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TAXATION-FEDERAL INCOME TAX-PAYMENTS UNDER WRITTEN AGREEMENT INCIDENT TO DIVORCE

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TAXATION—FEDERAL INCOME TAX—PAYMENTS UNDER WRITTEN AGREEMENT INCIDENT TO DIVORCE—Petitioner and her husband separated in January 1919 after marital difficulties. The following sequence of events transpired in the next four months: the husband employed detectives to follow his wife and discover evidence on which a divorce action could be predicated;

petitioner instituted proceedings for legal separation; a separation agreement was executed under which the husband was to give petitioner an initial payment of $200,000 and subsequent annual payments of $30,000 for her life; the husband began a suit for divorce to which petitioner counterclaimed for a divorce; a divorce was decreed in favor of petitioner. Petitioner did not ask for alimony, relying instead on the separation agreement which provided that it would be unaffected by a subsequent divorce. Petitioner failed to report as income the $30,000 received in 1942 and 1943 and a deficiency for those years was determined by the Commissioner. The Tax Court held these sums to be taxable income to the petitioner.[1] On appeal, *held,* affirmed. The conduct of the parties and the sequence of events demonstrated that the separation agreement was made in contemplation of divorce and payments made thereunder were "incident to" the divorce within the meaning of I. R. C., § 22(k). *Izrastzoff v. Commissioner,* (2d Cir. 1952) 193 F. (2d) 625.

Prior to 1942, alimony payments did not constitute taxable income to the wife nor were they deductible by the husband.[2] Congress sought to relieve the tax-harassed ex-husbands in the Revenue Act of 1942 which provided that payments made by a husband to his former wife under a decree of divorce or legal separation or under a "written instrument incident to such divorce" were includible in the gross income of the wife[3] and deductible from the gross income of the husband.[4] The principal case raises the much-litigated interpretation of the phrase "written instrument incident to such divorce." It is clear that there must be a decree of divorce or legal separation in the picture somewhere,[5] but the line between purely voluntary payments and payments under an instrument incident to the divorce has been difficult to draw. There should be little litigation concerning post-1942 agreements where the divorce lawyers have been forewarned that the safest way to bring these agreements within section 22(k) is to refer to the agreement in the divorce decree.[6] However, the bulk of the present litigation concerns pre-1942 agreements. These agreements fall into three categories: (1) those contracted subsequent to the divorce where there has been no previous support agreement, (2) those contracted subsequent to the divorce modifying agreements made incident to the divorce, and (3) those contracted prior to the divorce. An agreement made after the divorce where there has been no previous agreement is not "incident to the divorce" since the courts have construed "divorce" to mean the decree and not

[1] Estate of Daniel G. Reid, 15 T.C. 573 (1951).
[2] Gould v. Gould, 245 U.S. 151, 38 S.Ct. 53 (1917).
[3] I.R.C., §22(k).
[4] I.R.C., §23(u).
[5] Payments under voluntary separation agreement are not deductible by the husband, Charles L. Brown, 7 T.C. 715 (1946); Smith v. Commissioner, (2d Cir. 1948) 168 F. (2d) 446. Payments made under support order obtained by wife are not deductible by the husband. Frank J. Kalchthaler, 7 T.C. 625 (1946); Terrell v. Commissioner, (7th Cir. 1950) 179 F. (2d) 838.
[6] Treas. Reg. 111, §29.22(k)-(1)(a); Greer v. Schofield, 89 F. Supp. 75, affd. (5th Cir. 1951) 185 F. (2d) 551.

the continuing status of the parties.[7] Payments made under a subsequent agreement which modifies a previous agreement incident to the divorce come within section 22(k) to the extent of the amount specified in the original agreement,[8] but not as to any excess where the subsequent agreement increases the payments.[9] Where the agreement is contracted prior to or contemporaneously with the divorce it is not necessary that it make reference to the anticipated divorce or legal separation in order for it to be "incident to such divorce."[10] In the absence of such reference various tests are found in the decisions. Some say the agreement must be "a part of the package of the divorce,"[11] others say "made in contemplation of divorce,"[12] others state that mere contemplation of divorce is insufficient and would seemingly require that the agreement be conditioned upon a divorce,[13] or at least that both parties actually anticipated a divorce at the time of the agreement.[14] The court in the principal case does not attempt any final definition of the phrase, "incident to," but indicates that at least it is sufficient to show that "contemplation of divorce was a real possibility"[15] at the time the agreement was made. A liberal construction of the phrase "incident to" such as this court is disposed to use will help bring about the tax consequences that Congress sought to impose under sections 22(k) and 23(u). It is hoped that additional legislation will be enacted to extend the coverage of sections 22(k) and 23(u) to any enforceable support obligation contracted by the husband, regardless of the presence of a decree of divorce or legal separation.[16]

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[7] Ben Myerson, 10 T.C. 729 (1948); Cox v. Commissioner, (3d Cir. 1949) 176 F. (2d) 226.

[8] Dorothy Briggs Smith, 16 T.C. 639 (1951); Helen Scott Fairbanks, 15 T.C. 62 (1950), affd. (9th Cir. 1951) 191 F. (2d) 680. In Miriam Cooper Walsh, 11 T.C. 1093 (1948), affd. (D.C. Cir. 1950) 183 F. (2d) 803, the subsequent agreement recited that the previous agreement was rescinded rather than modified. The court held that no payments under the new instrument were deductible, thus placing a premium on form rather than substance.

[9] Frederick S. Dauwalter, 9 T.C. 580 (1947); Commissioner v. Murray, (2d Cir. 1949) 174 F. (2d) 816. The rationale of these decisions is that the husband is under no legal obligation to increase his support payments. Therefore any increase which he pays is purely voluntary and not deductible by him.

[10] The courts have recognized that such reference might make the agreement and the divorce subject to the charge of collusion. Robert Wood Johnson, 10 T.C. 647 (1948); Bertram G. Zilmer, 16 T.C. 365 (1951).

[11] Cox v. Commissioner, (3d Cir. 1949) 176 F. (2d) 226.

[12] Elizabeth E. Guggenheim, 16 T.C. 1561 (1951); George T. Brady, 10 T.C. 1192 (1948); Jessie L. Fry, 13 T.C. 658 (1949).

[13] Cecil A. Miller, 16 T.C. 1010 (1951).

[14] Joseph J. Lerner, 15 T.C. 379 (1950); George J. Feinberg, 16 T.C. 1485 (1951).

[15] 193 F. (2d) 625 at 628.

[16] At the time §22(k) was enacted, a decree of divorce or legal separation was thought necessary to prevent income tax evasion through fraudulent agreements which would place both husband and wife in lower tax brackets. Smith v. Commissioner, (2d Cir. 1948) 168 F. (2d) 446. This possibility has since been materially reduced by the split income provision of I.R.C., §51(b) which permits the husband and wife to file a joint return even though living apart.