2500 at the time of the divorce, \$200 per month for 30 months and then \$150 per month until the balance was paid, or a total payment period of 141 months. 36 T.C.M. (CCH) at 882.

payments were not identified as representing support or a property settlement.<sup>176</sup> The agreement provided for disposition of specific items of property. Although the decision rested on several bases, the Tax Court noted that \$25,000 was far greater than the husband's net worth at the time of the divorce. The court also observed that for payments to represent a property interest of the wife, such a property interest must be demonstrated.<sup>177</sup> The court conceded that the monthly payments were to continue after the wife's death or remarriage and that this was a strong indication that they represented a property settlement. Nevertheless, the \$25,000, even reduced to present value, could not have represented an interest in the husband's property or the couple's joint property, and the payments were consequently determined to be support.<sup>178</sup>

In *Derickson v. Commissioner*,<sup>179</sup> the taxpayer's divorce decree provided for disposition of several items of real and personal property to the taxpayer and her husband. It also provided that the husband make 121 monthly payments to the wife in the total sum of \$83,157.50. These payments were not specifically designated as support or as a property settlement. The payments were secured by liens and life insurance proceeds and were not subject to contingencies. All of these factors suggest that the payments represent a property settlement. As in *Hoeme*, however, the court noted that the principal sum of the payments far exceeded the net worth of the parties.<sup>180</sup> Although the division of assets between the parties was unequal, and such an unequal division has sometimes resulted in a finding that monthly payments were intended to equalize the disparity,<sup>181</sup> the court was persuaded otherwise. Because the amount of the payments greatly exceeded the parties' net worth, and because the taxpayer was unable to demonstrate a property interest relinquished in return for the payments, the court concluded that the payments constituted support.<sup>182</sup>

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176. See *supra* note 129 and accompanying text.

177. 36 T.C.M. (CCH) at 885 (citing *Hesse v. Commissioner*, 60 T.C. 685, *aff'd*, 511 F.2d 1393 (3d Cir. 1973), *cert. denied*, 423 U.S. 834 (1975)).

178. 36 T.C.M. (CCH) at 885.

179. 35 T.C.M. (CCH) 1325 (1976).

180. The net worth of the parties was \$48,539; the present value of the payments was \$62,327. *Id.* at 1328-29.

181. See *infra* notes 185 & 186 and accompanying text.

182. The court found that the parties did not own a significant amount of



Clearly, the recipient spouse faces a difficult burden in asserting that payments represent a property settlement when the parties do not possess assets valued at the amount of the payments reduced to present value. Correspondingly, a paying spouse should be readily able to sustain a contention that payments represent support when the sum of such payments is much larger than any interest the recipient could have in such property. In such a situation, however, the paying spouse must still prove a negative, the absence of a property interest of the recipient, and, at times, the courts have been imaginative in hypothesizing such property interests.<sup>183</sup>

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property at the time of their marriage, that the taxpayer had devoted her attention to the care of four children, and that she had acquired no property during the marriage from any source other than her husband. 35 T.C.M. (CCH) at 1329.

183. In *Martin v. Commissioner*, 73 T.C. 255 (1979), the husband attempted to deduct, as periodic payments, two payments of \$12,500 designated as "additional alimony" and payable in the two years after the divorce. *Id.* at 258. The husband also was to make monthly payments over 121 months. The wife received a house in Florida and some personal property. The court found that \$7,500 of each of the \$12,500 payments were non-deductible as payments of the wife's legal fees. *Id.* at 261-62 (citing *Rose v. Commissioner*, 459 F.2d 28 (6th Cir.), *cert. denied*, 409 U.S. 879 (1972); *Baer v. Commissioner*, 196 F.2d 646 (8th Cir.), *aff'd*, 16 T.C. 1418 (1951)). As to the remainder, the court determined that it represented a property settlement. The court, in so holding, was undaunted by the absence in the record of any indication of property to which the payments might correspond. It noted:

The petitioners . . . contend that a support agreement is indicated by the fact that the respondent cannot point to any property rights relinquished by [taxpayer's former wife] in exchange for the two \$12,500 payments. However, as we noted above, the terms of the agreement make it clear that [taxpayer's former wife] had some property rights that were to be settled by the agreement. The petitioners bear the burden of proving their right to alimony deductions.

73 T.C. at 265. *See also Hayutin v. Commissioner*, 39 T.C.M. (CCH) 449 (1979), *aff'd*, 508 F.2d 642 (10th Cir. 1974). In *Hayutin*, the Tax Court considered the husband's contention that monthly payments to his former wife constituted support. The payments for an earlier taxable year had been allocated as \$500 for support and \$200 for the wife's property. *See Hayutin v. Commissioner*, 31 T.C.M. (CCH) 509 (1972), *aff'd*, 508 F.2d 462 (10th Cir. 1974). The court, unable to point to ascertainable property to justify the continued allocation of \$200 to a property settlement in the taxable years involved, held:

We think it can reasonably be inferred from our prior decision that, despite the absence of a determination of the dollar amount involved, the value of the property acquired by [the husband] from [the wife] exceeded the value of the property transferred by him to her by considerably more than the relatively insignificant amount of \$1400 allocated thereto in the prior proceeding.

39 T.C.M. (CCH) at 454.

Assuming that assets subject to division in a property settlement may be identified, it is incumbent upon a party seeking to exclude payments from her income as representing a property settlement to establish an interest in such property. As indicated above, the interest need not be co-ownership, it may be inchoate. A recipient spouse stands a much better chance of demonstrating a property interest to support an exclusion in community property jurisdictions because of the rights in the assets of the community such jurisdictions grant the parties.<sup>184</sup> On the other hand, if a division of the assets of the community is unequal, the payor faces a difficult burden in demonstrating that the monthly payments are not intended to redress this disparity and, hence, do not represent nondeductible installments on a property settlement.<sup>185</sup> Obviously, if in a community property jurisdiction the recipient can be demonstrated to have received one-half or more of the community assets, it is then more difficult for her to demonstrate that such payments represent the purchase price of her share of the assets allegedly retained by the payor.<sup>186</sup>

The presence of a community property interest under state law may assist a recipient of payments to exclude them as a property settlement by counteracting an inference that such payments

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184. See Harris, *supra* note 172. This is also true in jurisdictions which, though they are not, strictly speaking, community property jurisdictions, vest interests akin to community property states in property acquired jointly during the marriage. See Jackson v. Commissioner, 54 T.C. 125, 130 (1970) (law of Oklahoma).

185. See, e.g., Westbrook v. Commissioner, 74 T.C. 1357 (1980). In Westbrook, the Tax Court upheld the taxpayer's exclusion from income of \$9900 annual payments she received from her former husband. *Id.* at 1368. The jurisdiction granting the divorce, California, is a community property state, but the taxpayer was unable to demonstrate the exact value of her interest in the community property at the time of the divorce and she had received other property, including a car, a home, furnishings, and \$11,700 in cash. The IRS contended that the payments represented support. Testifying for the IRS, the former husband attempted to minimize the value of business property he owned at the time of the divorce and in which she might have a community property interest. *Id.* at 1365. The court found incredible his testimony that the property, worth \$80 million at the time of the Tax Court trial in 1979, was worth only one-tenth that amount in 1974, the year of the divorce. *Id.* at 1366. The court noted that the payments were for a fixed amount, that they were not contingent, and that the unpaid sum bore interest. The presence of an interest in the wife created by state law was also deemed important. *Id.* at 1365. As the court stated, to bear her burden of proof the taxpayer "need not establish the precise extent of the community property interest she surrendered." *Id.* at 1367.

186. See Newbury v. Commissioner, 46 T.C. 690, 695 (1966).

represent a support obligation where they are actually used for support. If there is a community property interest which must be liquidated, payments to liquidate it represent a property settlement whether or not the recipient of payments needs support and uses divorce-related payments for subsistence.<sup>187</sup> In a common law property jurisdiction, the recipient must make a stronger showing of a property interest.<sup>188</sup>

Two cases which clearly illustrate typical analyses of recipients' alleged property interests in common law jurisdictions, but which are difficult to reconcile, are *Bernatschke v. United States*<sup>189</sup> and *Wright v. Commissioner*.<sup>190</sup> *Bernatschke* was an unusual case in that the recipient taxpayer did not argue in favor of complete excludability under section 71. Her former husband, in connection with their divorce in 1940 in Illinois, paid insurance companies \$647,000 to provide her with an annuity of \$25,000 per year for the rest of her life. The Commissioner asserted that the entire amount received for the taxable years involved was income to the recipient. The taxpayer contended that part of all sums was excludable under the annuity rules of section 72.<sup>191</sup> The annuity rules would be applicable only if the transfer of property to the insurance companies was viewed as compensation for the wife's interest in her husband's property or in the marital property. The transaction could also have been viewed as a transfer of property in connection with a divorce in

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187. See *Land v. Commissioner*, 61 T.C. 675, 683 (1974); *Jackson v. Commissioner*, 54 T.C. 125, 132 (1970).

188. See *Salapatas v. Commissioner*, 446 F.2d 79 (7th Cir. 1971); *Hesse v. Commissioner*, 60 T.C. 685 (1973); *Thompson v. Commissioner*, 50 T.C. 522 (1968); *Nathan v. Commissioner*, 19 T.C. 865 (1953). *Nathan*, in particular, demonstrates the burden of proof on a recipient of payments when the Commissioner asserts that the payments represent a legal obligation for support. In that case, the taxpayer received \$17,500 per year in semi-annual installments. The payments were subject to contingencies and approximated support payments while the parties were separated. In addition, the taxpayer was unable to sustain her contention that these payments represented compensation for an interest in her husband's business. *Id.* at 871.

189. 364 F.2d 400 (Ct. Cl. 1966).

190. 62 T.C. 377 (1974), *aff'd*, 543 F.2d 593 (7th Cir. 1976).

191. 364 F.2d at 404. Under I.R.C. sections 72(b) and (c), if applicable, the taxpayer would be able to exclude an amount that bore the same ratio to each payment that the husband's investment in the contract, \$647,000, bore to the expected return, i.e., \$2500 multiplied by the number of years of life expectancy of the recipient.

recognition of the husband's support obligation.<sup>192</sup> The payments bore at least a superficial resemblance both to support and to a property interest; they were to be made until her death but they were to be made, and were made, after her remarriage. The Court of Claims, adopting the findings and conclusions of law of its trial commissioner, determined that the consideration for the annuities was not paid pursuant to an obligation of support and, thus, were not fully taxable to the recipient.<sup>193</sup> The remarkably amicable circumstances of the taxpayer's divorce in 1940 lent an unusual degree of inexorability to the court's findings.

The taxpayer's husband was very wealthy and he was determined to make a generous settlement with his wife.<sup>194</sup> The taxpayer stated unequivocally that she wanted a lump sum settlement. The taxpayer's husband stated that he wanted to make a property settlement that approximated the taxpayer's dower interest in his property.<sup>195</sup> An individual who had been a business adviser to the husband's family for many years suggested to both parties that the husband should not turn over a large amount of liquid assets to the taxpayer because of her inexperience in business matters.<sup>196</sup> Thus, payment was arranged in the form of annuities by the taxpayer's husband. The taxpayer granted her former husband quitclaim deeds releasing to him all rights in property he owned in Massachusetts and Tahiti. In finding a property settlement, the court was not concerned that the taxpayer did not show specific interest in identifiable assets, something that might have been very difficult such a long time after the divorce. The court noted that mathematical exactitude is not a necessary attribute of a property settlement.<sup>197</sup>

The court was heavily influenced by the absence of any discus-

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192. Under I.R.C. section 71(d), when such a transfer of property is made, the husband does not take the income from property into his income; the recipient takes it into her income. *See* Rev. Rul. 238, 1965-2 C.B. 25. Under I.R.C. section 215, however, no deduction is permitted the husband for amounts includable in the wife's income under section 71(d).

193. 364 F.2d at 409.

194. *Id.* at 406.

195. Under 1939 Ill. Laws Ch. 3 § 18 (repealed 1976), a wife's dower interest was one-third. Since the husband possessed approximately \$2,000,000 worth of income-producing property, he decided to give her \$650,000. 364 F.2d at 406.

196. 364 F.2d at 406.

197. *Id.* at 407 n.7 (citing *Scott v. United States*, 225 F. Supp. 257 (D. Or. 1963)).

sion of alimony or support by either of the parties in the divorce negotiations. The court also noted that the taxpayer's standard of living changed drastically after the divorce; there was no attempt to maintain her in the style to which she was accustomed during the marriage.<sup>198</sup> The court was impressed by the lack of any attempt by the parties to value the taxpayer's right to receive alimony,<sup>199</sup> by the right of the taxpayer to designate the beneficiary of any refunds payable after her death,<sup>200</sup> and by the inability under the agreement to vary the amount of the payments according to the needs and means of the parties.<sup>201</sup>

The circumstances in *Bernatschke*, that is, the presence of a large amount of property, a legal interest in that property under state law in the recipient, acknowledgement by the other party of that interest, the absence of a demand for or consideration of alimony or support, and the fixed nature of payments provides a useful catalogue of the factors a recipient should adduce in order to demonstrate that payments are part of a property settlement. In cases where the paying spouse is attempting to prove that payments relate to a support obligation, it is useful to prove the reverse of as many of these factors as possible. In *Bernatschke*, the taxpayer had no adversary other than the IRS, as her former husband had no tax motivation to assert that the payments pertained to a support obligation at the time of the divorce, which preceded enactment of section 22(k) of the 1939 Code, or at the time of trial.<sup>202</sup> Despite its relatively unusual circumstances, *Bernatschke* would serve as a beacon for parties and draftsmen if its factors were applied consistently.

A significant case that is difficult to reconcile with *Bernatschke* is *Wright v. Commissioner*.<sup>203</sup> In this case, which involved petitions to the Tax Court by both parties to a divorce granted in Wisconsin, the husband sought to deduct, and the wife sought to exclude, monthly payments made pursuant to the divorce judg-

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198. Under the court's interpretation of Illinois law, the wife was entitled to be maintained in her lifestyle prior to divorce. 364 F.2d at 408 (citing *Walters v. Walters*, 341 Ill. App. 561, 94 N.E.2d 726 (1950), *aff'd*, 409 Ill. 298, 99 N.E.2d 342 (1951); *Herrick v. Herrick*, 319 Ill. 146, 149 N.E. 820 (1925)).

199. 364 F.2d at 407.

200. *Id.* at 408. The taxpayer exercised this right in favor of her former husband.

201. *Id.*

202. The husband would get no deduction under section 215. *See supra* note 192.

203. 62 T.C. 377 (1974), *aff'd*, 543 F.2d 593 (7th Cir. 1976).

ment. The payments at issue were to be made over ten and one-half years and were to total \$228,000. As in *Bernatschke*, the parties, separately or together, possessed a substantial amount of property,<sup>204</sup> and the jurisdiction granting the divorce was a common law property jurisdiction.<sup>205</sup> Unlike the divorce agreement in *Bernatschke*, the judgment in *Wright* provided for a transfer of substantial assets to the wife in addition to later monthly payments.<sup>206</sup>

Following the oral grant of a divorce, the state court, in considering objections of the husband to the proposed findings of fact and conclusions of law, considered whether the installment payments related to a division of property or to a legal obligation of support. The state court judge found that alimony was to be denied and that the \$228,000 was to be paid "as and for a complete division of the property of the parties . . ." <sup>207</sup> It was also provided that the payments were to be secured by an escrow of marketable securities and that in the event of the death of the husband prior to the payment of \$228,000, the balance was to be paid promptly to the wife.<sup>208</sup> Neither party contended that the award was subject to any contingencies and the Tax Court later concluded that it was not.<sup>209</sup>

In the Tax Court, the wife relied on *Bernatschke* and asserted that the payments represented compensation for her relinquishment of her property rights under Wisconsin law.<sup>210</sup> The Tax Court denigrated these statutory rights as "inchoate," not even.

204. Their estate, according to the Tax Court, comprised \$1,169,122 in assets and \$104,000 in liabilities. 62 T.C. at 380.

205. *Id.* at 390 (citing WIS. STAT. ANN. § 247.26 (West 1957), 1935 Wis. Laws Ch. 379 (current version at WIS. STAT. ANN. § 767.255 (West Supp. 1981))).

206. 62 T.C. at 383. The wife was to receive \$288,000 in assets exclusive of the present value of the monthly payments.

207. *Id.* at 384.

208. *Id.*

209. *Id.* at 392.

210. WIS. STAT. ANN. § 247.26 reads in pertinent part:

Upon every divorce from the bond of matrimony . . . the court may finally divide and distribute the estate, both real and personal, of the husband and so much of the estate of the wife as shall have been derived from the husband, between the parties and divest and transfer the title of any thereof accordingly, having always due regard to the legal and equitable rights of each party, the ability of the husband, the special estate of the wife, the character and situation of the parties and all the circumstances of the cases . . . .

WIS. STAT. ANN. § 247.26 (West 1957), 1935 Wis. Laws ch. 379. *See supra* note 205.

remotely reaching "the dignity of co-ownership,"<sup>211</sup> and found that the payments constituted alimony. It is clear, however, that the ability of the state court to divide the marital estate according to the equities would provide an incentive to a party to settle, granting the other party more property than that in which the other party has as ascertainable ownership interest. It is difficult to imagine how the mere expectancy possessed by the wife in *Bernatschke*, relied upon by the court therein to find a property settlement, could possibly be afforded more dignity than the rights created under the Wisconsin statute for the wife in *Wright*. The state court in *Wright* was empowered to make a division of property; it was not limited by considerations of actual ownership in making such a division and, when the issue of tax consequences was squarely joined before it, it specified that the payments represented a property settlement rather than alimony. In *Bernatschke*, the obvious intent of the parties in an amicable setting was honored. In *Wright*, the substance of the explicit resolution of a contested issue was disregarded. Clearly, the latter situation commanded as much judicial deference to the substance of the transaction as the former.

The Tax Court seized upon two bases, neither of which is persuasive, to distinguish *Bernatschke*. First, the court noted that alimony had not been discussed in the negotiations leading up to the settlement in *Bernatschke*.<sup>212</sup> In *Wright*, according to the Tax Court, alimony was considered before and during the divorce proceedings.<sup>213</sup> The Tax Court also noted the power of the state court to provide for both support and a division of the estate. This should not obscure the divorce court's specific holding that it was not awarding alimony.

Secondly, the Tax Court determined that the parties had

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211. The court cited *United States v. Davis*, 370 U.S. 65 (1962). 62 T.C. at 391. The use of *Davis* to demean the wife's interest in property owned by the parties is paradoxical. In *Davis*, the wife's inchoate dower rights were sufficient consideration to the husband to support a taxable exchange 370 U.S. at 71; yet in *Wright*, they were not regarded as consideration for the husband's payments. 62 T.C. at 392. The presence in the law of taxation of such single-edged blades, cutting only against the taxpayer, can only undermine public confidence in the administration of the revenue laws. As Justice Douglas once stated: "the Government in moving against the citizen should also turn square corners." *Commissioner v. Lester*, 366 U.S. 299, 396 (1961) (Douglas, J., concurring).

212. 62 T.C. at 391.

213. *Id.* at 392.

never discussed the inchoate rights of the wife and the negotiations surrounding the divorce.<sup>214</sup> Although evidence of negotiations of the parties was important in *Bernatschke*, it is difficult to posit that the use or nonuse of terms of art in negotiations should be a critical distinguishing factor when the state court explicitly stated that its award represented a property settlement and when the payments bore such a strong resemblance to a property settlement. The distinctions employed to evade *Bernatschke* create perhaps a semblance of justification, but they make prediction of tax consequences very difficult for the parties, the draftsmen, and the judge in a divorce case.<sup>215</sup>

What is clear from a comparison of *Bernatschke* and *Wright* is that the absence of an identifiable property interest in the recipient of payments is not a factor that is applied with litmus certainty in determining whether payments represent support or a property settlement. Other important factors in differentiating payments representing support from those representing a property settlement have also been applied with unsettling variation in characterizing divorce-related payments. The overriding certainty in such cases is the ability of the IRS to place the burden of proof on whomever it chooses. Indeed, the burden of proof serves too often as a means of reconciling apparently inconsistent characterization decisions. This is arguably so with at least

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214. *Id.* at 391-92.

215. The wife in *Wright* later sought amendment of the Wisconsin divorce judgment in the state courts to increase the amount of payments by \$102,840, the amount of tax on the installments, so that she would receive \$228,000 free and clear of tax. *Wright v. Wright*, 92 Wis. 2d 246, 284 N.W.2d 894 (1979), *cert. denied*, 445 U.S. 951 (1980). The wife argued that if the award was alimony for tax purposes, it was alimony under Wisconsin law and hence, subject to modification. The court, noting that the installments were not subject to contingencies, deemed it to be a division of estate and division of property, not subject to modification. *Id.* at 263, 284 N.W.2d at 903. The wife also sought modification on the basis that the judgment was ambiguous and that the \$102,840 was necessary to implement the original intent of the trial court that the wife not bear the tax consequences of the installments. The court noted that while the issue of tax liability for the payments was before the trial court, it adopted proposed findings of the wife which did not explicitly fix tax consequences. The court implied that if the wife wanted the decree to fix the tax consequences of the parties she should have appealed the judgment. *Id.* at 261, 284 N.W.2d at 900. In view, however, of the certitude of the trial court and later of the Wisconsin Supreme Court that alimony had not been awarded and that the payments represented a property settlement, it is difficult to see what the taxpayer would have appealed.



three factors used in distinguishing support from a property settlement: (1) the presence and amount of payments *pendente lite*; (2) the use of the payments by the recipient for maintenance; and (3) the presence of a contested claim to ownership of a specific interest in the property of the paying spouse.

1. *Similarity to Payments Pendente Lite*

It is not at all strange to posit that if support payments have been established by agreement or decree prior to the entry of a final divorce decree, undesignated payments which resemble the earlier support payments are, quite likely, also support. If the need for and amount of spousal support has been determined prior to any property division, later payments may easily be regarded as the continued fulfillment of such need. This was recognized in *Hayutin v. Commissioner*,<sup>216</sup> in which the United States Court of Appeals for the Tenth Circuit affirmed the Tax Court's<sup>217</sup> allocation of payments in the taxable year of \$700 per month as \$500 for support and \$200 for a property settlement.<sup>218</sup> The Tax Court was strongly influenced in fixing the amount of support by an agreement in which the parties fixed temporary alimony at \$500 per month and by the husband's making of such payments.<sup>219</sup> The court rejected the wife's contention that the entire \$700 per month be viewed as a property settlement.

While the court's resolution of the characterization issue in *Hayutin* is sensible, such analysis is clearly inconsistent with the language of the Tax Court in *Jackson v. Commissioner*:<sup>220</sup>

Nor are we persuaded that the payments in issue are alimony by the fact that the petitioner made monthly payments to his wife during the six years prior to the divorce. That petitioner may have felt an obligation to support his wife prior to the divorce does not bear on whether petitioner and his wife had jointly acquired property which was required to be divided between them on divorce.<sup>221</sup>

The inconsistent treatment of the issue by the courts in *Hayutin*

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216. 508 F.2d 462 (10th Cir. 1975).

217. 31 T.C.M. (CCH) 509 (1972).

218. The Tax Court subsequently applied this allocation to payments in later taxable years. See *Hayutin v. Commissioner*, 39 T.C.M. (CCH) 449 (1979).

219. 31 T.C.M. (CCH) at 569-70.

220. 54 T.C. 125 (1970).

221. *Id.* at 132.

and *Jackson* is perhaps reconciled by the fact that in each case the party who bore the burden of proof on the issue lost. The presence or absence of support payments *pendente lite* is a helpful characterization factor and should be applied consistently.

### 2. *Use of Payments by the Recipient as Maintenance*

If the demonstrated need for support by a recipient may be viewed as an indication that such payments represent support, then use of such payments for maintenance would plausibly support characterizing the payments as support. In *Warnack v. Commissioner*,<sup>222</sup> the recipient of 121 monthly payments in a total amount of \$257,125 asserted that the payments represented a property settlement. A strikingly disparate division of other assets of the estate of the parties<sup>223</sup> lent credence to the wife's contention that the payments were intended to effect an equal division of the parties' property. The court rejected the wife's contention, relying in part on her use of the payments as her sole means of support.<sup>224</sup>

While use of payments for maintenance provides strong evidence that such payments represent a support obligation, this factor has not been applied consistently. In *Crouser v. Commissioner*,<sup>225</sup> a taxpayer making payments to his former spouse urged that such payments be viewed as support, in part, because they were actually used as support. The court found this factor "unpersuasive."<sup>226</sup> An important factor in *Warnack* was virtually disregarded in *Crouser*. Again, a common denominator in these cases was that the party who bore the burden of proof on the issue lost.

### 3. *Presence of a Claim to an Interest in Property by the Recipient*

In determining whether payments represent a property settlement, it is useful to consider whether the recipient, in the course

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222. 71 T.C. 541 (1979).

223. The husband received assets valued at \$649,373.42 and the wife received assets valued at \$139,250, exclusive of the monthly payments. *Id.* at 546.

224. *Id.* at 553.

225. 73 T.C. 1113 (1980).

226. *Id.* at 1120 (citing *Land v. Commissioner*, 61 T.C. 675 (1974); *Jackson v. Commissioner*, 54 T.C. 125 (1970)).

of divorce proceedings, has made any claim to specific property. In *Pierce v. Commissioner*,<sup>227</sup> the parties were divorced in a 1964 Nevada action in which no alimony was ordered. In a subsequent divorce action in New Jersey, the court ordered the wife to pay the husband \$20,000 for shares of stock she had allegedly converted and ordered the husband to pay a lump sum of \$20,000 of "accumulated alimony."<sup>228</sup> No money changed hands as a result of that portion of the order, but the husband attempted to deduct the payment. In finding against the husband, the court was strongly influenced by the fact that the payment was a lump sum and that it was sandwiched between two property settlement provisions in the agreement.<sup>229</sup> The court also held, however, that the payment settled a longstanding dispute as to ownership of the stock. While the court noted that the payment was designed to forgive the wife's alleged conversion of the stock, the court treated ownership of the stock as disputed and viewed the payments as a resolution of the dispute. Thus, the wife's claim to the stock, asserted when she transferred it into her own name, created the property interest that, in part, sustained the property settlement characterization.<sup>230</sup>

In *Thompson v. Commissioner*,<sup>231</sup> the naked assertion of a property interest of the recipient in the property of the payor was insufficient to foreclose characterization of payments as support. The wife contended that the payments represented her one-half interest in the stock of a corporation and in real property owned by her former husband. The taxpayer had actually been a tenant-by-the-entirety in the real property before it was conveyed to the corporation in return for the stock in which she claimed an interest.<sup>232</sup> Nevertheless, the court dismissed the wife's claim to an interest in property as "a mere allegation in petitioner's amended complaint in the divorce proceeding."<sup>233</sup>

Again, the difference between the results in *Pierce* and

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227. 66 T.C. 840 (1976).

228. *Id.*

229. *Id.* at 847.

230. *Id.* at 846-47.

231. 50 T.C. 522 (1968).

232. The payments provided for interest on the unpaid balance, were secured by a mortgage, and would not terminate on the taxpayer's death or remarriage. *Id.* at 526.

233. *Id.*

*Thompson* stems not from application of common principles to different facts, but from inconsistent application of significant factors. In both cases the party with the burden of proof, the taxpayer, was unsuccessful.

The variety of results in decisions characterizing payments does not facilitate tax planning. Statutory presumptions must be established for particular types of payments and the factors used in overcoming such presumptions must be set forth clearly in regulations. This suggestion is developed in Part V of this article.

#### V. THE REQUIREMENT THAT PAYMENTS BE PERIODIC

Assuming that divorce-related payments represent an obligation of support, they must be periodic under section 71 to be deductible by the payor. As indicated earlier, neither the statute nor the committee reports accompanying the Revenue Act of 1942 define periodic.<sup>234</sup> Nevertheless, there are some guidelines available to draftsmen drawn from cases construing that term. No case was discovered in which the payor was denied deductions for payments which were indefinite in duration. This is not surprising; not only is indefiniteness ostensibly congruent with the term periodic, it is also antithetical to the notion of a property settlement.

Questions as to whether payments are periodic frequently arise when divorce decrees or agreements provide both for regular and equal or approximately equal payments of definite or indefinite duration, and for one or more payments which are much larger than the others and are made at the same time as or shortly after the divorce. The courts have tended to treat payments which are disproportionate to a stream of payments provided in the same decree or agreement as not periodic.<sup>235</sup> The willingness of the courts to segregate disproportionate payments from other payments pursuant to a decree or agreement has made it difficult to camouflage payments which represent a prop-

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234. See *supra* note 12.

235. See *infra* notes 237-49 and accompanying text. Even if such disproportionate payments are regarded as periodic, if the other payments are for a definite amount and a definite duration of longer than ten years, the payor's deduction in any one year is limited to 10% of the total of all payments. I.R.C. § 71(c)(2).

erty settlement by lumping them with periodic support payments.<sup>236</sup>

In *Knowles v. United States*,<sup>237</sup> the divorce decree of the parties provided, *inter alia*, for monthly payments to the wife of \$300 to be paid until decreed otherwise. The decree also required the taxpayer to make a lump sum payment of \$25,000 to the wife. The denial by the Commissioner of the taxpayer's deduction of the \$25,000 payment was the basis of the taxpayer's refund suit. The court held that the term "periodic" excluded a lump sum installment payment, relying on the ordinary meaning of the term "periodic."<sup>238</sup>

The *Knowles* decision was relied on in *Pierce v. Commissioner*,<sup>239</sup> to equate a lump sum payment with a property settlement. In *Pierce*, as discussed earlier,<sup>240</sup> the taxpayer liquidated a \$20,000 claim for "accumulated alimony" fixed by the divorce decree by forgiving a claim against his wife for her alleged conversion of stock valued in the same amount. The decree also provided for weekly support payments to the wife until further order of the court. The court, in denying a deduction for the \$20,000 payment, held that resort by the parties to the lump sum form of payment is a strong indication that the payment represents a property settlement.<sup>241</sup> Again, the disproportionate payment was not regarded as one of the periodic payments contained in the agreement.

Whether a large payment made shortly after the decree is viewed as a property settlement or simply as not periodic in a common sense meaning of the term, such a result is not difficult to justify if the payment is greatly disproportionate to regular monthly or weekly payments provided elsewhere in a decree or agreement. Such segregation becomes more tenuous in other circumstances. In *Houston v. Commissioner*,<sup>242</sup> the divorce decree provided in part that the husband was to pay the wife \$115,000

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236. See *Bernstein v. Commissioner*, 622 F.2d 442 (9th Cir. 1980).

237. 182 F. Supp. 150 (S.D. Miss. 1960), *aff'd*, 290 F.2d 584 (5th Cir. 1961).

238. 182 F. Supp. at 154 (citing *Norton v. Commissioner*, 16 T.C. 1216, *aff'd*, 192 F.2d 960 (8th Cir. 1951)).

239. 66 T.C. 840 (1976).

240. See *supra* text accompanying notes 227 & 228.

241. 66 T.C. at 847 (citing *Campbell v. Lake*, 220 F.2d 341 (5th Cir. 1955), and *Land v. Commissioner*, 61 T.C. 675 (1974)).

242. 442 F.2d 40 (7th Cir. 1971).

in cash within one month of the decree and then \$25,000 per year commencing more than one year after the divorce decree. While the \$115,000 is disproportionate with respect to the \$25,000 annual payments, which were determined by the Tax Court to possess support characteristics,<sup>243</sup> the annual payments were larger and less frequent than support payments generally. Thus, the basis for the segregation is not completely obvious. The language of the court should serve as a clear warning to draftsmen, however: "Where there is a substantial payment, such as this, which comes soon after the entry of the divorce decree, we think it not unreasonable to conclude that a property settlement was intended."<sup>244</sup>

Disproportionate payments in amounts smaller than those involved in *Knowles*, *Pierce*, and *Houston* have been regarded as nondeductible by the payor. In *Norton v. Commissioner*,<sup>245</sup> the Tax Court refused to treat a payment of \$5,000 "additional alimony" as one of a series of periodic payments when the other payments were \$200 per month.<sup>246</sup> While the Tax Court has recently observed that the fact that a payment is larger than other payments does not, in itself, prevent such a payment from qualifying as periodic,<sup>247</sup> disproportionately large payments at the time of the divorce or shortly thereafter appear to be a poor idea tax-wise for the paying spouse. Likewise, the transfer of property other than money, such as a home,<sup>248</sup> or making a down payment on a home,<sup>249</sup> are not likely to be regarded as periodic.

The unwillingness of the courts to treat large lump sums as periodic payments has not been limited to payments made at or near the time of the entry of the decree. Lump sum payments in consideration for liquidation of an obligation to make periodic

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243. See *Schwab v. Commissioner*, 52 T.C. 815, 818 (1969).

244. 442 F.2d at 42.

245. 16 T.C. 1216, *aff'd*, 192 F.2d 960 (8th Cir. 1951).

246. See also *Commissioner v. Goff*, 23 T.C.M. (CCH) 654 (1964). In *Goff*, husband was denied a deduction for cancelling a \$2500 debt. The cancellation was not treated as one of the periodic payments when such other payments were \$100 per month. *Id.* at 659.

247. *Miller v. Commissioner*, 41 T.C.M. (CCH) 714, 716 (1981) (citing *Thompson v. Commissioner*, 50 T.C. 522 (1968), and *Porter v. Commissioner*, 25 T.C.M. (CCH) 448 (1966), *aff'd mem.*, 388 F.2d 670 (6th Cir. 1968)).

248. See *Miller v. Commissioner*, 41 T.C.M. (CCH) 715 (1981).

249. See *Lounsbury v. Commissioner*, 321 F.2d 925 (9th Cir. 1963).

payments,<sup>250</sup> and lump sum payments on the recipient's remarriage<sup>251</sup> have been held not to be periodic. Lump sum prepayments of alimony have not been regarded as periodic.<sup>252</sup> One exception has been carved out for lump sum payments of arrearages in periodic payments. Such lump sum payments retain the characterization of the original payments.<sup>253</sup> Thus, while the reasoning of cases construing the "periodic" requirement of section 71(a) may be disputed in some instances, the cases are fairly consistent and their message easily discernible.

#### A. "Deemed" Periodic Payments Under Section 71(c)(2)

As noted earlier, payments representing installments on a principal sum are not regarded as "periodic" under section 71(c)(1).<sup>254</sup> Under section 71(c)(2), however, if the payment period of the principal sum is more than ten years from the date of the decree or agreement, the payments are treated as periodic. There is no explicit indication in the legislative history of the Revenue Act of 1942 why payments on a principal sum payable over a period exceeding ten years are given the same tax treatment as indefinite payments under section 71(a).<sup>255</sup> There is also no indication why payments on a principal sum payable over a period of less than ten years are not periodic payments.

Alimony or support that is limited in amount and duration is

250. See *Ashcraft v. Commissioner*, 255 F.2d 200 (7th Cir. 1958).

251. See *Commissioner v. Senter*, 242 F.2d 400 (4th Cir. 1957); *Hardy v. Commissioner*, 59 T.C. 857 (1973).

252. See, e.g., *Capiaux v. United States*, 43 A.F.T.R.2d (P-1 79-3791) (N.D. Cal. 1978).

253. See *Capodanno v. Commissioner* 602 F.2d 64 (3d Cir. 1979).

254. See *supra* note 14 and accompanying text.

255. In the Senate proposal for the Revenue Act of 1941, 55 Stat. 687, (1941) no installments on a principal sum were deductible by the payor. See S. REP. NO. 673, 77th Cong., 1st Sess. 33 (1942). Strangely enough, the House of Representatives' original version of the 1942 legislation provided that installment payments were treated as periodic payments: "If the amount thereof is 10 per centum or more of such principal sum or if such principal sum is required, by the terms of the decree or instrument, to be paid within a period ending *not more* than 10 years from the date of such decree or instrument." H.R. 7378, 77th Cong., 2d Sess. § 117 (1942) (emphasis added). The Senate Finance Committee amended this to provide that the principal sum must be paid over a period longer than ten years for installments thereon to be considered periodic. S. REP. 1683, *supra* note 12, at 84-85. The House acquiesced. H.R. REP. NO. 2586, 77th Cong., 2d Sess. 38 (1942) (conference report).

commonly called "alimony in gross" or "lump sum alimony."<sup>256</sup> Alimony in gross represents a trade-off between the parties. The amount of the paying spouse's obligation is final and non-modifiable, but it terminates at a date certain. It is not entirely unreasonable to speculate that the drafters of section 22(k) of the 1939 Code desired to impose a similar trade-off for tax purposes when the parties reduced the obligation to a gross or lump sum; a payor who limits the duration of his obligation must make payments over a period exceeding ten years or the payments will not be deductible.

As discussed earlier, the ability to shift income from the grantor to the recipient of an alimony trust was the only divorce-related tax benefit available prior to the Revenue Act of 1942.<sup>257</sup> A significant problem was that this benefit was not uniformly available. It was most likely to be permitted where, under local law, the divorce decree or agreement fixed the grantor's obligation such that it was not a continuing legal obligation subject to modification.<sup>258</sup>

In providing for the deductibility of payments made pursuant to a support obligation, Congress, in the Revenue Act of 1942, swept aside one of the underpinnings of *Douglas v. Willcuts*,<sup>259</sup> that the use of income to fulfill a legal obligation should result in taxation to the individual whose obligation was fulfilled.<sup>260</sup> It is not surprising, in that spirit, that alimony in gross, which is used to discharge a spouse's support obligation and forestall modification,<sup>261</sup> should have been accompanied by a requirement that it be paid over a period exceeding ten years to be deductible by the payor. The ten-year demarcation, in view of the rejection of a

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256. See H. CLARK, *THE LAW OF DOMESTIC RELATIONS* 447 (1968).

257. See *supra* notes 22-28 and accompanying text.

258. See Paul, *Five Years with Douglas v. Willcuts*, 53 HARV. L. REV. 1, 7 (1930); Raum, *Taxability of the Grantor Alimony and Similar Trusts*, 10 U. KAN. CITY L. REV. 25, 38 (1941).

259. 296 U.S. 1 (1935).

260. See *Old Colony Trust & Co. v. Commissioner*, 279 U.S. 716 (1929) (employer's payment of employee's taxes held to be income to employee).

261. The role of alimony in gross in foreclosing modification by fixing a certain amount and the duration of payments has been noted in federal tax cases. See, e.g., *Wright v. Commissioner*, 62 T.C. 377, 394 (1974), *aff'd*, 543 F.2d 593, 599 (7th Cir. 1976); *Riddell v. Guggenheim*, 281 F.2d 836, 839 (9th Cir. 1960); *Ryker v. Commissioner*, 33 T.C. 924, 930 (1960).



provision that would have provided periodic treatment for installments on principal sums payable in *ten years or less*,<sup>262</sup> evidences a fairly clear legislative intent that a recipient of support payments should benefit tax-wise if she consents to a fixed sum of payments terminating within ten years.

Despite this clear line apparently drawn for specific alimony obligations, the federal appellate courts<sup>263</sup> and then the Treasury Department, through regulations,<sup>264</sup> have determined that if payments of a fixed amount and duration less than ten years may be terminated by the death of either spouse, remarriage of the recipient, or other contingency,<sup>265</sup> or may be modified, the payments are income to the recipient and deductible by the payor. This seems incongruous in light of the apparent trade-off in section 71(c)(1) and (2), because the termination on the occur-

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262. See *supra* note 255.

263. See *Fidler v. Commissioner*, 231 F.2d 138 (9th Cir. 1956); *Prewitt v. Commissioner*, 221 F.2d 250 (8th Cir. 1955); *Davidson v. Commissioner*, 219 F.2d 147 (9th Cir. 1955); *Smith's Estate v. Commissioner*, 208 F.2d 349 (3d Cir. 1953); *Baker v. Commissioner*, 205 F.2d 369 (2d Cir. 1953).

264. In particular, Treas. Reg. § 1.71-1(d)(3) (1957) states:

(i) Where payments under a decree, instrument, or agreement are to be paid over a period ending ten years or less from the date of such decree, instrument, or agreement, such payments are not installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree, instrument, or agreement and are considered periodic payments for the purposes of section 71(a) only if such payments meet the following two conditions:

(a) Such payments are subject to any one or more of the contingencies of death of either spouse, remarriage of the wife, or change in the economic status of either spouse, and

(b) Such payments are in the nature of alimony or an allowance for support.

(ii) Payments meeting the requirements of subdivision (i) are considered periodic payments for the purposes of section 71(a) regardless of whether—

(a) The contingencies described in subdivision (i)(a) of this subparagraph are set forth in the terms of the decree, instrument, or agreement, or are imposed by local law, or

(b) The aggregate amount of the payments to be made in the absence of the occurrence of the contingencies described in subdivision (i)(a) of this subparagraph is explicitly stated in the decree, instrument, or agreement or may be calculated from the face of the decree, instrument, or agreement, or

(c) The total amount which will be paid may be calculated actuarially.

*Id.*

265. One of the more unusual contingencies is provided by New York law, which suspends payment of alimony during imprisonment of the payor. N.Y. DOM. REL. LAW § 247 (McKinney Supp. 1980).

rence of a contingency can only reduce an obligation which is already payable over too short a time to be deductible.<sup>266</sup> The determination in the leading case, *Baker v. Commissioner*,<sup>267</sup> and its progeny, that such payments are periodic, was predicated on the unpredictability of the amount to be paid. Since payments can be terminated, there is no principal sum. As the court in *Baker* stated: "[T]he computation seems as far beyond the reach of an educated guess as what will be the first name of the man or woman who will become President of the United States in 1983."<sup>268</sup> What is certain, however, is that the payments in *Baker* and related cases would terminate within ten years. At this stage, however, any argument with the result in cases such as *Baker* is futile, as the regulations have embraced the *Baker* rule and have been held to be consistent with the Internal Revenue Code.<sup>269</sup>

The possibility that the presence of contingencies may render payments taxable to the recipient, even if the agreement terminates such payments within ten years or less, must be reckoned with in drafting divorce agreements. It can produce unanticipated tax results because the contingencies may be implied by state law, whether or not they are in the agreement.<sup>270</sup> Most states provide for termination of alimony upon certain conditions, or for modification of divorce-related payments under cer-

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266. The treating as periodic of payments of fixed duration of less than ten years but subject to contingencies was rejected steadfastly by the Tax Court prior to the decision of the second circuit in *Baker v. Commissioner*, 205 F.2d 369 (2d Cir. 1953). See also *Fleming v. Commissioner*, 14 T.C. 1380 (1950); *Estate of Orsatti v. Commissioner*, 12 T.C. 188 (1949); *Steinel v. Commissioner*, 10 T.C. 409 (1948). The consistent position of the court with the greatest amount of tax expertise should probably have been given more deference by the federal courts of appeals. *Dobson v. Commissioner*, 320 U.S. 489 (1943).

267. 205 F.2d 369 (2d Cir. 1953).

268. *Id.* at 370.

269. See *Salapatas v. Commissioner*, 446 F.2d 79 (7th Cir. 1971). Interestingly, in at least one of the cases that accepted the reasoning of *Baker*, the court seemed more concerned with uniformity than with a correct result. Commenting on *Baker*, *Smith's Estate*, *Myers* and *Davidson*, the court in *Prewitt v. Commissioner*, 221 F.2d 250 (8th Cir. 1955) said: "So far as possible, and particularly with respect to questions of federal taxation, there should be uniformity of decision among the circuits. Unless we were convinced that we could demonstrate that cases we have referred to were incorrectly decided, we would not be justified in refusing to follow them." *Id.* at 252.

270. Treas. Reg. § 1.71-1(d)(3)(ii)(a) (1957). See *supra* note 264.

tain circumstances by statute or judicial decision.<sup>271</sup> In most states, however, these contingencies do not apply to all divorce-related payments that may be imposed by decree or incurred by agreement. The parties to a divorce, in order to determine its tax consequences, must examine not only whether state law provides contingencies, but also whether the agreement or decree takes a form to which the contingencies apply. If the decree or agreement takes such a form, the payments are periodic.

In *Stock v. Commissioner*,<sup>272</sup> the parties' agreement provided,

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271. See *Dubose v. Dubose*, 275 Ala. 220, 153 So. 2d 778 (1963); *Bulloch v. Bulloch*, 21 Ohio App. 2d 10, 255 N.E.2d 299 (1969); *Moore v. Moore*, 89 Wis. 2d 665, 278 N.W.2d 881 (1979); ALASKA STAT. § 09.55.220 (1973); ARIZ. REV. STAT. ANN. § 25-327 (Supp. 1981-82); ARK. STAT. ANN. § 34-1213 (Cum. Supp. 1979); CAL. [CIV.] CODE § 4801(b), (c) (West Supp. 1981); COLO. REV. STAT. § 14-10-122 (1973); CONN. GEN. STAT. ANN. § 466-86 (West Supp. 1981); DEL. CODE ANN. tit. 13, § 1519 (1981); FLA. STAT. ANN. § 61.14 (West Supp. 1982); GA. CODE ANN. § 30-204 (1980); HAWAII REV. STAT. § 580-51 (1976); IDAHO CODE § 32-709 (Com. Supp. 1981); ILL. ANN. STAT. ch. 40, ¶ 510(a) (Smith-Hurd 1980); IOWA CODE ANN. § 598.21(8) (West 1981); KAN. STAT. ANN. § 60-1610(e) (Cum. Supp. 1981); KY. REV. STAT. ANN. § 403.250(1) (Baldwin 1979); LA. CIV. CODE ANN. art. 160 (West Supp. 1982); ME. REV. STAT. ANN. tit. 19, § 721 (1981); MD. ANN. CODE art. 16 § 5 (1981); MASS. GEN. LAWS ANN. ch. 208 § 37 (West Supp. 1981); MICH. COMP. LAWS ANN. § 552.28 (Cum. Supp. 1981-82); MINN. STAT. ANN. § 518.64 (West Supp. 1982); MISS. CODE ANN. § 93-5-23 (Supp. 1981); MO. ANN. STAT. § 452.370 (Vernon 1977); MONT. CODE ANN. § 40-4-208 (1981); NEB. REV. STAT. § 42-365 (Cum. Supp. 1980); NEV. REV. STAT. § 125.150(b), (7) (1979); N.H. REV. STAT. ANN. § 458:32 (1968); N.J. STAT. ANN. § 2A:34-23 (West Supp. 1981-1982); N.M. STAT. ANN. § 40-4-7(2) (1978); N.Y. [DOM. REL.] LAW § 236. Part B(9)(b) (McKinney Supp. 1981-82); N.C. GEN. STAT. § 50-16.9 (1976); N.D. CENT. CODE § 14-05-24 (1971); OR. REV. STAT. § 107.135(1)(a) (1979) (amended 1981); PA. STAT. ANN. tit. 23 § 501(e) (Purdon Supp. 1981-82); R.I. GEN. LAWS § 15-5-16 (Cum. Supp. 1980); S.C. CODE ANN. § 20-3-170 (Cum. Supp. 1981); S.D. CODIFIED LAWS ANN. § 25-4-41 (Supp. 1981); TENN. CODE ANN. § 36-820(1) (Cum. Supp. 1981); UTAH CODE ANN. § 30-3-5 (Supp. 1981); VT. STAT. ANN. tit. 15, § 758 (1974); VA. CODE § 20-109 (Cum. Supp. 1981); WASH. REV. CODE ANN. § 26.07.170 (Supp. 1981); W.VA. CODE § 48-2-15 (1980); WYO. STAT. § 20-2-116 (1977).

Three states do not fit this pattern. In Indiana and Texas alimony may not be awarded. See *Savage v. Savage*, \_\_\_ Ind. App. \_\_\_, 374 N.E.2d 536 (1978), and *Lodge v. Lodge*, 368 S.W.2d 40 (Tex. Civ. App. 1963). In both jurisdictions there may be property settlements which are paid in installments, but in neither jurisdiction does it appear that such installments would terminate automatically upon certain contingencies. See *Firestone v. Firestone*, 567 S.W.2d 889 (Tex. Civ. App. 1978); IND. CODE ANN. § 31-1-11.5-10(c) (Burns 1980).

In Oklahoma, under OKLA. STAT. ANN. tit. 12 § 1278 (Supp. 1980), the court may not make an indefinite support order absent agreement of the parties. An agreement of definite amount and duration may be made terminable upon the death of either spouse or the remarriage of the recipient. *May v. May*, 596 P.2d 536 (Okla. 1979).

272. 551 F.2d 614 (5th Cir. 1977).

*inter alia*, that "as further alimony" the husband was to pay the wife a total sum of \$25,519.07 over five years.<sup>273</sup> Although the payment period was less than ten years, the husband argued that they were periodic because the law of Georgia, where the divorce was granted, made such payments contingent upon the death or remarriage of the wife or a change in the economic circumstances of the husband.<sup>274</sup> The court held, however, that the Georgia courts did not impose the statutory contingencies<sup>275</sup> on awards of a fixed or lump sum.<sup>276</sup> The inability of the taxpayer to demonstrate that the payments might terminate within the stated period under state law resulted in his failure to meet the periodic requirement as amplified by the regulations.

Familiarity not only with statutory provisions, but also with case law, if it is available, is essential to enable counsel to draft a divorce agreement. Deciphering a maze of state decisions, however, can be difficult, as the years since *Erie R.R. v. Tompkins*<sup>277</sup> have demonstrated in another context. Several taxpayers in recent years have discovered that the state law contingencies on which they relied to meet the periodic requirement did not apply to their decrees.<sup>278</sup> In providing for reference to state law, the regulations under section 71(c)(2) have the ironic by-product of giving tax effect to state policies with respect to alimony in gross while ignoring the ten-year demarcation specified by Congress.

Reference to state law is also questionable in light of the uniformity sought by Congress in the Revenue Act of 1942, because the variation among the states with respect to con-

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273. *Id.* at 615-16 n.1.

274. *Id.* at 618.

275. *See supra* note 271.

276. 551 F.2d at 618 (citing *Morris v. Padgett*, 233 Ga. 750, 213 S.E. 2d 647 (1975); *Herbert v. Huggins*, 231 Ga. 489, 202 S.E. 2d 443 (1973); *Eastland v. Candler*, 226 Ga. 588, 176 S.E. 2d 89 (1970)).

277. 304 U.S. 64 (1938).

278. *See Crouser v. Commissioner*, 73 T.C. 1113 (1980) (Ohio law), *appeal pending*; *Tracy v. Commissioner*, 70 T.C. 397 (1978) (Mississippi law); *Adams v. Commissioner*, 66 T.C. 830 (1976) (Oklahoma law); *Ellis v. Commissioner*, 40 T.C.M. (CCH) 267 (1980) (Georgia law); *Collins v. Commissioner*, 39 T.C.M. (CCH) 757 (1979) (North Carolina law); *Biddle v. Commissioner*, 38 T.C.M. (CCH) 1361 (1979) (Georgia law).

In *Guiberson v. United States*, 43 A.F.T.R.2d (P-H) ¶ 79-455 (D. Kan. 1978), although the court determined that it was not bound by state law in questions under section 71, it held payments to be periodic because of a contingency supplied by Kansas law. *Id.* at 79-459 to 79-460.

tendencies and alimony in gross is considerable. Many states provide that a divorce court may fix alimony or support in a certain amount and for a certain duration, that is, alimony in gross.<sup>279</sup> In two jurisdictions, Louisiana and West Virginia, cases addressing the availability *vel non* of alimony in gross are so old that it is difficult to determine whether it may be ordered.<sup>280</sup> Although many of the jurisdictions that permit alimony in gross or lump sum alimony provide that it may not be modified,<sup>281</sup> there appear to be at least three jurisdictions in which alimony in gross may be modified.<sup>282</sup> While some jurisdictions have held that alimony in gross is not terminable upon contingencies such as the death of

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279. See *Ex Parte* Thompson, 282 Ala. 248, 210 So. 2d 808 (1968); Lindsay v. Lindsay, 115 Ariz. 322, 565 P.2d 199 (Ariz. Ct. App. 1977); *In re* Marriage of Cohen, 610 P.2d 1092 (Col. Ct. App. 1980); Pulvermacher v. Pulvermacher, 166 Conn. 380, 349 A.2d 836 (1974); Hamilton v. Finch, 238 Ga. 78, 230 S.E.2d 881 (1976); *In re* Marriage of Preston, 81 Ill. App. 2d 672, 402 N.E.2d 332 (1980); *In re* Marriage of Gudenkauf, 204 N.W.2d 586 (Iowa 1973); Grundy v. Grundy, 4 Kan. App. 2d 302, 605 P.2d 162 (1980); Kahn v. Kahn, 353 Mass. 771, 233 N.E.2d 902 (1968); Hopkins v. Hopkins, 379 So. 2d 314 (Miss. 1980); D \_\_\_\_\_ E \_\_\_\_\_ W \_\_\_\_\_ v. M \_\_\_\_\_ W \_\_\_\_\_, 552 S.W.2d 280 (Mo. App. 1977); Van Pelt v. Van Pelt, 206 Neb. 350, 292 N.W.2d 917 (1980); Holt v. Holt, 84 S.D. 671, 176 N.W.2d 51 (1970); Spalding v. Spalding, 597 S.W.2d 739 (Tenn. Ct. App. 1980); ALASKA STAT. § 09.55.210 (3) (1973); FLA. STAT. ANN. § 61.08(1) (West Supp. 1982); ME. REV. STAT. ANN. tit. 19 § 721 (1981); MICH. COMP. LAWS ANN. § 552.23 (Supp. 1982-82); NEV. REV. STAT. § 125.150(1)(a) (1979); N.C. GEN. STAT. § 50-16.7 (1976); OHIO REV. CODE ANN. § 3105.18 (1980); OR. REV. STAT. § 107.105 (c) (1979); S.C. CODE ANN. § 20-3-130 (Cum. Supp. 1981).

As noted, Oklahoma requires that alimony awards be ordered for a definite time. See *supra* note 271. Maryland requires that support awards be for a limited time, which may be extended. MD. ANN. CODE art. 16 § 1(c) (1981). New Hampshire limits alimony awards to three years, although such awards may be renewed. N.H. REV. STAT. ANN. § 458.19 (Supp. 1981).

280. See *Scott v. Scott*, 197 La. 726, 2 So.2d 193 (1941) (probably no); *Tuning v. Tuning*, 90 W. Va. 457, 111 S.E. 139 (1922) (yes).

281. See *Ex Parte* Hartsfield, 384 So. 2d 1097 (Ala. Civ. App. 1980); *Lloyd v. Lloyd*, 23 Ariz. App. 376, 533 P.2d 684 (1975); *In re* Marriage of Cohen, 610 P.2d 1092 (Colo. App. 1980); *Benson v. Benson*, 369 So. 2d 99 (Fla. 1979); *Taulbee v. Taulbee*, 243 Ga. 52, 252 S.E.2d 481 (1979); *Oknaian v. Oknaian*, 90 Mich. App. 28, 282 N.W.2d 230 (1979); *Butler v. Hinson*, 286 So. 2d 716 (Miss. 1980); *Whitworth v. Whitworth*, 559 S.W.2d 292 (Mo. App. 1977); *Popovic v. Popovic*, 45 Ohio App. 2d 57, 341 N.E.2d 341 (1975); *Blakely v. Blakely*, 249 S.C. 623, 155 S.E.2d 857 (1967); *Holt v. Holt*, 84 S.D. 671, 176 N.W.2d 51 (1970); *Spalding v. Spalding*, 597 S.W.2d 739 (Tenn. App. 1980).

282. See *In re* Marriage of Preston, 81 Ill. App. 3d 672, 402 N.E.2d 332 (1980); *Grundy v. Grundy*, 4 Kan. App. 2d 302, 605 P.2d 162 (1980); ME. REV. STAT. ANN. tit. 19 § 721 (1981).

either party or the recipient's remarriage,<sup>283</sup> others have held that it may be terminable.<sup>284</sup>

According to *Stock* and similar cases,<sup>285</sup> when alimony in gross is awarded in a jurisdiction in which the awards may be neither modified upon changed conditions nor terminated upon the occurrence of contingencies, and the award is for ten years or less, the payments under such an award are not periodic. There are many jurisdictions that have not decided clearly whether alimony in gross is modifiable or terminable.<sup>286</sup> In such jurisdictions, a federal court attempting to decide whether divorce-related payments ordered for ten years or less are periodic would be forced to decide without the guidance of local law.<sup>287</sup>

Section 71 does not require that payments be ordered by a court in order to be deemed periodic; the obligation to make such payments may be incurred by agreement.<sup>288</sup> If payments under an obligation incurred by agreement are subject to contingencies under state law, they are periodic.<sup>289</sup> State decisions vary widely as to whether fixed alimony obligations incurred in an agreement may be modified or terminated. Some states hold that such payments may not be modified.<sup>290</sup> Others hold that an agreed sum may be modified if it is merged into or approved by a decree.<sup>291</sup>

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283. See *Viglione v. Viglione*, 171 Conn. 213, 368 A.2d 202 (1976); *Newell v. Newell*, 237 Ga. 708, 229 S.E.2d 449 (1976); *Kishner v. Kishner*, 93 Nev. 220, 562 P.2d 493 (1977).

284. See *Lindsay v. Lindsay*, 115 Ariz. 322, 565 P.2d 199 (1977); *In re Marriage of Preston*, 81 Ill. App. 3d 672, 402 N.E.2d 332 (1970); *Martin v. Martin*, 26 N.C. App. 506, 216 S.E.2d 456 (1975); *May v. May*, 596 P.2d 536 (Okla. 1979).

285. See *supra* note 278.

286. See *supra* the cases cited in notes 279-284.

287. Recognizing the variety of views as to whether alimony in gross is modifiable or terminable, it seems unsatisfactory and intrusive for a federal court to resort to legal encyclopedias or A.L.R. annotations in search of a general rule.

288. I.R.C. § 71(a). See *supra* note 2.

289. Treas. Reg. § 1.71-1(d)(3) (1956).

290. See *Richardson v. Richardson*, 3 Kan. App. 610, 599 P.2d 320 (1979); *Keltner v. Keltner*, 589 S.W.2d 235 (Mo. 1979); *Lawton v. Lawton*, 113 N.H. 429, 309 A.2d 150 (1973); VA. CODE § 20-109 (1975).

291. See *Lively v. Lively*, 222 Ark. 501, 261 S.W.2d 409 (1953); *Phillips v. Phillips*, 93 Idaho 384, 462 P.2d 49 (1969); *Scott v. Scott*, 529 S.W.2d 656 (Ky. 1975); *Knox v. Remick*, 371 Mass. 433, 358 N.E.2d 432 (1976) (contempt power may be removed although contractual obligation remains); *White v. White*, 296 N.C. 661, 252 S.E.2d 698 (1979); *Bingert v. Bingert*, 247 N.W.2d 464 (N.D. 1976)

Still other jurisdictions permit modification of an agreed sum on the same basis as modification of final judgments generally, for reasons such as fraud, duress, or mistake at the time of the agreement.<sup>292</sup>

Some contingencies that will permit modification of an agreed sum are more idiosyncratic. Alabama permits modification for clear and sufficient reasons;<sup>293</sup> Iowa does so only upon a showing of positive wrong or injustice;<sup>294</sup> Colorado permits modification when an agreement becomes unconscionable on the basis of changed circumstances;<sup>295</sup> New York will permit modification only when the recipient is in danger of becoming a public charge;<sup>296</sup> and Indiana and Kansas permit modification where the parties agree.<sup>297</sup> A number of jurisdictions permit amendment of an agreed sum unless there is an agreement to the contrary.<sup>298</sup> Would payments under an agreement extending ten years or less be periodic on the basis that they might be modifiable if the agreement became unconscionable, or if the recipient became a public charge, or if the parties could agree to modify the agreement? As unlikely as these contingencies may be in some circumstances, it would seem that they would make agreed alimony payments periodic.

As with alimony in gross or lump sum alimony, it is clear that not all of the legislatures have stated clearly whether alimony based upon agreement may be modified. Thus, the IRS and taxpayers are faced not only with a myriad of views among states

(but court should be reluctant to allow modification); *Marriage of Vaughn*, 25 Or. App. 655, 550 P.2d 1243 (1976); *Connolly v. Connolly*, 270 N.W.2d 44 (S.D. 1978); *Corbin v. Corbin*, 157 W. Va. 967, 1206 S.E.2d 868 (1974).

292. See *Davis v. Davis*, 268 A.2d 515 (D.C. 1970); *Bulloch v. Bulloch*, 21 Ohio Supp. 2d 76, 255 N.E.2d 299 (1969); *Grimshaw v. Grimshaw*, 581 P.2d 1329 (Okla. 1978); IND. CODE ANN. § 31-1-11.5-17 (Burns 1980).

293. See *Taylor v. Taylor*, 369 So. 2d 1240 (Ala. Civ. App. 1978), cert. denied, 369 So. 2d 1243 (1979).

294. See *Ellis v. Ellis*, 262 N.W.2d 265 (Iowa 1978).

295. See *In re Marriage of Cohen*, 610 P.2d 1092 (Colo. 1980) (except where agreement precludes modification).

296. See *Goldman v. Goldman*, 69 A.D.2d 758, 415 N.Y.S. 2d 7 (1979).

297. See IND. CODE ANN. § 31-1-11.5-10(a) (Burns 1980). KAN. STAT. ANN. § 60-1610(e) (1980).

298. See *In re Marriage of Nielsen*, 100 Cal. App. 3d 874, 161 Cal. Rptr. 272 (1980); *Watters v. Foreman*, 204 Neb. 670, 284 N.W.2d 850 (1979); *Marriage of Olsen*, 24 Wash. App. 292, 600 P.2d 690 (1979); *Estate of Hereford*, 250 S.E.2d 45 (W. Va. 1978); KY. REV. STAT. ANN. § 403.180(6) (Baldwin 1979); MD. ANN. CODE art. 16 § 28 (1981); MONT. CODE ANN. § 48-320(6) (Supp. 1977).

which have addressed the issue, but also with unanswered questions in jurisdictions which have not addressed the issue. This creates administrative difficulty, difficulty in planning, and a diversity of possible outcomes, which is at variance with the Revenue Act of 1942. The doctrine of the *Baker* case, as embodied in the regulations, should be rejected by statute.

## VI. CONCLUSION AND SUGGESTED CHANGES IN SECTION 71

Section 71 is unsatisfactory in many respects: increasingly slavish reference to state law as to what constitutes a support obligation and whether payments are periodic creates confusion and frustrates uniform administration of the tax law. The struggle to articulate substantive factors to differentiate between payments representing a support obligation of the payor and those representing a property interest of the recipient has generated a maze of factors too complex to be applied consistently or predictably. The burden of this complexity falls heaviest on the taxpayer, who, after all, bears the burden of proof in most instances.

The creation of presumptions for divorce-related payments would be preferable to the current structure of section 71.<sup>299</sup> Divorce-related payments made prior to the divorce or agreement should be presumed to be support. Payments in the year of the divorce decree or agreement should be presumed to represent a property interest of the recipient unless otherwise stipulated. Payments made later than the year of the decree or agreement should be presumed to represent a support obligation and, thus, would be deductible, unless stipulated otherwise. All stipulations should be presumed to have economic justification. A payor seeking to deduct payments made in the year of the divorce or a recipient seeking to exclude payments made in a

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299. Consider, for instance, the example of I.R.C. section 152(e), which determines which of divorced parents is entitled to dependency exemptions for minor children. Under section 152(e)(1)(B), the custodial parent provides \$1200. In the latter case, the noncustodial parent is presumptively entitled to the deduction unless the custodial parent proves that he or she has provided more support than the noncustodial parent. Treas. Reg. 1.152-4(e) (1971) provides instructions to taxpayers attempting to meet or overcome the presumptions in the statute.

This is a particularly useful example because it involves a situation where the IRS might be involved in completely inconsistent litigation with very unsophisticated taxpayers.



year later than the year of the decree or agreement, should be required to state with some particularity on an attachment to the return the basis for the deduction or exclusion. The Secretary of the Treasury should promulgate regulations setting out whichever of the factors currently used to distinguish between support obligations and property settlements<sup>300</sup> the IRS wishes to retain. These factors should be the bases for adjudicating challenges by taxpayers or the IRS to the presumptions proposed herein; retaining them would to some extent refute allegations that the presumptions unduly exalt form over substance in characterizing divorce-related payments.

Finally, the proposals herein would make the tax law related to divorce more mechanical. To the extent that making the law more mechanical makes it more predictable, easier to understand, and most important, easier for the taxpayer to administer, the limited exaltation of form over substance is a small price to pay.

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300. See *supra* Part IV of the text.