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INTRODUCTION

Divorce is a matter of significant public and private concern. Over the past fifty years in the United States, the divorce rate has steadily increased. In 1900, .4% of the male population was divorced. In 1963, 2.1% of the male population was divorced. This compares with .5% for females in 1900 and 2.9% in 1963.[1] The rate of increase shows no indication of slowing down.

Evidence indicates that the husband is most often the one who wishes to get out of the marriage. It is likely, however, that in about 60% of the cases, divorce was first suggested by the wife. The husband, consciously or unconsciously, merely makes himself so obnoxious that his wife is willing to be the moving party in seeking the divorce.[2]

Few lawyers and even fewer accountants appreciate the tax consequences of divorce. There are good reasons for this. Usually when a man (or woman) wants a divorce he doesn't go to his accountant, likewise he doesn't go to a lawyer who specializes in tax. He goes to a man he considers to be one of the fighting lawyers—a litigation man. Little does he realize, of course, that his great fighting champion will likely assign the case to the most junior man in the office. Divorce cases are a fertile training ground for the young lawyers interested in litigation. He learns how to get people in and out of jail, procure restraining orders, and ob-

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1 Bureau of the Census, U.S. Dep't of Commerce, *Statistical Abstract of the United States,* Table 29, Page 31 (1964).
2 GOODE, AFTER DIVORCE 114-37 (The Free Press, 1956).

tain injunctions. He soon becomes exposed to the numerous telephone calls and wet nursing that is required.

Seldom does this young lawyer call on an accountant for assistance. Usually, he is afraid to do so for fear of admitting there is something he doesn't know, or maybe he doesn't know enough to do so, or maybe he doesn't have enough authority. Seldom does this young gladiator call on his fellow tax lawyer. Usually, if he needs help, he calls on his litigation friends. However, even if he did call on his fellow tax lawyer or accountant, he might not get much help. The tax lawyer and accountant are concerned about deductions and credits, spin offs and split ups, organizations and reorganizations, gains and losses, carry overs and carry backs, basis, depreciation, etc. They spend their time servicing their great and wealthy corporate client. In truth, few "tax lawyers" handle divorce cases and few "divorce lawyers" handle tax matters.

Many learned authors have addressed themselves to the problem of divorce and its consequences in a social light. They have concerned themselves with problems of reform and the like. Few, however, have dealt with the tax problem. This is not surprising. Ordinarily, the law professor who teaches the subject of domestic relations in the law school does not also teach the tax course. The likelihood is that he knows very little about tax and desires to avoid it like the plague, hoping beyond hope that whatever important matters there are, aside from the deductibility of alimony payments, will be handled by the "tax man." On the other hand, the "tax man" is busy teaching about the "fruit and tree," whose income it is, when it is income, and the like. He knows little about divorce law and spends as little time as possible discussing taxation with respect to it.

At the onset of divorce, the husband and wife both must realize that there will be increases in the joint expenses. This hardly seems like a rational solution in those numerous divorce cases in which financial problems are said to be at the heart of things. It is unlikely there will be any increase in income to offset this increased cost of running the separated home, unless it is resolved by the wife obtaining outside employment. To further compound the financial problems involved, more than 80% of the people once divorced get remarried.[3]

Everybody, however, does know a few things about the tax consequences of divorce. The tax lawyer, the litigation lawyer, the accountant, and even the parties involved know that, once the parties are divorced, alimony payments made by the husband to the wife are usually deductible by the husband and taxable by the wife. It is at this point then that we begin consideration of the problem.

[3] Bureau of the Census, U.S. Dep't of Commerce, *Statistical Abstract of the United States*, Table 29, Page 31 (1964).

DETERMINATION AND EFFECT OF STATUS

For the purpose of ascertaining the applicability of the Internal Revenue Code provisions relating to alimony and separate maintenance payments, the status of the taxpayers is determined at the end of the calendar year.[4] If, at that time, the divorce decree is final, the parties are considered to have been unmarried for the entire year. They may no longer take advantage of any tax benefits which inure to the benefit of the married people. If the divorce is not final, but the parties are nevertheless separated and living apart or separated under an interlocutory decree of divorce, they have the option of either filing separate returns or filing jointly. If the parties are living apart under a written separation agreement and elect to file separate returns, or are actually divorced, payments made and received are considered principally under Internal Revenue Code of 1954, Sections 71, 215, and 682.[5] Once divorced, a man can no longer claim his ex-wife as an exemption even though he may provide 100% of her support.[6]

Payments made and actions taken in good faith under decrees which turn out to be invalid are generally treated as if the parties were, in fact, divorced.[7] The uncertainty which existed in this area for many years was cleared up by two recent Second Circuit decisions.

In *Estate of Borax v. Commissioner*,[8] the husband obtained an ex parte Mexican divorce and then remarried. His first wife brought suit in New York and had the Mexican divorce declared invalid, leaving her the legal spouse. The Commissioner upheld by the Tax Court then stepped in to deny the alimony deduction, the right to file a joint return with the second wife, and all the dependency deductions taken for the second wife, her children, and her parents. The Second Circuit, however, held that in the interests of uniformity and recognition of congressional intent, the Mexican divorce should be given effect for federal tax purposes. The court pointed out that it was not passing on the question where the state which granted the divorce declared it invalid, or where the rendering court's concept of divorce was entirely alien to that contemplated by the tax laws.[9]

[4] INT. REV. CODE OF 1954, §§ 143, 153.

[5] In order to take advantage of the § 215 deduction, however, all deductions must be itemized. INT. REV. CODE OF 1954, §§ 62, 63, 141.

[6] INT. REV. CODE OF 1954, § 152 (because wife does not bear the prescribed relationship). See also Dale E. Sharp, 15 T.C. 185 (1950).

[7] *But see* Daniel Buckley, 37 T.C. 664 (1962) where the divorce was "void."

[8] 349 F.2d 666, 65-2 U.S. Tax Cas. ¶ 9592 (2d Cir. 1965), *rev'g* 40 T.C. 1001 (1963).

[9] Prior to the *Borax* case there was only one clear appellate decision in point. This was Feinberg v. Commissioner, 198 F.2d 260, 263 (3d Cir. 1952) where the court stated: "The mere fact that the marital domicile of the parties did not recognize the Florida divorce does not render it a nullity for Federal tax purposes."

In *Wondsel v. Commissioner*,[10] the taxpayer secured an ex parte Florida divorce and remarried twice before his first wife had the divorce declared invalid by a New York court. The payments to both prior wives were held to be deductible alimony.

The tax effect of an annulment depends on local law. If the decree of annulment makes the marriage void ab initio, payments made (whether or not by court order) will not qualify as alimony or separate maintenance.[11] On the other hand, if the local law treats an annulment the same as a divorce for purposes of imposing the support obligation, payments made may qualify under Internal Revenue Code of 1954, Sections 71 and 215.[12]

The termination of a voidable marriage, such as one induced by fraud, should be treated the same as any other annulment.

STATUTORY SCHEME FOR ALIMONY

1. *Development of the Law*

Shortly after the adoption of the income tax law, the United States Supreme Court determined that alimony payments should not be considered income to the recipient.[13] It also concluded that there was, therefore, no reasonable basis for payor to deduct the alimony.[14] The result was that the husband had to ante up his alimony from after tax income.

An attempt by a husband to transfer the tax to his ex-wife by having the alimony paid from a trust also failed.[15] Taxwise, the payments were merely treated as a discharge of husband's general support obligation.[16]

In those early days it didn't matter too much since income tax rates were in the 7% and 8% area, deductions liberal, loopholes plentiful, and enforcement machinery not nearly so sophisticated as it is now. In the late 1930's, however, with the oncoming of World War II, tax rates increased substantially, and along with them the difficulties involved in paying alimony from after tax dollars. In 1942 our legislators in Congress (perhaps with some alimony obligations themselves and, therefore, not unmindful of the difficulty involved) adopted a substantial change with

[10] 350 F.2d 339, 65-2 U.S. Tas Cas. ¶ 9597 (2d Cir. 1965) *rev'g* Harold E. Wondsel, 33 P-H Tax Ct. Mem. 1399 (1964). *Cert. app'd for* December 23, 1965.

[11] Special Ruling December 8, 1944, 454 CCH ¶ 6092.

[12] Rev. Rul. 59-130, 1959-1 CUM. BULL. 61; Lily R. Reighley, 17 T.C. 344 (1951).

[13] Gould v. Gould, 245 U.S. 151 (1917). It is worth noting that the *Gould* case cast some general doubt on the constitutionality of taxing alimony. The doubt has, however, now been removed. See Mahana v. United States, 88 F. Supp. 285 (Ct. Cl. 1950), *cert. denied,* 339 U.S. 978 (1950), *reh. denied,* 340 U.S. 847 (1950).

[14] *Ibid.*

[15] Douglas v. Willcuts, 296 U.S. 1 (1935).

[16] Helvering v. Fitch, 309 U.S. 149 (1940); Douglas v. Willcuts, *supra.* note 15.

respect to the tax treatment of alimony and support payments. Such payments were made deductible by the husband and taxable to the wife if they were made pursuant to a divorce or separation decree or under a written instrument incident to divorce or separation.[17] Trust income was made taxable to the wife to the extent used to satisfy the husband's alimony obligation.[18]

Although the change in the law was a substantial improvement and established a greater tax equity, there were some things left to be desired. To qualify for the new treatment, payments had to be made under a final divorce or separation decree.[19] In many states, however, a decree does not become final until a lapse of time after the court hands it down. Thus, payments made under interlocutory decrees, alimony pendente lite, payments under a separation agreement, etc., all fell outside the scope of the statute and were not deductible. Payments would also qualify if made under a written instrument made "incident to" a divorce or separation.[20] These words were imprecise and productive of a large number of disputes.[21]

2. *The New Law and Its Improvements*

The present provisions in the law have been with us since 1954. Section 71 of the 1954 Code provides rules for the treatment of payments in the nature of, or in lieu of, alimony, or an allowance for support between spouses who are divorced or separated. Section 215 provides rules relative to the deduction by husband of periodic payments not attributable to transferred property. These sections, together with Section 682, which provides for the treatment of trusts, went a long way toward resolving the difficulties encountered in administering the 1939 Code.

(a) Principal Changes

The 1954 Code accomplished two principal improvements. First: It made periodic sums that the husband paid to his ex-wife for her support under a support or maintenance decree granted after March 1, 1954, de-

[17] INT. REV. CODE OF 1939, §§ 22(k), 23(u).
[18] INT. REV. CODE OF 1939, § 171.
[19] INT. REV. CODE OF 1939, §§ 22(k), 23(u).
[20] *Ibid.*
[21] *E.g.,* MacFadden v. Commissioner, 250 F.2d 545 (3d Cir. 1957); Holt v. Commissioner, 226 F.2d 757 (2d Cir. 1955); Lerner v. Commissioner, 195 F.2d 296 (2d Cir. 1952); Izrastzoff v. Commissioner, 193 F.2d 625 (2d Cir. 1952); Smith v. Commissioner, 192 F.2d 841 (1st Cir. 1951); Commissioner v. Blum, 187 F.2d 177 (7th Cir. 1951); Commissioner v. Murray, 174 F.2d 816 (2d Cir. 1949); Mahana v. United States, 88 F. Supp. 285 (Ct. Cl. 1950), *cert. denied,* 339 U.S. 978 (1950); Drake v. United States, 191 F. Supp. 84 (S.D. N.Y. 1961); Portfolio v. United States, 118 F. Supp. 367 (Ct. Cl. 1954); Bertha McKay Pease, 26 T.C. 749 (1956); Maurice Fixler, 25 T.C. 1313 (1956); Frances Hamer Johnson, 21 T.C. 371 (1953); Rowena S. Barnum, 19 T.C. 401 (1952); Jane C. Grant, 18 T.C. 1013 (1952); Miriam Cooper Walsh, 11 T.C. 1093 (1948), *aff'd,* 183 F.2d 803 (D.C. Cir. 1950). See also Hollander v. Commissioner, 248 F.2d 523 (9th Cir. 1957).

ductible by him and taxable to her provided, however, that they were separated and did not file a joint return.[22]

Second: It substantially eliminated the problem of determining whether the agreement, under which the payments were made, was incident to a divorce or separation decree by providing that payments made under a written separation agreement executed after August 10, 1954, are deductible by the husband and taxed to the wife, whether or not the agreement is enforceable or the parties are subsequently divorced or obtain a decree of separation.[23]

(b) Present Requirements

For separations and divorces subsequent to August 16, 1954, there is no longer any real need to draw any distinction between payments which are characterized as alimony, support or separate maintenance. Such payments are deductible by the husband and taxable to the wife if:

1. They are made to satisfy a legal obligation imposed on the husband because of the marital or family relationship.[24]

2. The husband and wife are either divorced or separated.[25]

3. The husband and wife do not file a joint return.[26]

4. The payments are made pursuant to either:
   (a) A divorce decree.[27]
   (b) Any type of legal decree for separate maintenance.[28]
   (c) A support decree.[29]
   (d) A written separation agreement.[30]

5. The payments are made subsequent to the decree or agreement.[31]

6. The payments are "periodic" as that term has been defined in the statutes, regulations, and cases.[32]

[22] INT. REV. CODE OF 1954, § 71(a)(3).
[23] INT. REV. CODE OF 1954 § 71(a) (2).
[24] INT. REV. CODE OF 1954, §§ 71, 215. In H.R. REP. NO. 2333, 77th Cong., 2d Sess. 72 (1942), the Ways and Means Committee stated: "This section applies only where the legal obligation being discharged arises out of the family or marital relationship in recognition of the general obligation of support made specific by the decree." See also S. REP. NO. 1631, 77th Cong., 2d Sess. 83 (1942). See also Newton v. Pedrick, 212 F.2d 357 (2d Cir. 1954); Alice L. Heath, 30 T.C. 339 (1958), *aff'd per curiam*, 265 F.2d 662 (2d Cir. 1959).
[25] INT. REV. CODE OF 1954, §§ 71, 215.
[26] *Ibid.*
[27] INT. REV. CODE OF 1954, § 71(a)(1).
[28] *Ibid.*
[29] INT. REV. CODE OF 1954, § 71(a)(3).
[30] INT. REV. CODE OF 1954, § 71(a)(2).
[31] INT. REV. CODE OF 1954, § 71(a)(1)-(3); Florence Korman, 36 T.C. 654 (1961), *aff'd per curiam*, 298 F.2d 444 (2d Cir. 1962); *cf.* Ruth W. Cooper, 31 P-H Tax Ct. Mem. 1313 (1962)
[32] See INT. REV. CODE OF 1954, § 71; Treas. Reg. § 1.71-1(d)(1) (1958); F. Ewing Glasgow, 21 T.C. 211 (1953).

(c) Agreements Made Before 1954 but Modified Thereafter

If the payments are made under a written separation agreement executed prior to August 16, 1954, they are neither deductible by the husband nor taxable to the wife. If, however, the agreement has been altered in writing in any material respect after that date, it will thereafter qualify for the alimony deduction.[33]

Payments made under a support decree, like payments under a written separation agreement, were not deductible by the husband or income to the wife under the 1939 Code. In the support decree area, however, March 1, 1954, is now the magic date. Payments made under a decree entered on or before that date do not qualify for treatment under the 1954 Code. Post March 1, 1954, modification, however, will bring the decree under the new law.[34]

(d) The Requirement of a Legal Obligation

The question of whether or not there is a legal obligation will normally be decided under local law. In the ordinary case, the local law imposes an obligation upon the husband or ex-husband to provide sufficient funds, consistent with his means, to his estranged wife or ex-wife in order to provide for her support and maintenance. Under some special circumstances, i.e. if the husband is physically or mentally incapacitated, the local law may even impose a support obligation upon the wife.[35] Repayment of a debt to an ex-wife is not an obligation rising out of the family relationship, but rather is a business transaction which does not come into the purview of the alimony provisions.[36]

There is at least a possibility that where periodic payments exceed the amounts required for the wife's support, the excess over the amount required for support constitutes a gift.[37] It seems clear then that amounts paid by the husband to the wife, or vice versa, to buy the other off, do not qualify as alimony.

(e) The Requirement of a Written Agreement

Alimony pendente lite or other support payments made pursuant to

[33] Treas. Reg. § 1.71-1(b)(2) (1958); Rev. Rul. 56-418, 1956-2 CUM. BULL. 27. Although August 19, 1954 is quite a while ago, cases still come up concerning pre-1954 modification. For example, H. Gregory Shea, 34 P-H Tax Ct. Mem. 1223 (1965 involved the question of whether or not modification made two weeks after August 16, 1954, which changed the weekly payments to semimonthly payments, was material enough to qualify under the language of the regulations. The Tax Court decided it was not.

[34] Treas. Reg. § 1.71-1 (b)(ii) (1958).

[35] No doubt the Congress contemplated a situation where the wife might be paying alimony to the husband. INT. REV. CODE OF 1954, § 7701(a)(17).

[36] Thorsness v. United States, 260 F.2d 341 (7th Cir. 1958); Miriam Finley Schwartz, 23 P-H Tax Ct. Mem. 509 (1954); J. H. England, 37 T.C. 1150 (1962); Jerome Blate, 34 T.C. 121 (1960); John Sidney Thompson, 22 T.C. 275 (1954); Thomas E. Hoag, 13 T.C. 361 (1949).

[37] E.T. 19, 146-2 CUM. BULL. 166.

an oral agreement of the parties will not be taxed under Section 71 or be deductible under Section 215. To qualify, the payments must be made after the execution of a written agreement or pursuant to an order of the court.[38]

(f) The Periodic Payment Requirement

The requirement of periodic payments may be satisfied in a number of different ways:

(i) The payment is periodic if it is indefinite in either or both amount to be paid and the period over which it is to be paid and is in the nature of alimony or support;[39] or

(ii) The payment is periodic if it is a definite amount payable over more than 10 years.[40]

Some examples of periodic payments are as follows:

Payment from husband to wife to terminate upon death or remarriage of wife.[41]

Payment from husband to wife to terminate upon death of husband.[42]

Payment from husband to wife, termination of which is not specified but which, under local law, may be modified or will terminate upon death of either spouse.[43]

Payment from husband to wife for a fixed period of less than 10 years but subject to the contingencies set forth above.[44]

Payment from husband to wife of a fixed amount payable in installments which are to be paid over a period of more than 10 years from the date of the decree.[45]

Payments from husband to wife which are contingent upon either husband's or wife's income.[46]

Payments from husband to wife which are a percentage of husband's income.[47]

[38] INT. REV. CODE OF 1954, § 71(a)(3).
[39] Treas. Reg. § 1.71-1(d)(3) (1958).
[40] INT. REV. CODE OF 1954, § 71(c)(2).
[41] Edward Bartsch, 18 T.C. 65 (1952), *aff'd per curiam*, 203 F.2d 715 (2d Cir. 1953).
[42] Smith v. Commissioner, 208 F.2d 349 (3d Cir. 1953).
[43] Laurence J. Ellert, 30 P-H Tax Ct. Mem. 407 (1961), *aff'd*, 311 F.2d 707 (6th Cir. 1962); Paul Shawhan, 32 P-H Tax Ct. Mem. 98 (1963).
[44] Rev. Rul. 59-45, 1959-1 CUM. BULL. 666; Bettye W. Hobbs 32 P-H Tax Ct. Mem. 16 (1963); Baker v. Commissioner, 205 F.2d 369 (2d Cir. 1953), reversing on this point, 17 T.C. 1610 (1952), where the decree provided that the wife was to receive $300 per month for one year and $200 per month for the next five year, but if she should die or remarry within that time, the payments would cease.
[45] INT. REV. CODE OF 1954, § 71(c)(2).
[46] Ronald Keith Young, 10 T.C. 724 (1948); John H. Lee, 10 T.C. 834 (1948).
[47] Treas. Reg. § 1.71-1(d)(3)(i)(a) (1958).

Periodic payments need not be made at regular intervals. They are simply payments made at different times and from time to time and may be of definite or indefinite amount or duration. The payments may be in cash or kind and may be made directly to the wife or may be paid to third persons in payment for goods or services supplied to the wife.[48]

(g) Installment Payments v. Periodic Payments

Periodic payments must be distinguished from installment payments, which are specifically excluded from treatment as alimony.[49] Generally, installment payments are payments made from time to time, either of equal or unequal amount, which are applied to discharge an obligation, the principal sum of which is definitely fixed in the decree or otherwise.[50] The only exception from the installment payment rule is where the principal sum may be or is to be paid within a period ending more than 10 years after the date of the decree or execution of the agreement under which the payments are made.[51]

If, under the terms of the divorce or separation decree or separation agreement, the husband may discharge the principal obligation by making payments over the 10 year period, the payments are deductible.[52] The principal obligation may, in fact, be discharged in less than 10 years but, so long as the decree permits discharge in more than 10 years, the payments may be considered periodic.[53] In cases where the obligation is satisfied in less than 10 years, the amount which is treated as a periodic payment is limited to 10% of the principal sum.[54] The 10% limitation, however, applies only to advance payments. Delinquent payments retain their character even though, when paid, the amount may be more than 10% of the total due.[55]

STATUTORY SCHEME FOR ALIMONY TRUSTS

1. *Section 71 Trusts*

When a husband sets up a trust to provide for the alimony payments instead of making them directly, the applicable code provisions are slightly

[48] Aline S. Fisher, 25 P-H Tax Ct. Mem. 403 (1956); Robert Lehman, 17 T.C. 652 (1951); Mary MacFadden, 25 P-H Tax Ct. Mem. 1221 (1956), *aff'd*, 250 F.2d 545 (3d Cir. 1957); *cf.* Smith v. Commissioner, 208 F.2d 349 (3d Cir. 1953).

[49] INT. REV. CODE OF 1954, § 71(c)(1).

[50] Treas. Reg. § 1.71-1(d)(3)(ii)(b), (c) (1950); Ralph Norton, 16 T.C. 1216 (1951), *aff'd*, 192 F.2d 960 (8th Cir. 1951).

[51] INT. REV. CODE OF 1954, § 71(c)(2).

[52] *Ibid.*

[53] Ellert v. Commissioner, 311 F.2d 707 (6th Cir. 1962); Alice Grabowski, 31 P-H Tax Ct. Mem. 284 (1962).

[54] INT. REV. CODE OF 1954, § 71(c)(2); Treas. Reg. § 1.71-1(d)(2) 1958).

[55] *Ibid.*; Antoinette L. Holahan, 21 T.C. 451 (1954), *aff'd*, 222 F.2d 82 (2d Cir. 1955); Jane C. Grant, 18 T.C. 1013 (1952), *aff'd*, 209 F.2d 430 (2d Cir. 1953); Sarah L. Noresckkine, 14 T.C. 1128 (1950), *aff'd per curiam*, 189 F.2d 257 (2d Cir. 1951).

different. Before the 1942 amendments, income from alimony trusts had been taxed to the husband.[56] The 1942 act[57] provided that trust distributions would be taxed to the wife rather than to the husband to the extent used to satisfy the husband's alimony obligation. Since the distribution is not included in the husband's income, there is no need for any provision allowing him to deduct the amounts paid.[58]

The full amount of periodic payments paid by the trust to satisfy the alimony obligation is taxable to the wife, regardless of whether the payments are made from trust income or corpus.[59] The Grantor Trust Rules,[60] which would otherwise cause the income to be taxed to the husband because it is used to discharge his support obligation, are not applicable.[61]

Ordinarily, the trust conduit rule provides that trust income in the hands of the beneficiary retains the same character it had in the hands of the trustee.[62] For example, capital gains and tax exempt income received by the trust retain the same character in the hands of the beneficiary. This is not so where a trust is established to satisfy a support obligation imposed by a divorce or separation. In the latter case, Internal Revenue Code of 1954, Section 71(a) makes all of the distributions taxable to the wife as ordinary income, whether the trustee received it as capital gain or income on tax exempt securities.[63]

2. *Section 682 Trusts*

To this point, we have been considering trusts which have been established for the specific purpose of providing the payments required by a separation agreement or divorce or separation decree. Such payments are taxed to the wife under Section 71. Where a trust was created before the divorce or separation and not in contemplation of it, Internal Revenue Code of 1954, Section 682 applies. This section supplements the provisions of Section 71 and provides that any trust income to which a wife is entitled because of a separation agreement or a divorce or separation decree, and which would otherwise be taxed to the husband, shall be

[56] Douglas v. Willcuts, 296 U.S. 1 (1935).

[57] INT REV. CODE OF 1939, § 171.

[58] Such as INT. REV. CODE OF 1954, § 215 in the case of direct periodic payments.

[59] Treas. Reg. § 1.71-1(c)(3) (1958).

[60] INT. REV. CODE OF 1954, §§ 673-77.

[61] Treas. Reg. § 1.71-1(c)(3) (1958).

[62] INT. REV. CODE 1954, §§ 652(b), 661(b).

[63] See, Muriel Dodge Newman, 26 T.C. 864 (1956); Anita Quinby Stewart, 9 T.C. 195 (1947). Now and again separation agreements have been drawn which provide that the husband is also to pay the wife's taxes. To counter this, the husband's lawyer may try to satisfy the alimony obligation by providing that payments are to be made from a trust, the corpus of which is to be tax exempt securities. To the knowledge of the author, the Internal Revenue Service has uniformly asserted that the receipts by the wife are taxable as ordinary income regardless of the source.

taxed to the wife. The important distinction between a Section 71 trust and a Section 682 trust is that under Section 682 payments are included in the wife's income only to the extent they are made out of trust distributable net income.[64]

If the husband assigns his interest in a trust already in existence to his wife pursuant to divorce or separation decree or separation agreement, the trust immediately comes under Section 71(a).[65]

3. *Examples*

The following examples illustrates the application of Sections 71 and 682(a):

Example I. Husband transfers $100,000 to a trust fund for his wife for her support pursuant to a property settlement agreement made in connection with their divorce. The trust is to pay the wife $10,000 per year from income and principal. The entire $10,000 is taxed to the wife under Section 71 regardless of whether it's from income or corpus.

Example II. Husband transfers $100,000 to a trust for his wife 10 years before the divorce and not in contemplation thereof. Under local law the husband has an obligation to support his ex-wife. The wife continues as beneficiary after the divorce. Section 682 relieves the husband from the Grantor Trust Rules (which would otherwise tax the income to the husband) and taxes income to the wife. If the wife receives distribution of corpus, she is not taxed on it. Capital gains and tax exempt income received by the trust and distributed to the wife retain the same character in her hands.

Example III. Grandfather tranfers $100,000 to a trust for his grandson and his wife upon their marriage, the income and principal to be distributed to either of them according to the trustee's discretion (sprinkle power). Three years later, upon divorce, the grandson assigns all his interest in the trust to the wife in satisfaction of the support obligation. The income is all taxed to the wife under Section 71. It is not clear how the distribution of principal would be handled. Most likely it would be handled under Section 71, since the assignment of *all* the husband's interest comes under Section 71.[65a]

4. *Other Trust Considerations*

(a) Trust for child support.

Whether the trust is a Section 71 trust or a Section 682 trust, the income is taxed to the husband to the extent that the trust instrument (or

[64] INT. REV. CODE OF 1954, § 682(a).

[65] Treas. Reg. § 1.682 (a)-1(a) (2) (1958). *But see* Anita Quimby Stewart, *supra* note 63

[65a] *But see* Anita Quinby Stewart, *supra* note 63.

divorce or separation decree or separation agreement) directs it to be used for the support of the husband's minor children.[66]

(b) Gain on transfer to trust.

There may also be a capital gain to the husband if he transfers appreciated property to the trust. In *Commissioner v. Mesta*,[67] for example, the husband transferred appreciated securities as part of a property settlement incident to a divorce. He was held taxable on the excess of the fair market value of the securities over the cost basis, the court finding the consideration to be the discharge of the support obligation and determining the latter to be equal to the fair market value of the securities given up. The husband, however, will not realize taxable income upon the transfer of appreciated securities to a trust for the benefit of his divorced wife unless the trust terminates his support obligation under the divorce settlement.[68] If the trust terminates the obligation in part, the husband must realize taxable income on the aliquot part of the appreciated value of the property transferred.[69]

(c) Estate tax problems with a trust.

There are no special estate tax provisions in the 1954 Code providing relief to the estate of a husband who has transferred property into a trust for his ex-wife's support, but who has retained a reversionary interest in it. The situation is governed by the Internal Revenue Code, 1954, Sections 2036, 2037, and 2038, which apply in both divorce and nondivorce settings.

In the usual case, an alimony trust is set up to terminate upon the death or remarriage of the ex-wife. If the instrument provides that the then corpus of the trust is at that time to revert to the husband or his estate, the husband has made a transfer with a reversionary interest which will be included in his taxable estate at death, whether or not it has, in fact, reverted to him.[70] Even an irrevocable trust for the support of minor children may be subject to estate tax on the husband's death, since the trust income might be deemed to satisfy the husband's legal obligation.[71] The theory is that if the income is used to satisfy the husband's legal obligation, it is the same as if he received it and used it in that manner.[71a]

[66] INT. REV. CODE OF 1954, § 682(a); Walter L. Ferris, 1 T.C. 992 (1943); Calvin H. Sugg, 1 T.C. 431 (1943)

[67] 123 F.2d 986 (3d Cir. 1941), *cert. denied*, 316 U.S. 695 (1941). See also Commissioner v. Halliwell, 131 F.2d 642 (2d Cir. 1942), *rev'g* 44 B.T.A. 740 (1941), *cert. denied*, 319 U.S. 741 (1943); E. Eugene King, 31 T.C. 108 (1958).

[68] Rev. Rul. 57-506, 1957-2 CUM. BULL. 65.

[69] Rev. Rul 57-507, 1957-2 CUM. BULL. 511; Rev. Rul. 59-47, 1959-1 CUM. BULL. 198.

[70] INT. REV. CODE OF 1954, § 2037.

[71] See INT. REV. CODE OF 1954, § 2036; Commissioner v. Dwight, 205 F.2d 298 (2d Cir. 1953), *cert. denied*, 346 U.S. 871 (1953).

[71a] *Cf.* Old Colony Trust Co v. Commissioner, 279 U.S. 716 (1929).

(d) Other arrangements may be better

Considering the adverse and potentially adverse tax consequences, an alimony trust should only be used in very limited circumstances. If the concern is over the dependability of the ex-husband to make the payments, an escrow or other security arrangement will do better and result in less adverse tax consequences.[72]

Life insurance can be used to protect against the husband's death, if this is a concern.[73]

Perhaps only when the wife's competency is so seriously in doubt that she cannot be relied upon to properly use or handle property, which would otherwise be received outright, should the trust be used. But even then, its purpose should not be only to provide the alimony payments, but rather to comprise a part of the lifetime estate planning of the wife and provide a means to conserve her property.

PROPERTY SETTLEMENTS

1. *Income Tax Consequences of the Transfer of Separately Owned Property*

(a) Amount Realized

A transfer by a husband in exchange for a total or partial release of his ex-wife's right of support is a taxable transaction.[74] If the husband's basis in the property he transfers is less than its fair market value, he realizes a gain which may be either ordinary or capital. The amount of the gain which must be recognized is equal to the difference between the fair market value of the property and the husband's basis.[75] The wife's new basis in the property she receives is its fair market value, and her holding period begins when she receives the property.[76]

If the fair market value is less than the husband's basis, no loss is allowed on the transfer because it is not a transaction entered into for profit.[78]

The statute which deals with the recognition of gain provides that "the amount realized from the sale or other disposition of property shall be the sum of money *received* plus the fair market value of the property (other than money) received."[78] (Emphasis added.)

The United States Supreme Court in *United States v. Davis*[79] established that the value of the property the husband receives is deemed to

[72] See Tilles v. Commissioner, 113 F.2d 907 (8th Cir. 1940), *cert. denied,* 311 U.S. 703 (1940).

[73] Blumenthal v. Commissioner, 183 F.2d 15 (3d Cir. 1950); Baker v. Commissioner, 205 F.2d 369 (2d Cir. 1953); Lemuel Alexander Carmichael, 14 T.C. 1356 (1950).

[74] INT. REV. CODE OF 1954, §§ 1001, 1002; Davis v. United States, 287 F.2d 168 (Ct. Cl. 1961), *rev'd.,* 370 U.S. 65 (1962).

[75] Davis v. United States, *supra* note 74.

[76] *Cf.* Farid-Es-Sultaneh v. Commissioner, 160 F.2d 812 (2d Cir. 1947).

[77] INT. REV. CODE OF 1954 §§ 165(c), 267(a) (1). See also Edward A. Walz, 32 B.T.A. 718 (1935).

[78] INT. REV. CODE OF 1954, § 1001.

[79] 370 U.S. 65 (1962).

be equal to the value of the property he transfers. *Davis* was heard by the Supreme Court because of a conflict in the circuits and in the Court of Claims. The rule in the Second and Third Circuits had been the same as in *Davis*.[80] The Sixth Circuit rule, which was followed by the Court of Claims, was different. [81] The Sixth Circuit, in *Marshman*, (which appeared to be a very well reasoned case), said:

> "Section 111 (b), (the Internal Revenue Code of 1939), requires that the capital gain be measured by the fair market value of the property . . . received' by the taxpayer, not by the fair market value of the property transferred by the taxpayer in exchange for the property received. To say that the fair market value of the property received is the same as the fair market value of the property given up, not only ignores realities, but is the use of a formula which is radically different from the well established and well recognized formula approved by the courts for determining fair market value. . . .
>
> Unfortunately, it is often the case that what a husband transfers to his wife in a so-called property settlement in a pending divorce action is not given merely in exchange for a release of alimony and dower rights, but also includes, without being so labeled, such additional amount as the husband may be willing to pay in order to have the marital status termined . . . the value of what is given up is no criterion of the fair market value of the property received."[82]

The Court of Claims thought *Marshman* stated the best rule, applied in it *Davis*, but was (and perhaps unfortunately) reversed by the Supreme Court.[83]

(b) Effect of Encumbrances

The amount realized by the husband in the transfer of property in a divorce or legal separation is not reduced by any encumbrances on the property.[84] This is true whether or not the encumbrance is assumed. Either way, it is considered to be part of what the husband receives.[85] If the wife doesn't assume, payments on any encumbrance are either additional property settlement or, if they meet the periodic payment test, additional alimony.[86]

[80] Commissioner v. Mesta, 123 F.2d 986 (3d Cir. 1941), *cert. denied*, 316 U.S. 695 (1942); Commissioner v. Halliwell, 131 F.2d 642 (2d Cir. (1942), *cert. denied*, 319 U.S. 741 (1943); E. Eugene King, 31 T.C. 108 (1958).

[81] Homer H. Marshman, 31 T.C. 269 (1958), *rev'd on other grounds*, 279 F.2d 27 (6th Cir. 1960), *cert. denied on taxpayers application*, 364 U.S. 918 (1960).

[82] Commissioner v. Marshman, 279 F.2d 27, 32 (6th Cir. 1960).

[83] United States v. Davis, 370 U.S. 65 (1962)

[84] E. Eugene King, 31 T.C. 108 (1958).

[85] *Ibid.*

[86] See pages 120 and 121 *supra;* see also Renstram v. United States, 220 F. Supp 688 (D. Neb. 1963); Klemm v. United States, 57-2 U.S. Tax Cas. ¶ 9906 (E.D. Wis. 1957); Edmund D. Steelman, 28 P-H Tax Ct. Mem. 365 (1959) (all non-deductible); Mace v. United States, 64-2 U.S. Tax Cas. ¶ 9732 (S.D. Cal. 1964) (deductible); Rev. Rul. 62-39, 1962-1 CUM. BULL. 17.

To illustrate the law, assume the following fact situation:

The husband owns an apartment building in which his adjusted basis is $50,000. The property is encumbered in the amount of $61,000, and its fair market value is $80,000. Pursuant to a divorce decree, the husband transfers this building to his ex-wife for the relinquishment of her right of support. The husband also agrees to continue to pay the mortgage. The principal of the mortgage is being repaid at the rate of $6,000 per year, with annual interest of $500, taxes of $500, and insurance of $500, making the total annual payment $7,500. On the transfer the husband's gain is $30,000, being the difference between the fair market value of $80,000 and his adjusted basis of $50,000.

To the extent that the husband continues to pay the mortgage payments, they qualify as alimony, since they are payable over a period of longer than 10 years from the date of the decree.[87] The husband gets to deduct $7,500 (the whole payment) per year, and the wife must include the same amount in her taxable income. The ex-wife can probably deduct the taxes paid, but there is a serious question as to her right to deduct the interest, since the interest is not an obligation of hers but is rather the husband's obligation. If the wife had assumed the mortgage and the husband had paid her $7,500 per year alimony so she could make the mortgage payments, there would be no question about her right to the deduction.[88]

(c) Wife's Basis in Support Rights

There is no law establishing what the wife's basis is in the suport rights that she gives up to get the property. Presumably, she is not taxed on what she parts with.[89]

2. *Income Tax Consequences of the Transfer of Jointly Owned Property*

(a) Division on the Basis of Ownership Interest

A division which recognizes the parties' ownership interests is tax free.[90] There may be tracing problems to find what the ownership interest of each is, but even if item by item tracing cannot be done, it will be sufficient if the taxpayers can show that each contributed a like amount to the basic purchase price of the property which is being divided.[91]

[87] See Mace v. United Sattes, *supra* note 86.

[88] Having wife assume should not be objectionable to either party, since either way the whole amount will be deductible by husband and taxable to wife; but if wife assumes, she gets the interest deduction; *but see* Rev. Rul. 58-52, 1958-1 CUM. BULL. 15, as modified by Rev. Rul. 62-38, 1962-1 CUM. BULL. 15; Deininger v. Commissioner, 313 F.2d 221 (4th Cir. 1963).

[89] See note 76 *supra.*

[90] Edward A. Walz, 32 B.T.A. 718 (1935); Ann Y. Oliver, 18 P-H Tax Ct. Mem. 347 (1949); Rev. Rul. 56-437.

[91] Dee Davenport, 22 P-H Tax Ct. Mem. 778 (1953); Osceola Heard Davenport, 22 P-H Tax Ct. Mem. 779 (1953).

(b) Division Partly on Ownership Basis

If the division recognizes part of the party's ownership interest, it will be treated like a sale or exchange only to the extent that it doesn't recognize the ownership interest.[92] For example, if the husband and wife had contributed equally to the purchase of a $20,000 home and held title to that home jointly and on divorce this home was transferred to the wife, it would be treated like a sale to the extent of the part owned by the husband and the recognition of the ownership interest of the wife to the extent of the part of the home which was purchased by her contribution. The wife's basis would be carried over on her allocable share and increased on the part received from her husband to the fair market value on the date that she received it.[93] To illustrate the application of this splitting the basis provision, consider the following fact situation:

> Husband and wife have acquired during their marital life a motel, the basis of which is $200,000. Each owns one-half and each contributed a like amount to acquire the motel. Thus, the basis for the wife, with respect to her share of the motel, would be $100,000, and the basis to the husband, for his part of the motel, would be $100,000. Assume that the fair market value of the motel is $400,000 at the time the parties are divorced. If the husband transferred his interest in the motel to his wife in exchange for her relinquishment of her support rights, he would have to recognize a gain of $100,000 on the transfer, which is the difference between his allocable share of the basis and his allocable share of the fair market value, to-wit, $200,000 fair market value share minus $100,000 basis. The wife's new basis in the property would be $300,000 computed as follows: $100,000 carry-over basis, (her allocable share of the total basis), plus $20,000 fair market value of the portion she received from her husband.

If, in the fact situation above set forth, it was decided to transfer cash to the wife in exchange for her share of the motel, the wife would, in fact, have a gain.[94] For example, assume that it was decided between the husband and wife that as part of the property settlement, the husband would buy out the wife's interest in the motel. In order to do so he would pay her $200,000 for her interest. At the time he paid the $200,000, the wife would have a gain of $100,000, which is the difference between the fair market value and her allocable share of the basis.

3. *Estate and Gift Tax Consequences of Property Transfer*

(a) Gift Tax

No gift is involved in a property settlement incident to a divorce if:
(i) The transfer is made to satisfy the support obligation,[95] or

[92] Rouse v. Commissioner, 159 F.2d 706 (5th Cir. 1947); Johnson v. United States, 135 F.2d 125 (9th Cir. 1943).
[93] Swanson v. Wiseman, 61-1 U.S. Tax Cas. ¶ 9264 (W.D. Okla. 1961).
[94] Jessie Lee Edwards, 22 T.C. 65 (1954).
[95] Paul Rosenthal, 23 P-H Tax Ct. Mem. 487 (1954).

(ii) It is incorporated into the divorce decree or is otherwise approved in the decree of the divorce court.[96]

Section 2516 of the Internal Revenue Code of 1954 gives further gift tax relief to divorced parties. It provides that:

> "Where the husband and wife enter into a written agreement relative to their marital and property rights, and divorce occurs within two years thereafter (whether or not such agreement is approved by the divorce decree), and transfers of property or interests in property made pursuant to such agreement—
>
> (1) to either spouse in settlement of his or her marital or property rights, or
>
> (2) to provide a reasonable allowance for the support of issue of the marriage during minority,
>
> shall be deemed to be transfers made for a full and adequate consideration in money or money's worth."

Relief from the gift tax is also provided in E.T. 19,[97] a gift tax release issued in 1946, which states:

> "Transfers of property, pursuant to an agreement incident to divorce or legal separation, are not made for adequate and full consideration in money or money's worth to the extent that they are made in consideration of a promised relinquishment of dower, curtesy or of a statutory estate created in lieu of dower, curtesy or other marital rights in the transfer or as property or estate; to the extent that the transfers are made in satisfaction of support rights, the transfers are held to be for an adequate and full consideration. The value of relinquished support rights shall be ascertained on the basis of the facts and circumstances of each individual case."

(b) Estate Tax

Unfortunately, income, gift, and estate taxes are not always construed *in pari materia*.[98] If they were, the gift problem would be resolved by *Davis*[99] and the estate tax problem would be resolved by E.T. 19.[100] There are no special privisions of the estate tax law dealing with the divorce or separation situation. To qualify as a claim against an estate, any indebtedness (whether or not in connection with separation or divorce) must be a result of the receipt of adequate and full consideration

[96] Harris v. Commissioner, 340 U.S. 106 (1950); McMurtry v. Commissioner, 203 F.2d 659 (1st Cir. 1959).

[97] 1946-2 CUM. BULL. 166.

[98] Estate and gift tax are construed *in pari materia:* Merrill v. Fahs, 324 U.S. 308 (1945); Commissioner v. Wemyss, 324 U.S. 303 (1945); but together they are not construed *in pari materia* with the income tax. Farid-Es-Sultaneh v. Commissioner, 160 F.2d 812 (2d Cir. 1947).

[99] Davis v. United States, *supra* note 74.

[100] 1946-2 CUM. BULL. 166.

in money or money's worth by the decedent before his death.[101] The relinquishment of dower, curtesy or statutory rights in lieu thereof, or other marital rights, is not considered adequate and full consideration in money or money's worth.[102]

A relinquishment of support and property rights is considered to be full and adequate consideration, and may, therefore, give rise to a valid claim against the ex-husband's estate.[103] If the divorce decree or agreement provides for the support of dependents other than the taxpayer's wife[104] or provides for alimony to be paid from the estate,[105] the value of these payments is ascertained, and they are deductible as a claim against the ex-husband's estate. Arrearages in support or alimony are also deductible[106] as well as any other claim founded upon a court order.[107] If the husband has an agreement incorporated in the divorce decree or separation agreement to leave part of his estate to his ex-wife or children and he fails to do so, claims that they make against the estate will be deductible.[108]

TREATMENT OF INSURANCE

1. *Incidents of Ownership Rule*

Life insurance is almost always involved in divorce matters. Usually it is on the husband's life and is payable on his death to the wife with the children as contingent beneficiaries. In the usual situation, an agreement is entered into whereby the husband will keep up the premium payments and name his wife as the irrevocable beneficiary. Under these circumstances, the husband will obtain a deduction for premiums paid, provided the wife is given all of the incidents of ownership and the husband retains no rights whatever over the policies.[109] If the husband retains any of the incidents of ownership, he gets no deductions for any premiums paid, and the proceeds of the policies paid upon his death will be included in his taxable estate.[110]

101 INT. REV. CODE OF 1954, §§ 2053(a)(3), 2053(c)(1), 2043(b), 2034.
102 INT. REV. CODE OF 1954, § 2043(b).
103 See cases cited *supra* note 96; E.T. 19, 1946-2 CUM. BULL. 166.
104 Commissioner v. Weiser, 113 F.2d 486 (10th Cir. 1940).
105 Yoke v. Fleming, 145 F.2d 472 (4th Cir. 1944); Commissioner v. Maresi, 156 F.2d 929 (2d Cir. 1946); Florida Nat'l Bank and Trust v. United States, 182 F. Supp. 76 (S.D. Fla. 1960).
106 Commissioner v. Watson, 216 F.2d 941 (2d Cir. 1954).
107 See cases cited *supra* note 105.
108 Commissioner v. Watson, *supra* note 106; Beecher v. United States, 280 F.2d 202 (3d Cir. 1960).
109 INT. REV. CODE OF 1954, § 101 (a)(2); I.T. 4001, 1950-1 CUM. BULL. 27; Ashcraft v. Commissioner, 252 F.2d 200 (7th Cir. 1958).
110 See I.T. 4001, *supra* note 109; Seligman v. Commissioner, 207 F.2d 489 (7th Cir. 1953); Beulah Weil, 22 T.C. 612 (1954); James Parks Bradley, 30 T.C. 701 (1958); Kiesling v. United States, 349 F.2d 110 (3d Cir. 1965).

2. *Transfer for Value Rule*
In the case of a transfer for good and valuable consideration, the transferee may find that she unexpectedly has to include the proceeds of the life insurance, which are paid on the death of the insured ex-husband, in her taxable income.[111] This rule is sometimes referred to as the "Transfer for Value Rule." It provides that part of the proceeds of the policy are included in the transferees gross income in the year of receipt. The amount included is that sum by which the amount of the insurance actually paid upon the death of the insured exceeds the actual value of the consideration for the transfer and any premiums subsequently paid by the transferee.[112] (It has been suggested now and then that this is a way for the husband to get the last laugh.) The following example will illustrate the rule.

> The husband transfers, as part of a property settlement, insurance on his life. The *Davis*[113] case applies, so the wife's basis or the consideration that the wife gives for the insurance is the actual cash value at the day of transfer, and here assume it is $3,000. The wife thereafter pays $2,000 in premiums. The husband then dies, and the wife collects the face value, which is $15,000. Ten thousands dollars is ordinary income in to the wife in the year of receipt. The same result would pertain if the husband paid all the premiums and the wife had all the incidents of ownership.

The best way to get around this undesirable tax situation is to have the wife purchase new insurance on the life of her ex-husband (if he is insurable).

CHILD SUPPORT PAYMENTS

1. *Payments Made After Divorce or Separation*
Payments made for the support of a minor child are specifically exexcluded from the alimony treatment provided by the Internal Revenue Code of 1954, Sections 71 and 215.[114] To be excluded, however, the amount of the payment which is to be used for the child's support must be definitely fixed by the terms of the decree, instrument or agreement.[115] If the only way the support portion may be ascertained is to look at the reduction in the total amount paid to the wife as each child dies, marries, reaches the age of 21 or is otherwise emancipated, the whole payment will be treated as alimony.[116] For the payment to be considered

[111] INT. REV. CODE § 101(a)(2); Treas. Regs. 1.101-1(b)(1).
[112] *Ibid.*
[113] Davis v. United States, *supra* note 74.
[114] INT. REV. CODE OF 1954, §§ 71(b), 682(a).
[115] Commissioner v. Lester, 366 U.S. 299 (1961); Louise Ross, 33 P-H Tax Ct. Mem. 2275 (1964); note also that a minor by definition is a child under the age of 21; William E. Borbonus, 42 T.C. 983 (1965).
[116] *Ibid.*

child support, it must be a definitely fixed amount or percentage, specifically designated for the purpose of supporting the minor children of the marriage.

The leading case, *Commissioner v. Lester*,[117] is illustrative. Taxpayer Lester made unitary payments under a written separation agreement to his ex-wife for her support and the suporpt of their three minor children. The payments were to be reduced by 1/6 upon the death, marriage or emancipation of each child. It could be inferred from the agreement that the parties actually intended 1/2 of the amount paid to be alimony and the other 1/2 to be for the support of the children during their minority, and under the earlier decisions, it was likely to be so regarded. The Second Circuit, however, held that even though some portion of the payment was to be used for the support of the minor children, the amount was not fixed, and fixing in definite terms was a requirement of the statute.

Although the agreement in the *Lester* case required the amount paid to be reduced by a fixed percentage upon the emancipation of each of the children, it did not require any specific amount to be used for the support of the children. The ex-wife was free to use her own discretion in allocating the monies received among herself and her children. Such broad discretion is tantamount to absolute ownership of the payments.[118]

Subsequently, the Commissioner issued a Revenue Ruling which states:

> ". . . where periodic payments for support are made by a husband and received by a wife under a divorce decree or an instrument or agreement described in section 71(a), such payments are includible in the gross income of the wife under section 71 of the 1954 Code and are deductible by the husband under section 215, except to the extent that the terms of the decree, instrument, or agreement specifically designate or 'fix' such payments, or a portion of such payments, as support for minor children of the husband." [119]

2. *Payments Made After Remarriage of Custodial Parent*

We are now left with an interesting and perhaps unanswered question.

[117] 366 U.S. 299 (1961).

[118] In affirming the Second Circuit, the United States Supreme Court noted that the legislative history indicated that the Congress wanted to give the husband and wife the power to fix the tax burden between themselves. Mr. Justice Douglas added spice and logic in his concurring opinion, quoting from Mr. Justice Holmes as follows: "In an early income tax case Mr. Justice Holmes said, 'Men must turn square corners when they deal with the government.' Rock Island A. & L. R. Co. v. United States, 254 U.S. 141, 143. The revenue laws have become so complicated and interrelated that I think the Government in moving against the citizen should also turn square corners. . . . Congress drew a clear line when it used the word 'fix'. Resort to litigation rather than the Congress, for a change in the law is too often the temptation of government which has a longer purse and more endurance than any taxpayer."

[119] Rev. Rul. 62-53, 1962-1 CUM. BULL. 41, *rev'g* Rev. Rul. 59-93, 1959-1 CUM. BULL. 22.

Can a husband obtain a deduction for payments made to his ex-wife after her remarriage if they are not specifically fixed as being for the support of his children? Suppose, for example, that he must continue to pay a reduced amount after her remarriage but the amount was not sufficiently fixed according to *Lester* to qualify as child support.

State law uniformly provides that upon remarriage of the wife, the ex-husband has no continuing obligation of support. It seems, therefore, that if payments are to continue after the wife's remarriage, they are not alimony under section 71. The Commissioner's ruling, *supra,* and all the cases dealing with this issue since *Lester* would apparently also preclude such payments from being child support. But what are they? A gift? Several cases worth noting have come close to deciding the point, but none have hit squarely upon it. In *Robert E. Dolan,*[120] for example, the taxpayer's wife, who had custody of their two children, did remarry, at which time the payments were reduced from $200 to $100 per week. Subsequently, however, she was again divorced and the issue presented to the court concerned the tax status of payments made after the second divorce. No mention was made of the lack of any support obligation after the remarriage. *Dorthy Turkoglu*[121] involved the tax status of payments made to an ex-wife for her own and her children's support. The wife, appearing *pro se,* indicated that she was not entitled to alimony under state law. The Tax Court, however, failed to discuss the point in finding the payments to be taxable alimony.

3. Modification of Existing Decrees

Divorce courts generally retain continuing jurisdiction over the alimony and custody aspects of a divorce decree. They do so because there is a continuing public interest in the well-being of the wife and child. There is little difficulty in obtaining a nunc pro tunc modificaton of a divorce decree.[122] If payments for child support were fixed in the first instance, they can be changed to qualify (as defined by *Lester*) as alimony.[123] The character of payments made prior to any modification, however, cannot be changed by order even if it indicates that the payments were not "fixed" for child support in the first instance. There is inherent power in courts of justice to remedy defects or omissions in its records by nunc pro tunc orders. However, the Revenue Service will not give retroactive affect to an order to the extent it purports to alter the legal status of the parties concerned for years gone by.[124]

[120] 30 P-H Tax Ct. Mem. 898 (1961).

[121] 36 T.C. 552 (1961).

[122] *E.g.,* Michel M. Segal, 36 T.C. 148 (1961); Dorthy Turkoglu, 36 T.C. 552 (1961).

[123] *Cf.* Edna M. Gilbertson, 20 P-H Tax Ct. Mem. 563 (1951); Rev. Rul. 58-52, 1958-1 CUM. BULL. 29. See also cases cited note 8 *supra.*

[124] *Ibid.; but see* Margaret Rice Sklar, 21 T.C. 349 (1953) (non acq.); Velma B. Vargason, 22 T.C. 100 (1954) (non acq.); government appeal withdrawn.

DEPENDENCY DEDUCTION

1. *Requirements for the Deduction*

We have seen that periodic payments marked for the support of the children are not taxable to the wife. Likewise, payments made, which qualify as alimony under Section 71 or Section 682, cannot be treated by the payor as amounts paid for the support of any dependent. There is, unfortunately, no special provision in the Internal Revenue Code determining who gets exemption for minor children of divorced parents. The right to such exemption is governed by the other sections of the Code which cover dependency exemptions generally.[125] To obtain the deduction, the party who asserts it must show that the claimed dependent is an individual with the prescribed decree of relationship to him and that the individual receives one-half of his suport from the taxpayer.[126]

2. *Bearing the Burden of Proof*

Showing the required relationship is generally no problem. However, showing that the support test has been met is another story. Whenever the non-custodial parent is the one attempting to obtain the exemption, it is almost impossible to prove that the support requirement has been met.[127] In cases which have been litigated, the Commissioner prevailed in the denial of the exemption four out of five times.[128] At the administrative level of the Revenue Service (Audit, Appellate, and District Conference), it is likely that the taxpayer is even less successful. The Service employees at these levels seem to strongly encourage the parties to make an agreement whereby each will take an equal number of the children. (It is obviously easier to accomplish this when there are two or four children than when there are three to one.) If the taxpayers fail to agree as to how the exemptions should be allocated, there is a marked tendency to disallow the exemption.[129]

In the usual case, the wife has custody and the husband makes periodic payments to her for the support of the minor children of the marriage. The husband usually has little difficulty showing how much he has contributed because he probably made the payments to the court or paid by

[125] INT. REV. CODE OF 1954, §§ 151, 152; Treas. Reg. § 1.152-1(a)(i) and (ii).

[126] *Ibid.*

[127] James R. White, 25 P-H Tax Ct. Mem. 1137 (1956); Roland H. Wilder, 32 P-H Tax Ct. Mem. 12 (1963).

[128] Ascertained by an actual count of the cases litigated in all courts since the alimony provisions became effective.

[129] The dependency exemption itself cannot be divided. Even though the marriage is terminated and household split up, the dependency exemption rests wholly with the person contributing more than 50 percent of the support required. To alleviate some of the difficulties, the 1954 Code § 152(c) introduced the multiple support agreement. It provides that if no one furnished over one-half of the support but contributes more than 10 percent and would be entitled to take the dependency exemption if he had, in fact, contributed one-half that parties may join in a multiple support agreement agreeing that one or the other person gets the exemption or they get it in alternate years.

check or money order. The husband, however, usually must do more than show how much he contributed. He must show what the total support is.[130]

Once the husband has shown the total support, a determination of whether or not he contributed more than 50 percent involves only simple mathematics. As a practical matter, however, for him to show the amount of the total support is very difficult, if not in most instances impossible. The ex-husband has no first-hand knowledge of the cost of the support of a child with whom he is not living and is, therefore, generally incompetent to testify as to total support.[131] The ex-wife who has custody will know what it costs to support the child, but will be an adverse witness. In addition, personal animosity, and the fact the ex-wife has the deduction at stake too, (since if husband loses the deduction, the wife will obtain it and vice versa) will make her even more adverse. Moreover, even if the taxpayer is willing to take his chances on calling his ex-wife as an adverse witness (understanding that he will be stuck with her testimony, good or bad), she may live in another state or in another part of the state and, therefore, not be available in the practical sense. To procure her testimony under such conditions would be costly as well as risky, if it could be procured at all. Children who live with the ex-wife may be competent witnesses if they are old enough and know enough about the financial dealings of the ex-wife, but this is not the usual case.

The Revenue Service won't help either. To the contrary, they have issued a Revenue Ruling which provides that the disclosure of information furnished the Service by the taxpayer's spouse, relative to amounts claimed for the support of their children, constitutes a disclosure of confidential matters and is prohibited by Section 7213(a)(1).[132] This is unrealistic and unfair to the husband. The information he needs to establish his case may already be in the hands of the Revenue Service or can be procured by them with little difficulty, yet, they refuse to make it

[130] Although in Lillian Mendel, 65-2 U.S. Tax. Cas. ¶ 9698 (4th Cir. 1965) and E. R. Cobb, Sr., 28 T.C. 595 (1957), the court found that the husband had carried his burden of proof on the "more than half" issue without showing what total support was. We must proceed cautiously in this area. Recently the Tax Court also noted that, although the burden of proof is difficult if not impossible to carry, there is no statutory ground for relieving the taxpayer of his burden. William B. J. Tibbits, 34 P-H Tax Ct. Mem. 726 (1965).

In Joseph I. Genco, 34 P-H Tax Ct. Mem. 209 (1965), Judge Kern put it this way: "The burden of proof is on petitioner and includes not only the burden of proving the amounts paid . . . for the support of his children but also the total amount spent for such support." Aaron F. Vance, 36 T.C. 547 (1961); Bernard C. Rivers, 33 T.C. 935 (1960). This burden cannot be met by "showing that someone else is not entitled to the exemption he is claiming." See also Warren C. Mawhinney, 43 T.C. 443 (1965).

[131] *But see,* Commissioner v. Mendel, 65-2 U.S. Tax Cas. ¶ 9698 (4th Cir. 1965); Markarian v. Commissioner, 65-2 U.S. Tax Cas. ¶ 9699 (7th Cir. 1965); Theodore Milgroom, 31 T.C. 1256 (1959); E. R. Cobb, Sr., 28 T.C. 595 (1957), where the husband was regarded as competant, to the end that he succeeded in obtaining the exemptions.

[132] Rev. Rul. 58-120, 1958-1 CUM. BULL. 498.

available. If the Revenue Service would disclose the total amount expended for the suport of the child, many of the cases would not be brought. Time and again, the Service has indicated its objective is to collect only the correct tax, no more or no less. It wants the image of the friendly tax collector. We are told the collection is not an adversary proceeding, yet, in the divorce setting where there is an opportunity for the Service to help the taxpayer make a correct determination, it refuses to do so.[133]

Another of the difficulties involved in the dependency controversy is the practical matter of how much tax is involved. In the majority of cases, there is not enough to justify the substantial legal expenses necessary to prosecute the action. Taxpayers appearing *pro se* have had little success in this or any other area of the law. A jury case in the United States District Court requires payment of the taxes first and entails a long delay and substantial legal expenses. Chances of success may be limited even there.

3. *Some Signs of Easing the Burden*

Prior to *Theodore Milgroom*,[134] there was not a single case in which an ex-husband obtained a dependency deduction without either showing the actual total costs of suport or that the ex-wife had such a small income she could not contribute more than one-half the support. In that case the Commissioner had disallowed exemptions claimed by the divorced taxpayer for his three children because he "failed to substantiate his claim to these dependency credits." The Commissioner did not determine that the taxpayer's children did not receive more than one-half of their support from him during the tax year. The only testimony adduced at the trial (which was that of the petitioner, who was an accountant) established that the amount contributed by the petitioner for the support of his children during the year in question was the approximate annual amount it took to support the children during the two preceding years. The taxpayer further testified that the standard of living of the children was no higher than it was in prior years. The court accordingly allowed the exemptions.

In relying on *Milgroom*, however, one must be sure to introduce evidence that the standard of living of the former wife and child was the same as it was in the year about which the petitioner is competent to testify. In *Victor E. Behrens*, [135] for example, the taxpayer failed to do so. He testified as to the total costs of the children's support during 1956. He further testified as to the amount of support he provided in 1957. His failure, however, to testify or to introduce evidence relating to the standard of living of the former wife and child subsequent to the separation

[133] See Rev. Proc. 64-22, 1964-1 CUM. BULL. 689.
[134] 31 T.C. 1256 (1959).
[135] 30 P-H Tax Ct. Mem. 759 (1961).

was fatal to his cause.[136]

The Tax Court will generally not apply the *Cohan Rule*[137] in determining the amount of support furnished.[138] Similarily, a statement in the trial court's order or in the property settlement agreement that one or the other of the parties is entitled to take the minor as a dependent for tax purposes is not sufficient proof that either is entitled to the exemption.[139]

4. *Items of Support*

Generally, support includes: Food, shelter, clothing, medical and dental care, education, necessary child care payments, necessary transportation and the like.[140] The amount of support furnished is equal to the expense incurred in furnishing the support item or its fair market value.[141]

Support items are determined with reference to the standard of living of the parties.[142] For example, an automobile might be necessary for some and not for others.[143] Expenses for singing and dramatic lessons might be items of support for some people.[144] Tuition paid for the attendance of a child at a private school may or may not be a proper support item.[145]

With respect to lodging as an item of support, the Service has ruled that support furnished in the form of lodging is measured in terms of

[136] *Cf.* Aleen Brooks, 26 P-H Tax Ct. Mem. 282 (1957). Practitioners have tried to prove the total amount of support necessary by expert testimony. In James R. White, 25 P-H Tax Ct. Mem. 1137 (1956), for example, the taxpayer offered testimony of experts on child care as to the average cost of support and maintenance of a child of the same age in the area in the year in question. Though the testimony showed that the average cost of support of such a dependent was less than twice the amount he contributed, the Tax Court felt he had not carried the burden of proof. It is difficult to offer an opinion on this point. On the one hand, there is substantial merit in requiring strict compliance with the literal word of the tax law, but on the other, one is entitled to be left with some lingering doubt in his mind about the refusal of the Tax Court to accept evidence offered by qualified experts. It must certainly be as clear to the Tax Court as it is to everyone else that the husband has an almost impossible burden to sustain, and one of the ways that he can sustain it is with the assistance of expert testimony. Rev. Rul. 235 1953-2 CUM. BULL. 23 provides that "in the absence of an actual record of expenses relating to the support of each member of the household, a pro rata portion of the aggregate of such expenses may be allocated to each member. Fred W. Hertwig, 26 P-H Tax Ct. Mem. 355 (1957), may help.

[137] Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930).

[138] Bernard C. Rivers, 33 T.C. 935 (1960).

[139] Kennedy v. Commissioner, 339 F.2d 335 (7th Cir. 1964); Robert T. Johnson, 31 P-H Tax Ct. Mem. 9 (1962).

[140] Treas. Regs. 1.152-1(a)(2)(i) and (ii).

[141] *Ibid.;* see also, Bennett H. Darmer, 20 T.C. 822 (1953).

[142] See Harriet C. Flowers, 57-1 U.S. Tax Cas. ¶ 9655 (W.D. Pa. 1957).

[143] Sid Dyer, 24 P-H Tax Ct. Mem. 536 (1955).

[144] Raymond M. McKay, 34 T.C. 1080 (1960).

[145] Martha J. Blyth, 21 T.C. 275 (1953); Bernard C. Rivers, 33 T.C. 935 (1960).

its fair market value.[146] At the administrative level of the Revenue Service, the tendency is to apportion the value of the lodging on a per capita basis among those living in the household. This can have devastating effects as far as the husband obtaining a dependency exemption. To illustrate the problem, assume that the wife received the house as part of the property settlement. She still lives there with the two minor children of the marriage. Assume the fair rental value of the house to be $175 a month (although the mortgage payments are only $120 a month), and the utilities are another $35 a month. On a per capita basis, $70 per month would be allocated to each of the members of the household as their share of the lodging.

Fortunately, the Tax Court appears willing to allocate on other than a per capita basis. In *Raymond M. McKay*,[147] for example, the court found the rental value of the house in which mother and daughter lived to be $140 per month. Of this, $50 per month was allocated to the daughter.

DEDUCTIBILITY OF ATTORNEY FEES

1. *The Origin and Character Test*

Legal fees for services performed in connection with the production of income, or for services relating to the management, conservation, or maintenance of income-producing property, are ordinarily deductible under the Internal Revenue Code of 1954, Section 212 (1) and (2). In a divorce or separation proceeding, however, even though the services may relate to the managemnt, conservation, or maintenance of the taxpayer's income-producing property, the fees may not be deductible.[148] A further test, best called the "origin and character test", must be satisfied. This test, established by the United States Supreme Court in the *Gilmore v. United States*[149] and *United States v. Patrick*,[150] requires that the fee for which the deduction is sought arise in connection with work done in the taxpayer's "profit-seeking activities." It is not sufficient that the taxpayer's profit-seeking activities be involved; the work done must have its origin and character therein. The best example is the *Gilmore* case. Gilmore had obtained an absolute divorce, without alimony, from his wife. He also successfully prevented her from obtaining his income-producing property as part of the property settlement. Deduction of the legal fees paid for the work necessary to accomplish this was not allowed even

[146] Emil Blarek, 23 T.C. 1037 (1955); Rev. Rul. 58-302; 1958-1 CUM. BULL. 62. Where there is no evidence as to reasonable rental value, the actual out-of-pocket expense for providing the lodging may be used. John Malinowsky, 28 P-H Tax Ct. Mem. 112 (1959); Rev. Rul. 53-235; 1953-2 CUM. BULL 23; Marvin O. Tucker, 26 P-H Tax Ct. Mem. 413 (1957).

[147] 34 T.C. 1080 (1960).

[148] Treas. Regs. § 1.262-1(b)(7).

[149] 290 F.2d 942 (Ct. Cl. 1961), *rev'd*, 372 U.S. 39 (1963).

[150] 372 U.S. 53 (1963).

though the work done was to conserve and maintain the taxpayer's income-producing property. The Supreme Court reasoned that the deductibility should not turn on the outcome of the litigation (here the successful conservation of Gilmore's income-producing property) but, rather, should depend on the essential origin and character of the claim. Since Mrs. Gilmore's claims arose as a result of the marital relationship rather than her ex-husband's business actiivties, the deduction did not have the right business character and was not allowed.

2. *Pre-Origin and Character*

Even prior to *Gilmore* and *Patrick,* however, taxpayer husbands were seldom successful in obtaining a deduction for attorney fees. The few cases in which he was successful are worth noting. *Baer v. Commission,*[151] for example, allowed a deduction for the part of the legal fee that the husband paid to his attorney for "services in the negotiations as to form and amount of alimony." Much like the *Gilmore* case, Baer's wife demanded his stock in his controlled corporation. Baer's lawyer, however, successfully negotiated an agreement whereby he transferred 4,000 shares of the corporate stock to his wife but retained voting power and the right to direct the ultimate disposition of the shares. In reaching its conclusion the Eighth Circuit said: ". . . (the attorneys' worked out the plan) by which he was placed in a position to meet these obligations and yet remain in control of the company and his stock. . . . In doing so they are, we think, conserving and maintaining property held by Baer for the production of income."[152]

The Fifth Circuit in *Owens v. Commissioner*[153] followed *Baer* and allowed deduction of the wife's attorney fees paid by the husband because they were for services rendered in salvaging the business in which the husband was a partner.

Baer and *Owens* were not, however, typical of the fortunes of the husin divorce cases.

3. *Post Origin and Character Profit-Seeking Activities*

In a follow-up decision to the United States Supreme Court decision, the district court finally gave Gilmore some relief.[154] They allowed him to capitalize the legal expense he couldn't deduct because it was paid to protect his stock interest, and "the cost of defending title to property is always capitalized—that is fundamental in the tax law."[155]

It is too early to tell yet what the impact of this district court case may be, but fundamentally, the court's reasoning appears to be correct.

151 196 F.2d 646 (8th Cir. 1952).
152 *Id.* at 650.
153 273 F.2d 251 (5th Cir. 1959).
154 Gilmore v. United States, 245 F. Supp. 383 (N.D. Cal. 1965).
155 The district court noted that the Supreme Court had not decided the basic question when *Gilmore* was before it. They also noted that the large number of cases, which dealt with title defense questions, had never applied the "origin and character test" to legal fees.

Immediately after *Gilmore* and *Patrick*, serious doubt arose about the deductibility of attorney fees paid by the wife to procure her alimony. The use of the words "profit-seeking activities" by the court were responsible for the doubt. The unanswered question was: Is alimony a profit-seeking activity? If not, does the profit-seeking origin and character test apply?

The Commissioner's regulations, as well as the earlier Tax Court cases of *Elsie B. Gale*[156] and *Barbara B. LeMond*,[157] indicated that the deduction should be allowed. The regulations read:

> Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either the husband or the wife. However, the part of an attorney's fee and the part of the other costs paid in connection with a divorce, legal separation, written separation agreement, or a decree for support, which are properly attributable to the production or collection of amounts includible in gross income under Section 71 are deductible by the wife under Section 212.[158]

Subsequently, the Tax Court in *Jane U. Elliott*[159] and *Ruth K. Wild*,[160] interpreted *Gilmore* and *Patrick* as not requiring disallowance of attorneys' fees paid by the wife to obtain alimony. Although this is a taxpayer victory, the deduction is usually of little value, since the husband in the vast majority of cases is ordered to pay the wife's attorney's fees.[161]

4. *Deductible as Fees for Tax Advice*

Note that in *Gilmore* and *Patrick* the Supreme Court was dealing with the question of deductibility of legal fees under the Internal Revenue Code of 1954, Section 212 (1) and (2) and not Section 212(3). The latter section, enacted in 1954, permits an individual to deduct the ordinary and necessary expenses incurred by him in connection with the determination, collection or refund of any tax. It should be involved in all divorce cases, but was not in *Gilmore* and *Patrick.*

The Revenue Service has sought a restrictive interpretation of Section 212(3) which would allow such deductions only for expenses incurred for advice or services with respect to completed transactions or where there was an actual tax controversy. The Service's position is supported by a House committee report which states:

> A new provision added by your Committee allows a deduction for expenses connected with determination, collection or re-

[156] 13 T.C. 661 (1949).
[157] 13 T.C. 670 (1949).
[158] Treas. Reg. § 1.262-1 (b) (7).
[159] 40 T.C. 304 (1963).
[160] 42 T.C. 706 (1964.
[161] See, Spence, *Counsel Fees in Matrimonial Actions*, 38 NEB. L. REV. 761 (1959).

> fund of any tax liability . . . Paragraph (3) is new and is designed to permit the deduction by an individual of legal and other expenses paid or incurred in connection with a contested tax liability, whether the contest be Federal, state, or municipal taxes, or whether the tax be income, estate, gift, property, and so forth. Any expenses incurred in contesting any liability collected as as a tax or as a part of the tax will be deductible.[162]

Notwithstanding this attempt to limit the deduction under Section 212(3) to fees incurred with respect to completed transactions or actual tax controversies, two recent decisions in the Court of Claims and one in the district court of Missouri are quite to the contrary.

In *Davis v. United States*,[163] the Court of Claims allowed a deduction for attorney fees paid for examining the tax aspects of a proposed separation and property settlement agreement. They relied on the language in Treasury Regulations, Section 1.212(1), that expenses paid "for tax counsel or . . . in connection with any proceedings involved in determining the extent of tax liability . . . are deductible." [164]

In *Kaufmann v. United States*,[165] the question before the court was the deductibility of fees paid to an accounting firm in connection with tax counsel, services, and advice in connection with a proposed plan of reorganization. The court, as in *Davis*, relied on the wording of Section 212(3) and Treasury Regulations, Section 1.212(1), and allowed the deduction for services performed in examining the tax aspects of the plan of reorganization and in preparing an application for a ruling. The court specifically rejected the Revenue Service's interpretation of the above-quoted House committee report as evidence of congressional intent to limit the deduction under Section 212(3) to completed transactions.

The Court of Claims struck another blow against the Revenue Services position in *Carpenter v. United States*.[166] There, as in *Davis*, the issue before the court was the deductibility of attorney fees paid for examining the tax aspects of a proposed separation and property settlement agreement. In holding the deduction allowable under Section 212(3), the Court of Claims merely relied on its decision in *Davis*, but it did also note that though *Davis* had been appealed to the United States Supreme Court, the question of the deduction under Section 212(3) had not been reviewed.

It should be noted that in *Davis*, the taxpayer's attorney allocated a portion of his fee to "tax matters." Presumably, such an allocation

[162] H. R. REP. No. 1337, 83d Cong., 2d Sess. 29, A59 (1959).
[163] 287 F.2d 168 (Ct. Cl. 1961).
[164] Although the *Davis* case was appealed, the appeal was brought on another point, and the Supreme Court specifically refrained from dealing with the § 212(3) question. United States v. Davis, 370 U.S. 65 (1962).
[165] 227 F. Supp. 807 (W.D. Mo. 1963).
[166] 338 F.2d 366 (Ct. Cl. 1964).

will avoid the general rule of Internal Revenue Code of 1954, Section 262.

5. *Help the Client Get the Deduction—Itemize Your Bill*

The attorney, in order to help his divorce client obtain the deduction, should break down his fee into three components, indicating:

(1) How much he is charging for services which relate to the preparation of pleadings, obtaining appropriate orders, and negotiating the custody of children. Fees paid for these services are not deductible.

(2) How much he is charging for defending title to stock, real property, or other business assets. It is possible that these Court decision in *Gilmore,* may be capitalized.

(3) How much he is charging for looking into the tax aspects of the proposed separation and property settlement agreement. This part of the fee should be deductible under the authority of *Davis, Kaufmann* and *Carpenter.*

CONCLUSION—SOME DO'S AND DON'TS

Most of the tax problems involved in the divorce and separation area involve income tax. In fewer cases, some estate tax problems may be involved. Gift tax problems are mostly all taken care of by either Internal Revenue Code of 1954, Section 2516 or E.T. 19. Within the framework of the known problem area, there are some suggestions which can be made and some real do's and don't with respect to handling divorce and separation cases from a tax point of view.[167]

1. *Periodic Payments versus Principal Sum*

Be sure that any principal sum, not intended to be alimony, does not become inadvertently qualified as a periodic payment because of contingencies or length of pay out period. It may be good tax planning, however, to try to qualify principal sums as alimony by making the payments contingent or providing that the pay out period be more than ten years. By doing so, it may be possible to shift the tax burden from the husband, who is usually in the higher tax bracket, to the wife. To take care of the additional tax, which may be due because of a change from a principal sum to a periodic payment, parties should consider increasing the amount by an additional amount equal to the tax which is estimated to be due.

2. *Filing Tax Returns*

If possible, the parties should agree to file joint tax returns for the period prior to the time their divorce is final. Usually the filing of joint tax returns will result in a net saving of tax to both parties. If the

[167] See, Mills, *Tax Check List for Negotiating Divorce and Seperation Agreements,* J. TAXATION (1965), for a very excellent short article on tax considerations attorneys must bear in mind in representing clients in divorce and seperations.

husband is to file the return jointly, he may do so by getting the blank return signed by his wife and a power of attorney to fill in appropriate information. He should then be required to cover any contingent liability, which may be visited on the wife because of his filing, by executing an indemnity agreement with respect to the return he is about to file and with respect to any open years which have already been filed. This indemnity agreement may be put in the separation agreement as one of the provisions and, subsequently, approved by the court. If it is in the separation agreement, it is then enforceable by the local court under its contempt powers. Provision should also be made for the distribution of any tax refund.

If joint returns are to be filed and the husband and wife are each to pay part of the tax, a formula by which the amount of tax each is to pay can be determined. Each should pay only that portion of the tax which is attributable to his or her income. The following computation will illustrate the manner in which this can be done:

Wife's tax filing separately	$ 3,000
Husband's tax filing separately................	$ 7,000
Total tax	$10,000
Total tax if husband and wife file jointly........	$ 8,000
Wife's share of joint tax: $\frac{3{,}000}{10{,}000} \times 8{,}000 =$	$2,400
Husband's share of joint tax: $\frac{7{,}000}{10{,}000} \times 8{,}000 =$	$5,600
Total joint tax	$8,000

3. *Attorney Fees*

The attorney should itemize his statement for services rendered. Tax advice is always deductible. That part of the fee which is attributable to protecting or acquiring the title to the property may be capitalized. It is a good idea to try to get the wife to pay her own attorney. If she does, she may obtain a deduction, while if her husband pays her attorney, he gets no deduction whatsoever. In order to obtain the tax savings and yet have the husband, in effect, pay the wife's attorney, alimony may be increased for a short period of time by such an amount as will equal the wife's attorney fee. For example, if the wife's attorney's fee is $600, the alimony payable by the husband can be increased $200 a month for the first three months of the alimony. This will give the husband an alimony deduction for the amount he pays and will give the wife a deduction for attorney fees. The wife's tax position will be unchanged. However, the husband will gain an additional deduction of $600.

4. *Use of Trusts*

The best idea is not to use any trusts at all. If one must be used, watch out for remainder or reversionary interests which may cause the corpus of the trust to be included in the husband's taxable estate.

5. *Insurance*
It is imperative that people dealing in the divorce area understand the Transfer For Value Rule. It is probably a better idea to have the wife take out new insurance on the husband's life if he is insurable.

6. *Property Settlement*
Do not use property with a fair market value less than the basis to satisfy the property settlement, since the loss will not be allowed. A better idea is to sell such property to a third party and obtain the loss. Likewise, do not use appreciated property to satisfy the property settlement unless the taxpayer is prepared to pay capital gains tax.

7. *Mortgage Payments*
Encumbrances are included in determining the amount received. If the mortgage payments are intended to qualify as periodic payments, it may be better to let the wife make them. This way she gets the deduction, otherwise, if the husband makes the payments, the interest deduction may be lost by both. This may be handled by increasing the alimony in the amount equal to the mortgage payments required.

8. *How to Negotiate*
Understanding the tax problems involved in divorce and separation is only half the battle. The more difficult task is finding a reasonable way to cope with them. Personal animosities and vindictiveness between the parties often stand in the way of tax savings in a divorce situation. From the point of view of both parties, it may be best to find out what the wife wants, come to some conclusion as to what she is to get, and then allow the husband and his tax advisors to work out the most advantageous way to provide it.

(EDITOR'S NOTE)

Attorneys in Oklahoma should be aware of a new statute[1] enacted by the last Oklahoma Legislature which, if complied with, profoundly affects the deductibility of Oklahoma alimony payments under Section 215 of the Internal Revenue Code of 1954. Section 215 provides that a husband shall be allowed as a deduction amounts includible in the gross income of the wife and deductible by the husband. Section 71(c)(1) provides alimony payments are to be included in the gross income of the wife. Such periodic payments are therefore deductible by the husband. "Periodic" means payable over a period of indefinite duration. Thus, a lump sum payment is not periodic, and is not includible in the gross income of the wife and deductible by the husband. Section 71(c)(1) provides that installment payments discharging a part of an obligation the principal sum of which is specified in the decree, instrument, or agreement shall

[1] OKLA. STAT. tit. 12, § 1289 (Supp. 1963).

not be treated as periodic payments. However, Section 71 (c) (2) provides for an exception in cases where such principal sum, by the terms of the decree, instrument, or agreement, may be or is to be paid over a period ending more than ten years from the date of such decree, instrument or agreement. In such cases, the installment payment is considered a periodic payment, but only to the extent that the installment payment or sum of the installment payments received during the wife's taxable year does not exceed ten percent of the principal sum.

Th existing alimony statute [2] in Oklahoma provides for a sum of money payable in gross or in installments. The Oklahoma Supreme Court has construed this statute as providing the wife an allowance in a fixed and definite sum of money referred to as alimony in gross. In applying the rule of alimony in gross, the court has held that where the decree providing for alimony does not fix the amount ultimately to be paid, the decree is void as to the alimony award. The award of alimony in gross may be paid in one lump sum or it may be paid in installments if the total amount to be paid is ascertainable.[3] As is readily apparent, an Oklahoma alimony in gross award payable in a lump sum is never includible in the gross income of the wife and deductible by the husband, and Section 71(c)(1) and (2) of the Internal Revenue Code of 1954 prohibits payments of Oklahoma alimony in gross award payable in installments from being includible in the gross income of the wife, and therefore deductible by the husband, unless the principal sum is to be paid or may be paid over a period ending more than ten years from the date of such decree, instrument, or agreement.

The new Oklahoma statute reads: "In a divorce decree which provides for periodic payments of alimony, the court may, in its discretion, declare that the obligation to pay future installments automatically ceases on the death or remarriage of the person receiving the alimony."

The Oklahoma legislature apparently lifted the words "periodic payments" from the statutory language of Section 71 of the Internal Revenue Code of 1954. We submit that a husband may now deduct payments of an Oklahoma alimony in gross award payable in installments for ten years or less if the decree (1) provides for an award of a fixed and definite sum of money payable in installments, and (2) provides that the obligation to pay the installments automatically ceases on the death or remarriage of the wife. This would result in the payments being periodic payments under Section 71, since the payments would be payable over a period of indefinite duration due to the contingencies of death or remarriage. Thus, the payments would be includible in the gross income of the wife and deductible by the husband.

[2] OKLA. STAT. tit. 12, § 1278 (1961).
[3] For authorities and further discussion see 3 TULSA LAW JOURNAL 50 (1966).