The Taxation of Alimony: Policies, Problems and a Proposal

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THE TAXATION OF ALIMONY: POLICIES, PROBLEMS AND A PROPOSAL

JOHN H. DAVIES*

Alimony payments are taxable to the wife and deductible by the husband; however, to be considered alimony, the payments to the wife must be both out of the husband's current income and in discharge of his legal obligation to support his wife. This is a peculiar statutory definition, because it refers to both the source and application of the payments and the author suggests that Congress was unable to decide whether alimony payments are an income or expense item. The result of this congressional ambivalence has been an unequal application of the laws: those who have expert legal advice can reap advantages of this confusion. The author examines the policies behind the two approaches to taxing alimony and suggests statutory reforms to cure the present inequities.

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I. INTRODUCTION

Alimony payments are taxable to the wife as she receives them and deductible by the husband as he pays them.\(^1\) For tax purposes, alimony payments are limited to payments that are both (1) in discharge of the husband’s legal obligation to support the wife, rather than to discharge her dower or other marital rights, and (2) out of the husband’s current income, rather than his past savings, or “capital.” Accordingly, payments to discharge obligations other than the support of the wife and payments constituting divisions of capital are neither taxable to the wife nor deductible by the husband.\(^2\) Payments for child support also are not taxable to the wife and not deductible by the husband.\(^3\)

The obligation-of-support requirement is set forth in the statute in subjective terms. The Internal Revenue Code refers to “a legal obligation which, because of the marital or family relationship is imposed on or incurred by the husband.”\(^4\) The Treasury Regulations

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1. I.R.C. §§ 71 (a), 215. Although these sections are phrased in terms of payments by the “husband” and receipts by the “wife,” section 7701(a)(17) states that these terms are interchangeable. Likewise, the references in this article to “husband” and “wife” are for convenience only; the reverse is also to be understood. Where the context requires, the terms “husband” and “wife” include “former husband” and “former wife.” This too parallels the concept of interchangeable terms in section 7701(a)(17).

2. There is no express Code section so providing, but the long-standing practice of the Internal Revenue Service indicates that such payments are simply not to be thought of as ‘gross income’ within section 61. See part III, infra.

3. I.R.C. §§ 71(b), 215.

4. I.R.C. § 71(a)(1). Section 71(a)(2) contains a similar phrase. Section 71(a)(3) refers to “her support and maintenance.”
and committee reports equate this language with the husband’s obligation of support. By contrast, the Code does not refer directly to an out-of-income requirement but rather to “periodic payments” of an indefinite sum and to “installment payments” of a fixed principal sum extending for “more than 10 years.” The Treasury Regulations note that the statute does not in fact require the payments to be made from income, but the committee reports clearly state that the intent behind “periodic payments” and the “10-year rule” was to draw an objective line between payments out of income and payments out of capital.

This is a peculiar statutory approach. Congress chose to define alimony by reference to both the source and the application of the payments. No other tax item is so treated. Usually, income items are taxed solely by reference to their source (e.g., dividends, capital gains, tax-exempt bond interest), and expense items are treated for tax purposes solely by reference to the application of the payment (e.g., business expense, personal expense, capital expenditure). By conditioning alimony both as to its source and its application, Congress was apparently unable to make up its mind as to whether alimony payments really are income items or expense items.

From the wife’s standpoint, of course, the alimony she receives is income either way; and from the husband’s standpoint, the payments are deductible either way. That is not the problem. The problem is whether the wife’s alimony income is to be considered income from the husband or whether the wife should be considered as by-passing the husband and receiving income in place of the husband. From the husband’s standpoint, the question is not whether alimony is deductible, but whether alimony is deductible as a true expense or whether the deduction is simply a device for splitting the husband’s income so that part of it will be considered directly as the wife’s income. These are questions that go to the very heart of what is taxable as alimony. They go first to determining the appropriate tax policy underlying the taxation of alimony and from there to determining the correct statutory definition of alimony.

The two policies which underlie these statutory requirements are logically inconsistent with each other. Acceptance of one re-

6. I.R.C. §§ 71(a), 71(c).
quires rejection of the other. On the one hand, the taxation of alimony payments to the wife and the deduction of those payments by the husband could be viewed as an "income-splitting" device, the policy being to tax the wife on that which is truly her income and to tax the husband only on that which is truly his income. In this case, the reasons why the wife received the income (as support or otherwise) would be irrelevant, and the portion of the current statute requiring that the payments be in discharge of the husband's obligation of support could be repealed.

On the other hand, the taxation of alimony to the wife and the deduction of alimony by the husband could be viewed as the payment of an expense, namely the expense of supporting the wife. The policy permitting its deduction would be that it represented an extraordinary, non-discretionary expenditure which materially reduced the husband's ability to pay taxes. It could be likened to the deduction of major medical expenses or casualty losses. In this case, it would not matter whether the expense was paid out of current income or past savings of the husband, and the portion of the statute which requires, in effect, that the payments be out of current income could be repealed.

Those who doubt the practical importance of selecting between these two policies rather than continuing with a statute that reflects both need only look at the case-by-case results of over thirty years of operating under the current statute. Upon a confused statutory base has grown a body of law that is equally confused, complex and artificial. As a result, those that are fortunate enough to have the benefit of expert tax advice can usually cause their alimony payments to be taxed to the husband or to the wife depending upon who is in the lower tax bracket. In this way, the lowest possible combined tax will result.9 Often, the result is a lower tax than Congress probably intended. Those without expert advice, however, can easily step into one or more of the statutory pitfalls that await the uninitiated. Their combined tax may turn out to be much higher than that which was intended by Congress.

The objective of this article is to review these two competing policies in light of their broad implications and practical problems.

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9. The lowest tax will be paid if both the husband and wife have exactly the same amount of taxable income. The joint return rates automatically produce this result for married couples.
and to determine which one should govern the taxation of alimony. Before taking up these subjects, however, it might be helpful to review briefly the basic statutory rules for the taxation of alimony. These are found in sections 71, 215, and 682 of the Internal Revenue Code.

II. THE BASIC RULES

A. Section 71(a): Alimony Payments

Payments are treated as alimony—taxable to the wife and deductible by the husband—only if the payments are made pursuant to one of three types of written documents. These are: under section 71(a)(1),10 a decree of divorce or of separate maintenance or a written instrument incident to such divorce or separation; under section 71(a)(2), a written separation agreement; and under section 71(a)(3), a decree for support or maintenance.

Section 71(a) also includes an entire shopping list of additional requirements. Some of these statutory rules apply regardless of the type of written document. To be taxable as alimony, the payments must be "periodic."11 Although section 71(a) expressly states that to be "periodic" the payments do not have to be made at regular intervals, this requirement obviously means something more than a single lump-sum payment. The payments must also be made in discharge of the husband's legal obligation to support the wife. This subjective requirement has caused considerable confusion.12 Moreover, although the Code is silent on the point, the Treasury Regulations provide that the husband and wife actually must be living apart.13

On the procedural level, payments made by the husband under section 71(a) are includible in the income of the wife only when actually received by her (which is the general rule for the cash method of accounting) regardless of whether she is using the cash method or the accrual method of accounting for other purposes.14 Moreover, if the husband and wife file a joint return, the payments

10. All references to "sections" are to sections of the Internal Revenue Code of 1954, as amended.
11. See part V infra.
12. See part VI infra.
for that year will not be considered alimony.15 This problem might arise if the husband and wife are not yet divorced but merely separated.

Each of the three subsections under section 71(a) also has its own separate rules: Under section 71(a)(1), the payments must be made after a "decree of divorce or of separate maintenance" has been entered and in discharge of a "legal obligation" imposed on or incurred by the husband "under the decree" or "under a written instrument incident to the divorce or separation."

Under section 71(a)(2), even if the husband and wife are not divorced or legally separated, they may enter into a "written separation agreement" to achieve the same effect for tax purposes. The Treasury Regulations state that even a separation agreement which is not legally enforceable will satisfy section 71(a)(2).16 The agreement, however, must have been executed after August 16, 1954, the date on which section 71(a)(2) was executed.17 If a later written agreement is based on an earlier written agreement executed before that date, the later agreement must constitute a material alteration or modification of the earlier agreement in order to comply with the August 16, 1954 date.18 The actual payments under section 71(a)(2) must be made after the agreement was executed and pursuant to it.19 Thereafter, if the parties become divorced or legally separated, payments made pursuant to the written separation agreement will continue to qualify.20

Under section 71(a)(3), the payments must be made after August 16, 195421 and pursuant to a decree for support or maintenance entered after March 1, 1954.22 The Treasury Regulations state that any type of support or maintenance order or decree will do.23 A decree of separate maintenance is not required (such a decree is already covered by section 71(a)(1)). The Treasury Regulations cite an interlocutory decree of divorce and a decree of alimony pendente lite as examples of decrees satisfying section 71(a)(3).24

15. I.R.C. §§ 71(a)(2), (3).
17. Id.
20. Id.
24. Id.
As to the March 1, 1954 date, a decree which is altered or modified after March 1, 1954 will qualify. The Regulations, in contrast to those under section 71(a)(2), omit any reference to "material" alterations or modifications. Apparently, an order by a court making even a minor alteration or modification will be deemed sufficient to re-date an earlier order or decree.

B. Section 71(b): Child Support

Payments to the wife for child support are neither taxable to her nor deductible by the husband. This is true of payments designated as child support even if they are pursuant to one of the types of documents in section 71(a), and in all other ways within section 71(a).

Section 71(b) specifies that the children must be "minor" children. They must be children "of the husband." The payments must be "fixed," in terms of money or a part (fraction or percentage) of a larger fixed payment and earmarked exclusively for the children; and all this must be spelled out in the decree, instrument or agreement.

If the husband falls behind in his alimony and child support payments and then makes only a partial payment, section 71(b) specifies that the partial payment is to be considered first in satisfaction of his child support obligation. Only after this obligation is fully up to date will any remaining payments be considered alimony.

The proper tax treatment of child support payments is a subject that is beyond the scope of this article. The considerations are not the same as those underlying support payments for the wife. Congress, through joint returns, has permitted the husband and wife to be treated as a taxpaying unit. Congress has not yet focused on the entire family as a taxpaying unit. Moreover, separated or divorced husbands and wives are seen as being able to fend for themselves.

27. I.R.C. § 71(b).
28. The Tax Court has held that "minor" means age 21 regardless of state law. William E. Borbonus, 42 T.C. 983 (1964).
30. I.R.C. § 71(b); Treas. Reg. § 1.71-1(e) (1957).
themselves when it comes to being taxed on income used for support payments. Children are not. Finally, it is the husband and wife who are separating or getting divorced. Legally, except for the question of who gets custody of the children, the status of parent and child remains unchanged.

C. Section 71(c): Installment Payments

Section 71 does not provide rules for lump sum property divisions. Because they are omitted from section 71, these are not considered to be alimony. Thus, no income would be reportable by the wife and no deduction would be available to the husband. Each would simply be considered to be drawing down what was his or her own property all along.

Section 71(c), however, represents an attempt to draw a line between alimony payments on the one hand, and property divisions not paid in a lump sum but in installments, on the other. Section 71(c) provides that installment payments of part of a principal (lump) sum will not be treated as periodic payments (and therefore not alimony income to the wife and not deductible by the husband) if the installments do not extend beyond ten years. The principal sum must be specified in the decree instrument or agreement and must be stated in terms of money or property. The Treasury Regulations require that the total of the principal sum either be stated in the section 71(a) document or be able to be calculated from the language of the document. For example, it would be sufficient to specify payments of "$1,000 per year for 5 years" without expressly stating the $5,000 total.

If the installment period extends beyond ten years, however, section 71(c)(2) states that the payments shall be treated as "periodic" for purposes of section 71(a). To avoid a loophole in which, for example, ninety percent of a principal sum paid in the first year and one percent paid in each of the subsequent ten years might qualify as alimony even though the ninety percent really was very close to a lump sum payment, section 71(c)(2) limits the maximum per year that can qualify as periodic to ten percent of the total principal sum. Thus, in the example, only ten percent rather than ninety percent would qualify as alimony in the first year. The remaining eighty percent received in the first year would be a lump

sum payment. The one percent amounts in each of the subsequent ten years, of course, would qualify as periodic because each would be well within the ten percent rule. Section 71(c)(2) then closes a second loophole by providing that the ten percent rule applies regardless of whether the amounts which exceed ten percent are paid on time (as specified in the decree, instrument or agreement) or as pre-payments relating to future years.

A key feature of section 71(c), however, is that it only goes to the question of whether particular payments are periodic. If they are, for example, because the payments are of a principal sum but are to last beyond ten years, that does not automatically mean that all of the other requirements of section 71(a) are also satisfied so that the payments qualify as alimony. It simply means that the payments are "periodic": that one of the requirements in section 71(a) is satisfied. All of the remaining requirements of section 71(a) outlined above also must be satisfied before the payments will be considered alimony. If, on the other hand, the document calls for a fixed principal sum payable evenly over ten years or less, then it is certain that the payments are not periodic. Lacking that one requirement, the payments cannot be alimony under section 71(a).

D. Section 215: Deduction for the Husband

If the wife is taxable on alimony received from the husband, he may take a deduction under section 215. The Code as revised by Tax Reform Act of 1976 makes alimony deductible from gross income in arriving at adjusted gross income.33 If the wife is not taxable on the amount received because it is an installment payment of a principal sum payable over a period of ten years or less within section 71(c), or a child support payment within section 71(b), or a lump sum property division (not within section 71 at all), then the husband cannot take a deduction under section 215.

There are, moreover, three additional instances in which the wife is taxable because of the receipt of income but the husband still cannot take a section 215 deduction. Assume first that a lump sum property settlement occurs pursuant to which the husband transfers to the wife certain income-producing securities. That transfer is not taxable to the wife and not deductible by the husband. It is not covered by section 71 at all. But the wife now owns the securities,

and when they produce income, the income will belong to the wife, and she will be taxed on it. The husband still will not get a deduction even though he once owned the securities. Section 71(d) accomplishes this by stating that the husband’s income does not include amounts (1) includible in the wife’s income as alimony and (2) attributable to transferred property. Section 215 then denies the husband a deduction for amounts covered by section 71(d).

This is a fair result since the husband, by transferring complete ownership to the securities, has also succeeded in keeping all future income from them out of his tax return. By comparison, if he had kept the securities and then used the income from them to pay alimony, he would first have had to report the income from the securities as his income and then offset it with a section 215 deduction.

The second instance in which the wife is taxable on the receipt but the husband gets no deduction is in the case of a trust. Instead of transferring the securities just mentioned directly to the wife, assume that the husband places them in a trust. The trustee is to pay the trust income to the wife. She is taxed on the receipt of such trust income as alimony. Sections 71(a)(1) and 71(a)(2) expressly permit the use of a trust to discharge the husband’s obligation to make periodic payments. The payments still are alimony if all of the other rules are satisfied. The husband, however, does not have to report the trust income as his income because of section 71(d). Income from a trust is considered to be income attributable to transferred property. Therefore, he does not get a deduction under section 215. If anyone should get a deduction, it is the trust, and sections 651 and 661 so provide.

The third exception to the general rule that section 215 allows a deduction to the husband when the wife is taxed on the receipt involves section 682 trusts. Section 682 provides that the income of any trust (not already covered by section 71(a)) received by a wife who is divorced or legally separated under a decree of divorce or separate maintenance, or who is separated under a written separation agreement, shall be taxable to the wife and not includible in the gross income of the husband. Because section 682 serves to keep the trust income out of the husband’s income, he has no need of a

34. See Treas. Reg. § 1.215-1(c) (Example 1) (1957).
section 215 deduction. Section 215, therefore, denies the husband a deduction for such income.

E. The Section 71(a) Alimony Trust

As just noted, there are two kinds of alimony trusts, those covered by section 71(a) and those covered by section 682. It is necessary to examine each of these in more detail. Sections 71(a)(1) and 71(a)(2) state that the husband's obligation to make periodic payments which are taxable to the wife as alimony can be satisfied (if the decree, instrument or agreement so provides) by a transfer of income-producing property to a trust. Typically, the trustee would be instructed to make the appropriate alimony payments to the wife out of the trust income and then, when the husband's alimony obligation ceases, to return the income-producing property to him.

Interestingly, section 71(a) only extends the use of a trust to section 71(a)(1) (decrees of divorce or separate maintenance) and section 71(a)(2) (written separation agreements). An alimony trust may not be based upon a support decree or order in section 71(a)(3). Section 71(a)(3) specifically refers to payments received "from her husband" under a decree "requiring the husband to make the payments" and contains no reference at all to the use of a trust.

As noted earlier, although the husband cannot take a deduction under section 215, the trust itself can take a deduction under either section 651 or 661 to the extent that all or a portion of its income is required to be distributed or in fact is distributed to the wife. The trust must rely on section 651 or 661; it cannot rely for a deduction on section 215. Section 215 is available only for non-trust payments made directly by the husband. This creates two differences. A trust deduction under section 651 or 661 may be taken for income required to be paid regardless of whether it actually is paid by the end of the year. Correspondingly, under section 652 and 662, the wife must include such amounts in income for the year the trust is required to pay even though she in fact did not receive the amount by the end of the year. By contrast, a section 215 deduction is available only for an actual payment by the husband. To the wife, direct alimony payments are income only when actually received.

The second difference is that sections 651 and 661 permit deductions only of that portion of the payment from the trust which is deemed to be out of the annual trust income even though section 71 requires the wife to include in her income the entire payment.
By contrast, if a trust is not used, so long as the payment is a “periodic payment” a section 215 deduction is available for the full amount included by the wife in her income under section 71. It is conclusively presumed that the payment came from current income regardless of whether the husband in fact made the payment from his current income or from his capital.35

F. The Section 682 Alimony Trust

Section 682 also taxes alimony trust income to the wife and prevents such income from being taxed to the husband. Section 682 applies only to trusts which are not within section 71(a).36 In cases in which both sections would apply, the rules in section 71(a) control.37 In some respects, section 682 is narrower than section 71(a). Section 682 taxes trust income to the wife and keeps the trust income out of the husband's income only if (1) the husband and wife are divorced or are legally separated under a decree of separate maintenance or (2) the husband and wife are separated under a written separation agreement. Section 682 thus goes only as far as sections 71(a)(1) and 71(a)(2). A section 71(a)(3) support order will not do. Section 682, moreover, taxes to the wife and not to the husband only that portion of the payments which are deemed to be out of trust income. Payments out of principal are not to be taxed to the wife. By contrast, payments out of principal would be taxed to the wife if the trust satisfied the requirements for a section 71(a) alimony trust.

In other respects, section 682 is broader than section 71(a). Section 682 applies regardless of whether the payments are “periodic” and regardless of whether the payments are made “under” the divorce or separate maintenance decree or the separate maintenance agreement. Section 682 also applies regardless of whether the separate maintenance agreement pre-dates August 16, 1954 and regardless of whether any substantial modification of a pre-existing separate maintenance agreement took place after August 16, 1954. In fact, as noted earlier, section 682 applies even to payments that are not made. The only requirement is that the wife be “entitled to receive” the amounts in question.

37. Id.
Section 682 contains an exception for payments specifically earmarked for child support. Just as under section 71(b), such payments would not be income to the wife. The trust would get a deduction under section 651 or 661 for child support payments made out of trust income, but the husband would be the one who would have to report the income under section 677 since the payments would operate to discharge his obligation of support. Moreover, the husband would not be entitled to a deduction under section 215; the treatment of child support payments under section 682 to all parties would be exactly the same as if the trust were governed by section 71(a) or indeed as if there were no trust at all and the husband made the payments directly.

This summary of the statute, while far from complete, should serve to facilitate an understanding of the more detailed discussion that follows. Before proceeding to a discussion of the policy considerations and problem areas underlying the federal income taxation of alimony, however, it will be helpful to consider how the tax treatment of alimony and related payments compares with similar payments by a husband to (or for the benefit of) his wife and children prior to separation or divorce.

III. Payments During Marriage

A. Support Payments

Many payments between happily married couples could be characterized as gifts. As such, they would be excluded from federal income taxation under section 102. Unless they were quite large, they would also avoid federal gift taxation. True support payments, however, cannot be considered gifts for income tax purposes because they are usually motivated by the legal or moral obligation that the husband has to support his wife and children. Generally, it is to discharge these obligations rather than simply to show his love and affection that a husband provides for the support of his wife and children. Accordingly, support payments would not qualify as "gifts" for income tax purposes.

Why then are support payments not taxable income to the wife and children? If they are not gifts, no section of the Internal Reve-

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38. See I.R.C. §§ 2503(b), 2505, 2523. Respectively, these sections provide an annual exclusion of $3,000 per donee, a variable credit, and a marital deduction.
The Revenue Code expressly excludes them. Why are they not simply "income" within section 61, which states that "... income means all income from whatever source derived ..."? Basic as this question is, it never has been answered directly, presumably because it has been Internal Revenue Service policy never to raise it. The position of the Internal Revenue Service is that support payments are just not "income" as that term is used in section 61.

If support payments were "income," they would not be offset by any matching deductions of the husband because the payments would be his "personal" expenses, and thus not deductible under section 262. Nor would the husband be able to deduct them as being in satisfaction of a preexisting debt, because payments of preexisting debts are never deductible; they are not "expenses" at all.

From the wife's perspective, characterizing the payments as being in satisfaction of a preexisting debt owed to her by her husband would not enable her to avoid realizing income. The argument for taxation would be that the payments would be in exchange for her surrender of an intangible asset, her right to support, and that she should be taxed as if she were disposing of an asset. The problem with this argument is that her asset, her right to support, cost her nothing; and so she has no basis for it. Lacking a basis, even if she is considered to have given it up in exchange for the support payments from her husband, her gain logically still should be the full amount received.

Introducing joint return rates into the picture also is no help if support payments are viewed as personal expenses to the husband. Even though a wife and husband can combine their income and deduction items by filing a joint return, they still would not be able to offset support payment income to the wife (if such should exist) by support payment deductions of the husband because, as already noted, the husband is not entitled to any deductions for personal expenses. The joint return election does not change this rule.

The conceptualization thus comes full circle back to alimony. If the only way to rationalize the non-taxation of support payments during a marriage is that such payments simply are not "income" within the general statutory definition, then why should such

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40. I.R.C. § 1(a). The joint return rates produce a result that is the same as if the husband and wife each earned exactly one-half of their joint income. This causes their joint income to be taxed in the lowest possible brackets.
payments be taxable as “income” under section 71 upon divorce or separation? On the deduction side, if support payments during a marriage are non-deductible personal expenses, why should such payments be deductible under section 215 upon divorce or separation?

Perhaps a better rationalization for the non-taxation of support payments during a marriage is to view such payments simply as an optional splitting of the husband’s income between him and his wife. That is, by electing to file a joint return, the husband and wife are agreeing that one-half of the husband’s income really is income directly owned by, and taxable to, the wife and vice versa.

If the source of the husband’s income is property rather than personal services, then a joint return election, in effect, treats the husband’s property as community property and the income therefrom as community income which is automatically owned in equal shares by both. This theory receives support from the legislative history behind the joint return provision. One reason for its enactment was to place taxpayers in non-community property states on a more equal footing with taxpayers in community property states.41

Comparing this rationale with the taxation of alimony to the wife and its deduction by the husband produces a more logical result. Just as the joint return option serves to treat the wife as the true taxpayer of part of the husband’s income, so too the alimony provisions treat part of the husband’s income as income of the wife. The husband is then allowed a deduction not because the payment is a true expense but because he is permitted to remove that portion of income from his return that really is not his income at all. The legislative history of the alimony provisions lends some support to this view. Among the reasons cited in favor of enacting the predecessors to sections 71 and 682 was that income used for alimony should be considered income of the wife and not income of the husband.42

B. Non-Support Payments

Attention now is turned from alimony to payments for marital rights other than support. These include payments in discharge of dower and other statutory rights to the husband’s property. Non-

42. See part IV infra.
support payments during a marriage are not analogous to support or alimony because they usually are gifts—the husband is under no legal obligation and is probably motivated by love and affection. A look at pre-marital payments for such marital rights, however, sheds some light on this problem. In *Farid-Es-Sultaneh v. Commissioner* the wife-to-be received some shares of stock pursuant to a pre-marital agreement in return for her release of dower and other marital property rights. The Second Circuit held that her basis for the stock (for the purpose of computing gain on her later resale) was equal to the full fair market value of the stock when she received it.

Was the receipt taxable to the wife-to-be in *Farid*? That issue was not before the court. The implication is that the receipt was taxable. How else would the wife have been entitled to a new basis equal to the full fair market value of the stock? Dictum in an opinion from the District Court for the Southern District of New York also supports the theory that such pre-marital payments are taxable. By contrast; if similar payments are made as damages, for example, for breach of promise to marry, the rule is that the payments are not taxable. The distinction seems to be that pre-marital payments for release of marital rights result in a true realization of gain, an enrichment, while payments for damage to marital rights do no more than make the taxpayer whole, without enrichment.

If this distinction between pre-marital release payments and damage payments is valid, which rule should apply to divorce payments for marital property rights? On the one hand, divorce payments are paid for a release of the marital rights. On the other hand, there are strong similarities between a divorce and a breach of promise to marry which would lead to a non-taxable result. In any case, the Internal Revenue Service has ruled that payments pursuant to a divorce in discharge of the wife's dower rights are not taxable. The reason given was that the value of the wife's dower rights was equal to the value of the property received. This is puzzling because it is arguable that the wife has no basis in her dower

43. 160 F.2d 812 (2d Cir. 1947).
rights, and it is not value, but the difference between basis and the amount received that measures gain upon the disposition of property.\textsuperscript{48} Perhaps an alternative reason that payments upon divorce in discharge of dower rights should not be taxable is that there has been no disposition. The wife is merely drawing down what was her property all along. This is different than in the \textit{Farid} situation because a wife-to-be has no pre-existing rights in her husband's property, whereas a wife, after marriage, does have such rights. If this approach is adopted, it would follow that the wife, upon receipt of property in discharge of her dower or other statutory rights, would take the same basis that the husband had so that the same potential gain (or loss) would carry over.

The next section of this article considers the history of the present statutory provisions, with particular emphasis on whether the legislative and constitutional arguments for taxing alimony to the wife seem to rest on an income-splitting policy or an obligation-of-support policy.

\section*{IV. Legislative and Constitutional Considerations}

\subsection*{A. Alimony Payments Before 1942}

Initially, a question was raised as to whether Congress intended alimony to fall within the general statutory definition of "gross income" in what is now section 61. In 1917, the Supreme Court in \textit{Gould v. Gould}\textsuperscript{49} held that alimony was not within the statutory definition of income. The Court, in a three page opinion, simply concluded that alimony did not fall "fairly within any of the terms employed"\textsuperscript{50} in the statutory definition. After \textit{Gould}, there was no satisfactory way to plan for alimony payments which would be taxable to the wife and deductible by the husband. Direct periodic payments were ruled out in \textit{Gould}. Even if alimony payments had been held to be income in \textit{Gould}, they still would have been personal expenses, not deductible by the husband.

There was only one sure way to shift the taxation of income to the wife. The property which was to produce the income first had

\textsuperscript{48} I.R.C. § 1001. The anomaly presented in this situation may be resolvable by conceiving of the wife's basis in her dower rights as inchoate until the moment the taxable transaction occurs. Thus there could never be a recognition of gain at that point in time.

\textsuperscript{49} 245 U.S. 151 (1917).

\textsuperscript{50} \textit{Id.} at 153.
to be transferred outright to the wife. Thereafter, the income earned from the property would be taxable to the wife simply because she owned the property. However, most husbands were unwilling or unable to make outright transfers.

B. The Alimony Trust Before 1942

Before the predecessors to sections 71(a) and 682 were enacted in 1942 alimony trusts were usually considered to be “grantor” trusts, that is, trusts which were set up to make payments to the wife which would discharge the legal obligation of the husband to support his wife or children.51 The general rule was (and still is, in section 677) that trust income paid to discharge the support obligation of the grantor should be treated as constructively paid to the grantor and thus should be taxed to the grantor. Sections 71(a) and 682 have changed that rule where they apply, but the rule remains intact in situations such as child support payments not covered by sections 71(a) or 682.

Prior to the enactment of sections 71(a) and 682, however, there was one possible escape from the grantor trust rule. The one way to assert that alimony was taxable to the wife and not to the husband under an alimony trust was to argue that the initial lump sum transfer of property into the trust was itself in satisfaction and complete discharge of the husband’s obligation of support.52 Thereafter, if no obligation of support existed, the future income payments from the trust property could not be in discharge of any support obligation of the husband. The trust, therefore, could not be a grantor trust. If it was not a grantor trust, the trust income was taxable, under the general trust rules, to the wife as the beneficiary entitled to receive it.53

The difficulty with this argument, of course, was in proving that the initial transfer into the trust, not the subsequent income payments, discharged the husband’s obligation. This was tantamount to arguing that the wife rather than the husband was the true grantor and that the placing of the property in trust rather than the making of a direct lump sum transfer of the property to the wife was primarily for her benefit and not for the husband’s benefit. In prac-

51. E.g., Douglas v. Willcuts, 296 U.S. 1, 8-9 (1935).
52. E.g., Helvering v. Fuller, 310 U.S. 69, 75 (1940).
tice, the trust device was probably most often sought by the husband as a way to transfer only the income from the property to the wife while retaining and preserving the underlying remainder interest in the property for himself.

Most of the cases which involved this issue looked to whether, under state law, the initial transfer to the trust did or did not discharge the husband from his legal obligation of support. In 1940, in a series of three cases, the Supreme Court approved the controlling effect of state law. But even in those states which would have held that an initial transfer to a trust would have discharged the husband's legal obligation, the opportunity proved illusory. The husband still had to make an actual lump sum transfer to a trust. Many were still unwilling or unable to do this for personal or financial reasons.

C. The Legislative History of the 1942 Changes

Congress felt that it was unfair to discriminate between those husbands who could afford to shift the taxation of income to the wife by making a lump sum payment to her and those who could not afford such a settlement but had to rely instead on periodic payments out of their current income from services or property. The legislators reasoned that periodic payments out of income consisted, in effect, of splitting the income between husband and wife and that, accordingly, the taxation of the income should be similarly split.

Additionally, Congress was spurred to enact some relief for separated or divorced couples from the high wartime tax rates. Perhaps it was even thought that by allowing a husband to deduct alimony he might be induced to pay larger amounts to his ex-wife. Finally, Congress wanted to end the uncertainty and lack of uniformity under varying state laws that resulted from using alimony trusts to discharge the husband's obligation of support.

D. The Constitutionality of Section 71.

For these reasons, sections 71, 215 and 682 were enacted in 1942. The constitutionality of section 71 was upheld in 1950 by the Court of Claims in Mahana v. United States and in 1954 by the Tax Court in Daisy M. Twinam. This constitutional question still has not been passed upon by the Supreme Court although certiorari was denied in Mahana. In Twinam, the Tax Court expressly left open the question of whether alimony was constitutionally taxable to the wife as income if the husband had no income and had in fact made the payments from other property. The Tax Court later answered this question in favor of taxing his wife in Muriel Dodge Neeman. The Second Circuit affirmed.

In Twinam and Mahana the argument was made that the Supreme Court, by implication, had already decided against the constitutionality of taxing alimony received by the wife as part of its 1917 decision in Gould. The argument ran that the general statutory definition of income under review in Gould represented an exercise by the Congress of the full power to tax which was contained in the 16th amendment; therefore, the meaning of "income" in the statutory definition and in the 16th amendment was exactly the same. The decision in Gould, that alimony was not within the statutory definition, therefore, had to mean that alimony was also not within the 16th amendment.

This argument was rejected in Mahana simply by observing that the Supreme Court in fact had not directly taken up the specific constitutional question of whether alimony was income under the 16th amendment, and the Court's general statements in other cases as to the congressional intent to exercise fully the 16th amendment power should not be taken so literally. Everyday usage, said Judge Madden for the Court of Claims in Mahana, would dictate that one who had received alimony payments "would be regarded as having an income."

Four years later, the Tax Court in Twinam agreed with the Court of Claims. The Tax Court in Twinam repeated the Mahana arguments and added the argument that al-
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It is clear from the foregoing that there exist two separate and competing policies. The first of these policies is to treat divisions of income separately from divisions of capital. Divisions of the husband’s income are to be taxed as alimony while divisions of his capital are not. Today this is based on a desire to harmonize the tax situation of a divorced husband and wife with that of a married couple who can rely on the joint return provisions to divide their income. Historically, it is based on the notion that income ought to be taxed to the party who ultimately received it.

The second policy is to treat payments in discharge of the husband’s support obligation separately from payments in discharge of other obligations of the husband to the wife. Support payments are to be taxed as alimony while payments in discharge of other obligations are not. Historically, this policy appears to be grounded largely in sympathy for a husband who was required to pay such large amounts to support his wife that he was thereby rendered unable to pay his own federal income taxes out of the income he had left. The high tax rates in effect during World War II (when the alimony provisions were adopted) contributed to the sympathy that Congress felt for the husband.65

Regarding the first policy, sections 71(a) and 71(c) were the primary devices used by Congress to separate divisions of income from divisions of capital. Payments in indefinite duration, lump-

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64. 282 U.S. 101 (1930).
sum payments and installment payments of a fixed principal sum extending for not more than ten years were considered divisions of capital, while installments extending for more than ten years were considered periodic payments and thus divisions of income. The rationale for such a division was purely a practical one. The longer the period over which a series of installment payments extended, the more likely that current income was the primary source for such payments. On the other hand, if the installment period was relatively short and if the total of the payments was fixed and agreed upon at the outset, it was likely that the husband planned to dip into his accumulated capital in order to make the payments.

Section 71(a) was the primary vehicle used by Congress to carry out the second policy, to separate payments in discharge of the husband’s support obligation from payments in discharge of other marital obligations which he had to his former wife. In section 71(a), alimony treatment was expressly reserved for payments made “because of the marital or family relationship” or “for her support and maintenance.”

It is inconsistent to base the taxation of alimony on both of these policies. Either the wife’s alimony comes from the husband or it comes from the same sources as the husband’s income. It cannot come from both. Either the husband is paying a personal expense or he is simply excluding income which is not his income. He is not doing both. The difficulty is to decide which policy is preferable. An overview of the broad legislative and constitutional considerations has been presented. In the end, the choice must turn in large part on practical considerations. Which policy would result in a tax structure which is easier to understand and easier to administer? These considerations must be examined. The first to be discussed will be those arising out of the obligation-of-support requirement.

V. THE OBLIGATION-OF-SUPPORT REQUIREMENT

A. The Statutory Language

Sections 71(a)(1) and (2) require that periodic payments, to be taxed as alimony, be in discharge of a “legal obligation which, because of the marital or family relationship, is imposed on or incurred

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66. I.R.C. §§ 71(a)(1)-(2).
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by the husband." On its face, there might be some question as to whether this language can be restricted to the husband's obligation or support. As interpreted in the Treasury Regulations, however, this language is equivalent to the husband's legal obligation of support: "Section 71(a) applies only to payments made because of the family or marital relationship in recognition of the general obligation to support which is made specific by the decree, instrument, or agreement."68

This Regulation was taken almost verbatim from the House Ways and Means Committee report.69 Section 71(a)(3) includes this requirement by referring to "payments for her support or maintenance." If payments are intended to discharge any of the wife's other property rights, they will not qualify as alimony. This is true even of other property rights which arise by reason of the marriage. For example, in Bernatschke v. United States,70 payments of $25,000 per year in discharge of the wife's dower rights were held by the Court of Claims not to be in discharge of a "marital obligation."

B. Circumstantial Evidence: The Balancing of Factors

It is often difficult to place the correct label on payments made between husband and wife. In Charles S. Presbey71 the Tax Court found that payments labelled "alimony" really were repayments of a loan from the wife prior to the marriage. Alimony treatment was denied. The Treasury Regulations contain a similar example.72 Recently the Tax Court held that a lump-sum $20,000 payment was not alimony for tax purposes because it was not in discharge of the husband's obligation of support even though the $20,000 was paid pursuant to an order of a New Jersey court which referred to the payment as "alimony."73

In other cases the nature of the payments has been used to suggest whether or not they were paid in discharge of the obligation of support. For example, in Van Orman v. Commissioner,74 the Sev-

70. 364 F.2d 400 (Ct. Cl. 1966).
72. Treas. Reg. § 1.71-1(b)(4) (1957) (repayment of a loan is not a payment in discharge of a legal obligation to support).
74. 418 F.2d 170 (7th Cir. 1969).
enth Circuit held that mortgage payments by the husband on a home for the wife were in satisfaction of a property right rather than alimony. The court said that the taxpayer's obligation was "to provide a lump sum to the ex-wife." The fact that the mortgage on the house was to last more than ten years (so that the ten-year installment provisions of section 71(c) were avoided) did not change the character of the obligation: "The mere fact that the taxpayer chose to pay off the basic obligation in conveniently small amounts does not change the character of the basic obligation."  

In Van Orman the court's conclusion was reinforced by the fact that, in addition to the obligation to supply the wife with a home and pay the mortgage, there existed another periodic payment obligation which was concededly alimony. This approach, rejecting one provision in a property settlement agreement because alimony has clearly been provided elsewhere, has also been used by the Ninth Circuit.  

Other circumstantial evidence may tip the scales in cases where the direct evidence of intent is not clear. A wife receiving, in kind, property which she initially contributed to the marriage has been held to be receiving the property in satisfaction of property rights other than her right to support. Similarly, a recital in the decree that "there shall be no alimony" plus circumstances indicating that the parties attempted to divide the property equally has been found by the Tenth and Sixth Circuits to be a property settlement rather than alimony.  

State law also has an impact on whether the payments are intended as alimony. In Martha K. Brown, payments that were considered alimony before the wife remarried were not alimony thereafter because, under state law, a husband had no obligation to pay alimony after his ex-wife re-married. On the other hand, in West v. United States, installment payments of a fixed sum were alimony because, under state law, a fixed total sum of alimony was always required to be stated in the decree.

75. Id. at 171.  
76. Id. at 171-72.  
77. Soltermann v. United States, 272 F.2d 387 (9th Cir. 1959).  
78. Mills v. Commissioner, 442 F.2d 1149 (10th Cir. 1971).  
79. Lambros v. Commissioner, 459 F.2d 69 (6th Cir. 1972); McCombs v. Commissioner, 397 F.2d 4 (10th Cir. 1968).  
80. 50 T.C. 865 (1968), aff'd per curiam, 415 F.2d 310 (4th Cir. 1969).  
Some courts rely on their own special recipe of factors. In Hayutin v. Commissioner, total payments of $3,500 were held to be for support. The Tenth Circuit looked to "the true nature of the transfer under Colorado law" and determined that, as to the $3,500, the "factors are inconsistent with the idea of co-owned property." The Tenth Circuit cited the divorce court's discretion to divide the marital estate based, among other things, upon the value of the estate, the financial condition, health, age, earning ability of each of the parties, and the contribution of each to the marital estate.

In the end, what if the court has considered all the factors it thinks are relevant and still is not sure of the purpose of the payments? The Tax Court has an answer. The purpose may be held to be a dual purpose—neither the property settlement purpose nor the support purpose would predominate and the payments may be allocated between the two.

C. After the Death of the Husband

The initial question is whether the intent of the parties is to have the alimony obligation survive the death of the husband. In Fairbanks v. Commissioner, the Ninth Circuit held that an agreement entered into between the wife and the trustees and executors of the husband's estate after the husband's death was merely a modification of the earlier right of the wife to receive alimony and was not a substitution of a new agreement for the old alimony right. Accordingly, the court held that the payments made by the executors and trustees subsequent to the husband's death continued to be taxable as alimony to the wife.

Even if the parties intend the alimony obligation to survive, some state statutes provide that there shall be no obligation to continue paying alimony after the death of the husband. In some cases, the state statute may control. In other states, however, it may

82. 508 F.2d 462 (10th Cir. 1974), aff'd, 31 T.C.M. (CCH) 509 (1972).
83. Id. at 469.
84. E.g., Brantley L. Watkins, 53 T.C. 349 (1969) (acq.). For other cases in this area, see Coker v. United States, 327 F. Supp. 169 (D. Neb. 1971), aff'd 456 F.2d 676 (8th Cir. 1972); Grant R. Bishop, 56 T.C. 720 (1971) (acq.) (payments to repay a former loan from the wife to the husband); Enid P. Mirsky, 55 T.C. 664 (1971) (payment to divest wife's interest in property held in tenancy by entirety); Edith M. Gerlach, 55 T.C. 156 (1970) (payments to buy out the wife's interest in community property).
85. 191 F.2d 680 (9th Cir.), cert. denied, 343 U.S. 915 (1951).
still be possible for the parties to voluntarily agree that payments will continue to be made to the wife from the estate of the husband or from a trust fund set up by his estate.

In the latter states, the question is whether the payments will continue to be treated as alimony for tax purposes. In Ada M. Dixon, the question before the Tax Court was whether payments to the wife pursuant to a settlement agreement continued to be alimony even though they extended beyond the death of the husband and were paid from his estate. The wife alleged that the payments could not be alimony, arguing that New York law did not allow alimony after the death of the husband. The Tax Court construed the New York law to mean that although the obligation to pay alimony ceased at the husband’s death, the husband could voluntarily contract to provide for the wife both before and after his death. The court then held that the payments after the husband’s death were still in discharge of the husband’s earlier legal contract obligation to provide alimony.

Judge Mulroney dissented in Dixon. In his view, after the death of the husband, the wife received payments which were not pursuant to the earlier settlement agreement but pursuant to the will of the husband. Judge Mulroney was thus drawing a distinction between payments directly connected to an earlier legal obligation and the payments in Dixon which were only indirectly connected to the earlier agreement (but directly connected to the will of the husband). An additional problem not mentioned in either the majority or dissenting opinion in Dixon was how, in the absence of a statute, the legal obligation could be said to have arisen “out of the marital or family relationship.” If it could not, any undertaking by the husband to continue support after his death must either have been

86. 44 T.C. 709 (1965).
87. The Tax Court in Dixon cited three California cases for the proposition that payments made by a husband’s estate were deductible by the estate as alimony even though California law specifically prohibited alimony after the husband’s death. One was United States v. Soltermann, 163 F. Supp. 397 (N.D. Cal. 1958). The Tax Court’s citation to the district court opinion in Soltermann appears to be erroneous. No mention was made of whether alimony payments could continue after the death in this opinion. It dealt solely with the distinction between property settlements and alimony payments. The case was appealed, however, and the issue was touched upon in dictum at the circuit court level. Soltermann v. United States, 272 F.2d 387, 390 (9th Cir. 1959). The other cases were: Helen Scott Fairbanks, 15 T.C. 62 (1950), aff’d 191 F.2d 680 (9th Cir. 1951), cert. denied, 343 U.S. 915; Daisy M. Twinam, 22 T.C. 83 (1954).
gratuitous or based upon some other consideration. In either case the payments would not be alimony.

D. After the Remarriage of the Wife

Payments to the wife which continue beyond her remarriage can, in general, still qualify as alimony.88 But again, under state law, the legal obligation of the husband to pay alimony may cease upon the remarriage of the wife. In Allen Hoffman89 the Tax Court held that, under Illinois law, payments made pursuant to a settlement agreement were taxable as alimony to the wife prior to her remarriage but not thereafter. Although the agreement specified that the payments would continue to be made, Illinois law provided that any legal obligation of the husband to pay alimony would cease upon the wife's remarriage.90 The Tax Court concluded that "state law is determinative of the existence of a 'legal obligation' for purposes of section 71(a)(1)."91 In so holding, the Tax Court rejected the Commissioner's contention that the reference to a "legal obligation" in section 71(a)(1) did not depend upon state law but was rather a federal standard referring to a general obligation of support which arose from the marital or family relationship.

Although its earlier opinion in Dixon was cited in the Hoffman opinion, the Tax Court made no attempt to explain the difference in the results of the two cases. Comparing the opinions the Tax Court found that in Dixon, New York law provided that although the obligation to pay alimony ceased at the husband's death, the husband may voluntarily assume an obligation to continue alimony after his death. In Hoffman, the Illinois statute provided essentially the same thing, but there was no express finding that the voluntary undertaking to provide alimony after the remarriage of the wife or the death of either party was (or was not) enforceable.

88. Rev. Rul. 70-557, 1970-2 C.B. 10. Payments apparently intended to be for the support of the children subsequent to the wife's remarriage were held to be alimony because the payments were not sufficiently "fixed" within the meaning of the Supreme Court's opinion in Commissioner v. Lester, 366 U.S. 299 (1961).
89. 54 T.C. 1607 (1970), aff'd per curiam, 455 F.2d 161 (7th Cir. 1972).
90. The Illinois statute provided in part that, "[a] party shall not be entitled to alimony and maintenance after remarriage; but, regardless of remarriage by such party or death of either party, such party shall be entitled to receive the unpaid installments of any settlement in lieu of alimony ordered to be paid or conveyed in the decree." ILL. REV. STAT. ch. 40, § 19 (1956).
91. 54 T.C. at 1611.
The court in *Hoffman* relied upon its earlier decision in *Martha K. Brown*\textsuperscript{92} in which it held that, because the husband's sole liability was imposed by the decree and because state law provided that alimony was to cease upon the wife's remarriage, payments made after the wife's remarriage were not pursuant to a "legal obligation" and therefore were not taxable to her under section 71(a)(1).

An interesting final twist was added in *Herbert I. Joss*.\textsuperscript{93} The Tax Court held that because the obligation of the husband to make alimony payments terminated upon the remarriage of his wife, payments actually received by the wife after her remarriage (due to the fact that she did not disclose such remarriage to her former husband) were includible in her gross income as embezzled funds under section 61. In such a case, the payments presumably would be deductible by the husband under section 165(c)(3) as a theft loss. The net effect would be almost the same as alimony treatment.

**E. After Annulment**

A problem which is similar to those just discussed is whether payments which otherwise would have been alimony will be construed as such if, instead of ending in divorce, the marriage ends in an annulment. The issue is whether, by reason of the annulment, the marital or family obligation of the husband which otherwise would have existed is no longer imposed upon him under state law. If a marriage has been annulled, will it be recognized as ever having existed so as to give rise to a family or marital relationship? If not, there could be no obligation of support arising therefrom.

In *George F. Reisman*\textsuperscript{94} the Tax Court held that payments made by the husband pursuant to an annulment decree should be treated as alimony under section 71. The court adopted a flexible approach to interpreting the tax provisions: "We believe the Federal statute here involved is more concerned with the function of the payments rather than the label of the action under which they were decreed."\textsuperscript{95} As to the issue of whether a "family or marital relationship" ever existed, the court indicated that it would disregard the fiction that an annulment defaces a marriage "as if it had never been." In

\textsuperscript{92} 50 T.C. 865 (1968), aff'd per curiam, 415 F.2d 310 (4th Cir. 1969).
\textsuperscript{93} 56 T.C. 378 (1971).
\textsuperscript{94} 49 T.C. 570 (1968) (acq.).
\textsuperscript{95} Id. at 572.
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support, the court cited several New York cases to the effect that the fiction of an annulment could be ignored for state law purposes as the "purposes of justice" are deemed to require.96

In apparent response to the argument that an annulment decree could preserve the obligation of support only if the grounds for the annulment arose subsequent to the marriage,97 the Tax Court cited two previous Tax Court cases in which the grounds for the annulments existed at the time of the marriage and held that whether the grounds existed prior to the marriage or arose subsequent to the marriage made no difference.

F. After an Invalid Divorce Decree

Interestingly, although the Internal Revenue Service acquiesced in Reisman, it announced that it would not follow the decision of the Second Circuit in Borax v. Commissioner.98 In Borax, the Second Circuit held that a Mexican divorce should be upheld as valid for purposes of section 71 even though the decree had already been declared invalid by a New York court.

In so holding, the Second Circuit cited the goals of certainty and uniformity which it said were fostered by permitting the tax consequences to be determined by the Mexican decree. In addition, the court noted that its result would be in accordance with the policy of taxing payments made in cases of separated couples to the person who actually received and had the use of the payments.99

Judge Friendly, in dissent, pointed out that Borax is inconsistent and in conflict with the Ninth Circuit opinion in Gersten v. Commissioner.100 Judge Friendly would have had the court base its

99. See also Feinberg v. Commissioner, 198 F.2d 260 (3d Cir. 1952), which held that a Florida divorce decree would support the treatment of periodic payments as alimony under section 71 even though the Florida decree was subsequently declared invalid by a New York court.

To be contrasted with Borax is the situation in which the original court which granted the divorce subsequently reverses itself and declares the divorce obtained invalid. In Estate of Daniel Buckley, 37 T.C. 664 (1962), the Tax Court held that under these circumstances, the element of a "decree of divorce" was missing. For further discussion of this area, see Spolter, Invalid Divorce Decrees, 24 Tax. L. Rev. 163 (1969).
100. 267 F.2d 195 (9th Cir. 1959).
decision upon the New York judgment invalidating the Mexican decree. He pointed out that if the Commissioner were now to bring an appeal from the related Tax Court decision which had held that the wife need not include in income the payments made by Borax, the Second Circuit would be hard pressed to meet her argument that she should not have to include the payments as alimony because, under the subsequent judgment of the New York court, she was indeed not divorced from Borax. Carrying Judge Friendly's opinion to its logical conclusion, one can imagine a situation in which a husband and wife, having been declared divorced in Mexico, might resume living together after the Mexican decree was declared invalid. Would all subsequent support payments made by the husband to the wife be deductible as alimony under the majority opinion in *Borax*? 101

In *Gersten* the husband and wife were residents of California. The husband obtained a divorce in Mexico and immediately thereafter remarried and attempted to file a joint return for federal income tax purposes with his second wife. The Ninth Circuit affirmed the Tax Court and held that the husband and second wife were not permitted to file a joint return. Even though there had been no express finding by a California court that the original Mexican divorce and the subsequent marriage were illegal and void, the Ninth Circuit so held for tax purposes and then went on to conclude that the husband and his second wife could not file a joint return. As Judge Friendly noted in his dissent in *Borax*, it is not possible to distinguish the Ninth Circuit opinion in *Gersten* from that of the majority of the Second Circuit in *Borax* simply on the ground that *Gersten* involved the filing of a joint return while *Borax* involved the question of whether alimony payments were deductible by the husband.

To be compared with *Gersten* is Louise Ross102 where the Tax Court held that payments received by the wife were alimony even though she had originally married her husband one day before he was divorced from his first wife. The second wife argued unsuccessfully that her marriage to the husband was therefore invalid and that there was no need for a subsequent divorce decree. The Tax

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101. A denial of alimony treatment in such a case presumably could not rest on the ground that the husband and wife were living together since the Regulations do not apply that requirement to section 71(a)(1).

102. 23 T.C.M. (CCH) 2061 (1964).
Court declined to decide this question, deferring instead to the state court which had granted the divorce and which had apparently passed on the validity of her marriage. The state court, in granting a divorce, apparently had found that, even though the wife had married her husband one day before his divorce from his first wife, such marriage was valid and there was need of a divorce decree to end the marriage.

Recently the Seventh Circuit disagreed with the Second Circuit over whether an earlier *ex parte* divorce which was later held to be invalid would control the question of who was the surviving spouse. In *Steffke v. Commissioner* the Seventh Circuit held that the later decision declaring the divorce invalid would control, while in *Spalding v. Commissioner* the Second Circuit, citing *Borax*, followed the earlier divorce decree.

The Second Circuit explained in a subsequent case, decided just eleven days after *Spalding*, that the state court decision declaring the divorce decree invalid would be respected only if that decision were from the state where the parties resided.

**G. The Existence of a Decree, Instrument or Agreement**

Closely allied with the question of whether a decree is invalid, as discussed in *Borax* and similar cases, is the question of whether the required decree, instrument or agreement as specified in section 71(a) was ever in existence. In *Sylvia E. Taylor* the Tax Court took a rather strict view of this requirement. The court held that no decree could be found. The wife had requested an award of temporary alimony which had been denied by the state court on the ground that the husband was already paying her $60 per week on a voluntary basis. In another similar situation, the husband was denied a divorce from his wife but was ordered to pay her $20 a week. The Tax Court held that these payments were not deductible alimony to the husband since they were not pursuant to a decree of divorce or separation and there was no evidence of a written separation agreement. It is not clear why these payments did not fall into

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103. 538 F.2d 730 (7th Cir. 1976).
104. 537 F.2d 666 (2d Cir. 1976).
105. Goldwater v. Commissioner, 539 F.2d 878 (2d Cir. 1976).
106. 55 T.C. 1134 (1971).
section 71(a)(3) which provides that alimony may be based upon a decree for support.

By contrast, the Internal Revenue Service has ruled in favor of a support order entered by a New York court based upon an *ex parte* divorce granted to the husband in a Florida proceeding which had not provided alimony to the wife. The Service ruled that the order by the New York court was within section 71(a)(3). It noted that:

> [t]he legislative history of section 71(a)(3) of the Code emphasizes that the factual status of whether the parties are living apart rather than their exact marital status in law is to be the key in determining whether amounts paid by the husband under a court order or decree for support of the wife are deductible.108

A common situation which is similar to payments made in the absence of a decree of divorce is the situation in which payments are made before they are required to be made by the decree. The Tax Court has held that such payments are not deductible as alimony.109 Because such payments are in advance of those called for in the decree, they are deemed gratuitous. They are not made pursuant to the husband’s obligation of support.

**H. Incident to Such Divorce or Separation**

Section 71(a)(1) requires that the payments be made in discharge of a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree of divorce or decree of separate maintenance. This section adds that the legal obligation may also be imposed upon or incurred by the husband under a written instrument “incident to such divorce or separation.”

For years, a controversy has existed as to whether the phrase “incident to such divorce or separation” meant incident to the *decree* of divorce or separate maintenance or whether it meant simply incident to the *status* of divorce or legal separation. If payment

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was required to be incident to the decree, further questions arose. Were written instruments executed before as well as after the decree to be included? Did the written instrument actually have to be referred to in the decree? In *Mahana v. United States*¹¹⁰ the Court of Claims in 1950 expressly declined to decide whether “incident to such divorce or separation” meant incident to the status of divorce or legal separation rather than to the decree. The court noted that resolution of the issue was not necessary to its decision since the payments in *Mahana* qualified as alimony under either interpretation.

In 1954 the Second Circuit, and in 1957 the Ninth Circuit, rendered decisions holding that “incident to the status” of divorce or legal separation was sufficient.¹¹¹ The Internal Revenue Service announced it would follow these decisions upon substantially similar facts.¹¹² The Treasury now seems to accept the status argument. The Regulations refer to “a written instrument incident to such divorce status or legal separation status.”¹¹³ Since 1954, moreover, the addition of sections 71(a)(2) and 71(a)(3) which now permit alimony pursuant to a written separation agreement or a decree for support, has brought under the alimony umbrella additional written instruments which might not otherwise be incident to either the status or the decree of divorce or separate maintenance.

Still, the issue continues to surface. Notwithstanding the position in the Treasury Regulations that “incident to the status” is sufficient, the Tax Court has continued to approach the problem somewhat differently. Although the Tax Court has held that the agreement must be incident to the decree, it has adopted liberal views on what is incident to the decree. According to the Tax Court, the agreement need not necessarily be mentioned in the decree.¹¹⁴ Indeed, the divorce decree need not mention an obligation for alimony. The question is one of fact which may be proved in other

¹¹⁴ Randal W. Clark, Jr., 58 T.C. 519 (1972).
ways, for example by oral testimony. In one case, the Tax Court held that a payment was alimony even though the agreement under which it was paid was not mentioned in the decree, and the wife had testified that the payment was intended as a property settlement.

I. Payments to Third Parties

A problem which is indirectly related to the husband's obligation of support can arise in the case of payments by the husband to a third party for the benefit of the wife. The question is whether the indirect benefit received by the wife is equivalent to a direct payment in discharge of the husband's obligation to support the wife. In Phillips v. United States, a district court in Florida held that the husband was not entitled to a deduction for payments to the wife's sisters. The payments served to discharge the wife's moral, but not legal, obligation to support her sisters. The wife, therefore, was not charged with alimony income and the husband's deduction was denied. In Robert Lehman, by contrast, payments by the husband to the wife's mother, whom the wife did have a legal obligation to support, were held to be alimony by the Tax Court.

It is difficult to distinguish these cases. The husband should get a deduction in either case if an indirect payment was agreed upon between the parties and if it substitutes for a direct payment. It is similar to the payment of life insurance premiums. The payments to the wife's sisters in Phillips did bestow a benefit on the wife just as much as the payments in Lehman if it is accepted that in Phillips the wife herself, would otherwise have made the payments to her sisters. The Internal Revenue Service has entered a non-acquiescence in Phillips.

Another common clause in a decree or property settlement agreement requires that the husband pay the wife's medical expenses. This is another example of an indirect payment that should qualify as alimony. It should make no difference whether the hus-

115. See Elizabeth W. McCullough, 27 T.C.M. (CCH) 360 (1968).
118. 17 T.C. 652 (1951), aff'd, 234 F.2d 958 (2d Cir. 1956), cert. denied, 352 U.S. 926 (1956). See also Melvin A. Christiansen, 60 T.C. 456 (1973) (acq.) (holding payments to the wife's niece and nephew of whom the husband and wife had legal custody before the divorce were alimony).
120. Illene Isaacson, 58 T.C. 659 (1972) (acq.).
band pays the doctor or hospital bills directly or reimburses the wife for them. In either case, the wife should have alimony income if the payments substitute for direct support payments. Premiums for medical insurance also should qualify as alimony. The wife would then be entitled to treat as medical expenses under section 213 all medical expenses or premium payments charged to her as alimony.

J. Alimony Trusts

As noted earlier, both section 71(a) and section 682 provide tax rules for alimony trusts. Section 71(a) governs those alimony trusts created pursuant to a decree of divorce or separate maintenance or pursuant to a written separation agreement. Alimony trusts not covered by section 71(a) are covered by section 682.

Historically, section 682 was enacted to eliminate the differences in tax treatment between alimony trusts which were created for reasons other than divorce or separation and trusts which were created in contemplation of divorce or separation. Trusts created pursuant to ante-nuptial agreements would be examples. Under section 682, any trust not created in contemplation of divorce will qualify for alimony treatment after the date of the divorce or separate maintenance decree or the property settlement agreement. For example, in A. M. Daniel the IRS apparently conceded that income from a trust which was received by the wife was taxable to her under section 682. The husband in A. M. Daniel had assigned part of his interest in a preexisting trust to his wife. This is surprising because absent section 682, section 71, with all of its complex rules, is the exclusive route to alimony treatment.

121. See F. Ewing Glasgow, 21 T.C. 211 (1953); Aline S. Fisher, 15 T.C.M. (CCH) 507 (1956).
122. If the payments are for past medical services, however, they might constitute separate lump-sum payments or installments of a fixed principal sum payable in ten years or less and thus not alimony under section 71(c). See F. Ewing Glasgow, 21 T.C. 211 (1953).
124. 49 T.C. 484 (1968) (acq.).
125. To be compared with A. M. Daniel is Richard T. Daniel, Jr., 56 T.C. 655 (1971), aff'd per curiam, 461 F.2d 1265 (5th Cir. 1972). In Richard T. Daniel the Tax Court held that amounts paid from a trust in which the husband had a beneficial interest were includible in his income since he had not transferred the beneficial interest to his wife. Because the amounts were not periodic payments, the husband was also not entitled to deductions under section 215.
The main difference under section 682 is the absence of the support requirement. Under section 682, the trust income is taxable to the wife regardless of whether the trust has any connection with the husband's obligation to support the wife.\(^\text{124}\) Because section 682 ignores the obligation-of-support requirement, it represents a pure income-splitting device. Thus, if Congress is really serious in achieving uniformity in the treatment of alimony trusts, section 682 represents a strong argument for also eliminating the support requirement from section 71.

Experience with the support requirement of section 71(a) trusts has uncovered a problem concerning the discretion given the trustee. If too much discretion is given to the trustee, the right to income may be held to be in satisfaction of obligations in addition to the husband's obligation of support. If there is too little discretion, the right to income may be held not broad enough to cover the husband's obligation of support. The Internal Revenue Service has held\(^\text{127}\) that even though a transfer in trust satisfied all of the formal requirements of section 71(a), distributions of income were not includable in the wife's gross income where the distributions were limited to purposes other than the general support of the wife.

Another problem under section 71(a) is whether the so-called trust conduit rules apply. The Internal Revenue Service has held that these rules do not apply, and all payments received by the wife from a section 71(a) trust are taxable to her as alimony payments (ordinary income) regardless of the nature of the income to the trust.\(^\text{128}\) The Sixth Circuit held in 1969, however, that a receipt by the wife of income which was tax-exempt income to the trust retained its character as tax-exempt income in the hands of the wife.\(^\text{129}\) The Internal Revenue Service disagreed.\(^\text{130}\)

With regard to section 682 trusts, the conduit rules clearly apply.\(^\text{131}\) Thus, capital gains remain taxable as capital gains to the wife, tax-exempt interest remains tax-exempt, and distributions out of trust capital are tax free. Looking ahead to the following discus-
sion on the income-splitting policy, if that policy were adopted as the sole policy governing all alimony payments, the trust conduit rules might serve as a starting point for solving the problem of separating income from capital.

Before leaving this discussion of trusts, however, it must be pointed out that although the use of a trust solves some problems, it creates others. One problem is whether a trust exists at all. Courts have wrestled with whether a transfer of property constituted an absolute transfer of the property to the wife or merely a temporary transfer in trust with the wife receiving only a beneficial right to the income from the property. In Micholas C. Miller, for example, the question before the Tax Court was whether a leasehold interest had been transferred outright to the wife or merely placed in trust. This question was complicated in Miller by the fact that the property in question, a leasehold interest, was in economic terms a mere right to income. The court, in holding that a transfer in trust had been effected, relied upon the formality of the transfer, the fact that both husband and wife joined in the transfer, and the fact that the wife was entitled only indirectly to the leasehold income.

The fact that a mere right to income was involved in Miller raises another interesting question. Can a trust be created to hold property which is no more than a mere right to income? Miller supports an affirmative answer in the case of leasehold interests, but an attempted transfer of a right to salary income, for example, might produce a different holding. If a trust is held not to exist, the attempted transfer might then be treated as an anticipatory assignment of income. The husband, not the wife, would be taxed on the income. The only recourse would be an argument that, after charging the income to the husband, the court should imply periodic payments from husband to wife which satisfied section 71. This might be pushing the court too far, especially since the original transfer was, in fact, a lump-sum transfer. If the transfer of the income rights to the trust were upheld, however, then section 71 (or section 682, if applicable) should clearly override the anticipatory assignment of income doctrine, and the income should be taxed to the wife and not to the husband as in Miller.

132. 49 T.C. 484 (1968) (acq.).
VI. The Requirement of Income-Splitting

A. Periodic Payments

Section 71(a) limits alimony treatment to "periodic payments." Thus a lump-sum payment will not qualify as alimony. If the duration of the payments is indefinite, so that it is impossible to be sure of the eventual total, the payments will be "periodic." This is true even of payments which extend only over a short time. Often, however, a series of payments is fixed either by stating a fixed total amount or by stating a fixed number of payments. In this case, section 71(c) comes into play.

B. The Ten-Year Rule

Section 71(c) represents a congressional attempt to draw an objective line between income divisions and capital divisions. It drew this line at installment payments extending for not more than ten years. Installment payments of a fixed principal sum extending for not more than ten years generally are treated as capital divisions, while installment payments extending for more than ten years are treated as "periodic payments."

By adopting the ten-year rule and the requirement of "periodic payments," Congress avoided the harder to prove question of whether the payments actually came from the husband's income. The Treasury Regulations state that alimony treatment does not depend upon whether the payments in fact came from the husband's income. Payments from the husband's capital can qualify as alimony so long as the ten-year test is met. As a practical matter, however, Congress knew that payments stretched out over a long term were more likely to come from current income whereas payments over a short term were more likely to come from the husband's capital.

Lest there be any doubt, the committee reports expressly state that the ten-year rule and the concept of "periodic payments" were intended, in a general way, to limit alimony treatment to payments out of the husband's income. The staff report of the Senate Fi-

133. I.R.C. § 71(c).
nance Committee, in support of the 1976 amendment that permits the section 215 deduction to be taken from gross income in arriving at adjusted gross income, stated:

It is argued that the splitting of income or assignment of income through the payment of alimony is not properly treated under current law since only an itemized deduction is allowed for alimony. The view often expressed is that the payment of alimony should be taken into account in determining net income.\footnote{137}

Objective though it may be, however, the ten-year rule has spawned a number of problems. The following sections are directed toward examining these vexing questions.

C. The Three Contingencies

The Treasury Regulations\footnote{138} state that if installment payments of an otherwise fixed principal sum are to extend for a period of ten years or less they will be considered periodic and thus will qualify as alimony “only if” such payments are subject to the contingency of (1) death of either spouse, or (2) remarriage of the wife, or (3) change in economic status of either spouse. The reason is that such contingencies prevent the existence of a fixed principal sum.

The limitation of the Regulations to three stated contingencies raises a question as to whether specifying other contingencies can cause installment payments to be considered periodic. It can be argued that in the Regulations the Treasury Department has attempted to restrict the relevant contingencies to the three expressly listed. On the other hand, it can be argued that other contingencies can also serve to destroy the existence of a “principal sum.” To reconcile this latter argument with the Regulations, it could be argued that the three contingencies listed in the Regulations will conclusively be presumed to destroy the existence of a principal sum whereas other contingencies may or may not have that effect but do not have the benefit of a presumption. If the taxpayer intends to rely on other contingencies, it is reasonable that he will have to prove that their effect is to destroy the existence of the principal sum. For example, this could be held to turn on whether the other contingencies were substantial and likely to occur.

\footnote{137. \textit{Joint Committee Staff Report for Senate Finance Committee}, Committee Print 3, (1976) (emphasis added).}
\footnote{138. \textit{Treas. Reg.} § 1.71-1(d)(3)(i)(a) (1957).}
The argument that the three listed contingencies are not exclusive might be implied indirectly by the Regulations which state that any of the three will have the effect of rendering the installments periodic regardless of whether such contingency is imposed by express language in the decree, instrument or agreement or is imposed by local law. These Regulations further state that the same result will accrue even if an aggregate principal sum is stated explicitly in the agreement or even if the aggregate principal sum may be calculated actuarially, for example, by reference to the life expectancy of the wife.

The existence of any of the three contingencies listed in the Regulations has one additional effect. If the payments are to extend beyond ten years so that they would be periodic in any event, but if they are also subject to any of the listed contingencies, then the ten percent rule in section 71(c) will not be applicable. That is, a large payment in one year can still qualify entirely as alimony even if it exceeds ten percent of the principal sum. This is presumably because the existence of such a contingency will have the effect of destroying the principal sum altogether thus rendering it impossible to calculate ten percent of anything. Again, the next question is whether other contingencies than the three listed could have the same effect.

The Treasury Regulations were adopted in 1957. They were based upon a series of cases which had held that the three contingencies of death or remarriage or change in financial circumstances destroyed a fixed principal sum. In *Myers v. Commissioner*, the Ninth Circuit held that specifying monthly payments of $250 for a period of six years was not sufficient to spell out a principal sum even though the total obviously was subject to exact mathematical calculations. In *Myers* the contingency of remarriage was expressly excluded. By contrast in *Baker v. Commissioner* and in *Smith's Estate v. Commissioner* the obligation to make payments was

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142. E.g., Davidson v. Commissioner, 219 F.2d 147, 149 (9th Cir. 1955) ("The existence of these contingencies [death or remarriage] makes it impossible to determine in advance with any degree of accuracy the amount to be paid under the decree").
143. 212 F.2d 448 (9th Cir. 1954).
144. 205 F.2d 369 (2d Cir. 1953).
145. 208 F.2d 349 (3d Cir. 1953).
expressly contingent upon death or remarriage. The Second and Third Circuits held that no principal sum existed. In *Baker* the Second Circuit expressly declined to decide whether a contingency of death by itself would be sufficient to destroy a principal sum, the wife's life expectancy being predictable actuarially.

In *Salapatas v. Commissioner*\(^1\) the Seventh Circuit, in 1971, upheld the Regulations and stated:

The purpose of the statute is to create a reasonably definite rule by which to distinguish, at least in an approximate way, between payments by a divorced (or legally separated) husband to his divorced (or legally separated) wife which represent a division of income for current needs of living from payments which represent a division or transfer of capital, and to shift the impact of the income tax from husband to wife with respect to the amounts of the former type of payment.\(^2\)

The court then went on to hold that the Regulations in question were valid since they served the purpose for which the statute was enacted.

Interestingly, the Seventh Circuit in *Salapatas* did not comment on the fact that the contingency which was upheld in that case was to the effect that the husband's obligation to make installment payments would terminate if the wife died before the full amount was paid unless their child was still a minor. The child was 15 years old at the time payments commenced and would have been just short of 23 years old at the time of the last payment. This contingency is not quite the same as the contingency of death specified in the Regulations. This lends some weight to the argument that the contingencies in the Regulations are not exclusive.

The Seventh Circuit decision in *Lemasters v. Commissioner*\(^3\) might be contrasted with its earlier decision in *Salapatas*. In *Lemasters* the court declined to find the contingencies of change in economic status and death of the wife sufficient to destroy the principal sum. The husband argued that a contingency as to economic status was introduced by an Indiana statute which provided that a separation agreement could be approved by a court in a subsequent divorce proceeding only if it was executed fairly, without fraud,

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\(^1\) 446 F.2d 79 (7th Cir. 1971), aff'd 28 T.C.M. (C.C.H.) 1205 (1969).

\(^2\) *Id.* at 82.

\(^3\) 466 F.2d 789 (7th Cir. 1972).
duress or undue influence. The Seventh Circuit dismissed this argument out of hand with the observation that such contingencies exist with respect to all contracts.

The taxpayer then argued that the Indiana succession statute provided that, if his wife predeceased him, he would inherit her estate which would include all her rights to future payments under the separation agreement. The husband argued that this amounted to a contingency which would cause his obligation to cease upon the death of the wife. The Seventh Circuit rejected this argument and noted that the wife could make a will or the expenses of her estate could intervene to deprive the husband of his right to receive back her rights to all future separation payments. Although the court in Lemasters does not expressly so state, by limiting its opinion to the contingencies in the Regulations, the court implied that no other contingencies could possibly have sufficed to destroy an otherwise fixed principal sum.

D. The Dates of the Ten-Year Period

Another issue which is raised by section 71(c) is when the ten-year period begins to run. This is often not as easy to determine as it may seem. Assume, for example, that the parties have entered into a property settlement agreement and then, at some later date, the agreement is incorporated into a divorce decree. Assume also that the payments are to extend for just under ten years from the date of the divorce decree but would extend for more than ten years if the date of the earlier property settlement agreement is used. Which date controls? If the earlier property settlement agreement date controls, section 71(c) is avoided and the payments are alimony.

In Joslin v. Commissioner the Seventh Circuit first held that the date depended upon whether the legal obligation to make the payments stemmed from the property settlement agreement alone or whether the subsequent divorce decree was necessary before the obligation became operative. In Joslin, however, a new twist was

149. 424 F.2d 1223 (7th Cir. 1970).
150. The court in Joslin cites numerous cases for its original proposition that the effective date depends upon which document, the property settlement agreement or divorce decree, is necessary in order to make the legal obligation effective. Among these are Estate of Spicknall v. Commissioner, 285 F.2d 561, 564 (8th Cir. 1961); Commissioner v. Blumm, 187 F.2d 177, 180 (7th Cir. 1951); Munderloh v. Commissioner, 48 T.C. 452, 458 (1967). In Spicknall, for
added. The Seventh Circuit first assumed, arguendo, that the taxpayer was correct; that the intent of the parties was to bind themselves to make the payments beginning with the earlier date of the property settlement agreement. Even so, the court found that under the law of Nevada, parties to a divorce are powerless to so bind themselves. The court found that the state divorce court may in its discretion cast aside and refuse to adopt any agreement which the parties might have entered into even though in the utmost good faith. Accordingly, the court held that the later date of the divorce decree controlled and the payments were not alimony.

The *Joslin* decision raises some interesting possibilities. Assume, for example, that the husband and wife entered into a written separation agreement to be effective immediately but never got divorced. Presumably, even in a state like Nevada, the date for purposes of determining the start of the ten-year period would be the date on which the written separation agreement was effective. This situation differs from *Joslin*. There the payments were not to commence until the divorce decree was entered. Next, assume that after a written separation agreement is signed and the payments commenced, a divorce decree is indeed entered under a statute like the Nevada statute and that the written separation agreement is approved. If the remaining payments under the written separation agreement have less than ten years to run from the date of the divorce decree, is their character automatically changed from alimony to non-deductible installments? Does that change relate back to the payments made prior to the divorce decree? What is the effect of the Treasury Regulation which provides that payments made pursuant to a written separation agreement may continue to be made under section 71(a)(2) (that is, under the agreement) even though a divorce decree is subsequently entered so long as the agreement continues in existence?151

Perhaps, in a state such as Nevada, a subsequent divorce decree would have the effect of splitting a single obligation into two obligations, one based upon the written separation agreement and a second later obligation based upon the divorce decree. If so, it is

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possible that both of them would end up being for less than ten years. The one based upon the written separation agreement arguably might still result in periodic payments because of the contingency (at the time the agreement was originally signed) as to when a divorce decree would be entered. On the other hand, such a contingency is not one of those listed in the Regulations. Thus, the problem comes full circle back to the question of whether a nonlisted contingency can serve to destroy the existence of a "principal sum." 152

A related question will arise from an agreement or decree which states that the husband's obligation to begin making payments starts on one date although the first payment is not due until, say, a month later. In Lillard v. Wiseman, 153 a district court in Oklahoma held that the earlier date commenced the ten-year period. Accordingly, the payments extended for more than ten years and were deductible as alimony. If a decree awarding alimony is appealed, the Tax Court has held that the ten-year period does not begin to run until the appellate court renders its decision. 154 On the other hand, the Tax Court recently held that the ten-year period began to run when the divorce decree was entered even though the decree did not become final until one year after that date. 155 It is virtually impossible to reconcile these opinions.

Similar problems arise concerning the termination date. The husband cannot simply stretch the payments to more than ten years and thus avoid section 71(c) if the decree, instrument or agreement does not, by its terms, permit him to do so. 156 Moreover, the Tax Court in Westhafer 157 held that an original period of less than ten years had not been extended to more than ten years by a court order specifying that an arrearage of $75 was to be paid on a date which turned out to be more than ten years from the starting date. The

152. See Furrow v. Commissioner, 292 F.2d 604 (10th Cir. 1961). The Tenth Circuit held that alimony payments prior to a divorce decree could not be tacked onto the period following the divorce decree for the purpose of producing a period which extended for more than ten years.
153. 57-1 U.S.T.C. (CCH) ¶ 9282 (W.D. Okla. 1956).
156. Section 71(c)(2) expressly requires that the "terms of the decree, instrument, or agreement" set the payment period. See also Robert D. Stecker, 31 T.C. 749 (1959), where it was expressly held that non-compliance with a ten-year term would not serve to extend the term to more than ten years.
TAXATION OF ALIMONY

court order related to back payments by the husband and thus did not serve to amend the original agreement but rather to bring the husband's payments back in line with the original agreement.

E. Unified Payments

A further problem relates to the manner in which a decree or agreement is drafted. The question is whether payments intended to be property settlements will be combined with other payments intended to be alimony so that all of the payments will qualify either as alimony or as a division of property. As a general rule, payments which are treated separately in the agreement or decree will not be lumped together into a unified plan. On the other hand, just because the agreement specifies two series of payments does not always mean that each will be characterized differently, one as alimony and one as a property settlement. In the cases of Enid P. Mirsky and William M. Haag the Tax Court held that two separate series of payments were both intended as alimony. In Haag, one of the series of payments was then disallowed as alimony however, because it was for less than ten years.

In S. Brad Hunt the taxpayer contended that payments under separate provisions of a settlement agreement should be treated as a unified plan with the result that the payments would extend for a period beyond ten years. In the settlement agreement, the husband had agreed to pay $150 a month until he had paid $15,000 (which would take place in less than ten years). Thereafter, in a separate clause, the agreement provided that the husband should annually pay to the wife the difference between the income from certain stock and $2,400. The court held that these two clauses should be construed separately with the result that the earlier payments, ending within ten years, did not qualify as alimony.

At the opposite end of the spectrum is the decree or agreement which in form states a single series of payments but which includes a balloon payment either at the beginning or the end of the series.

158. E.g., Edward Bartsch, 18 T.C. 65 (1952), aff'd per curiam, 203 F.2d 415 (2d. 1953); Estate of Frank C. Smith, 11 T.C.M. (CCH) 1167, aff'd, 208 F.2d 349 (3d Cir. 1953). See also Houston v. Commissioner, 442 F.2d 40 (7th Cir. 1971); Coker v. United States, 327 F. Supp. 169 (D. Nebr. 1971), aff'd per curiam, 456 F.2d 676 (8th Cir. 1972).

159. 56 T.C. 664 (1971).


Of course, even if the entire series is determined to be periodic and alimony, if it involves a fixed principal sum, section 71(c) might apply so as to limit the amount to be treated as alimony in any one year to a maximum of ten percent of the principal sum. If the series is subject to a contingency, however, or if no fixed principal sum is stated, the ten percent limitation will not apply. The question then becomes whether the balloon payment is to be treated as a separate, lump-sum, nonperiodic payment or as part of the series of periodic payments and alimony. Most often, if the balloon payment is substantially larger than the others, the parties will have a difficult time showing that it should not be treated as a separate nonperiodic payment. On the other hand, if the balloon payment is not substantially larger than the others, the parties may be able to convince the court that the balloon payment should be treated as part of a single series of periodic payments.

A similar issue is whether a series of payments should be divided if only part of the payments in that series is subject to contingencies such as death or remarriage while the remaining part is not. In 1972, the Tax Court held that such a series should be split into two series. The result was that one series, which was not subject to contingencies, fell within the ten-year rule of section 71(c) and thus lost its character as periodic payments.

F. Community Property

Special problems are presented in those states which have adopted the community property system. These involve differentiating between payments which are to be treated as alimony and payments which are simply property divisions. The eight states which have adopted the community property system are Washington, California, Texas, New Mexico, Nevada, Arizona, Idaho and Louisiana.

The landmark Supreme Court decision is Poe v. Seaborn, where the Court held that the income from community property should be taxed one-half to each of the spouses because they were

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163. See, e.g., Helen L. Hilgemeier, 42 T.C. 496 (1964); Wilma Thompson, 50 T.C. 522 (1968).
considered to be joint owners of that property. Therefore, upon a separation or divorce the parties must contend with the fact that the wife is already considered to be the owner of one-half of all the community property. Accordingly, payments by the husband to the wife, even though they may be cast in a periodic form, are not treated as alimony to the extent that they merely discharge the wife's claim against the community property. In other words, these payments fail to meet the requirement that they be made out of the husband's income.

A related distinction between community and noncommunity property states is that in community property states a division of appreciated community property does not result in gain or loss to the transferor. Under *Davis v. United States*, such a division would be considered a taxable exchange in a noncommunity property state.

**G. Indirect Payments**

In general, the form of the payment does not determine whether it qualifies as alimony or not. Payments may be in cash or other property. It matters not whether the payments come directly from the husband or from some other source pursuant to his direction. According to the Treasury Regulations, the payments may be direct or from property in a trust, a life insurance policy, an annuity or endowment contract, or any other interest in property. There are two areas involving indirect payments, however, which have caused problems. These are payments for improvements to a residence, and payments for insurance premiums. In each case, the issue is the same: Are the payments "periodic" payments or are they part of an underlying asset which constitutes a lump-sum transfer?

Payments for capital improvements to a residence cannot be deducted as alimony if the underlying property is not alimony. For example, in *Gentry v. United States*, payments by the husband for extensive repairs to the wife's house did not qualify as alimony.

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166. See Collins v. United States, 412 F.2d 211 (10th Cir. 1969), on remand from 393 U.S. 215 (1968), vacating 388 F.2d 353 (10th Cir. 1968); Ann Y. Oliver, 8 T.C.M. (CCH) 403 (1949); Frances R. Walz, 32 B.T.A. 718 (1935).
169. *Id.*
170. 283 F.2d 702 (Ct. Cl. 1960).
The transfer of the house itself was not alimony, and the repairs were therefore held by the Court of Claims to be nondeductible capital improvements.

Payments on a mortgage, are viewed differently. The Fourth Circuit had originally held that periodic payments did not qualify as alimony because the wife was obligated in the divorce decree to apply the payments to the mortgage on the house where the husband and wife owned the house jointly. The Internal Revenue Service later surrendered this victory, reversing its position in ruling that where husband and wife are joint owners, the portion of the mortgage payments made by the husband which relates to the wife’s equity in the house is alimony. This is true even though the payments are capital expenditures in the sense that they serve to increase the wife’s equity. If the husband’s payments result in an increase in his equity in the house, however, they will not be treated as alimony.

Where the husband rents a house for the wife to use, the Tax Court has held that the rental payments can qualify as alimony. On the other hand, if the husband buys the house and then lets the wife use it rent free, the fair rental value would not be deemed alimony because the initial agreement to let the wife use the house would be a lump-sum transfer.

Another common provision for indirect payment in property settlement agreements and divorce decrees concerns life insurance. If the husband agrees to name the wife as the beneficiary of his life insurance policy and to pay the premiums, are the premium payments alimony? The key to whether insurance premiums qualify as alimony is whether the wife receives present economic benefits from the payments. If not, the wife will receive only a lump-sum benefit at death. Payments resulting in present economic benefits can be accomplished with certitude only by assigning to the wife formal

legal title plus all of the substantive ownership rights in the policy.\textsuperscript{177}

The ownership by the wife must not be merely a matter of form. If the wife is the formal owner with some rights while other rights of ownership are denied her, it is uncertain whether the premiums paid by the husband will qualify as alimony. In \textit{Stevens v. Commissioner}\textsuperscript{178} the Second Circuit reversed a 1969 decision of the Tax Court and held that the premiums were alimony. The wife was the record owner, but her right to receive the proceeds upon the death of the husband was limited to unpaid alimony, while her rights to change the beneficiary, borrow on the policy and surrender the policy were subject to court order. The Tax Court persisted in \textit{William H. Broderson},\textsuperscript{179} holding that premiums paid under similar circumstances were not alimony. \textit{Broderson} was reviewed by the full Tax Court and was not appealed. The earlier \textit{Stevens} case was distinguished on the grounds that it involved a whole life, rather than a term insurance policy. The court also offered the somewhat dubious distinction that in \textit{Broderson}, the husband had retained possession of the policy, whereas in \textit{Stevens} he had not.

To assure alimony treatment, not only must the wife presently own all the rights to the policy, her rights must be completely vested and nonforfeitable. The Court of Claims in \textit{Cosman v. United States}\textsuperscript{180} held that premiums were not alimony even though the wife was the record owner, because her rights were forfeitable if she remarried or if she failed to survive her husband. The court concluded that the wife had received no present economic benefit from the payment of the premiums.\textsuperscript{181} In \textit{Seligmann v. Commissioner}\textsuperscript{182} the Seventh Circuit, on facts similar to those in \textit{Cosman}, held that not only must the wife receive a present economic benefit, but also such benefit must be presently measurable in dollars and cents. The existence of a contingency that the wife might remarry and lose her rights to the proceeds deprived her economic interest of present

\textsuperscript{177} E.g., Kiesling v. United States, 349 F.2d 110 (3d Cir.), \textit{cert. denied}, 382 U.S. 939 (1965); Hyde v. Commissioner, 301 F.2d 279 (2d Cir. 1962); Lois A. Cole, 40 T.C.M. (P-H) ¶71,073 (1971); Rev. Rul. 70-218, 1970-1 C.B. 19.

\textsuperscript{178} 439 F.2d 69 (2d Cir. 1971), \textit{rev'd}, 28 T.C.M. (CCH) 711 (1969).

\textsuperscript{179} 57 T.C. 412 (1971).

\textsuperscript{180} 440 F.2d 1017 (Ct. Cl. 1971).

\textsuperscript{181} See also Weil v. Commissioner, 240 F.2d 584 (2d Cir. 1957); Griffith v. United States, 245 F. Supp. 678 (D. N. J. 1965), \textit{aff'd per curiam}, 360 F.2d 210 (3d Cir. 1966); Rev. Rul. 70-218, 1970-1 C.B. 19.

\textsuperscript{182} 207 F.2d 489 (7th Cir. 1953).
measurability. Thus the premium payments were held not to be alimony. The Tax Court also has held that premiums were not alimony where the contingency of the wife's death terminated the husband's obligation to keep up the premium payments.\textsuperscript{183} The stated rationale was that such contingency prevented the wife from having an absolutely vested present economic interest. The Third Circuit has agreed.\textsuperscript{184}

The opposite circumstance, in which the wife is not the record owner but does own all of the substantive attributes of ownership, may be sufficient to preserve alimony treatment for the premiums, but it presents risks. In \textit{Anita L. Ellis}\textsuperscript{185} the wife was named as irrevocable beneficiary although title to the policy remained in the husband's name. The premiums were held to be alimony by the Tax Court. However, the position of the Internal Revenue Service remains that failure to transfer record ownership of the policy to the wife prevents alimony treatment for the premiums.\textsuperscript{186}

Short of a transfer of all attributes but formal title, even the Tax Court has refused to find alimony. In \textit{Harold Ostrov},\textsuperscript{187} the Tax Court held the premiums not to be alimony because, although the wife was otherwise the complete owner and an irrevocably designated beneficiary, the husband reserved the right to borrow against the cash surrender value. It is not clear whether alimony treatment was denied because the borrowing destroyed only the cash surrender value or because it could also reduce the potential proceeds. If only the former, then, by analogy, premiums for term insurance might never qualify as alimony since term insurance has no cash surrender value.\textsuperscript{188} The Tax Court has come close to this view. It has held that premiums for term insurance owned by the husband but naming the wife as irrevocable beneficiary are not alimony.\textsuperscript{189} This is hard to defend without ruling out term insurance premiums altogether since being named the irrevocable beneficiary is the only major incident of ownership that term insurance provides. Some term insurance is

\begin{itemize}
\item[183.] James P. Bradley, 30 T.C. 701 (1958).
\item[184.] Kiesling v. United States, 349 F.2d 110 (3d Cir. 1965); Griffith v. United States, 245 F. Supp. 678 (D. N. J. 1965), aff'd per curiam, 360 F.2d 210 (3d Cir. 1966).
\item[185.] 32 T.C.M. (CCH) 736 (1973).
\item[186.] Rev. Rul. 57-125, 1957-1 C.B. 27.
\item[187.] 53 T.C. 361 (1969).
\item[188.] See Stevens v. Commissioner, 439 F.2d 69 (2d Cir. 1971), rev'g 28 T.C.M. (CCH) 711 (1969).
\item[189.] William H. Broderson, 57 T.C. 412 (1971).
\end{itemize}
renewable or carries level premiums for five years at a time, but these are minor incidents at best. Of course, one might argue that being named irrevocable beneficiary plus having the premiums paid does not result in a present economic benefit to the wife, but this argument appears weak since the wife would have a present economic benefit in that she would be relieved of the burden of applying for such coverage.

Even if the husband agrees to make an absolute present transfer coupled with a non-contingent promise to pay the premiums until his death regardless of what happens to the wife, such a transfer may present other tax problems. If the husband makes an absolute transfer of an existing insurance policy, the cash surrender value of the policy will be taxable to the husband to the extent that it exceeds the total premiums (the cost) paid by the husband. Moreover, it apparently will do no good to arrange the payment of the premiums so that the husband first pays an equivalent amount directly to the wife with a requirement that she pay the premiums herself. In Cosman v. United States, the Court of Claims held that such payments to the wife were not alimony since she was required to use them to pay the premiums on an insurance policy held in trust under which the wife was only a contingent beneficiary. It appears that the only safe way to render payments for insurance premiums taxable as alimony is to make the payments directly to the wife with no requirements that she use the money to pay the premiums. If the wife is not required to pay the premiums, the amounts paid directly to her should not be disqualified as alimony simply because she does in fact use them to pay the premiums.

VII. A Proposal for Reform

The two competing policies underlying the present taxation of alimony have been reviewed. The broad questions of legislative intent and the constitutionality of the taxation of alimony, as well as the relationships between the alimony provisions and other analogous areas of tax law have been examined, as have the numerous problems that have arisen in the more than thirty years of experience with the alimony provisions. The question remains, which is the preferable policy upon which to base the taxation of alimony:

190. Samuel Morrison, 15 T.C.M. (CCH) 740 (1956).
191. 440 F.2d 1017 (Ct. Cl. 1971).
should alimony payments be viewed as a splitting of the husband’s income, or should they be viewed as expense payments in discharge of his obligation of support?

The income-splitting policy seems preferable on several grounds. First, it would seem to reflect more closely the legislative history of alimony taxation. The legislature’s reasoning seems to be premised on the belief that a portion of the husband’s income is really the wife’s income. Second, the income-splitting rationale appears to be on firmer constitutional ground. The question would not be whether a payment from husband to wife could constitutionally be “income,” but rather whether the wife could stand in the husband’s shoes and thus derive “income” from the same sources as the husband could have done.

Third, the income-splitting policy would not come into conflict with the long-standing policy that support payments during a marriage are not income. A clear cut analogy to joint returns and community property income could be drawn. The *Poe v. Seaborn* holding would seem directly applicable. Finally, all of the practical problems inherent in the distinction between payments for support and payments for other marital rights would be avoided.

Still, a problem would remain in differentiating between payments of income and payments of capital. Claims against specific pieces of property would be controlled by the nature of that property as income or capital. As to sources of current income (borrowing an idea from section 682 trusts) the statute might contain a presumption that a payment was not out of current income unless secured by an assignment or pledge of a particular source of current income.

It might be simpler to administer a rule which states that all payments are considered to be out of current income, up to a maximum of one-half of the husband’s adjusted gross income each year, with no carryovers to future years. Even this rule might not yield readily predictable results to the wife if the husband’s income was uncertain or fluctuated widely. Further, there would be a problem in ensuring that the wife could discover at year’s end the husband’s income for the year.

Again borrowing from section 682, it would also seem fairer to adopt the conduit rule for all alimony payments. This would prevent capital gains and tax-exempt income from being converted

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arbitrarily into ordinary income in the hands of the wife, but this would simultaneously increase the complexity of the law as well as increase the problems the wife might have in predicting her taxes in advance and in obtaining information from the husband at year's end. If lack of certainty and the lack of communication should be regarded as problems of sufficient magnitude, the present ten-year rule could be retained, although, as noted above, this rule poses a plethora of additional problems.

All of these income versus capital problems could be avoided, of course, by adopting the obligation-of-support policy as the touchstone. Such a rule would allow a deduction for all payments for support even if the funds came from the husband's savings rather than current income. This would be consistent with the treatment of all other deductible expenses in that the source would be ignored. Practical problems then would flow from the need to distinguish payments for support from payments for other marital rights such as dower or the wife's statutory share. Payments for reasons not at all related to the marriage would be somewhat easier to distinguish, but would also present problems. For example, repayments of loans or of specific property which the wife originally had brought to the marriage might be confused with payments for support.

The current statute attacks this problem by requiring the obligation to be spelled out in one of the listed types of written documents. Still, the parties are not dealing at arms length over this point since both should agree that their goal is to keep their combined taxes as low as possible. Thus, the requirement of a writing does not add much. The parties are quite free to manipulate the document to suit their common purpose of reducing taxes. Even if a method were found for separating payments for support from other payments with some certainty, one might still question whether the husband ought to be allowed a deduction for what is really a personal expense. It is true that some extraordinary personal expenses such as major medical expenses and casualty losses are permitted as deductions, but alimony may not be perceived as falling into a similar category.

Also to be considered is the nondeductible treatment of support payments during a marriage. If a married couple files a joint return, denial of the deduction makes little difference. For those who do not file a joint return, however, consistency would demand that an equivalent deduction for the husband (with income to the wife) be permitted. One problem, however, would be in distinguishing be-
between deductible support and nondeductible gifts paid between married taxpayers who do not file joint returns. If this line could not be drawn and gifts had to be deductible as between married couples, the next logical step would be to allow a deduction for all gifts (with income recognized by the donee) and thus repeal section 102 altogether. Few would want to go this far, and since the delineation is so difficult, it would seem better not to use the obligation-of-support policy at all.

On balance, then, considerations of legislative history, constitutionality, consistency with the taxation of related areas (such as community property, support between married couples, gifts and joint returns), and especially the practical problems which have arisen under both policies, all seem to suggest that income-splitting is the preferable policy. Alimony treatment should apply to any payment by the husband to the wife out of his income.