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Federal Income Taxation: Alimony Deduction: "Fixed" Payments for the Support of Children

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that the court will limit its investigation to plaintiff's good faith when the action is commenced.

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Federal Income Taxation—Alimony Deduction—"Fixed" Payments for the Support of Children. A deficiency was asserted against the taxpayer because he took a deduction for the full amount of alimony paid to his wife. The Commissioner's contention was based on a provision in the divorce decree that "in the event that any of the [three] children . . . shall marry, become emancipated, or die, then the payments herein specified [which were awarded to the wife alone] shall on the happening of each such event be reduced in a sum equal to one-sixth of the payments which would thereafter otherwise accrue." He asserted that this provision bought one-half of the alimony payments within the terms of the predecessor of Section 71(b) of the 1954 Internal Revenue Code[1] as sums "fixed" for the support of children. Also, since such sums would not be included in the wife's gross income, they should not have been taken as deductions by the husband.[2] The Tax Court[3] agreed with the Commissioner and held that the decree "as a whole," fixed these payments for the support of the children. The Court of Appeals[4] reversed and held that this provision did not "fix" any sum that the wife was *obligated* to use for the support of the children prior to the happening of any of the contingencies. The United States Supreme Court granted certiorari and affirmed. It held that the intent of Congress was to provide certainty in this area and thus there must be a specific designation of amounts to be used for the support of children, and not an allocation based on inference or conjecture. *Commissioner v. Lester,* —U.S.—, 81 S. Ct. 1343 (1961).

Prior to this decision, there was a dispute in the Tax Court and the various circuit courts over the interpretation of Section 71(b). By granting certiorari,[5] the Supreme Court finally decided to take a position and settle the dispute. Provisions in divorce decrees which stated that a certain unqualified sum was to go to the wife, or that specified that

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[1] Section 22(k) of the Internal Revenue Code of 1939, as amended in 1942, provided: "This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband." Section 71 (b) contains substantially the same language: "Subsection (a) shall not apply to that part of any payment which the terms of the decree, instrument, or agreement fix, in terms of an amount of money or a part of the payment, as a sum which is payable for the support of minor children of the husband." In this article, further reference to the provision will be made to Section 71(b) only.

[2] See: Int. Rev. Code of 1954, §215.

[3] Lester v. Commissioner, 32 T.C. 1156 (1959).

[4] Lester v. Commissioner, 279 F.2d 354 (2d Cir. 1960).

[5] Certiorari was denied in Commissioner v. Weil, 353 U.S. 958 (1957), and Eisinger v. Commissioner, 356 U.S. 913 (1958).

a certain amount was to be paid to the wife and a separate portion paid for the support of the children have caused no difficulty. The dispute arose from provisions that gave a sum to the wife which was to be used for the support of herself and her children and was to be modified in the event she remarried or the children died or became of age.

The two opposing positions in the interpretation of Section 71(b) were the "liberal" and the "strict" views. The "liberals" were comprised of the Tax Court,[6] and the First,[7] Seventh[8] and Ninth[9] Circuits. Their interpretation of the section was that the decree was to be read as a whole, and if such reading disclosed that the parties had earmarked or had designated some portion for the support of the children, then such portion was to be "fixed" for such purpose by the decree.[10] Thus, this view would look at the modification provisions and would make an inference of an allocation from them. The Tax Court held that *any* of the contingencies for reduction contained in the modification provisions were sufficient to make this allocation,[11] but the court in *Eisinger v. Commissioner*[12] disregarded contingencies which might never come into being and held that these did not enter into a determination of an allocation. In view of the Service's ruling,[13] it seems that the "contingency which might never come into being" is the remarriage of the wife.

The "liberals" also contended that since the husband has the duty to support the children, it would be harsh and inequitable to the wife for a strained or an unnatural construction of the statute which shifts the tax burden from the husband to the wife.[14] The label on a decree should

[6] A list of all the cases of both positions can be found in the annotation in 4 A.L.R. 2d 252, §10, and the A.L.R. 2d Supplemental Service volumes. The Tax Court has consistently held, except in Seltzer v. Commissioner, 22 T..C. 203 (1954), and in Newcombe v. Commissioner, 20 P-H Tax Ct. Mem. 141 (1951), that the insertion of specific amounts in the modification provisions "fixes" part of the payments for the support of the children.

[7] Metcalf v. Commissioner, 271 F.2d 288 (1st Cir. 1959).

[8] Mandel v. Commissioner, 185 F.2d 50 (7th Cir. 1950).

[9] Eisinger v. Commissioner, 250 F.2d 303 (9th Cir. 1957).

[10] *Id.* at 308.

[11] Hirshon v. Commissioner, 27 T.C. 558 (1956), *rev'd,* 250 F.2d 497 (2d Cir. 1957); Weil v. Commissioner, 22 T.C. 612 (1954), *supplemental opinion,* 23 T.C. 630 (1955), *rev'd,* 240 F.2d 584 (2d Cir. 1957), *cert. denied,* 353 U.S. 958 (1957).

[12] *Supra* note 9, at 308.

[13] Rev. Rul. 93, 1959-1 CUM. BUL. 22. "The Service will follow the decision of the United States Court of Appeals in the *Weil* case on this issue in cases involving similar facts and circumstances. [The *Weil* case involved a decree which modified the payments *only* in the event of the wife's remarriage.] However, in determining whether payments made under a divorce decree or separation agreement are to be treated as alimony or whether a portion is for the support of minor children, the Service will continue to follow its position as set forth in the rationale of the decision of the United States Court of Appeals in the *Eisinger* case." For an argument as to why the remarriage clause should not be said to "fix" payments for the support of children see: Miller, *Courts, IRS, Struggle With Taxation of Alimony When Part Is Spent on Others,* 11 J. TAXATION 160 (1959).

[14] Eisinger v. Commissioner, *supra* note 9, at 308, and Mandel v. Commissioner, *supra* note 8, at 52.

not be controlling, especially where, as an afterthought, the parties do make some sort of an allocation.[15] Basically, this position maintains that by the insertion of specific amounts in modification clauses, the parties themselves can be said to have intended a certain part of the payment to be necessary for the support of the children.[16]

On the other hand, the "strict" view, made up of the Second[17] and Sixth[18] Circuits, held that there was no ambiguity in the language of Section 71(b). "Fixed" was construed in its usual sense of "to assign precisely; to make definite and certain."[19] In the decision of *Weil v. Commissioner,*[20] it was stated that "sums are 'payable for the support of minor children' when they are to be used for that purpose only. Their use must be restricted to that purpose, and the wife must have no independent beneficial interest therein." An intention to provide for the wife and she in turn to provide for the children is different from an intention to provide for the children specifically.[21]

Prior to the Second Circuit's holding in the *Lester* case, the "strict" view had never been faced with the type of provision that the rule in the *Eisinger* case was intended to govern. The *Weil* case provided for modification only in the event of the wife's remarriage, which had been considered one of the uncertain contingencies. In *Deitsch v. Commissioner*[22] there was no consistency in the amount of reduction when the various contingencies occurred. The *Lester* case did have this consistency in its modification provisions and did include reductions in the event of the death or the becoming of age of the child. But it also contained a provision that all the payments were to cease upon the remarriage of the wife. However, this can be considered as an uncertain contingency.

The *Lester* case, which is the only decision that actually can be compared with cases applying the "liberal" view, agreed with the rationale of

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[15] Ashe v. Commissioner, 33 T.C. 331, 335 (1959).
[16] Eisinger v. Commissioner, *supra* note 9, at 307-8.
[17] Weil v. Commissioner, 240 F.2d 584 (2d Cir. 1957); Hirshon's Estate v. Commissioner, 250 F.2d 497 (2d Cir. 1957); and Lester v. Commissioner, 279 F.2d 354 (2d Cir. 1960).
[18] Deitsch v. Commissioner, 249 F.2d 534 (6th Cir. 1957). It is interesting to note that the Sixth Circuit decided Budd v. Commissioner, 177 F.2d 198 (6th Cir. 1947), in favor of the "liberal" position. The court in the *Deitsch* case did mention, though, that the modification provisions in the *Budd* case "earmarked" the payments for the support of the children. In Solomon, *Some Recent Developments in the Taxation of Alimony and Support Payments,* N.Y.U. 16TH INST. ON FED. TAX. 787, 794-95 (1958), the author discusses this change of position and states that, "if the essential factor is whether the wife is free to use some of the funds, which the agreement might otherwise be deemed to designate as being for child support, for her own benefit . . . then the *Budd* case was incorrectly decided."
[19] Deitsch v. Commissioner, *supra* note 18, at 536.
[20] 240 F.2d 584, 588 (2d Cir. 1957).
[21] *Ibid.*
[22] *Supra* note 18.

the *Weil* case. The Second Circuit reasoned that the wife is given the whole sum to use as her best judgment dictates. The reduction in the modification provisions does not indicate that before the happening of such contingencies the wife's discretionary power has been limited to the amount specified. To allow an allocation based on the modification provisions would take away the wife's discretion entirely[23] and would logically allow a suit by the children to compel the mother to use certain amounts for their support. The court felt that this construction of Section 71(b) did not work any greater hardship on the wife than the effect of decrees that gave the wife a lump sum and contained no modification provisions. Congress must have realized that where the wife was given a lump sum, part of it would be used for the support of the children and yet it desired to tax the wife on it.

In affirming the "strict" view, the Supreme Court devoted much of its decision to a review of Congressional pronouncements at the time that this section was passed. The court quoted from the House and Senate Committee Reports which indicated that the new law was designed " ' to remove the uncertainty as to the tax consequences of payments made to a divorced spouse, . . . to produce uniformity in the treatment of amounts paid,' " and to assure the department of collecting a tax, since after paying the alimony, the husband might not have any money left for taxes.[24] The first draft of the section used the phrase, "specifically designated" instead of "fix," but this change was only to achieve a "more streamlined language."[25] Because of these statements, the court held that Congress intended that payments to the wife were to be included in her gross income unless the decree expressly specified or "fixed" a certain sum or percentage of the payment for child support, and "a sufficiently clear purpose" on the part of the parties is insufficient to shift the tax.[26]

The court stated that a person is taxed on income which he is free to enjoy at his own option, whether he sees fit to enjoy it or not. Here, the wife was free to spend the monies received as she saw fit, and therefore she should have been taxed upon this amount. This reasoning was considered by the court to be in conformity with the underlying philosophy of the Code because it gives "as great an internal symmetry and consistency as [the Code's] words permit."[27]

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[23] Lester v. Commissioner, *supra* note 4, at 357.
[24] Commissioner v. Lester, —U.S.—, 81 S. Ct. 1343, 1345 (1961).
[25] *Id.* at 1346.
[26] Commissioner v. Lester, *supra* note 24, at 1347.
[27] *Id.* at 1346. Although the court did not mention it, there is some authority for this "control" test in a statement in the House discussion of the bill by a Mr. Disney. "The amount of a husband's income which goes to the wife as alimony under a court order is in reality not income to him at all since he has no control over it as the use to which it is to be put. The bill recognizes this reality by permitting the husband to deduct so much of his income as is paid

Uniformity and consistency in the interpretation of Section 71(b) have been achieved by this decision. It is no longer necessary to determine whether the contingencies are certain or uncertain, and if certain, whether they provide a basis for an allocation. Also, the ingenuity of the draftsman is not of prime importance. The Supreme Court's decision abolishes any resort to deceptive modification provisions which would not have been held to "fix" a sum for the support of children. Such provisions formerly achieved practically the same result as provisions which were subject to an allocation by the "liberal" courts.[28]

Therefore, where a state statute allows a general alimony provision for the support of the wife and the care of the minor children,[29] the parties may bargain with one another to achieve the best possible tax result. One of the factors to be considered is which of the parties desires to take the $600 exemption for each of the children. If the husband would rather take a deduction for the full amount of the alimony paid instead of the $600 exemption, he might be able to persuade the wife to take a larger amount of alimony, which would include the money needed to pay the tax. No matter what result the parties agree upon, the law remains that where the payments are to the wife for her support and for the support of the children, such payments are to be included in her gross income regardless of any modification provisions. It is only when the decree specifically states, for example, that $300 is to be paid for the support of the wife, and $200 for the support of the children, that the amount for the support of the children is not included in the wife's gross income.[30]

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out in alimony." 1 SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAWS, 1953-1939 p. 1280 (1954). This "control" test is consistent with the definition of income subject to tax which was applied in Rutkin v. United States, 343 U.S. 130 (1952). There it was held that taxable income is possessed when the recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. This would occur when cash is delivered by its owner to the taxpayer in a manner which allows the recipient freedom to dispose of it at will.

[28] Articles which have discussed the various ways to draft decrees to escape an allocation are: Burke, *Gift, Estate and Income Tax Problems in Marriage and Divorce Arrangements,* 1959 TULANE TAX INST. 174, 201; Brawerman, *A Practical Approach to Tax Problems in Divorce and Property Settlement Agreements,* U. So. CAL. 1960 TAX INST. 753, 758-59; and Holland Piper, Bailey, and Sander, *Matrimony, Divorce and Separation,* N.Y.U. 18TH INST. ON FED. TAX. 901, 913 (1960).

[29] An example of such a statute is WIS. STAT. §247.26 (1959).

[30] Although the federal courts may not infer an allocation for tax purposes, this does not prevent the state courts from doing so for the purpose of modifying the decree. For a general discussion of the latter issue, see: *Allocation of Apportionment of Previous Combined Award of Alimony and Child Support,* 78 A.L.R. 2d 1110 (1961). The Supreme Court in the *Lester* case, *supra,* note 24, at 1346-47, recognized this power of the state courts, but held that even if such an allocation was made, the allocation would not affect its holding on the interpretation of Section 71(b).