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DIVORCE AND THE FEDERAL INCOME TAX

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INTRODUCTION

One can only wonder how many of the attorneys involved in the 19,550 divorces in Florida during 1959,[1] deemed it necessary to reflect on the income tax consequences to their clients. It has been suggested that "those sections of the Internal Revenue Code dealing with the taxation of alimony stand as an example of how an area of legal practice may become tax-dominated."[2]

Even if an attorney were to review the code provisions dealing with alimony, he could still, without more, fall prey to the "traps which abound for the uncautious and the ill-advised [and which indeed] may even trip up experienced counsel."[3] Furthermore, some tax questions that arise in divorce may not be specifically answered in sections dealing with alimony.

The purpose of this article is to present to the general practitioner,[4] a discussion of the effect of the federal income tax upon some of the more common problems associated with alimony and property settlements.

ALIMONY PAYMENTS—"PERIODIC" OR "INSTALLMENT"

Prologue to Congressional Action

As tax advisor to the Secretary of Treasury in 1942, Randolph E. Paul appeared before the House Ways and Means Committee to explain certain provisions of the then pending Revenue Revision of 1942.[5] Indicating that high wartime rates made it necessary to eliminate

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1. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 70 (1962).

2. BITTKER, FEDERAL INCOME, ESTATE AND GIFT TAXATION 173 (2d ed. 1958).

3. Horne, *Tax Pitfalls in Alimony and Separation Payments*, 35 TAXES 751 (1957).

4. The term here is meant to imply an attorney who neither specializes in income taxes nor has had special training in the area.

5. *Hearings on the Revenue Revision of 1942 Before the House Committee on Ways and Means*, 77th Cong., 2d Sess. 1 (1942).

existing inequities that distorted the tax burden of certain taxpayers,[6] Paul pointed out that "rising tax rates have in some cases absorbed the entire income of a husband required to pay the tax on his income and that of the divorced wife."[7] He also urged that divorced wives receiving tax-free alimony "possessed a privileged status under our tax laws which relieved them of any share of the tax burden."[8]

To appreciate the full thrust of Paul's arguments and the resulting legislation, it is necessary to review the pre-1942 treatment of alimony by the courts and the commissioner. The scope of this article, however, demands that such reflection into the past be succinct.

The first recorded clash of federal taxation and alimony payments appears in *Gould v. Gould*,[9] wherein the Supreme Court held that a "direct" alimony payment was not "income" to the recipient. Immediately, the question of how to treat payments from alimony trusts was raised. The statutory scheme for taxation of trusts contemplated that the beneficiaries were to pay the tax on the trust's distributable income. Was income derived from alimony trusts, therefore, now to be treated differently than alimony received directly? Treasury officials had difficulty in arriving at a conclusion.[10] Finally in 1931, the government adopted the position that income from an alimony trust was taxable to the husband.[11]

The Tax Court's holdings on income from alimony trusts depended upon the circumstances of the case. A "collateral security" trust insuring the payments to the wife and involving no irrevocable transfer of title caused the husband-grantor to be taxed.[12] The trust income, however, was taxed to the wife if the husband created an irrevocable trust and retained no rights therein.[13]

Confusion on the subject was also apparent among the federal courts. In *Douglas v. Willcuts*,[14] the Eighth Circuit Court of Appeals taxed to the husband the income of an alimony trust created by him for

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6. *Id.* at 87.

7. *Id.* at 92.

8. *Ibid.* Paul had previously raised this argument in a 1939 law review article. See Paul, *Five Years with Douglas v. Willcuts*, 53 HARV. L. REV. 1, 3, n.6 (1939).

9. 245 U.S. 151 (1917).

10. Within one year, they first held income from an alimony trust taxable to the husband, O.D. 399, 2 CUM. BULL. 156 (1920), and then reversed themselves and held such income taxable to the wife, O.D. 1092, 5 CUM. BULL. 190 (1921).

11. In Mary R. Spencer, 20 B.T.A. 58 (1930), the Government was unsuccessful in an attempt to tax the wife; therefore, it changed its position in I.T. 2628, XI-1 CUM. BULL. 34 (1931).

12. Frank B. Turner, 28 B.T.A. 91 (1933), *aff'd per curiam* 71 F.2d 1018 (2d Cir. 1934).

13. S. A. Lynch, 23 B.T.A. 435 (1931).

14. 73 F.2d 130 (8th Cir. 1934), *aff'd* 296 U.S. 1 (1935).

the benefit of his wife. The basic lesson of *Willcuts*, however, was not that the income from all alimony trusts should be taxable to the husband. Rather, it stood for the proposition that the doctrine of constructive receipt[15] requires taxing the trust income to the husband if the creation of the alimony trust did not release the husband from the duty of supporting his wife. The net result of the decision and its subsequent judicial interpretations[16] was that the tax incidence of income from an alimony trust was made to depend upon the various state laws. Consequently, two husbands divorced from their wives in two different states, but under similar decrees, were subject to different tax burdens. The tax result depended upon the existence or non-existence of a continuing legal obligation, under applicable state law, to support the ex-wives.[17]

This, then, was the status of the law of alimony taxation which, when combined with the high wartime rates being invoked in 1942, was the basis of Paul's plea to eliminate "existing inequities which distort the tax burden of certain taxpayers."[18]

Had alimony trusts been the only facet of the problem, a statutory solution would have been simple. Congress, in order to treat all trust income equally, merely had to provide that income from alimony trusts would be taxable to the wife.[19] It would have been neither politically expedient nor equitable, however, for Congress to have ceased its labors at that point. Such a cessation would have discriminated between those financially able to telescope their obligation by a lump sum transfer into trust and those obligated to pay alimony over a period of time. In an attempt to eliminate these discriminations—for example, between the various holdings in the alimony trust cases and also between alimony trusts and direct payments—Congress, for the first time, provided in the

15. In affirming the Eighth Circuit in *Willcuts*, the Supreme Court aptly described this doctrine: "[T]he net income of the trust fund, which was paid to the wife under the decree, stands substantially on the same footing as though [the husband] had received the income personally and had been required by decree to make the payment directly." 296 U.S. 1, 9 (1935).

16. Helvering v. Fitch, 309 U.S. 149 (1940) (wherein the Court, not convinced that the Iowa courts were without power "to modify alimony awarded in a lump sum or a property settlement ratified by the divorce decree," held the husband taxable.) Helvering v. Fuller, 310 U.S. 69 (1940) (wherein the Court, having found that the Nevada court could not modify the decree, held the wife taxable on the income). Helvering v. Leonard, 310 U.S. 80 (1940) (wherein the Court held the husband taxable because he failed to show that a New York court could not modify the decree).

17. The husband could have been taxable if he voluntarily assumed such continuing legal obligation. Alsop v. Commissioner, 82 F.2d 148 (3d Cir. 1937), *cert. denied* 302 U.S. 767 (1938).

18. *Hearings on Revenue Revision of 1942, supra* note 5, at 87.

19. Int. Rev. Code of 1939, §171 (now INT. REV. CODE OF 1954, §682).

Internal Revenue Code[20] for the taxation of alimony to the wife[21] and a corresponding deduction for the husband.[22]

Statutory Scheme

Having remained silent on the subject for twenty-nine years, Congress quickly became effusive on the question of taxing alimony. No less than four code sections are required reading for the complete picture.

Section 71[23] of the Internal Revenue Code of 1954 provides for the inclusion of alimony in income under certain circumstances. Once a decision is made that the alimony is taxable under section 71, section 215[24] then provides for its corresponding deductibility by the payor. The tax consequences of the use of the trust vehicle to provide alimony are set forth in sections 682[25] and 71.

Section 71–Legal Prerequisite. Under the 1939 Code, before the alimony provisions could come into play, either a decree of divorce or a legal separation under a decree of separate maintenance was required. No other type of legal relationship would suffice.[26]

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20. Int. Rev. Code of 1939, §22(k) (now INT. REV. CODE OF 1954, §71). During the hearings on the 1942 proposals, only one reported witness opposed the plan to tax alimony to the wife. One of this witness's arguments was that the provisions would encourage the breakup of the family. Seemingly, the committee summarily dismissed the idea that a provision of the Internal Revenue Code could affect the divorce rate. *Hearings on Revenue Revision of 1942, supra* note 5, at 2158. Yet, ten years later, a noted tax attorney, while discussing the economic value of the split income provisions to the husband, said, "this may be the principal reason why the nation's divorce rate has dropped since the income splitting privilege was adopted nationally in 1948." University of Chicago, Conference on Divorce 18, Feb. 29, 1952.

These same hearings provide us with another possible reason for the legislation. Congressman John D. Dingell, after an emotionally charged exchange between himself and the witness referred to above, summed up his feelings on the whole matter by saying, "they [wives] not only come into court and attempt to prove their cases, but they prove them, and get their alimony, and *I think it is just an infernal racket and it ought at least to be taxed, and as far as I am concerned it is going to be taxed.*" *Hearings on Revenue Revision of 1942, supra* note 5, at 2164. (Emphasis added.)

21. For simplicity, the person paying the alimony has been and will be referred to as "husband" and the person receiving the alimony, as "wife." See INT. REV. CODE OF 1954, §7701(a)(17).

22. See INT. REV. CODE OF 1954, §215, which does not come into the picture until the question whether the alimony is or is not required to be included in the wife's gross income has been answered.

23. Int. Rev. Code of 1939, §22(k).

24. Int. Rev. Code of 1939, §23(u).

25. Int. Rev. Code of 1939, §171. The fourth section is §7701(a)(17). See note 21 *supra.*

26. Thus, in Ben Myerson, 10 T.C. 729 (1948), a voluntary separation sans a court decree was held to be insufficient. In Joseph C. Brightbill, 18 P-H Tax Ct. Mem.

Thus, prior to 1954, alimony pendente lite, payments under an interlocutory divorce decree, support payments, and payments under a separation agreement were neither includible in the wife's gross income nor deductible by the husband. With the passage of the 1954 Internal Revenue Code, however, alimony and separate maintenance payments, assuming certain other requirements were met, were placed in three taxable classifications under section 71(a):

(1) payments made under a decree of divorce or separate maintenance (including payments made pursuant to a written instrument incident to such divorce or separation),[27]
(2) payments made under a written separation agreement,[28]
(3) payments made under a decree for support.[29]

Assuming a legal status under one of the above classifications, the payments received will be taxable to the wife if they are:[30]

(a) "periodic" and not "installment,"
(b) in discharge of the husband's legal obligation to support his wife as a result of their marriage.[31]

Payments for Less Than Ten Years—"Periodic or Installment." The provision by which Congress has chosen to express the requirement for the taxation of alimony is deceptively simple. In fact, one noted author

83 (1949), *aff'd per curiam* 178 F.2d 404 (3d Cir. 1949), a husband was denied a deduction when his payments were under a separation agreement without a divorce despite the fact that he had subsequently obtained a divorce. If, however, under the *Brightbill* facts, the parties had provided that the separation agreement was to survive a divorce whether incorporated in it or not, seemingly the amount would be taxable to the wife and deductible by the husband. See Commissioner v. Moses, 214 F.2d 912 (2d Cir. 1954), *cert. denied* 348 U.S. 913 (1955).

27. INT. REV. CODE OF 1954, §71(a)(1).

28. INT. REV. CODE OF 1954, §71(a)(2). Although this section requires that such agreement be executed after August 16, 1954, (date 1954 Code was enacted) a pre-1954 agreement may be modified to bring it within this section. See, Treas. Reg. §1.71-1(b)(2) (1957); Rev. Rul. 56-418, 1956-2 CUM. BULL. 27. Note, however, that such modification must be "material."

29. INT. REV. CODE OF 1954, §71(a)(3). Seemingly, the section requires that the payments be made pursuant to a decree entered after March 1, 1954. Treas. Reg. §1.71-1(b)(3)(ii) (1957) provide, however, that "any decree which is altered or modified by a court order entered after March 1, 1954 will be treated as a decree entered after such date."

30. If the payments are made under §71(a)(2) [Written Separation Agreement] or under §71(a)(3) [Decree for Support], the provisions for taxing alimony to the wife are not applicable if the husband and wife file a "joint return."

31. Cases under this requirement arise too infrequently to justify delving into this area. For such a case see Maurice Fixler, 25 T.C. 1313 (1956), *acq.* 1956-2 CUM. BULL. 5. For a full discussion of this problem see 5 MERTENS, LAW OF FEDERAL INCOME TAXATION, §31A.02 (1956). For a discussion concerning payments under

has opined that the alimony sections "have engendered a surprising volume of litigation."[32] One court has ventured a possible answer for the extensive litigation over which label—"periodic" or "installment"—should be placed on payments made under divorce or separation decrees. After reviewing the statutory requirements of section 71(c),[33] the court noted that "[A]ll of this is easy [and] said rapidly. But when the general rules are set down on the varying provisions . . . difficult problems arise in determining whether a given payment is to be assigned to the 'installment' or 'periodic' class."[34]

Perhaps the defect is in the statutory draftsmanship. In section 71(a) we are told only that "periodic" payments will be included in a wife's gross income—assuming, of course, that the payments meet all other requirements. Congress, however, failed to give us a definition of "periodic" payments. Instead it chose to tell us that as a general rule "installment payments discharging a part of an obligation the principal sum of which is . . . specified in the decree, instrument or agreement shall not be treated as periodic payments."[35] If, however, the installment payments are payable over a period of more than ten years from the date of the decree or agreement, these payments or a portion of them may qualify as "periodic."[36]

On the question whether certain payments for ten years or less were to be included as "periodic," there was, until fairly recently, a cleavage in the opinions of the Tax Court and some circuit courts of appeals.

a. Tax Court v. Courts of Appeals

The opinion in *J. B. Steinel*[37] sets the tone for the Tax Court's earlier feelings on this question. In that case, the divorce decree required the

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an agreement entered into by the husband and the ex-wife after the divorce, see Note, 69 YALE L.J. 153 (1959); *cf.* Estate of Louis Fabrikant, 39 T.C. ___ (1963); Commissioner v. Walsh, 183 F.2d 803 (D.C. Cir. 1950) *affirming* 11 T.C. 1093; Cox v. Commissioner, 176 F.2d 226 (3d Cir. 1949) *affirming* 10 T.C. 955. See also Rev. Rul. 60-142, 1960-1 CUM. BULL. 34.

See also Spec. Rul. Dec. 8, 1944, P-H FED. TAX GUIDE ¶7859, holding that payments made under an annulment declaring the marriage void *ab initio* are not considered alimony for federal income tax purposes. If, however, a decree of annulment treats the marriage as valid until dissolved, payments made thereunder are considered alimony. Lily R. Reighley, 17 T.C. 344 (1951).

32. BITTKER, FEDERAL INCOME, ESTATE AND GIFT TAXATION 172 (2d ed. 1958).

33. This section sets forth the "statutory" rules as to when "installment" payments will be treated as "periodic" and therefore includible in the wife's gross income.

34. Smith's Estate v. Commissioner, 208 F.2d 349 (3d Cir. 1953), *affirming in part and reversing in part* 11 CCH Tax Ct. Mem. 1167 (1952).

35. INT. REV. CODE OF 1954, §71(c)(1).

36. This exception which is set forth in §71(c)(2) will be discussed subsequently.

37. 10 T.C. 409 (1948).

husband to pay $100 monthly until $9,500 was paid, unless his former wife remarried. The taxpayer argued that the word "obligation" [in 71(c)(1)] meant a definite and unconditional obligation of a specific sum of money; therefore, because the payments were contingent on the wife's not remarrying, the obligation was indefinite, uncertain and conditional. The Tax Court felt the legislative history of the alimony provisions indicated that the word "obligation" was used in a general sense to include even an obligation subject to contingencies that had not yet occurred.[38] Consequently, the court found that the principal sum was specified, and refused to allow the husband to deduct the amounts paid to his ex-wife. The result, insofar as original tax impact is concerned, would be the same if the divorce decree itself labeled the payments "periodic" and required the wife to pay the income tax. The Tax Court quickly headed off any possible ideas that taxpayers could so allocate the tax burden; it held that Congress imposes the tax and consequently, such imposition may not be changed by prior agreement.[39]

If the alimony payments were in some way based on a percentage of the husband's income, the Tax Court's decisions depended on the substance of the divorce decree. Thus, if no specific total sum was mentioned, so that the payments were based solely on a percentage of the husband's income (for example, ten per cent of the husband's gross income), the Tax Court found such payments too indefinite to establish any total fixed sum; therefore, the payments were "periodic."[40] On the other hand, when a specific sum was stated, subject to change as net income changes, the court refused to label such payments "periodic."[41] It is difficult to argue that the Tax Court had been inconsistent; albeit, the decisions created a tax trap for the unwary practitioner. In the cases in which a specific sum was stated and the contingencies of death, remarriage, or a change in the husband's net income were involved, the

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38. The court restated this conclusion one year later in Estate of Frank P. Orsatti, 12 T.C. 188 (1949).

39. Frank R. Casey, 12 T.C. 224 (1949). Although it serves no useful purpose within the scope of this article, to fully discuss this decision other than to cite the general proposition for which it stands, it is submitted that a court, faced with this same fact situation today, may decide differently. Thus, the possibility that the intent of the parties has been circumscribed—husband will not get the deduction and wife will not pay the tax—may be a sound basis for a suit to reform the agreement. Thus it may be argued that the total amount to be paid under the original agreement cannot be calculated; therefore, the payments are "periodic." As to ineffectiveness of the label "property settlement" on payments which are actually alimony, see Elizabeth H. Bardwell, 38 T.C. 84 (1963).

40. Roland Keith Young, 10 T.C. 724 (1948) (the amounts to be paid during a year depended upon the amount of the net income of the husband for the preceding year); John H. Lee, 10 T.C. 834 (1948) (husband was to pay 33⅓% of the first $12,000 of net income and 25% of the excess, if any).

41. Clay W. Prewett, Jr., 22 T.C. 270, *rev'd* 221 F.2d 250 (8th Cir. 1955).

Tax Court pegged its decisions on the fact that during the taxable year the contingencies that would avoid the fixed and stated obligation had not arisen. On the other hand, if the amount of alimony was dependent solely on the net income of the husband and no specific sum was stated, a contingency was present at all times and the obligation was neither fixed nor stated.

In 1953, the circuit courts of appeals were afforded their first opportunity to inspect a Tax Court decision dealing with this area of the alimony provisions. Under the appellate microscope in *Baker v. Commissioner*,[42] was an agreement that provided, in part, that the husband pay the ex-wife for the six years subsequent to the date of the agreement, unless she died or remarried.[43] Holding fast to the doctrine that it had set forth in *Steinel*[44] and *Orsatti*,[45] the Tax Court found that the amounts paid were installment payments, each discharging a part of an obligation, the principal sum of which was specified in the decree—that is, not "periodic."[46]

On review, the Second Circuit felt that the Tax Court had overlooked the contingencies of death or remarriage. In reversing, the court sidestepped the fact that death of the wife was, actuarially speaking, predictable. It pointed out that even if such fact were important, there was the further contingency of the wife's remarriage.[47] In the same year, the Third Circuit Court of Appeals in a case similar to *Baker*, partly reversed a decision of the Tax Court which once again had held fast to its previous holdings.[48]

The Tax Court was subsequently presented with an excellent opportunity to retreat gracefully, if so inclined, and to adopt the rationale of the Second Circuit in *Baker*. In *James M. Fidler*,[49] the divorce decree required the husband to pay his wife $800 per month for four years and five months. It further provided, however, that should the husband's

42. 205 F.2d 369 (2d Cir. 1953).

43. The agreement was for $300 per month for the first year and $200 per month for the next five years.

44. *Supra* note 37.

45. *Supra* note 38.

46. F. Ellsworth Baker, 17 T.C. 1610 (1952).

47. The court noted that in an estate tax case it had affirmed the Tax Court's reliance on American experience tables relating to the chances of continued celibacy of widows in determining the probability that a particular divorced woman would take a new spouse. However, in a footnote, the court cited Rohmer v. Commissioner, 153 F.2d 61, 65 (2d Cir. 1946) for the proposition that "it is well to remember that the concepts employed in construing one section of a statute are not necessarily pertinent when construing another with a distinguishable background."

48. Smith's Estate v. Commissioner, *supra* note 34. Other circuits also held against the Tax Court on this point. See Davidson v. Commissioner, 219 F.2d 147 (9th Cir. 1955); Prewett v. Commissioner, 221 F.2d 250 (8th Cir. 1955).

49. 11 CCH Tax Ct. Mem. 1128 (1952), *withdrawn and superseded* 20 T.C. 1081 (1953).

Rosenkranz: Divorce and the Federal Income Tax

radio contract fail to award compensation equal to the amount he was receiving at the date of divorce, monthly payments to the extent of $300 were to be reduced by a certain proportion. If the husband had no radio contract whatsoever, monthly payments to the extent of $300 were to be waived completely.

In a decision handed down before *Baker*, the Tax Court, following *Steinel* and *Orsatti* and distinguishing *John H. Lee* and *Roland Keith Young*,[50] held the payments to be "installment"; thus, not deductible by the husband. Following the *Baker* decision, the Tax Court vacated its decision in *Fidler* and handed down a new one[51]—although with the same result. The court acknowledged that in reversing *Baker*, the Second Circuit Court of Appeals had refused to follow the Tax Court's rationale in the *Steinel* case. Be that as it may, the Tax Court felt, despite its "great respect" for the court of appeals, that upon a careful re-examination of *Steinel* it could "find no basis in the statute for refusing to give effect to its plain language."[52]

The difference between the Tax Court and the circuit courts of appeals was a narrow one. Did principal sum, as the Tax Court was contending, include a fixed and stated obligation that was subject to contingencies which had not yet arisen? Or did the term imply, as the courts of appeals were contending, an amount of a fairly definite character, unencumbered with any suggestion of uncertainty?

The 1954 Code added nothing to the alimony provisions to aid in deciding which contention was correct. Because of the time lag between the enactment of the 1954 Code and the adoption of the regulations under section 71, the Treasury was on notice that every circuit court reviewing the question had decided it in line with *Baker* and against the Tax Court. Thus, the regulations completely adopted the holdings of the circuit courts of appeals on this point.[53] The regulations provide, in part, that if payments are to be made over a period of ten years or less, and such payments are subject to one or more of the contingencies of: death of either spouse, remarriage of the wife, or change in the economic status of either spouse,[54] they are not installment payments discharging an obligation "the principal sum of which is specified."

Faced with this two-pronged attack—the courts of appeals, on the one hand and the regulations, on the other—the Tax Court finally sur-

50. In the *Lee* and *Young* cases, *supra* note 40, the court noted that the amount of alimony was dependent directly upon the husband's net income and contrary to the *Fidler* case no specified sum was stated.

51. 20 T.C. 1081 (1953).

52. The Ninth Circuit Court of Appeals later found that up to $300 per month was "periodic" and thus deductible by the husband. Fidler v. Commissioner, 231 F.2d 138 (9th Cir. 1956), *modifying* 20 T.C. 1081 (1953).

53. Treas. Reg. §1.71-1(d)(3) (1957).

54. Rev. Rul. 59-45, 1959-1 Cum. Bull. 666, in effect applies these rules to cases arising under the 1939 Code.

rendered. In *Helen Stewart Cramer*[55] the divorce decree required the husband to pay the wife $250 per month until any one of three events occurred: (1) The wife "completed three collegiate or university years of two semesters or three quarters each . . . ." (2) The wife had "been gainfully employed on a full time basis for not less than one year . . . ." (3) The wife "dies or remarries."

Considering the tenacity with which it had adhered to its interpretation, the capitulation by the Tax Court was amazingly "short and sweet": [56]

> In the light of the foregoing, [contrary holdings of the circuit courts of appeals] we have concluded . . . that the principle expressed by the Second Circuit in the *Baker* case should here be followed. The contrary principle applied in the *Steinel* case will no longer be followed. Accordingly we hold that the payments here involved are "periodic payments" within the meaning of Section 71(a)(1) of the 1954 Code.

Thus, there is now unanimity of opinion, between the tribunals and the regulations, that if payments are to be made over a period of ten years or less and are subject to one or more of the contingencies of: death of either spouse, remarriage of the wife, or change in the economic status of either spouse, they are "periodic." Indeed, according to the regulations[57] and *Alton F. Lounsbury*,[58] this will be the result whether the contingencies are set forth in the decree or imposed by local law.

A review of Revenue Ruling 59-190,[59] indicates that the local law rule pronounced in the regulations has been so extended as to make nearly all payments "periodic" and thus includible in the wife's gross income and deductible by the husband. The ruling holds that if the courts of a state have the power to modify, alter, or revise alimony payments, or if under local law the obligation to pay alimony terminates upon the death of either spouse, the requisite contingencies are imposed by local law so as to make "periodic," alimony payments required to be paid over a period of less than ten years.

Seemingly, therefore, if a Florida court required a husband to pay his wife a stated sum per month for a period of less than ten years, without any specific provision for contingencies,[60] the alimony would be "periodic" on two grounds: (1) the right of the circuit courts to decrease or increase such payments[61] and (2) the holding of the Florida

55. 36 T.C. 1136 (1961).
56. *Id.* at 1141.
57. Treas. Reg. §1.71-1(d)(3) (1957).
58. 37 T.C. 163 (1961).
59. 1959-1 CUM. BULL. 23.
60. These were the facts in Rev. Rul. 59-190. See text at note 59 *supra*.
61. FLA STAT. §65.15 (1962).

Supreme Court that, barring an agreement of the husband to bind his personal representative, the obligation to pay alimony dies with the person so obligated.[62]

The result will be the same if, instead of the court's handing down a decree that requires the husband to pay alimony to his ex-wife, it adopts a prior alimony agreement entered into by the parties. The rule in Florida[63] and the general rule[64] seems to be that, if a state court has the general power to modify a decree providing alimony or support, the exercise of the power is not affected by the fact that the decree incorporates the parties' agreement as to alimony payments.[65] The result is not the same if the agreement deals strictly with property rights. Such an agreement, barring fraud, et cetera, will not be modified by a Florida court.[66] Should the agreement settle both property rights and alimony payments, the Florida courts will retain jurisdiction as to alimony portions of the agreement.[67]

b. Court Decisions and Treasury Pronouncements v. Legislative History

> Resort to legislative history is only justified where the face of the act is inescapably ambiguous and then I think we should not go beyond Committee Reports, which presumably are well considered and carefully prepared. [Justice Jackson's concurrence in *Schwegmann Bros. v. Calvert Distillers Corp.*][68]

> I should concur in this result more readily if the Court could reach it by analysis of the statute instead of by psychoanalysis of Congress. [Justice Jackson's concurrence in *United States v. Public Utilities Commission.*][69]

The temptation to try to read the collective mind of Congress is almost irresistible. This urge is greatly accentuated when, as here, there is an absence of the usual legislative indicia. The committee reports are

62. Allen v. Allen, 111 Fla. 733, 150 So. 237 (1933).

63. Vance v. Vance, 143 Fla. 513, 197 So. 128 (1940); FLA. STAT. §65.15 (1962).

64. See Annots., 58 A.L.R. 639 (1927), 109 A.L.R. 1068 (1937).

65. Absent a statutory provision to this effect, the reason usually given for adhering to the general rule is that the prior agreement merges into the divorce decree, thereby losing its contractual nature. See Annot., 166 A.L.R. 679 (1947) for cases so holding.

66. Dix v. Dix, 140 Fla. 91, 191 So. 205 (1939); Fowler v. Fowler, 112 So. 2d 411 (1st D.C.A. Fla. 1959).

67. Kosch v. Kosch, 113 So. 2d 547 (Fla. 1959), *conformed to* 114 So. 2d 18 (3d D.C.A. Fla. 1959).

68. 341 U.S. 384, 395-96 (1951) (concurring opinion).

69. 345 U.S. 295, 319 (1953) (concurring opinion).

completely silent as to the reasons for adoption of the "installment"—"periodic" dichotomy. Thus, the congressional analyst has no limitations on his diagnosis of congressional intentions.

Courts, nevertheless, have struggled, and no doubt will continue to struggle, with the basic problem of alimony legislation. To date, the judicial disposition of the problem and the Treasury's adoption thereof, seems to demonstrate the danger of the legislature's failure to express its principal purpose, either within the statute itself, or within the standard sources of legislative history—the committee reports. It is submitted that this leads to the mere utilization of mechanical rules, which are applied with too broad a brush; consequently, some cases are covered that really lie outside the underlying policy factors that led to the original legislation.

In this respect, the only clear guides applicable to the problem of alimony payments over a period of less than ten years are:

(1) Congress intended, in 1942, to change existing law—not merely clarify it.[70]

(2) Congress dealt with incidents of a legal relationship and proceeding that is peculiarly within the province of the several states.[71]

(3) The usual local law concept of alimony is a payment by the husband, from his current income, of the current living expenses of the wife.[72] This is to be contrasted with a lump sum payment to the wife, which is designed to permit her to create her own income in the future to pay her then current expenses.[73]

Thus, it is fairly clear that section 71 contains some distinction between the lump sum payment "and the month to month kind of payment for *support*, in which the Congress was seeking relief for alimony-paying ex-husbands."[74] In attempting to conclude why Congress placed such an onus on "lump sum" payments, one should not lose sight of the arguments presented by Randolph Paul[75] in pressing Congress to adopt the alimony provisions. Paul was concerned with the taxpayer who was paying alimony out of income and the wife who was receiving a portion of this income to meet current expenses. There would be an entirely differ-

70. See note 20 *supra*.

71. Williams v. North Carolina, 325 U.S. 226, 233 (1945).

72. Floyd v. Floyd, 91 Fla. 910, 108 So. 896 (1926); Bredin v. Bredin, 89 So. 2d 353 (Fla. 1956).

73. FLA. STAT. §65.08 (1962) provides that the court may award permanent alimony in a lump sum.

74. Smith's Estate v. Commissioner, 208 F.2d 349, 353 (3d Cir. 1953). (Emphasis added.)

75. See text at notes 7 and 8 *supra*.

Rosenkranz: Divorce and the Federal Income Tax

ent result, however, if the husband made a transfer of "capital" to the wife who had to generate her own "income" with which to meet current expenses.

At the extremes, the factual situations give no problems. If a husband were ordered to pay his wife $200 per month so long as she lives, we should have no difficulty squaring this with the policy of "periodic" payments. Thus, with high tax rates, a husband who continually paid such alimony without a deduction suffered an extreme financial burden when the alimony was combined with his taxes. Also, $200 per month for life is clearly a shifting of the husband's current income to the wife for her current expenses. On the other hand, if the husband were ordered to pay the wife $50,000 semiannually for three years, one should have no difficulty squaring this with a policy of not requiring the wife to include the money in her gross income and of not allowing the husband the corresponding deduction. It is clear that, in the usual case, this is not a division of the husband's income. In addition, the high tax rates would wipe out a great deal of the economic benefit received by the wife. Finally, such a payment, even over three years, greatly resembles a transfer into trust, which, under the most favorable pre-1942 decision, would only have caused the income earned on such a sum to be taxed to the wife and would have provided no corresponding deduction to the husband. It should also be noted that if the husband can pay out this sum of money in such a manner, then Randolph Paul's arguments as to financial and economic worries are not applicable. A question to keep in mind, when reviewing the judicial holdings and the regulations in this area, is whether this last result should be any different simply because the three-year payments are contingent on subsequent events. Thus, if the decree provides that the husband pay the wife $50,000 semiannually for three years unless the wife dies or remarries, are the policy considerations any different? The high tax rates would still greatly reduce the wife's monetary and economic benefit; the semiannual payments are still comparable to a transfer into trust; and the husband in such a case is not affected by the tax considerations that, in part, led to the adoption of section 71. Seemingly, the only change is the possibility that the wife will receive less money in less time.

Factual situations similar to the one found in *Smith's Estate v. Commissioner*,[76] cause difficulty when placed between the policy factors that seemingly underlie the taxation of alimony, and the broad holdings of the courts and the regulations in this area. In that case, the decree contained three different schedules of cash payments to the wife:

> (1) twenty-five thousand dollars over five years in ten equal semiannual installments (February 1947 to August 1951),

76. *Supra* note 67.

(2) three hundred dollars every month for a period of five years from December 1946,

(3) one hundred dollars every month, beginning December 1, 1951, for the wife's life.

The decree further provided that all of the above payments would cease upon either the death of the husband, remarriage of the wife, or the death of the wife.

At the outset it should be noted that, under the current state of the law, all of the above payments, because each is subject to the contingencies of death and remarriage, would be "periodic" and thus included in the wife's gross income. Yet, in deciding *Smith's Estate,* the Third Circuit Court of Appeals, one year prior to the adoption of the regulations under section 71, arrived at a partially different result.

Although recognizing the *Baker*[77] decision, the court held the rule announced therein did not apply to the twenty-five thousand dollars to be paid over five years in ten equal semiannual installments:[78]

> The Baker case is important and will be discussed below. But we find nothing in it to change what *seems to us an obvious installment payment under this contract to a "periodic" payment.*

The government sought to extend this argument to the payment of three hundred dollars every month for five years. The court held, however, that these payments were "periodic." Two reasons were given. First, the rationale of *Baker* was adopted. Thus, because of the contingencies of death and remarriage, the promise to pay was not one which could be mathematically calculated as a certain obligation of the husband.

The court stated its second reason as follows:[79]

> Furthermore we do not read into the statute a requirement *that the terms of payment must run over ten years in order that this become a periodic contract.* . . . It seems to us that this set of facts calls for a fairly clear application of the distinction indicated in section [71], which provides for both the lump sum payment, on which it would be quite unfair to tax the wife, and *the month-to-month kind of payment for support, in which Congress was seeking relief for alimony paying ex-husbands.*

It is submitted that the Third Circuit propounded a clear statement of the principles that should control when the problem arises whether alimony payments for less than ten years should be labeled "periodic" or

77. 205 F.2d 369 (2d Cir. 1953).
78. Smith's Estate v. Commissioner, *supra* note 67, at 353. (Emphasis added.)
79. *Ibid.*

"installment"—albeit, they may be difficult to apply under certain circumstances. If the payments represent a transfer of capital—$15,000 over two taxable years[80]—they should be held "installment" payments. On the other hand, if the payments represent a division of the husband's current income for the month to month support of the ex-wife—$300 per month for five years—they should be held "periodic."

The Treasury's pronouncements and most of the cases, however, have gone much further by resorting to the mathematical certainty test. The regulations, revenue rulings, and cases, by merely following this test without further examination of the facts, have arrived at results which clearly do violence to the statutory provisions for taxing alimony. Thus, as noted above, the $25,000 payment in *Smith* would today be held "periodic," despite the fact that it is the clearest case of a lump sum transfer of capital.

Congress should lift its veil of silence and make clear just what was intended when it drafted the "installment"—"periodic" dichotomy. Its silence only adds instability to an area of the law which by its very nature contains more than enough friction and emotional disturbance. Prior to the *Baker* decision, it was possible to shift the tax burdens of divorce according to the wishes of the parties simply by making the installments cover more or less than ten years. With the adoption of the *Baker* rationale, it has been suggested that flexibility in negotiating divorce settlements has been reduced.[81] Furthermore, because of the broad judicial decisions and the Treasury's reasoning in this area, certain monetary transactions are being taxed in a manner seemingly contrary to Congress' intent in drafting section 71 and its predecessor section 22(k). Despite the fact that no great federal monetary collections are at stake and that a change in the alimony provisions will have no great effect on the economy,[82] Congress should amend section 71 to make its intent clearly ascertainable.

Period for Installment Is More Than Ten Years. On the assumption that a line must be drawn somewhere, it may be pointed out that the

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80. The schedule of payments approved in Cocalis v. Cocalis, 103 So. 2d 230 (3d D.C.A. Fla. 1958). Approval was granted under FLA. STAT. §65.08 which allows the award of "permanent alimony" in a lump sum. Despite this label it is submitted that the payments represent a transfer of capital to the wife who must generate her future income (or part of it) from the fund. Thus, the payments in *Cocalis* should be non-deductible by the husband and non-taxable to the wife. Yet, the result is just the opposite; the payments are deductible by the husband and includible in the wife's gross income.

81. Rosenfeld, *Drafting a Property Settlement Agreement Under the 1954 Code: Part 1,* U. So. CAL. 1956 TAX INST. 675, 683-84.

82. Seemingly a primary test for any changes in the Internal Revenue Code. See President Kennedy's Tax Message. CCH 1963 STAND. FED. TAX REP., Spec. 1, Jan. 24, 1963.

policy factors that led to Congress' refusal to require the wife to include lump sum "installment" payments for a period of less than ten years in her gross income, are not present if the period exceeds ten years.[83] Consequently, Congress has provided,[84] in general, that "installment" payments for a period of more than ten years will be treated as "periodic." Section 71(c)(2), which so provides, must be followed with extreme caution. If not, what started out as an arrangement that would require the wife to include the amount in gross income and give the husband a deduction, could very well end up as one that allows him no deduction.

The subsection requires, in part, that the principal sum must be one that "is to be paid or may be paid over a period ending more than ten years from the date of [the] decree, instrument or agreement."[85] Consequently, care must be exercised in drafting the beginning and ending dates of the payment period or a question may arise as to the computation of the required period.[86] The following two cases, although resolved in favor of the taxpayer, point up the problem of drafting the beginning and ending dates.

Suppose a husband and wife entered into a contract, on February 27, 1961, preparatory to and in contemplation of a settlement of their marital difficulties. The contract provides that the husband is to pay the wife $120,000 in the following manner: $7,500 *on or before* March 1, 1962 and a like sum on or before the first day of March in each and every year thereafter with a final $52,500 payment on or before March 1, 1971. The divorce decree specifically incorporating the contract[87] is signed on February 28, 1961 and recorded March 2, 1961. If February 28 is the controlling starting date, the ten-year rule poses no obstacle; however, if March 2 controlled, the payments were over a period of less than ten years and not includible in the wife's gross income. In *Blum v. Commissioner*,[88] the Seventh Circuit Court of Appeals held the payments deductible on two grounds: (1) The judgment or decree in Illinois was

83. Although some argument can be made for adopting a shorter period of time.

84. INT. REV. CODE OF 1954, §71(c)(2).

85. The regulations provide that if a principal sum is payable over a period longer than ten years but subject to the contingencies of death, remarriage, or economic condition, the sum is to be regarded as "periodic" without regard to the requirements and limitations of §71(c)(2). See Treas. Reg. §1.71-1(d)(3)(i)(c) (1957).

86. See Rich, *Avoiding Tax Traps in Making Alimony Arrangements*, N.Y.U. 7TH INST. ON FED. TAX. 849 (1949).

87. See Commissioner v. Newman, 248 F.2d 473 (8th Cir. 1957), *affirming* 26 T.C. 717 wherein the Eighth Circuit Court of Appeals held the payments "installment" because the divorce decree failed to incorporate a prior property settlement agreement.

88. 177 F.2d 670 (7th Cir. 1949), *reversing* 7 CCH Tax Ct. Mem. 798 (1948). See also Estate of Spicknall v. Commissioner, 61-1 U.S. Tax Cas. ¶9179 (8th Cir.

effective the moment it was pronounced or entered by the court; consequently, the period running from the decree to the last payment exceeded ten years. (2) The obligation to pay arose from the contract; therefore, the time requirement was met.

An even more startling example of how this subsection can bring forth results opposite from those contemplated by the parties was present in *Reis v. United States*.[89] In that case a Kansas divorce decree entered on March 24, 1947 required the husband to pay $36,000 to his ex-wife—$300 per month *"commencing April 1, 1947."* The court found that under Kansas law, the decree made the monthly payments due on the first day of each month, but payable without default at any time up to and including the last day of each month. Consequently, because the last monthly payment was not finally due until March 31, 1957, the court found that the requirement of more than ten years from date of decree had been fulfilled.

Both taxpayers and the commissioner immediately learned what a "tax difference" the wording of a decree can make. Thus a decree requiring 120 monthly payments *on the first day of each calendar month"* was held[90] not susceptible of an interpretation, similar to *Reis*, which allowed payment without default at any time up to and including the last day of the month. On the other hand, a decree ordering 120 monthly payments *beginning on the 10th day of July 1951* was construed as[91] not requiring payment on July 10; rather, the court held that the first payment was due August 10, 1951.[92]

In conjunction with this ten-year-period requirement, the Tax Court[93] was called upon to interpret the word "may" in the phrase "is to be paid or may be paid over a period ending more than ten years. . . ." The taxpayer argued that if he failed to make the required payments, any balance due would, under the agreement, have to be paid from the proceeds of his life insurance. He further argued that inasmuch as payment from such proceeds could not be made until he died there was a possibility it might be paid more than ten years from the date of the decree. The court held against the taxpayer, and simply recognized the ever-present possibility "that a divorced husband may not comply with the terms of a separation agreement." Nevertheless, the court concluded

1961), *reversing* 18 CCH Tax Ct. Mem. 1029 (1959).

89. 214 F.2d 327 (10th Cir. 1954).

90. John A. Isfalt, 24 T.C. 497 (1955).

91. Lillard v. Wiseman, 57-1 U.S. Tax Cas. ¶9298 (W.D. Okla. 1956); *cf.* John W. Furrow, Jr., 34 T.C. 931 (1960), *aff'd* 61-2 U.S. Tax Cas. ¶9587 (10th Cir. 1961).

92. The court was assisted in such a finding, however, by a *nunc pro tunc* order of the Oklahoma state court clarifying the original decree by deleting the "10th day of July" as the starting date and inserting "10th day of August" in its place.

93. Robert D. Stecker, 31 T.C. 749 (1959).

that, "the statute does not . . . recognize the possibility of noncompliance as a factor to be taken into consideration in determining the period during which payments of a principal sum are to be paid."[94] Once he hurdles this ten-year rule, the taxpayer has only one more major obstacle to conquer. Although "installment" payments over more than ten years will be treated as "periodic," such will be the case only for a maximum of ten per cent of the principal sum in any one taxable year of the wife.[95] Thus, suppose a divorce decree requires the husband to pay the wife $150,000 ($20,000 per year for five years and then $5,000 per year for ten years).[96] During each of the five years she receives $20,000, the wife will include only $15,000 in her gross income—that is, ten per cent of the principal sum of $150,000. The husband's corresponding deduction will be limited to $15,000.[97] This result seems to tie in with the policy of preventing a husband from manipulating the payments so as to receive a greater tax benefit from a large deduction in one year,[98] thereby causing the wife to pay high taxes, and reducing the economic benefit she receives from the alimony.

Arrearage Alimony Payments. Arrearage alimony payments seem to be an exception to the "ten per cent of the principal sum" rule. Section 71(c)(2) discusses the tax effects of arrearage payments in an inferential and backhanded manner. The last sentence of the subsection points out that any part of the principal sum received in one tax year, "which is allocable to a period *after*" the taxable year in which it is received is to be treated as an installment payment for the year received. Therefore, by inference, payments to the wife that are allocable to years *prior* to the taxable year in which paid, if otherwise deductible in those years, are deductible in full in the year paid and must be included in the wife's gross income.[99] Thus, suppose a decree ordered the husband to pay the wife $100,000—$5,000 per year for twenty years. Clearly, the $5,000 would be treated as "periodic" within the "ten per cent of principal sum" rule. Suppose, however, the husband fails to make the $5,000 payment in each of two years. In the third year, however, he pays $15,000 (current

94. *Id.* at 752.

95. This requirement was added to the original House proposals by the Senate Finance Committee in 1942. S. Rep. No. 1631, 77th Cong., 2d Sess. (1942). Int. Rev. Code of 1954, §71(c)(2); Treas. Reg. §1.71-1(d)(2) (1957).

96. Treas. Reg. §1.71-1(d)(5) (1957), example 4.

97. In the ten years in which $5,000 is paid, the entire amount is treated as "periodic."

98. This is to be compared with the tax results when the husband pays arrearages. See subheading *"Arrearage Alimony Payments" infra.*

99. Grant v. Commissioner, 209 F.2d 430 (2d Cir. 1953), *affirming* 18 T.C. 1013 (1952); Margaret O. White, 24 T.C. 452 (1955); Rev. Rul. 55-457, 1955-2 Cum. Bull. 527; *cf.* Frank J. Loverin, 10 T.C. 406 (1948).

year's payment and two previous years). The entire amount is included in the wife's gross income and deductible by the husband despite the fact that the total payment exceeded ten per cent of the principal sum. This result follows because the delinquent payments would have been "periodic" if they had been paid in the years when they originally came due.[100]

At first blush it would seem that such a result is squarely in conflict with the policy underlying the ten-year rule on "installment" payments. On reflection, however, it is to be noted that the wife can avail herself of the power of a state court in order to prevent her husband from being in arrears. Consequently, in the usual case, the husband's failure to make payments was not motivated solely by a desire to secure a larger single deduction in one year and thus he should not be penalized by the loss of a deduction. Be that as it may, it is clear that the wife is paying a larger tax than if the husband had made the payments on schedule. Perhaps a new code section is in order. Such a section would allow the wife to compute her tax in the year of receipt of arrearages by paying the lesser of the tax on the income for the taxable year with the arrearage payments included, or the tax payable if the arrearages had been received in the proper taxable years.[101]

Payment of the Ex-Wife's Taxes. Problems in computing the "principal sum" can arise in other ways. Thus, suppose a decree entered January 1, 1961 required the husband to pay the ex-wife $12,000 per year for twelve years and further requires the husband to pay the tax cost of receipt of such an amount by the wife.[102] For the taxable year 1961, the ex-wife would include $12,000 in her gross income paying a tax of $2,304,[103] and the husband would take a deduction of $12,000. In the taxable year 1962, the ex-wife would include in gross income the $12,000 alimony for 1962 plus the $2,304 tax for 1961 which the husband paid on or before April 15, 1962. The husband, meanwhile, for 1962 would take a deduction of $14,304, the alimony plus the tax paid.[104] In 1963 the husband would pay $12,000 plus the income tax generated by the

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100. See last sentence of Treas. Reg. §1.71-1(d)(2) (1957). See also Rev. Rul. 55-457, 1944-2 CUM. BULL. 527.

101. *Cf.* INT. REV. CODE OF 1954, §§1301-07; Hazel Potter, CCH Tax Ct. Mem. Dec. 25,939(M) (1963).

102. See Muriel Dodge Neeman, 13 T.C. 397, *aff'd per curiam* 200 F.2d 560 (2d Cir. 1952) in which the court held that an agreement by the husband to pay the tax due on his ex-wife's alimony is not binding on the commissioner and cannot prevent him from determining the amount of taxes due from the ex-wife.

103. Assuming no other gross income, the standard deduction and one exemption for herself.

104. See Mahana v. United States, 88 F. Supp. 285 (Ct. Cl. 1950), *cert. denied* 339 U.S. 978 (1950). This case demonstrates that if the husband is to pay a stated

payment of $14,304 in 1962. Each succeeding year the amount paid by the husband would increase in this manner. Therefore, in a year when the husband would pay over $14,400,[105] the excess over ten per cent of the principal sum due to his payment of the wife's taxes is deductible in full as a "periodic" payment that is subject to the contingency of the wife's yearly taxable income. Such a contingency prevents a principal sum from being mathematically calculable; consequently, under the *Baker* rationale these amounts for taxes are deductible without regard to the installment payment rule.

From the above result it is clear that an alimony decree can contain both "periodic" and "installment" payments.[106] In drafting a divorce settlement in Florida, however, one should not rely on the tax cases on this point. Florida has held that if a divorce decree provides for payment of permanent alimony in a series of periodic payments, a lump sum award may not also be granted.[107]

Support of Minor Children. If the terms of the divorce decree, separation agreement, or decree for support "fix . . . a sum . . . payable for the support of the minor children of the husband," such sum is not includible in the wife's gross income nor deductible by the husband.[108]

Until recently, the word "fix" was the cause of constant tax litigation. The litigation culminated in *Lester v. Commissioner*.[109] In that case, the divorce decree, after setting forth the payments to be made by the husband, further provided:[110]

> In the event that any of the children [of which there were three] of the parties hereto shall marry, become emancipated or die, then the payments herein specified shall on the happening of each such event be reduced in a sum equal to one-sixth of the payments which would thereafter otherwise accrue and be payable in accordance with the terms and provisions hereof.

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sum annually plus the wife's tax thereon, the latter amount as well as the former will be alimony deductible by the husband and taxable to the wife. *Cf.* Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929).

105. Ten per cent of the $144,000 principal sum.

106. The courts have never had difficulty in finding within the same divorce decree amounts that would be subject to the "installment" payment rule and amounts that would be classified "periodic." See Edward Bartsch, 18 T.C. 65 (1952) *aff'd per curiam* 203 F.2d 715 (2d Cir. 1953); James M. Fidler, *supra* note 49; Alton F. Lounsbury, 37 T.C. 163 (1961). There is, of course, no question of deductibility of amounts paid for the wife's taxes if the principal payments are periodic. See Rev. Rul. 58-100, 1958-1 Cum. Bull. 31.

107. Harrison v. Harrison, 115 So. 2d 709 (3d D.C.A. Fla. 1959).

108. Int. Rev. Code of 1954, §71(b).

109. 366 U.S. 299 (1961), *affirming* 279 F.2d 354 (2d Cir. 1960), *reversing* 32 T.C. 1156 (1959).

110. Jerry Lester, 32 T.C. 1156, 1157 (1959).

Other than naming them joint beneficiaries of an insurance policy, the decree contained no other provision for the minor children. Despite this fact, the commissioner contended, and the Tax Court agreed,[111] that the decree "fixed" one-half of all the payments made to the wife as sums "payable for the support of [the] minor children of such husband."[112]

The Supreme Court held, however, that Congress intended that the agreement must specifically state[113] the amounts or parts thereof allocable to the support of the minor children of the husband in order for the payments to be within section 71(b).[114] In the opinion, the Court specifically noted that under the laws of some states the wife would be required to use the unspecified child support payments for the support of such child. It further recognized, however, that Congress intended to produce uniformity in the treatment of amounts paid, regardless of the variance in the laws of different states.

As noted by Justice Clark in the *Lester* opinion, support payments for the minor children of the parties pursuant to section 71(b) can give the parties some flexibility. Thus, having arrived at the amount of the "periodic" payments, the parties may reduce the wife's tax liability by fixing a portion of the payments for support of the minor children.[115]

The problem of stating the amount allocable for child support in decrees can be prevented in Florida. A decree should award separate amounts for alimony and for support of the minor children.[116] Indeed, although an undivided award for alimony and child support is not void, each party is entitled to request, at any time, an allocation of a specific amount for alimony and for child support.[117]

If an amount is specifically stated to be for the support of minor children, in addition to "periodic payments," any payment that does not

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111. Jerry Lester, 32 T.C. 1156 (1959), *rev'd* 279 F.2d 354 (2d Cir. 1960).

112. The commissioner's position on this point had previously been adopted in Metcalf v. Commissioner, 271 F.2d 288 (1st Cir. 1959) and Eisinger v. Commissioner, 240 F.2d 584 (2d Cir. 1957), *cert. denied* 353 U.S. 958 (1957) which deviated from the commissioner's position. The commissioner agreed to follow *Weil* when similar facts were present. Rev. Rul. 59-93, 1959-1 CUM. BULL. 22.

113. "It [the code section] does not say that 'a sufficiently clear purpose' on the part of the parties is sufficient to shift the tax. It [the code section] says that the 'written instrument' must 'fix' that 'portion of the payment' which is to go to the support of the children." Lester v. Commissioner, *supra* note 109, at 303.

114. INT. REV. CODE OF 1954. Actually the case involved Int. Rev. Code of 1939, §22(k).

115. Mere support payments to a child, alone, do not guarantee the husband the right to take the six hundred dollar exemption allowed by §151(e). The husband must provide *"over half"* of such support before he can take the exemption. See INT. REV. CODE OF 1954, §152(a).

116. Hardy v. Hardy, 118 So. 2d 106 (1st D.C.A. Fla. 1960).

117. Zalka v. Zalka, 100 So. 2d 157 (Fla. 1958).

equal the total amount due will be allocated first to the support payment —that is, not includible in the wife's gross income.[118]

It should be noted that if the wife receives support payments for a person other than minor children of the husband, the payments are fully taxable to her, regardless of allocation.[119]

Miscellaneous Considerations. The "alimony" provisions of the Internal Revenue Code may be applicable in instances other than decrees of divorce or legal separation. Thus, payments made by a husband under a written separation agreement may be subject to taxation.[120] The same is true of payments received by a wife who is separated from her husband under a decree requiring the husband to make support payments.[121]

If the husband and wife are not divorced or legally separated under a judicial decree, they are still considered husband and wife for income tax purposes.[122] Consequently, if the husband's alimony payments are not made pursuant to a decree of divorce or legal separation, the husband and wife are subject to the rules concerning the election of the standard deduction.[123] Therefore, if the husband deducts "periodic" alimony payments, made pursuant to either section 71(a)(2) or (3), the wife must compute her taxable income by itemizing her deductions rather than by taking the standard deduction.[124] Furthermore, if for some reason the husband elects the standard deduction rather than itemizing his specific deductions, five hundred dollars is the maximum standard deduction for the wife.[125]

Finally, it should be noted that "alimony" payments under the legal relationships set forth in section 71(a)(2) or (3), do not prevent the husband and wife from electing to file a "joint return."[126] If such an election is made, however, the "alimony" payments are neither includible in the income of the wife nor deductible by the husband.[127]

LIFE INSURANCE PREMIUMS AS ALIMONY

A divorce decree may provide for assignment to the wife of a life

118. INT. REV. CODE OF 1954, §71(b); Martha J. Blyth, 21 T.C. 275 (1953).

119. Treas. Reg. §1.71-1(e) (1957); *cf.* Mandel v. Commissioner, 229 F.2d 382 (7th Cir. 1956).

120. INT. REV. CODE OF 1954, §71(a)(2).

121. INT. REV. CODE OF 1954, §71(a)(3).

122. INT. REV. CODE OF 1954, §§143(2), 153(2), 6013(d)(2).

123. See generally INT. REV. CODE OF 1954, §§141-45.

124. INT. REV. CODE OF 1954, §§63(a), 142(a).

125. INT. REV. CODE OF 1954, §141.

126. INT. REV. CODE OF 1954, §6013(d).

127. INT. REV. CODE OF 1954, §§71(a)(2)-(3).

insurance policy on the husband's life. If the policy is paid-up, the problem of taxability does not arise.[128]

Suppose, however, the husband is required not only to transfer the policy to the wife but also to continue to make the premium payments. The result seems to depend on the outcome of the interplay between the doctrine of "constructive receipt" and the alimony provisions. Under the doctrine of constructive receipt, if A pays the premiums on life insurance policies owned by B; then, assuming no gift, B must include in his gross income an amount equal to the premiums paid on the policies.[129]

Thus, if the divorce decree requires the husband to pay the premiums and the husband absolutely assigns the policies to his wife (who will thereafter irrevocably have all the incidents of ownership), the premiums will be included in the wife's gross income and can be deducted by the husband.[130] On the other hand, if the policy was intended only to represent security for the payment of alimony,[131] or if the interest of the wife in the policy is contingent,–that is she must outlive her husband–treatment of premiums as alimony payments has been denied.[132]

It has been suggested that, if fewer than ten annual payments remain to be paid at the time the husband unqualifiedly assigns the policy to the wife, the payments will be "installment" and not "periodic."[133] Seemingly, however, if the obligation to pay the premiums is subject, either by decree or by local law, to the contingencies of death, remarriage, or change in economic circumstances, then such payments will probably be "periodic" and includible in the wife's gross income.[134]

128. Samuel Morrison, 15 CCH Tax Ct. Mem. 740 (1956).

129. The rationale underlying this result has been applied by the Treasury to the portion of an alimony award that is allocated for payment by the wife of insurance and real estate taxes with respect to property owned by the parties as tenants by the entirety. Rev. Rul. 62-38, 1962-2 CUM. BULL. 15. This is also true if the property is held by tenants in common. Rev. Rul. 62-39, 1962-2 CUM. BULL. 17. *Cf.* Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929); Hyde v. Commissioner, 62-1 U.S. Tax Cas. ¶9402 (2d Cir. 1962), *affirming* 36 T.C. 51 (1961).

130. Hyde v. Commissioner, *supra* note 129; Lemuel Alexander Carmichael, 14 T.C. 1356 (1950); Anita Quinby Stewart, 9 T.C. 195 (1947); I.T. 4001, 1950-1 CUM. BULL.

131. Blumenthal v. Commissioner, 183 F.2d 15 (3d Cir. 1950); Beulah Weil, 22 T.C. 612, 619 (1954), *rev'd on other grounds* 240 F.2d 584 (2d Cir. 1957), *cert. denied* 353 U.S. 958 (1957).

132. Smith's Estate v. Commissioner, 208 F.2d 349 (3d Cir. 1953); Florence H. Griffith, 35 T.C. 882 (1961); I.T. 4001, 1950-1 CUM. BULL. 27; Rev. Rul. 57-125, 1957-1 CUM. BULL. 27 (no deduction for premium payments even though the decree required husband to pay the premiums, to maintain wife as primary beneficiary, and precluded husband from borrowing on the policies).

133. Frisch, *Divorce and Separation Tax Techniques*, N.Y.U. 20TH INST. ON FED. TAX. 35, 40 (1962).

134. See subheading *"Tax Courts v. Courts of Appeal" supra.*

Florida Law Review, Vol. 16, Iss. 1 [1963], Art. 1

PROPERTY SETTLEMENTS

Introduction

Instead of providing for payments over a number of years or for life, the parties may agree that the husband shall transfer certain property to the wife in exchange for her release of claims for support and marital rights. It is clear that contracts intended to facilitate or promote the procurement of a divorce are contrary to public policy and will not be enforced.[135] Florida will, however, recognize bona fide agreements relating to alimony or the adjustment of property rights between husband and wife, even though in contemplation of divorce, "if not directly conducive to the procurement of a divorce."[136]

Despite the fact that such agreements are recognized and, in most cases, adopted by the Florida courts, the courts do have the power to approve, modify, or disapprove of the agreement in its entirety.[137] However, once a property settlement has been adopted and incorporated in the divorce decree, it will not, if it is fair and valid on its face, be modified or altered by the courts of Florida.[138]

Income Tax Consequences

Generally speaking, the fair market value of property received by the wife in a property settlement[139] is neither taxable to her[140] nor deductible by the husband.[141] The courts have recognized, however, that a decree may contain elements of a property settlement and elements of "periodic" payments.[142] Thus in *Thomas E. Hogg*,[143] the husband paid

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135. Gallemore v. Gallemore, 94 Fla. 516, 114 So. 371 (1927).

136. 94 Fla. 516, 519, 114 So. 371, 372 (1927); Miller v. Miller, 149 Fla. 722, 7 So. 2d 9 (1942) (if such agreements are "made in good faith, free from fraud, deceit, or trickery . . . .").

137. Florida Nat'l Bank & Trust Co. v. United States, 182 F. Supp. 76 (S.D. Fla. 1960).

138. Haynes v. Haynes, 71 So. 2d 491, 493 (Fla. 1954). For a case dealing with the problem whether the stipulation approved in the final decree constituted a property settlement in connection with divorce or an agreement to pay stated sums at certain intervals, see Hunter v. Hunter, 108 So. 2d 478 (1st D.C.A. Fla. 1959).

139. Property settlement here is not meant to cover the situation in which the court adjudicates property rights between the parties as an incident to the divorce. See Picchi v. Picchi, 100 So. 2d 627 (Fla. 1958).

140. Treas. Reg. §1.71-1(d) (1957).

141. Treas. Reg. §1.215-1(a) (1957).

142. Although Florida will not allow periodic "alimony" and lump sum alimony in the same decree, see text at note 107 *supra*, seemingly the courts will allow a property settlement and an award of permanent alimony. Fowler v. Fowler, 112 So. 2d 411 (1st D.C.A. Fla. 1959).

143. 13 T.C. 361 (1949).

$1,200 monthly for the wife's current annual support and transferred to her a furnished home, car and other property. The court held that the $1,200 per month was deductible by the husband and includible in the wife's gross income; however, the transferred property was treated as a property settlement.

Until very recently, a lawyer found himself in an uncertain position when advising clients as to the tax consequences of transferring appreciated property for purposes of a property settlement. The Internal Revenue Code provides that the gain upon sale or other disposition of property shall be the excess of the amount realized over the property's basis.[144] The Code further provides that the "amount realized" is, in general, the sum of money and the fair market value of any property received on the sale or disposition.[145]

The courts had no difficulty in agreeing that the transfer by the husband, of appreciated property to his wife, in exchange for her release of claims for support and marital rights, was a taxable event.[146] The difficulty arose in attempting to assign a value to the "amount realized" by the husband. *Mesta*[147] and *Halliwell*[148] held that the amount realized was equal to the value of the property transferred to the wife. *Marshman,*[149] on the other hand, held that the rights given up by the wife were dependent upon so many uncertain factors as to make it impossible to place a fair market value on the property she transferred.

Recently, certiorari was granted in a case[150] decided by the Court of Claims "a la *Marshman.*"[151] In *U.S. v. Davis,*[152] the Supreme Court held that the fair market value of the transferred property was approximately the value to the husband of his discharged obligation and, therefore, the fair market value of the property received by him on the exchange. Thus, if the husband, in exchange for the wife's releasing of her marital rights, transfers securities that cost him $50,000 and that are now worth $75,000, he has a gain of $25,000.[153] Furthermore, the court concluded that the value of the property transferred establishes the tax basis for the wife.

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144. INT. REV. CODE OF 1954, §1001(a).

145. INT. REV. CODE OF 1954, §1001(b).

146. Commissioner v. Mesta, 123 F.2d 986 (3d Cir. 1941); Commissioner v. Halliwell, 131 F.2d 642 (2d Cir. 1942); Commissioner v. Marshman, 279 F.2d 27 (6th Cir. 1960).

147. *Supra* note 121.

148. *Supra* note 121.

149. *Supra* note 121.

150. Davis v. United States, 368 U.S. 813 (1961).

151. Davis v. United States, 287 F.2d 168 (Ct. Cl. 1961).

152. United States v. Davis, 370 U.S. 65 (1962).

153. The nature or character of the gain depends on the nature of the property transferred. INT. REV. CODE OF 1954, §1221; *cf.* Kenan v. Commissioner, 114 F.2d 217 (2d Cir. 1940), *affirming* 40 B.T.A. 824 (1939).

This harsh result may be mitigated if the parties first fix the amount of the husband's obligation—that is, husband is to pay wife $100,000—and the husband, assuming the wife agrees, then transfers property in discharge of that obligation. Under these facts, the wife's marital rights have a value placed on them and should serve as the "amount realized" rather than fair market value of the property transferred by the husband.[154]

One result of the *Davis* case is that the transfer of property creates a taxable gain to the husband, but the transfer produces no cash with which to pay the resulting taxes. On its face, this is a harsh result. Furthermore, the *Davis* decision represents another step away from Congress' intent to tax alimony equally in every state. Thus, property settlements in community property states will give rise to no taxable gain.[155] Congress should consider a new code provision whereby, in *Davis* type situations, the husband has no taxable gain on the transfer and the wife takes his basis for the property received.[156]

Such a congressional solution would equate property settlements with other transactions that Congress has seen fit to treat as non-taxable.[157] Indeed, transfers of property due to divorce have been likened to involuntary conversions which, pursuant to section 1033, Congress has elected to treat, under most circumstances, as a non-taxable event.[158]

DEDUCTIBILITY OF ATTORNEY'S FEES

It is basic tax law that a taxpayer can take no deduction for "personal expenses" unless such a deduction is specifically provided for by the Internal Revenue Code.[159] Seemingly, therefore, the proposition that attorneys' fees arising from a divorce suit are non-deductible[160] should

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154. See Aleda N. Hall, 9 T.C. 53 (1947); Cristina deBourbon Patino, 13 T.C. 816 (1949), *aff'd* 186 F.2d 962 (4th Cir. 1950).

155. Swanson v. Wiseman, 61-1 U.S. Tax Cas. ¶9264 (W.D. Okla. 1961); Francis R. Walz, 32 B.T.A. 718 (1935).

156. A change in the tax laws recommended by the American Law Institute. The institute recommended a statutory change under which gain or loss would not be recognized with respect to the property transferred pursuant to a divorce, separation agreement, anti-nuptial agreement, or other marital settlement, and the wife would take the husband's basis for the property. A.L.I., Fed. Income Tax Stat. (Feb. 1954 Draft) Vol. I, 368.

157. INT. REV. CODE OF 1954, §§1031, 1033, 1034. See Rev. Rul. 55-410, 1955-1 CUM. BULL. 297, wherein the Internal Revenue Service agreed not to tax the donor of a charitable contribution on the appreciated value of the property contributed—a result which has been affected by P.L. 87-834, §13(d) which added "new" §170(e) and redesignated "old" 170(e) as 170(f).

158. 61 MICH. L. REV. 612 (1963).

159. INT. REV. CODE OF 1954, §262.

160. Henry Sanderson, 23 B.T.A. 304 (1931); Robert A. McKinney, 16 T.C.

pose no difficulty. Be this as it may, the law in this area, especially as to husbands, was formerly unsettled.[161]

The unsettled condition revolved around the deduction allowed by the Code "for the production or collection of income and for the management, conservation, or maintenance of property held for the production of income."[162]

The wife's right to deduct attorney's fees, has not provided a great source of difficulty. Thus, that "part of an attorney's fee and of the other costs paid in connection with a divorce . . . which are properly attributable to the production of collection of amounts includible in gross income under section 71 are deductible by the wife under section 212."[163]

As far as husbands are concerned, however, the law, until 1963, was in a state of flux. The seed of the difficulty was sown by the Eighth Circuit in *Baer v. Commissioner.*[164] In that case, the wife demanded that the husband transfer stock in a controlled corporation. The husband's attorneys negotiated a compromise whereby the husband transferred a certain number of shares to his wife, but he retained the voting rights and power of disposition over the shares. In allowing a deduction for that part of the attorneys' fees which could be properly allocated to the protection of the husband's income producing property, the court noted:[165]

> [T]hrough the efforts of [his] attorneys . . . [the husband] was placed in the position to meet [his] obligations and yet remain in control of the company and his stock therein. In so doing they were . . . conserving and maintaining property held . . . for the production of income.

Subsequent to the decision, a conflict of views arose among the courts as to the result reached in the *Baer* case.[166]

Two recent Supreme Court decisions have put the issue largely at

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916 (1951).

161. Baer v. Commissioner, 196 F.2d 646 (8th Cir. 1952).

162. INT. REV. CODE OF 1954, §§212(1)-(2).

163. Treas. Reg. §1.262-1(b)(7) (1958); Elsie B. Gale, 13 T.C. 661 (1949), *aff'd* 191 F.2d 79 (2d Cir. 1951); Barbara B. LeMond, 13 T.C. 670 (1949). The rule also holds true as to legal separations, written separation agreements, and decrees for support. The portion of the wife's attorney's fees allocable to the receipt of money or property not included in income—that is, property settlements or installment payments—is not deductible. Barbara B. LeMond, *supra.*

164. 196 F.2d 646 (8th Cir. 1952).

165. *Id.* at 650.

166. Compare Owens v. Commissioner, 273 F.2d 251 (5th Cir. 1959); Lewis v. Commissioner, 253 F.2d 821 (2d Cir. 1958); Tressler v. Commissioner, 228 F.2d 356 (9th Cir. 1955).

rest.[167] Grounding its decisions on the legislative history of what is now section 212[168] and the judicial decisions prior to its original adoption, the Court held that the right to a deduction under section 212 "depends on whether or not the claim *arises in connection with* the taxpayer's profit seeking activities." "It does not depend on the *consequences* that might result to a taxpayer's income producing property from a failure to defeat the claim. . . ."

Thus, the law seems generally settled in this area. The wife may deduct that portion of her attorney's fee allocated to the production of income—alimony; on the other hand the husband will be unable to deduct the cost of attorney's fees arising from the usual divorce suit.[169] It should be noted, however, that the portion of the attorney's fee allocated for "tax advice or consultation" is still deductible.[170] This tax advice, however, must be received by the person seeking the deduction and not by the other party to the divorce litigation.[171]

ALIMONY TRUSTS

Introduction[172]

The 1954 Internal Revenue Code attempted to clarify and bring together in one subchapter the basic rules as to the taxation of income earned by a trust.[173] Under that chapter, trusts are divided into three general categories:

(1) ordinary trusts,[174]

(2) "grantor trusts"—that is, trusts which are so drafted that the grantor's dominion and control causes, for income tax purposes, the

167. United States v. Gilmore, 63-1 U.S. Tax Cas. ¶9285 (1963), *reversing and remanding* 290 F.2d 942 (Ct. Cl. 1961); United States v. Patrick, 63-1 U.S. Tax Cas. ¶9286 (1963), *reversing* 288 F.2d 292 (4th Cir. 1961).

168. Int. Rev. Code of 1939, §23(a)(2).

169. Nor will the husband be able to deduct attorney's fees paid to his wife's attorney. Lewis v. Commissioner, 253 F.2d 821, 828 (2d Cir. 1958), *affirming* 27 T.C. 158 (1957); United States v. Patrick, *supra* note 167.

170. Treas. Reg. §1.212-1(1) (1957).

171. United States v. Patrick, *supra* note 167.

172. This introduction is only for the purpose of setting forth some broad general rules as to the Internal Revenue Code's treatment of trusts. For this introduction the author has borrowed heavily from two sources: (1) MICHAELSON, INCOME TAXATION OF ESTATES AND TRUSTS (rev. ed. 1961) and (2) HUFFAKER, STUTSMAN & ANGUIRE, TAX PROBLEMS OF FIDUCIARIES (1961).

173. INT. REV. CODE OF 1954 ch. 1, subchapter J. Some feel that Congress did not achieve a sufficient amount of clarity. See Lauritzen, *We Must Simplify the Taxation of Estates and Trusts*, 49 A.B.A.J. 146 (1963).

174. See INT. REV. CODE OF 1954, §641.

income to be taxed to the grantor and the corpus to be regarded as still owned by him also,[175]

(3) trusts created for special situations.[176]

Ordinary trusts are taxed on any income that is neither distributed nor distributable to the beneficiaries. Generally, the trust will be taxed as though it were an individual.[177] A deduction is allowed the trust, however, for any income that is distributed or distributable to the beneficiaries.[178] The amount so deducted by the trust is taxable to the beneficiary,[179] and in his hands the income retains any special characteristic—that is dividend, capital gain, et cetera—it may have had when received by the trust.[180]

Whether an alimony trust, or the wife as beneficiary thereof, will be taxed, as generally outlined above, depends upon the facts and circumstances of each case. It is a surprise[181] to some practitioners to find that there are two types of alimony trusts, each with propensities to different income tax consequences. On the one hand there are "section 71" trusts, consisting of those created either under a separation agreement or pursuant to or in contemplation of a decree of separation or divorce, and, under certain circumstances pre-existing trusts. On the other hand, a pre-existing trust may give rise to a "section 682" trust.

Section 71 Trusts

It has been suggested that there are at least four advantages to be derived by providing for "periodic payments" through the use of a "section 71" trust:[182]

(1) Secure the advantage of "periodic payments" to the husband by providing that the payments to the wife will cease upon the happening of a certain event.

(2) The husband can satisfy his obligation out of the trust income while providing for the return of trust corpus to him or his estate at such time as the payments cease.

(3) The wife's worries as to any fluctuations in the husband's income are generally obviated.

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175. See INT. REV. CODE OF 1954, §§671-78.

176. INT. REV. CODE OF 1954, §401 (pension trusts), §682 (alimony trusts).

177. INT. REV. CODE OF 1954, §641(a).

178. INT. REV. CODE OF 1954, §§651, 666.

179. INT. REV. CODE OF 1954, §61(a)(15).

180. INT. REV. CODE OF 1954, §§652(b), 662(b).

181. Frisch, *Divorce and Separation Tax Techniques*, N.Y.U. 20TH INST. ON FED. TAX. 35 (1962).

182. Comment, 66 YALE L.J. 881 (1957).

(4) The wife is generally freed from the hardship of enforcing compliance with the monetary portion of the alimony decree.

In requiring the wife to include "periodic payments" of alimony in her gross income, the Code provides that such payments are includible even if attributable to property transferred in trust.[183] For example, assume a divorce decree requires the husband to pay his wife $500 per month until she dies or remarries. To meet this obligation, the husband creates a trust and provides: up to $500 per month shall be paid to the wife until she dies or remarries, the trustee may invade corpus to the extent the income is insufficient to provide the $500, and upon the wife's death or remarriage the property is to return to the husband.

Because it was created "in discharge of an obligation imposed upon . . . the husband [and] made specific under the court . . . decree . . . divorcing . . . the husband and wife," the trust is a "section 71" trust.[184] The tax consequences of such a trust will be dissimilar to those arising under ordinary trusts. The wife will be taxed at ordinary income tax rates on all payments made by the trust, whether from corpus or income and regardless of the character of the income in the hands of the trust.[185] Needless to say, the husband will receive no deduction for any amounts paid out by the trust.[186]

A "section 71" trust may arise in another way. If, before any divorce or separation agreement is contemplated, the husband had created such a trust for his wife, he would be required to include in his income any amounts paid to the wife under the trust.[187] If the parties are subsequently divorced, however, and the decree incorporates the trust for the purpose of alimony, the tax results are diametrically opposite. Here, payments from a previously created trust are used in discharge of an obligation imposed upon the husband under the court's decree.[188] Consequently, the husband will no longer be taxed upon the income from the trust and the wife will be required to include the payments from the trust in her gross income, whether such payments are derived from trust corpus or income.[189] Similar tax consequences result if the

183. INT. REV. CODE OF 1954, §§71(a)(1)-(2). Section 71(a)(3) seems to require that the payments be made directly from the husband to the wife.

184. Treas. Reg. §1.682(a)-1(a)(2) (1957).

185. Treas. Reg. §1.71-1(c)(3) (1957); Muriel Dodge Neeman, 26 T.C. 864 (1956), *aff'd per curiam* 255 F.2d 841 (2d Cir. 1958), *cert. denied* 358 U.S. 841 (1958).

186. INT. REV. CODE OF 1954, §§71(d), 215.

187. INT. REV. CODE OF 1954, §677(b).

188. INT. REV. CODE OF 1954, §71(d); Rev. Rul. 57-506, 1957-2 CUM. BULL. 65.

189. Treas. Reg. §1.682(a)-1(a)(2) (1957); Muriel Dodge Neeman, 13 T.C. 397 (1949), *aff'd per curiam* 200 F.2d 560 (2d Cir. 1952). The result would be the same if the parties were legally separated pursuant to a decree or written separation

payments are made, incident to the court decree or written separation agreement, by a trust of which the husband is the beneficiary.[190]

Section 682 Trusts

The regulations, and the fact that there is a paucity of judicial decisions to the contrary, have resulted in a severe restriction of the situations in which a "section 682" alimony trust can arise. For such a trust to exist, two factors, in addition to a divorce, legal separation, or separation under a written agreement, must be present:

(1) Except for section 682, the trust income would be taxable to the husband.[191]

(2) The trust was in existence prior to the divorce, legal separation, or separation under a written agreement and was not created in contemplation or incident to such events.[192]

If before a divorce or a separation is contemplated, the husband creates a trust to pay his wife $1,000 a month and retains the right to revoke the trust at any time, it is clear that the income from the trust will be taxed to the husband and not to the wife.[193] Should the husband and wife become divorced and the decree fail to award any alimony out of the trust or incorporate the trust into the decree, the trust would become a "section 682" trust. Consequently, the wife, and not the husband, would incur any individual tax consequences arising out of the receipt of trust distributions.[194] Under these circumstances, however, the normal trust rules will apply; therefore, the wife will be taxed only on distributions from the trust up to the trust's distributable net income for the tax year.[195] Furthermore, the income will retain, in the wife's hands, any special characteristic it would have had in the trust's or husband's hands.[196] These results will in no way be different if, instead of creating the trust, the husband was the beneficiary of a trust and assigned his rights thereunder to his wife.[197]

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agreement. INT. REV. CODE OF 1954, §71(a)(2); Treas. Reg. §1.682(a)-1(a)(2) (1957).

190. INT. REV. CODE OF 1954, §682; Treas. Reg. §1.682(a)-1(a)(3) (1957).

191. INT. REV. CODE OF 1954, §682(a).

192. Young v. Hassett, 68 F. Supp. 943 (D. Mass. 1946); Treas. Reg. §1.682(a)-1(a)(4) (1957), examples 1 and 2.

193. INT. REV. CODE OF 1954, §676(a).

194. Young v. Hassett, *supra* note 192; Treas. Reg. §1.682(a)(1)-(a)(4) (1957), example 2.

195. Treas. Reg. §1.682(a)-1(a)(2) (1957).

196. Anita Quinby Stewart, 9 T.C. 195 (1947).

197. Anita Quinby Stewart, *supra* note 196; Treas. Reg. §1.682(a)-1(a)(3) (1957).

Support for Minor Children

The payments to the wife, from an alimony trust—whether "section 71" or "section 682"—may be "fixed"[198] for the support of the minor children of the parties. If so, any portion of payments "fixed," is not includible in the wife's gross income.[199] If the income from the trusts would have been taxed to the husband except for the alimony provisions, then that portion of the trust's payments "fixed" for the support of the minor children of the parties is includible instead in the husband's gross income.[200]

CONCLUSION

We have seen that the many provisions of section 71 must be read and followed with great care. It will be extremely difficult, without specifically so providing, to draw an alimony arrangement in Florida that will allow the husband to complete his financial responsibility over a period of less than ten years, and at the same time prevent an income tax burden on the wife. This, despite the fact that Congress clearly intended that a wife should not be taxed on transfers of capital made by her husband over a period of less than ten years. Furthermore, in view of the cases and certain Treasury pronouncements, lump sum "installment payments" over a period of more than ten years will be treated, because of Florida law, as "periodic payments"; hence, the rule of section 71(c)(2) would seem of little importance to parties divorced in Florida.

An attorney representing the wife should impress upon her the necessity, from a tax standpoint, of preventing the husband from being in arrears with the alimony. Arrearages, of sufficient amounts, paid to her in one tax year, could very well wipe out a large segment of the economic benefit intended to be guaranteed the wife by the husband's obligation to pay alimony.

Many divorce decrees attempt to provide for the support of the minor children of the parties. If the parties have agreed, or the court has ordered, that this support, including income taxes, shall be the husband's burden, a proper decree to this effect should be drawn. Thus, the amount intended for the support of the minor children of the parties must be separately and specifically stated. One should not attempt to provide for this support by stipulating that the amount paid to the wife shall decrease by a certain amount as each child attains his majority. To do so is tantamount to placing the complete income tax burden caused by the receipt of these payments on the wife.

The divorce decree may require the husband to transfer certain life

198. See subheading *"Support of Minor Children," supra.*

199. INT. REV. CODE OF 1954, §682(a).

200. Treas. Reg. §1.682(a)-1(b) (1957).

Rosenkranz: Divorce and the Federal Income Tax

insurance policies to his wife. In addition, the court may require the husband to pay the premiums. To have these premiums treated as "periodic" payments–deductible by the husband and includible in the wife's gross income–the husband must absolutely assign the policies to his wife and place in her all the incidents of ownership.

The parties may decide that, in lieu of alimony, the husband shall transfer certain property to the wife in exchange for her release of claims for support and marital rights. The tax consequences of such a transfer are governed by sections of the Code other than those specifically dealing with alimony. It is clear that the proceeds of such a settlement are neither taxable to the wife nor deductible by the husband. On the other hand, if the husband transfers property to the wife that has a fair market value in excess of his basis he must recognize the difference as taxable gain.

As far as the deductibility of attorney's fees incurred in the divorce is concerned, the tax result depends on which party is seeking the deduction. Clearly the wife may deduct that portion of the attorney's fee directly connected with securing alimony that is required to be included in her taxable gross income. The husband, on the other hand, is denied the right to deduct the costs he incurred in the usual divorce suit; however, he may deduct the attorney's fee for "tax advice or consultation."

The parties may desire to avail themselves of a trust to pay the wife her alimony. Care must be taken in ascertaining whether the trust is a "section 71" trust or a "section 682" trust. If the former, all "periodic" payments to the wife, whether from corpus or income, will be included in her gross income and will lose any special characteristics which the income had when earned by the trust. On the other hand, a "section 682" trust will be taxed pursuant to the normal rules for the taxation of trusts. Thus, the wife will be taxed on all amounts distributed or distributable from the trust, not to exceed the "distributable net income" of the trust for the tax year. Furthermore, the payments will generally carry with them any special characteristics which the amounts had when earned by the trust–that is, dividends, capital gains, et cetera.

Many years subsequent to a divorce or property settlement a new litigant may happen upon the scene. Thus the commissioner may become a vocal third party to a matter that the parties contemplated had been permanently concluded. This intervention by the Internal Revenue Service could very well change the monetary and economic results the parties intended to achieve.

With proper planning at the time of the divorce or separation, such action by the Internal Revenue Service may be prevented. To achieve this result, however, an attorney must be thoroughly armed with an understanding of the applicable provisions of the Code and the judicial gloss with which they have been covered.