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# ALIMONY AND THE INCOME TAX

## BACKGROUND AND EFFECT OF THE PROVISIONS IN THE REVENUE ACT OF 1942†

ALAN L. GORNICK

The provisions of the Revenue Act of 1942 relating to the treatment for income tax purposes of alimony and separate maintenance payments are revolutionary in the sense that this is the first time in the history of the income tax that Congress has legislated directly upon the matter.<sup>1</sup> The provisions represent a major operation. By them Congress intended to establish a uniform rule for the taxation of any and all payments received by a divorced wife in the nature of or in lieu of alimony; and, generally, "to treat such payments as income to the spouse actually receiving or actually entitled to receive them."<sup>2</sup> To accomplish this end, Congress necessarily had to make sweeping changes in the existing law dealing with the income tax treatment of the various means (such as trusts, annuities, life insurance settlements, *etc.*) usually employed by husbands to discharge their obligations to support their former wives. Like so many statutes which are the outgrowth of complications arising out of court decisions, the new provisions require a familiarity with the decisions which led the legislature to enact them. Consequently, in the interest of clarity and understanding, the background will be reviewed briefly, against which the new provisions may be silhouetted and their scope and effect determined.

### I. BACKGROUND

#### A. Direct Alimony Payments

In 1917, in the case of *Gould v. Gould*,<sup>3</sup> the Supreme Court held that alimony payments made directly to a divorced wife by her former husband pursuant to a court decree were not taxable as "income" to her under the Income Tax Act of 1913.<sup>4</sup> The opinion of the Court, rendered by Mr. Justice McReynolds, appeared to consider that because of the husband's legal and

†The writer gratefully acknowledges the helpful suggestions of Harrison Tweed, Esq.

<sup>1</sup>The provisions were adopted as Section 120 of The Revenue Act of 1942 [56 STAT. 816, 26 U. S. C. §§ 22(b)(2), 22(k), 23(u), 25(b)(2)(A), 171(a) and (b), 3797(a) (Supp. 1942)], amending various provisions of the Internal Revenue Code. Certain proposals were made by the Senate Finance Committee in this respect in its report on the Revenue Act of 1941 [SEN. REP. No. 673, 77th Cong., 1st Sess. (1941) 11, 32], but they were laid aside for later consideration. 87 CONG. REC. 7418, 7421 (1941).

<sup>2</sup>SEN. REP. No. 1631, 77th Cong., 2d Sess. (1942) 83; H. R. REP. No. 2333, 77th Cong., 2d Sess. (1942) 71.

<sup>3</sup>245 U. S. 151, 38 Sup. Ct. 53 (1917).

<sup>4</sup>38 STAT. 114, 166, c. 16 (1913).

moral obligation to support his wife, alimony merely represented her equitable portion of his estate. The Court relied upon the somewhat questionable precedent of *Audubon v. Shufeldt*,<sup>5</sup> which held that a claim for alimony does not constitute a provable debt in bankruptcy. In all probability, however, the motivating influence for the decision in the *Gould* case was the fact that any other determination would have led to double taxation, for the Court specifically pointed out that under the statute the husband was not allowed a deduction for such payments and, consequently, that his net income "subject to taxation was not decreased by payment of alimony under the court's order."<sup>6</sup>

Whatever the basis for the decision, however, it established the basic rule consistently adhered to thereafter that direct alimony payments made to a divorced wife under a decree of court are not taxable as income to her.

### B. Alimony Trusts

No trust or other agreement was involved in the *Gould* case, and, therefore, the question still remained open as to whether the income from alimony trusts, or allowances under a separation agreement, should be treated differently from outright alimony. The Board of Tax Appeals and the Commissioner found no difficulty in following the decision so far as direct payments under a separation agreement were concerned.<sup>7</sup> Since the revenue laws provided a specific plan for the taxation of trusts under which distributable income was taxable to the beneficiaries,<sup>8</sup> the problem with respect to alimony trusts was complicated by the question of whether the income from them should be treated as ordinary trust income or as alimony. For some twenty years after the *Gould* case the Treasury<sup>9</sup> and the lower courts<sup>10</sup> struggled with this prob-

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<sup>5</sup>181 U. S. 575, 21 Sup. Ct. 735 (1901).

<sup>6</sup>245 U. S. 151, 154, 38 Sup. Ct. 53, 53 (1917).

<sup>7</sup>Jane B. Coates, 3 B.T.A. 429 (1926); *Acq.* V-1 CUM. BULL. 2 (1926); *cf.* Commissioner of Corporations, *etc.* v. Dalton, 304 Mass. 147, 23 N. E. (2d) 147 (1939).

<sup>8</sup>Presently contained in §§ 161 and 162 of the Internal Revenue Code. 53 STAT. 66 (1939), 26 U. S. C. §§ 161 and 162 (1940). Corresponding prior law sections are §§ 161 and 162 of the Revenue Acts of 1936, 1934, 1932, and 1928, and § 219 (a) and (b) of the Revenue Acts of 1926 and 1924.

<sup>9</sup>The Treasury in 1920 ruled that income from an alimony trust was taxable to the husband. O. D. 399, 2 CUM. BULL. 156 (1920). A year later it revoked this ruling and stated that such income was taxable to the wife. O. D. 1092, 5 CUM. BULL. 190 (1921). Still later it returned to its earlier position and again ruled such income taxable to the husband on the ground that he was the true trust beneficiary. I. T. 2628, XI-1 CUM. BULL. 34 (1931).

<sup>10</sup>The Board of Tax Appeals and the courts adopted a distinction. Such income was held not taxable to the husband where he retained no interest in the trust principal except a remote reversionary one. *S. A. Lynch*, 23 B. T. A. 435 (1931), *review petition dismissed*, Feb. 5, 1932 (C. C. A. 5th). But where there was no irrevocable transfer of ownership, and the trust was established merely as collateral security, the husband was

lem. The conflict finally reached the Supreme Court in 1935 and the lengthy, but, unfortunately, not lucid, opinion in *Douglas v. Willcuts*<sup>11</sup> was the result. Applying the broad and elastic principle of constructive receipt<sup>12</sup> to the particular facts before it, the Court held the income of the alimony trust created by Mr. Douglas for the support of his divorced wife taxable to him. In doing so it stated that it did "not regard the provisions of the statutes as to the taxation of trusts" as intended "to apply to cases where the income of the trust would otherwise remain, by virtue of the nature and purpose of the trust, attributable to the creator of the trust and accordingly taxable to him."<sup>13</sup>

The Court apparently did not hold that the income from all alimony trusts should be taxable to the husband, but rather limited taxation to him of income from trusts which he might be deemed to have constructively received. Trouble immediately arose, therefore, because this elastic doctrine of constructive receipt could be given certainty only when translated into the combination of factors present in the *Douglas* case, namely, (1) a legal obligation imposed on a husband by local law to support his divorced wife, (2) incorporation of the trust agreement into the divorce decree, and (3) continuing jurisdiction in the court to revise its decree or the trust instrument, and, therefore, a continuing obligation on the part of the husband to pay alimony. A fourth factor, a provision in the trust instrument whereby the husband was to make up any deficiency in income should such income fall below the amount specified, was present but not specifically relied upon by the Supreme Court, although emphasized in later decisions of the lower courts.<sup>14</sup> The difficulties of the latter arose when one or more of these factors were absent, and their decisions necessarily often resulted in a process of factual addition and subtraction.<sup>15</sup> Fundamentally, confusion ensued because the case left open the vital question of whether income from an alimony trust was taxable to the husband only when there was a continuing obligation under

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held taxable. Frank Turner, 28 B. T. A. 91 (1933), *aff'd*, 71 F. (2d) 1018 (C. C. A. 2d, 1934); John M. Longyear, Jr., 28 B. T. A. 1086 (1933), *aff'd*, 77 F. (2d) 116 (App. D. C. 1935); *cf.* Arthur H. Van Brunt, 11 B. T. A. 406 (1928).

<sup>11</sup>296 U. S. 1, 56 Sup. Ct. 59 (1935).

<sup>12</sup>The Court cited *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, 49 Sup. Ct. 499 (1929) (income taxes of employee paid by employer) and *United States v. Boston and M. R. Co.*, 279 U. S. 732, 49 Sup. Ct. 505 (1929) (income taxes of lessor paid by lessee).

<sup>13</sup>296 U. S. 1, 9, 56 Sup. Ct. 59, 63 (1935).

<sup>14</sup>*Alsop v. Commissioner*, 92 F. (2d) 148 (C. C. A. 3d, 1937); *Glendinning v. Commissioner*, 97 F. (2d) 51 (C. C. A. 3d, 1938); *Cap. Andrew Tilles*, 38 B. T. A. 545 (1938); *E. T. Weir*, 39 B. T. A. 400 (1939).

<sup>15</sup>See, generally, Paul, *Five Years with Douglas v. Willcuts* (1939) 53 HARV. L. REV. 1; Note (1939) 52 HARV. L. REV. 804.

local law to pay alimony, or was always taxable to him by virtue of the creation of the trust, which may or may not have completely discharged his obligation to support.

After the lower courts had struggled with the confusing doctrine of the *Douglas* case for about five years, the Supreme Court again considered the problem in the related cases of *Helvering v. Fitch*,<sup>16</sup> *Helvering v. Fuller*,<sup>17</sup> and *Helvering v. Leonard*.<sup>18</sup>

In the *Fitch* case, which involved an Iowa divorce,<sup>19</sup> the majority of the court by interpretation limited the *Douglas* case to the principle that income from an alimony trust is taxable to the husband only when it is used to discharge a "continuing obligation" of the taxpayer "to support his divorced wife."<sup>20</sup> It held that a husband, in order to sustain "the burden of establishing that his case falls outside the general rule expressed in *Douglas v. Willcuts*" must produce "clear and convincing proof" that "local law and the alimony trust have given the divorced husband a full discharge and leave no continuing obligation however contingent."<sup>21</sup> After making an independent examination of the law of Iowa, the Court declared that it was not convinced that the Iowa courts were without power "to modify alimony awarded in a lump sum or a property settlement ratified by a divorce decree"<sup>22</sup> and, accordingly, held that Mr. Fitch remained taxable on the income of the trust.

In the *Fuller* case, the Supreme Court applied the rule of the *Fitch* case and held that the husband had shown that the local law (Nevada) there involved and the trust instrument gave him a full discharge and imposed no continuing obligation upon him.<sup>23</sup> The Court, after reviewing the Nevada

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<sup>16</sup>309 U. S. 149, 60 Sup. Ct. 427 (1940).

<sup>17</sup>310 U. S. 69, 60 Sup. Ct. 784 (1940).

<sup>18</sup>310 U. S. 80, 60 Sup. Ct. 780 (1940).

<sup>19</sup>The alimony trust in question was created a few years before the divorce while the taxpayer and his wife were separated and in settlement of a suit by her for separate maintenance. Certain premises (a hair tonic factory and a long-term lease thereon) were transferred to a trustee under provisions to pay the wife \$600 a month for her life and the balance to the grantor-husband for his life. In 1925 the wife filed suit for divorce in an Iowa court. A property settlement was agreed upon which included the trust agreement and, in addition, provided for a transfer to her by her husband of cash and certain shares of stock of F. W. Fitch Co. The divorce decree confirmed the property and alimony settlement. The claim of the Commissioner, to the effect that the income distributed in 1933 under the terms of this trust to the divorced wife should have been included in the husband's taxable income for that year, was sustained by the Supreme Court, Mr. Justice McReynolds dissenting.

<sup>20</sup>309 U. S. 149, 152, 60 Sup. Ct. 427, 428 (1940).

<sup>21</sup>*Id.* at 156, 60 Sup. Ct. at 430 (1940).

<sup>22</sup>*Id.* at 155, 60 Sup. Ct. at 430 (1940).

<sup>23</sup>Briefly stated, it appeared that the taxpayer and his wife, residing in Connecticut, entered into an agreement on July 25, 1930, in contemplation of divorce, which provided, among other things, for the creation by him of a trust of certain shares of stock of the

cases, expressed the opinion that the Nevada court retained no power to alter or modify the divorce decree. It also found that the trust agreement itself imposed no "continuing obligation" on the husband because he did not "underwrite the principal or income from the trust or any part thereof or make any commitments, contingent or otherwise, respecting them."<sup>24</sup> Accordingly, the majority held that the income from this trust was taxable to the wife.<sup>25</sup>

In the *Leonard* case, a majority of the Court applied the rule of the *Fitch* case and held that the taxpayer had not shown that the laws of New York there involved and the trust instrument gave him a full discharge and imposed no continuing obligation upon him. By the trust instrument, executed by the husband as an incident to the divorce subsequently obtained by his wife in New York, he guaranteed the payment when due of the principal and interest of certain bonds of an oil company comprising part of the corpus of the trust.<sup>26</sup> Mr. Justice Douglas, who wrote the opinion for the majority of the Court, after a review of the New York cases, thought the husband had not established by "clear and convincing proof" that the settlement could not be modified by the courts of New York. Even though wrong in this respect, he thought the husband "clearly taxable" on "that portion of the trust income which was received from the guaranteed bonds" because the guarantee was a "continuing obligation."<sup>27</sup> Mr. Justice Reed concurred in the result while the

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Fuller Brush Company. The trust was to be irrevocable and was to continue for ten years, upon the expiration of which the principal was to be transferred to her outright. The wife repaired to Reno, Nevada, and obtained a divorce decree on November 12, 1930, which approved the agreement referred to. On December 22, 1930, the divorced husband created the trust provided for in the agreement.

<sup>24</sup>310 U. S. 69, 73, 60 Sup. Ct. 784, 787 (1940).

<sup>25</sup>Mr. Justice Reed in a separate dissenting opinion took the view that the husband should be taxed upon the income. In his opinion continuing liability was not the real basis for the decision in *Douglas v. Willcuts*, 296 U. S. 1, 56 Sup. Ct. 59 (1935), but rather "the prior appropriation, by the creation of the trust, of future income to meet an obligation of the taxpayer." Accordingly, in his view, it made no difference whether the creation of the trust did or did not discharge the husband's duty to support.

<sup>26</sup>It appeared that in 1928 the wife instituted a suit in New York for an absolute divorce. On June 4, 1929, while that suit was pending, the husband and his wife entered into a separation agreement and executed a trust agreement. Under the latter the husband contributed certain cash and securities which included \$400,000 principal amount of six per cent First Mortgage bonds of an oil company. The husband guaranteed the "payment when due of the principal and interest" on those bonds. The net income of the trust was to be paid \$5,000 a year to each of three children and the remainder to the wife during her life for her maintenance and support. The separation agreement incorporated the trust agreement by reference and, among other things, provided for the husband to pay his wife an additional \$35,000 a year during her life. The decree of divorce became final in October, 1929. It "approved and affirmed and made a part of the judgment herein" the separation agreement (which incorporated the trust agreement) and in addition directed the husband to pay the wife \$35,000 a year for her life.

<sup>27</sup>310 U. S. 80, 84, 60 Sup. Ct. 780, 783 (1940).

Chief Justice, Mr. Justice McReynolds, and Mr. Justice Roberts were "of the opinion that the judgment of the Circuit Court of Appeals" which held that the husband had no continuing obligation either under local law or the trust instrument,<sup>28</sup> should be "affirmed."

The continuing obligation theory thus established by the Supreme Court in the *Fitch*, *Fuller*, and *Leonard* cases had numerous bad aspects.<sup>29</sup> In order to determine who was taxable upon the income from an alimony trust, it was necessary first to decide whether the husband had (1) a "continuing obligation" to support his divorced wife either under (a) "local law" or (b) "the trust instrument." The concept of a "continuing obligation" in the first place was inherently indefinite, obscure, and confusing. For example, although the majority of the Supreme Court held otherwise, the Circuit Court of Appeals for the Second Circuit, and, apparently, at least three justices of the Supreme Court itself, did not think that the guaranteed payment of principal and interest in the *Leonard* case was a "continuing obligation."

In the second place, the existence of this indefinite concept was itself dependent upon local law which in most cases was equally, if not more, obscure, indefinite, and difficult of ascertainment.<sup>30</sup>

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<sup>28</sup>105 F. (2d) 900 (C. C. A. 2d, 1939).

<sup>29</sup>See, generally, Lowndes, *Community Income and Alimony* (1941) 20 TAXES 3; Gornick, *Taxation of Alimony Trusts—A Need for Congressional Reform* (1942) 20 TAXES 529.

<sup>30</sup>Particularly revealing in this respect, is the story of the trials and tribulations of Mr. Fitch subsequent to the Supreme Court decision in his case holding that he had not shown by "clear and convincing" proof that the law of Iowa imposed no "continuing obligation" upon him to support his wife. After that decision Mr. Fitch took the only avenue of escape seemingly left open to him—he filed a petition on May 7, 1940, in the District Court of the State of Iowa in and for Polk County, asking the court to modify the divorce decree entered on December 17, 1925. He stated that since that date his property and assets had diminished in value and "become impressed with a far greater burden than originally existed" because "for the year 1933, and years subsequent thereto, the United States Commissioner of Internal Revenue has determined that income of the aforesaid trust payable to the plaintiff, pursuant to the terms thereof, is constructively the income of the defendant in that said income is discharging the defendant's continuing obligation to support the plaintiff and that he is subject to the federal income tax thereon." Mr. Fitch's former wife responded by filing a motion to dismiss the petition on the ground that it showed "on its face that the decree of divorce entered herein was a final adjudication of all marital and property rights between these parties" and that the court retained no jurisdiction "either for the purpose of reallocating the income of the trust referred to or to redistribute any of the property involved in the settlement." The court sustained the motion to dismiss, declaring that under the law of Iowa it was without power "to modify, amend or change the decree of divorce entered herein or to reallocate the income of the trust referred to." This action of the district court was affirmed by the supreme court of Iowa on November 12, 1940. *Fitch v. Fitch*, 229 Iowa 349, 294 N. W. 577 (1940). The court severely criticized the United States Supreme Court's interpretation of the law of Iowa declaring that it was "of the opinion that this question has been considered, by the bench and bar of this state, fairly well settled," and that "as we read our decisions, we can find little room for doubt as to the attitude we have here-

Not only did the rule of the *Fitch*, *Fuller*, and *Leonard* cases impose an appalling interpretative burden upon taxpayers, but it also led to unjustifiable discrimination between taxpayers. First, it discriminated between men like Mr. Fitch, who were financially able to create trusts and thus avoid paying a tax on the alimony paid to their divorced wives, and men who were financially unable to create trusts, and, consequently, were required to pay the tax on the \$20, \$30, or \$50 weekly alimony paid by them out of their earnings directly to their divorced wives. Second, it destroyed any uniformity in the taxation of alimony trusts, for, under it, even in the same jurisdiction, some were taxable and others were not, depending upon the skill with which the draftsmen avoided incorporating any vestige of a "continuing obligation, however contingent" into them.<sup>31</sup> Third, the rule discriminated between taxpayers of different states, for in some states an alimony trust could be created which would discharge a husband's future obligations, while in others it could not.<sup>32</sup>

tofore taken in reference to this question." Mr. Fitch's troubles, however, were not yet over. Despite the Iowa decision, the Commissioner determined that Mr. Fitch was taxable on the income of the trust received by his divorced wife on the ground that the decision of the United States Supreme Court, relating to similar income for the year 1933, made the question as to income for subsequent years *res judicata*. A merciful Board of Tax Appeals, however, held to the contrary [F. W. Fitch, 43 B. T. A. 773 (1941)] and the Government finally acquiesced. 1941—1 CUM. BULL. 4.

<sup>31</sup>As Mr. Justice Reed in his dissenting opinion in the *Fuller* case aptly put it:

"We are now at the point where the taxability of the settlor depends not only on the 'clear and convincing proof' of the finality of the decree but the ability to produce that proof depends upon the skill of the draftsman of the settlement. Fine distinctions are necessary in reasoning but most undesirable in a national tax system."  
310 U. S. 69, 78, 60 Sup. Ct. 784, 789 (1940).

<sup>32</sup>It was held that a divorce obtained in the following states relieved a husband from any further obligation to support his former wife; and, therefore, that the income of an alimony trust created as an incident thereto was taxable to the wife: *Arizona*—Melville H. Haskell, 46 B. T. A. 592 (1942); *Connecticut*—Ingraham v. Commissioner, 119 F. (2d) 223 (C. C. A. 9th, 1941); *Illinois*—William H. Stanley, 41 B. T. A. 1233 (1940); *Maine*—Susan Sturgis Barry, 42 B. T. A. 592 (1942); *Nevada*—Helvering v. Fuller, 310 U. S. 69, 60 Sup. Ct. 784 (1920); *Ohio*—Henry M. Lucas, 44 B. T. A. 213 (1941); *Oregon*—Commissioner v. Nicolai, 126 F. (2d) 927 (C. C. A. 9th, 1942); *Pennsylvania*—Dixon v. Commissioner, 109 F. (2d) 984 (C. C. A. 3d, 1940); *Texas*—Ernestine Mitchell, 38 B. T. A. 1336 (1938); cf. *Pearce v. Commissioner*, 315 U. S. 543, 62 Sup. Ct. 754 (1942).

On the other hand, it was held that a divorce obtained in the following states, did not relieve a husband from any further obligation to support, and, therefore, that he remained taxable upon the income of such a trust: *California*—Murray Innes, 42 B. T. A. 93 (1940); *contra* after remarriage of the wife, Murray Brookman, 41 B. T. A. 557 (1940); *Iowa*—Helvering v. Fitch, 309 U. S. 149, 60 Sup. Ct. 427 (1940); but see the subsequent history of this case, note 30 *supra*; *Michigan*—Thompson v. Kavanaugh, 36 F. Supp. 263 (E. D. Mich. 1941); *New York*—Helvering v. Leonard, 310 U. S. 80, 60 Sup. Ct. 780 (1940). Similarly, as to French divorce, see *Havemeyer v. Helvering*, 121 F. (2d) 454 (C. C. A. 2d, 1941); and as to Latvian divorce before remarriage, see *Reginald B. Parsons*, 44 B. T. A. 1142 (1941).

Even though the local law relieved the husband from any further obligation to support,

Thus two trusts, precisely alike in every respect, drawn for the purpose of providing maintenance and support for a former wife, had different tax results depending upon the state of residence of the respective settlors or, at least, upon the state where the divorce was obtained. In this respect, if income taxes were of predominant importance, prospective divorcees were encouraged to migrate to states such as Nevada where the finality of the settlement was clearly established.

Moreover, the taxation of alimony trusts was further complicated by the fact that such trusts were subject to the limitations imposed by the Internal Revenue Code upon trusts generally. For example, even though a husband was given a full discharge by local law and the trust instrument, he might, nevertheless, still be held taxable upon the income paid to his divorced wife under Section 166 of the Code<sup>33</sup> if he retained a power to revest the corpus in himself,<sup>34</sup> or under Section 167<sup>35</sup> if the income might be distributed, or held or accumulated for future distribution to him,<sup>36</sup> or under Section 22(a)<sup>37</sup> if he retained sufficient control to be considered the owner of the trust property within the doctrine of *Helvering v. Clifford*.<sup>38</sup>

The situation with respect to the income taxation of alimony trusts thus facing Congress was, indeed, a troublesome and unhappy one. The rule improvised by the courts was confusing and unworkable. Moreover, under it the income from some trusts was taxable to the husbands, while the income from others was taxable to the wives. If clarity and uniformity were to be

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he was nevertheless held taxable where under the terms of the trust instrument he had a "continuing obligation" to make up deficiencies in trust income. *Alsop v. Commissioner*, 92 F. (2d) 148 (C. C. A. 3d, 1937) (French divorce: husband taxable notwithstanding wife's remarriage); *Glendinning v. Commissioner*, 97 F. (2d) 51 (C. C. A. 3d, 1938) (Pennsylvania divorce); *Weir v. Commissioner*, 109 F. (2d) 996 (C. C. A. 3d, 1940), *cert. den.* 310 U. S. 637, 60 Sup. Ct. 1080 (1940) (Pennsylvania divorce).

<sup>33</sup>53 STAT. 68 (1939), 26 U. S. C. § 166 (1940).

<sup>34</sup>Discussed generally in MONTGOMERY, FEDERAL TAXES ON ESTATES, TRUSTS AND GIFTS (1943) 166; 6 MERTENS, LAW OF FEDERAL INCOME TAXATION (1942) 311; MAGILL, TAXABLE INCOME (1936) 274. Cf. *Reinecke v. Smith*, 289 U. S. 172, 53 Sup. Ct. 570 (1933); *Corliss v. Bowers*, 281 U. S. 376, 50 Sup. Ct. 336 (1930); Note (1941) 132 A. L. R. 785.

<sup>35</sup>53 STAT. 68 (1939), 26 U. S. C. § 167 (1940).

<sup>36</sup>Cf. *Douglas v. Willcuts*, 296 U. S. 1, 56 Sup. Ct. 59 (1935); Note (1936) 101 A. L. R. 397; *Henry Martyn Baker*, 43 B. T. A. 1029 (1941); Note (1941) 132 A. L. R. 819.

<sup>37</sup>53 STAT. 9, amended 53 STAT. 574 (1939), 26 U. S. C. § 22(a) (1940).

<sup>38</sup>309 U. S. 331, 60 Sup. Ct. 554 (1940) (short term family trust; substantial control retained by settlor). In *Helvering v. Fuller*, 310 U. S. 69, 60 Sup. Ct. 784 (1940) [see note 23 *supra*], the Supreme Court, in passing the point because it had not been advanced, stated that the husband might also have been held taxable under the *Clifford* case because he retained considerable control over the trustee shares of stock. Cf. *Frank Turner*, 28 B. T. A. 91 (1933), *aff'd per curiam*, 71 F. (2d) 1018 (C. C. A. 2d, 1934). See generally, Note (1941) 132 A. L. R. 844; Pavenstedt, *The Broadened Scope of Section 22 (a)* (1942) 51 YALE L. J. 213.

achieved, therefore, a drastic and sweeping revision of the existing rule by Congress was imperative.

### C. Lump-Sum Settlements

No case, it seems, has ever held that in the event a husband discharges his obligation to support his former wife by a lump-sum settlement, the amount of the settlement is taxable as income to him, or that he will thereafter be taxable upon the income derived from it. On the contrary, the Supreme Court, in the *Fuller* case, *supra*, declared that if the husband "had not placed the shares of stock in trust but had transferred them outright to his wife as part of the property settlement," there would "be no doubt that income subsequently accrued and paid thereon would be taxable to the wife, not to him."<sup>39</sup> The income received by a wife from property so transferred to her, said the Court, "is to be treated the same as income accruing from property after a debtor has transferred that property to his creditor in full satisfaction of his obligations."<sup>40</sup> This general rule, however, it would seem, would not be applicable in case the husband retained any substantial right or interest in the property transferred, for, in such event, he might be deemed the owner for purposes of the federal revenue laws.<sup>41</sup>

Since a lump-sum settlement in lieu of alimony was not generally taxable as income to the husband, would the transaction constitute a gift subject to the gift tax? This question was answered in *Commissioner v. Mesta*,<sup>42</sup> in which it was held that a lump-sum settlement in lieu of alimony did not constitute a gift, but was rather in the nature of a sale or exchange upon which gain was realized.<sup>43</sup>

### D. Life Insurance, Endowment, and Annuity Contracts

Like lump-sum settlements the proceeds of life insurance, in general, paid to a divorced wife by virtue of the death of her former husband were not taxable as income to her. Section 22 (b) (1) of the Internal Revenue Code<sup>44</sup>

<sup>39</sup>310 U. S. 69, 74, 60 Sup. Ct. 784, 787 (1940).

<sup>40</sup>*Id.* at 75, 60 Sup. Ct. at 787.

<sup>41</sup>*Cf.* *Harrison v. Schaffner*, 312 U. S. 579, 61 Sup. Ct. 331 (1941); *Helvering v. Eubank*, 311 U. S. 122, 61 Sup. Ct. 149 (1940); *Helvering v. Horst*, 311 U. S. 112, 61 Sup. Ct. 144 (1940); *Helvering v. Clifford*, 309 U. S. 331, 60 Sup. Ct. 554 (1940).

<sup>42</sup>123 F. (2d) 986 (C. C. A. 3d, 1941), *cert. den.* 316 U. S. 655, 62 Sup. Ct. 1290 (1942). *Accord:* *Commissioner v. Halliwell*, 131 F. (2d) 642 (C. C. A. 2d, 1942), *cert. den.* 318 U. S. —, 63 Sup. Ct. 1029 (1943); *Herbert Jones*, I. T. C. No. 160 (1943).

<sup>43</sup>The husband transferred 5200 shares of certain stock to his wife in settlement of all claims for support. The original cost of the stock was about \$7500, while its value at the date of transfer was approximately \$156,000. It was held that the difference was taxable to the husband as capital gain.

<sup>44</sup>53 STAT. 9 (1939), 26 U. S. C. § 22 (b) (1) (1940).

broadly exempted all amounts received by any beneficiary under a life insurance contract by reason of the death of the insured "whether in a single sum or otherwise," excepting only interest on undrawn proceeds.<sup>45</sup>

The situation, however, was different where amounts were paid other than by reason of the death of the insured under life insurance, endowment, or annuity contracts. Section 22 (b) (2) of the Internal Revenue Code,<sup>46</sup> generally, provided that such payments should be taxable to the recipients to the extent that they exceeded the premiums or other consideration theretofore paid. The Supreme Court, in *Pearce v. Commissioner*,<sup>47</sup> considered the income tax effects of such payments made to a divorced wife in lieu of alimony. In a divided opinion, the Court added a further refinement to the rule of the *Fitch*, *Fuller*, and *Leonard* cases, and held that the appellant wife, who obtained a divorce in Texas, was subject to tax on income received under an annuity contract purchased for her by her husband for a lump sum from an insurance company. The majority proceeded upon the ground that the wife had not shown that the husband was under "a continuing contractual obligation" to support her, nor that it was "doubtful and uncertain" that the Texas court retained control over the annuity contract.<sup>48</sup>

#### E. Support of Children

It had long been established that amounts paid by a husband, by means of a trust or otherwise, for the support of his minor children were taxable as income to him.<sup>49</sup> The fact that the husband and wife were, or became,

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<sup>45</sup>The Treasury Department, by regulation [see U. S. Treas. Reg. 103 § 19.22 (b) (1)-1], has attempted to reach proceeds payable in certain installments without apparent success. See *Allis v. La Budde, et al.*, 128 F. (2d) 838 (C. C. A. 7th, 1942); *Commissioner v. Buck*, 120 F. (2d) 775 (C. C. A. 2d, 1941); *Commissioner v. Winslow*, 113 F. (2d) 418 (C. C. A. 1st, 1940).

<sup>46</sup>53 STAT. 9 (1939), 26 U. S. C. § 22 (b) (2) (1940).

<sup>47</sup>315 U. S. 543, 62 Sup. Ct. 754 (1942).

<sup>48</sup>In a vigorous dissent, Mr. Justice Frankfurter, with the concurrence of the Chief Justice, said:

"The decisions of this Court dealing with the question before us have turned upon whether local law was uncertain as to the existence of a continuing obligation on the part of the husband to support the wife. The opinion of the Court now introduces another element, namely, whether the local law is uncertain as to the power of the state courts to remake the particular settlement. This, it seems to me, has no valid relation to the basic principle of tax liability that 'he who receives benefits should be taxed.' Whether a husband is benefited from the payment of monies to his divorced wife depends upon his obligation to her which the payment of the monies served to discharge, not upon the nature of the wife's interest in the property he has transferred to her. To introduce such an unwarranted refinement is to clog the administration of the revenue laws." *Id.* at 555, 62 Sup. Ct. at 760 (1942).

<sup>49</sup>*Helvering v. Schweitzer*, 296 U. S. 551, 56 Sup. Ct. 304 (1935); *Helvering v. Stokes*, 296 U. S. 551, 56 Sup. Ct. 308 (1935).

divorced and the specified payments were made directly to her for this purpose, made no difference.<sup>50</sup> In *Bok v. Rothensies*,<sup>51</sup> however, the District Court for the Eastern District of Pennsylvania made an exception to this rule and held that the husband was not taxable on any part of the income of a trust paid to a divorced wife for the support of herself and of minor children where there was no specific designation of the portion to be used for the support of such children.<sup>52</sup>

#### F. Summary

The rules generally governing the income tax treatment of alimony and separate maintenance payments at the time Congress enacted the Revenue Act of 1942, therefore, may be summarized as follows:

(1) Direct alimony payments made to a divorced wife under a decree of divorce, or under a separation agreement in lieu of alimony, were not taxable as income to her but rather to her former husband.

(2) The income from an alimony trust paid to a divorced wife might be taxable to the husband or the wife depending upon whether the husband (1) had a "continuing obligation" under either (a) "local law" or (b) "the trust instrument," and (2) had given up every interest in, and complete control over, the transferred property so as to avoid the effects of Sections 166 and 167 of the Internal Revenue Code, and the doctrine of the *Clifford* case.

(3) A lump-sum settlement was not taxable as income to either the wife or the husband, but the income from such a settlement thereafter was taxable to the wife. The husband might realize a taxable gain on the transfer.

(4) The proceeds of a life insurance policy paid by reason of the death of the insured to his former wife were exempt from tax. Amounts so paid other than by reason of death, under life insurance, endowment, or annuity contracts were taxable either to the wife or the husband depending upon whether (1) he had a "continuing contractual obligation" to support his former wife, or (2) local law retained control over the contract.

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<sup>50</sup>*Ingraham v. Commissioner*, 119 F. (2d) 223 (C. C. A. 9th, 1941); *Helvering v. Leonard*, 310 U. S. 80, 60 Sup. Ct. 780 (1940) (see note 26 *supra*); *Longyear v. Helvering*, 77 F. (2d) 116 (App. D. C. 1935); *Henry Martyn Baker*, 43 B. T. A. 1029 (1941). *Quaere* whether this would be so if the former husband had no obligation to support the minor children under the applicable local law. *Cf.* *H. Cecil Sharp*, 42 B. T. A. 336 (1940); *Commissioner v. Yeiser*, 75 F. (2d) 956 (C. C. A. 6th, 1935); *Yarborough v. Yarborough*, 290 U. S. 202, 54 Sup. Ct. 181 (1933).

<sup>51</sup>143 F. Supp. 377. (E. D. Pa. 1942), *aff'd per curiam* November 12, 1942 (C. C. A. 3d).

<sup>52</sup>*Compare Ingraham v. Commissioner*, 119 F. (2d) 223 (C. C. A. 9th, 1941), which held to the contrary on facts strikingly the same with the single exception that the settlor provided for repayment to him out of the trust income such sums as he might be obliged to spend for the support of the children.

(5) Amounts appropriated for, or paid to, a former wife for the support of minor children were taxable to the husband, except in the case where no specific amount was specified, for this purpose.

This summary reveals the confused status of, and the complete lack of uniformity in, the income tax treatment of divorce settlements as developed by the courts based upon settled legal analogies in the absence of any legislative guideposts. It also reveals that relief from this unfortunate situation could come only from the congressional enactment of a basic policy with respect to alimony in its tax laws. That enactment having been made, we may now turn to a consideration of it, and its effect on the stated rules.

## II. THE PROVISIONS OF THE REVENUE ACT OF 1942

### A. *Direct Alimony Payments*

In view of the existing wide variance in the income tax treatment of payments in the nature of, or in lieu of alimony, it was obvious that if Congress were to achieve its aim of producing uniformity it must necessarily first enact a broad general rule, and then amend other relevant provisions of the Internal Revenue Code to conform to it. This first task it achieved by adding a new subsection, designated "(k),"<sup>53</sup> to the end of present Section 22 of the Internal Revenue Code (relating to the definition of gross income), which new subsection is entitled "Alimony, *etc.* Income." The general rule, which broadly taxes alimony to the divorced wife rather than to the husband, is contained in the complicated first sentence of this new subsection which states that

"In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband."

Complementing this new Section 22 (k), an amendment to Section 23 of the Code (relating to deductions from gross income) incorporates a new subsection, (u),<sup>54</sup> by which the husband is allowed a deduction for payments includible in the wife's income under Section 22 (k).

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<sup>53</sup>56 STAT. 816, 26 U. S. C. § 22 (k) (Supp. 1942).

<sup>54</sup>56 STAT. 816, 26 U. S. C. § 23 (u) (Supp. 1942).

The rule thus established completely reverses *Gould v. Gould*,<sup>55</sup> and, accordingly, direct alimony payments hereafter made to a divorced wife are taxable as income to the wife under Section 22 (k) and deductible by the husband under Section 23 (u). It is to be noted that this treatment has also been extended by the Act to the case of a husband and wife who are not divorced but living separate and apart under a decree of legal separation. The Act also reverses the existing rule in this respect.<sup>56</sup>

New Section 22 (k), however, embodies many limitations to the stated general rule, which must be carefully noted:

(1) The rule applies only in case the wife is divorced or legally separated under a *decree* of divorce or of separate maintenance.

Thus no change has been made in the existing rule taxing to the husband payments made to a wife not legally separated from the husband, but living apart from him pursuant to an informal separation agreement.<sup>57</sup> Such cases are frequent, of course, where religious considerations compel the parties to forego obtaining a divorce. Congress might very well have extended the new rule to this situation. In all probability, however, the possibility of income tax evasion and the difficulty of disproving the *bona fides* of an informal separation compelled Congress to limit the rule to cases where a decree either of divorce or of legal separation has been obtained.

Some difficulty will no doubt be experienced in determining what is meant by a "decree." Does it mean only a decree of a court of law? Or does it include also an act of a legislature dissolving a marriage? The nature of the legislation, and the broad provisions of the statute would seem to compel a conclusion that it was the intent of Congress that the word "decree" should cover the pronouncement of any official tribunal authorized to dissolve a marriage or specifically to sanction a legal separation.<sup>58</sup> The same considerations would seem to compel a conclusion that "decree" does not necessarily mean a "final decree," and, accordingly, that the statute applies to temporary alimony awarded to a wife by an interlocutory or other preliminary decree. The Treasury Department in its Regulations covering the new provisions, how-

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<sup>55</sup>245 U. S. 151, 38 Sup. Ct. 53 (1917).

<sup>56</sup>See note 7 *supra*.

<sup>57</sup>See note 7 and text *supra*.

<sup>58</sup>It has been suggested that "decree" may be limited to mean only a decree recognized as valid and entitled to full faith and credit under *Williams v. North Carolina*, 317 U. S. 287, 63 Sup. Ct. 207 (1943). There is no warrant for such an interpretation in the statute. It would be regrettable if such a limitation were imposed by judicial construction, for in cases of this nature it would effectively lead to a transformation of the Tax Court into a court of domestic relations.

ever, has taken a contrary position and states that temporary alimony awarded to a wife pending a "final decree" is not taxable to the wife.<sup>58a</sup>

(2) The rule applies only to "periodic payments" received "subsequent to such decree."

(3) The rule applies only where the legal obligation being discharged arises out of the family or marital relationship "in recognition of the general obligation to support, which is made specific by the instrument or decree."<sup>59</sup> Thus, the section does not apply to that part of any periodic payment attributable to any interest in the property so transferred which interest originally belonged to the wife, unless, of course, she received it from her husband in contemplation of, or as an incident to, the divorce or separation.

(4) The section does not apply to that part of any periodic payment which, by the terms of the decree or the instrument, is specifically designated as a sum payable for the support of minor children of the husband.<sup>60</sup> Moreover, if an amount or portion is so fixed, but the amount of any periodic payment made is actually less than the amount specified to be made, then, to the extent of the amount which would be payable for the support of such children out of the originally specified amount, such payment is considered a payment for such support. For example, if the husband is by the terms of the decree required to pay \$200 a month to his divorced wife, \$100 of which is designated by the decree to be for the support of their minor children, and the husband pays only \$150 to his wife, \$100 is nevertheless considered to be a payment by the husband for the support of the children, and, accordingly, taxable to him.

Although there is no specific statement to this effect in the Act, the preceding provision implies, and it was the expressed intention of Congress, that if the periodic payments received by the wife for the support and maintenance of herself and of minor children of the husband without specific designation

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<sup>58a</sup>U. S. Treas. Reg. 103 § 19.22(K)-1, *Example (1)*.

<sup>59</sup>H. R. REP. No. 2333, 77th Cong., 2d Sess. (1942) 72. Similarly SEN. REP. No. 1631, 77th Cong., 2d Sess. (1942) 84. Compare the statement in *Douglas v. Willcuts*, 296 U. S. 1, 8, 56 Sup. Ct. 59, 62 (1935): "Amounts paid to a divorced wife under a decree for alimony are not regarded as income of the wife but as paid in discharge of the general obligation to support, which is made specific by the decree."

<sup>60</sup>Sec. 22 (k) provides:

"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. In case any such periodic payment is less than the amount specified in the decree or written instrument, for the purpose of applying the preceding sentence, such payment, to the extent of such sum payable for such support, shall be considered a payment for such support."

having been made of the portion for the support of the children, the entire amount is income of the wife.<sup>61</sup> This amendment, therefore, adopts the rule declared by the district court in *Bok v. Rothensies*,<sup>62</sup> and, consequently, whatever may be the final disposition of that case, the rule declared by the district court would seem to prevail for all taxable years to which the new provisions of the Code are applicable.

### B. Alimony Trusts

In order to make the general rule applicable to alimony trusts two new provisions were required. New Section 22 (k) includes within it the case where a husband's alimony or separate maintenance obligation is discharged through periodic payments attributable to property transferred in trust. Section 22 (k), however, specifically applies only to alimony trusts created pursuant to the divorce or separate maintenance decree or pursuant to a written agreement "incident" to the divorce or separation. It thus does not apply to the case of trusts which have been created prior to the divorce or legal separation. Moreover, as we have seen, under existing law, some alimony trusts were subject to the limitations of Sections 166 and 167 of the Internal Revenue Code, and, consequently, taxable to the husband even though they otherwise would not be, and, also that under Section 22 (a) of the Code the doctrine of *Helvering v. Clifford* has been declared applicable to certain other alimony trusts in order to achieve the same result.<sup>63</sup> Therefore, in order to bring any and all alimony trusts within the general rule enunciated in Section 22 (k) Congress added a new section, Section 171, to Supplement E (relating to taxation of trusts, estates, etc.) of the Internal Revenue Code. Subsection (a) of this new section, in part, provides, in sweeping terms, that there shall be included in the gross income of the wife, and not the husband, the amount of the income of any alimony trust which she is entitled to receive, and which, except for this new section, would have been taxable to the husband, regardless of Section 166, Section 167, or any other income tax provision.<sup>64</sup> In view

<sup>61</sup>SEN. REP. No. 1631, 77th Cong., 2d Sess. (1942) 86; H. R. REP. No. 2333, 77th Cong., 2d Sess. (1942) 74.

<sup>62</sup>43 F. Supp. 377 (E. D. Pa. 1942). See note 46 and text *supra*.

<sup>63</sup>See notes 33 to 38 inclusive and text *supra*.

<sup>64</sup>56 STAT. 817, 26 U. S. C. § 171 (Supp. 1942) (Income of an Estate or Trust in Case of Divorce, *Etc.*). This section reads in part as follows:

"(a) Inclusion in Gross Income.—There shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance the amount of the income of any trust which such wife is entitled to receive and which, except for the provisions of this section, would be includible in the gross income of her husband, and such amount shall not, despite section 166, section 167, or any other provision of this chapter, be includible in the gross income of such husband."

of the broad and sweeping terms contained in this provision, coupled with that of Section 22 (k), it would seem impossible to conceive of any case in which the income of a *bona fide* trust paid to a wife who is divorced or legally separated for her support and maintenance can hereafter be held taxable to the husband. The "continuing obligation" rule of the *Fitch, Fuller*, and *Leonard* cases, therefore, has been put finally to its well-merited death, and, it is to be hoped, has been effectively buried.<sup>65</sup>

It is apparent, however, that, in substitution for the difficulties connected with the former rule, the new provisions give rise to certain difficulties of construction. For example, under the general rule enunciated in Section 22(k), quoted above, taxability to the divorced wife of payments received from an alimony trust is predicated principally upon whether such payments come within the concept "periodic payments—attributable to property transferred (in trust or otherwise)." A "periodic payment" is an entirely new concept which is not defined anywhere in the new provisions except in the case of lump-sum settlements (discussed more particularly hereinafter) payable in more than ten installments. As applied to trusts, does the term mean "periodic" payments made from income of the trust? Or does it also include payments made from the corpus of the trust in the event it is necessary to invade corpus to make up an annual sum stipulated to be made in the trust instrument? If so, is it limited only to such cases in which the corpus may be invaded for a period exceeding ten years? If the term applies only to income payments, does it apply to such payments made from income derived

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<sup>65</sup>The alimony trust provisions of the new law, therefore, have the effect of reversing for taxable years beginning after their effective date the line of lower court decisions which, on the basis of the *Fitch, Fuller*, and *Leonard* cases, have held the income of particular trusts taxable to the husband. See *Havemeyer v. Helvering*, 121 F. (2d) 454 (C. C. A. 2d, 1941), *aff'g* B. T. A. Memo. Op. Nov. 9, 1940, Docket No. 98544; *Thompson v. Kavanaugh*, 36 F. Supp. 263 (E. D. Mich. 1941); *Henry Martyn Baker*, 43 B. T. A. 1029 (1941); *Murray Innes*, 42 B. T. A. 93 (1940); and other cases cited in note 32 *supra*. The new law thus brings such cases into conformity with the result of the cases which under the doctrine of the *Fitch, Fuller*, and *Leonard* cases held the income of particular trusts taxable to the wife, for typical examples of which see: *Bush v. Commissioner*, 133 F. (2d) 1005 (C. C. A. 2d, 1943), *rev'g* 45 B. T. A. 609 (1941); *Ingraham v. Commissioner*, 119 F. (2d) 223 (C. C. A. 9th, 1941); *Reginald B. Parsons*, 44 B. T. A. 1142 (1941); *Walter S. Halliwell*, 44 B. T. A. 740 (1941), *rev'd on another point*, 131 F. (2d) 642 (C. C. A. 2d, 1942); *Harry T. Nicolai*, 42 B. T. A. 899 (1940), *aff'd*, 126 F. (2d) 927 (C. C. A. 9th, 1942); *cf.* note 32 *supra*.

Thus, under the new law the income of a trust established to discharge a husband's alimony obligation to his former wife is taxable to her whether the husband has or has not a "continuing obligation" to support her under local law. This is true, of course, only so far as trust income is used to discharge an *alimony* obligation of the husband. To the extent that the trust income may be used to discharge other obligations of the husband-grantor, however, he still may be held taxable. See *Estate of William J. Garland*, 43 B. T. A. 731 (1941).

by the trust in the form of tax-free interest from government bonds? These and other questions remain to be resolved by judicial decision or further congressional clarification. In the meantime, it should be noted that the Treasury Department has ruled that the full amount of a "periodic" payment made to a divorced wife is taxable to her regardless of whether made from trust income or corpus, and, apparently, regardless of the period of possible corpus invasion.<sup>65a</sup> Under this interpretation the total amount subject to income tax possibly may exceed the actual combined income of a husband and wife for a given year. To illustrate: Suppose a husband's sole income in 1943 is \$12,000 salary; that under an alimony trust created as an incident to a New York divorce the wife is to receive \$3,000 annually from income if possible and, if not, out of corpus; and that the trust has income of only \$1,000 in 1943. The husband in his 1943 return will be required to report his \$12,000 salary, and his wife the \$1,000 of income received from the trust. However, she receives \$2,000 of trust corpus upon which she is also taxed under the Regulations. Thus together they are taxed a total of \$15,000 (\$12,000 to the husband, \$3,000 to the wife) whereas their actual combined income was only \$13,000. This obviously inequitable result is difficult to justify upon any assumed intent of Congress, particularly in view of the background and nature of the legislation.<sup>65b</sup>

Similarly to Section 22 (k), new Section 171 (a) excepts from its terms so much of the income of a trust as the decree, or trust instrument provides, in terms of an amount of money or a portion of such income, shall be payable for the support of minor children of the husband. It also contains a provision similar to that in Section 22 (k), discussed heretofore, that in case such income is less than the sum or amount specified in the decree or instrument, then, to the extent of the sum or amount which would be payable for the support of such children out of the originally specified payment, such payment shall be considered a payment for support. New Section 171 also makes the general rules for accounting for the income of a trust or estate applicable to that part of any periodic payment which is a distribution of the trust or estate and which is required under Section 22 (k) or Section 171 (a) to be included in the income of the wife. Section 171 (b), in this respect, provides that the wife entitled to receive the payment shall be considered as the beneficiary of the

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<sup>65a</sup>U. S. Treas. Reg. 103 §§ 19.22(K)-1 (b), 19.171-1 (a), 19.171-2, 19.23(u)-1.

<sup>65b</sup>It is interesting to note in this connection that the proposed amendments were recommended to Congress for adoption in order to relieve "hardships and inequities." See Statement of Randolph Paul, Tax Adviser to the Secretary of the Treasury, *Hearings Before the Committee on Ways and Means*, 77th Cong., 2d Sess. (1942) 92.

trust.<sup>66</sup> "It is contemplated under these provisions that the trust or estate will be entitled to a deduction in computing its net income for amounts required to be included in the wife's income under Section 22 (k) or Section 171 to the extent that such amounts are paid, credited, or to be distributed out of income of the estate or trust for its taxable year."<sup>67</sup>

### C. Lump-Sum Settlements

As has already been stated, the general rule is limited to "periodic payments." Since lump-sum settlements generally are not considered periodic payments, they are not covered by Section 22 (k), and, accordingly, the existing law, as previously outlined, continues as a general rule with respect to such settlements.<sup>68</sup> One important exception to the existing law in this respect, however, has been made, and that is that lump-sum settlements payable in certain installments are subject to the section, and, accordingly, taxable to the wife. It is generally provided in new Code Section 22 (k) that "installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument" shall be excluded from the concept of "periodic payments." But it is specifically provided that there shall be included in the concept of "periodic payments" an installment payment if the amount thereof is not more than ten per cent of such principal sum, or if such principal sum is required, by the terms of the decree or instrument, to be paid within a period ending more than ten years from the date of such decree or instrument. For this purpose, the portion of a payment of the principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be considered an installment payment for the taxable year in which it is received. To illustrate: If under the terms of the decree of divorce the husband is to pay the wife \$100,000 in installments of \$5,000 a year for twenty years, and in 1942, the husband pays the wife the regular \$5,000 installment plus \$10,000 in advance installments, or a total of \$15,000, only ten per cent of the principal sum (ten per cent of \$100,000) or \$10,000 is

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<sup>66</sup>56 STAT. 817, 26 U. S. C. § 171 (b) (Supp. 1942). This subsection provides:

"For the purposes of computing the net income of the estate or trust and the net income of the wife described in section 22 (k) or subsection (a) of this section, such wife shall be considered as the beneficiary specified in this supplement. A periodic payment under section 22 (k) to any part of which the provisions of this supplement are applicable shall be included in the gross income of the beneficiary in the taxable year in which under this supplement such part is required to be included."

<sup>67</sup>SEN. REP. No. 1631, 77th Cong., 2d Sess. (1942) 85. See also, H. R. REP. No. 2333, 77th Cong., 2d Sess. (1942) 73.

<sup>68</sup>See notes 39-43 and text *supra*.

to be considered a periodic payment includible in the wife's income for 1942 and deductible by the husband for 1942. Thus no income or deduction results under Section 22 (k) or Section 23 (u) from \$5,000 of the advance installment payment.

*D. Life Insurance, Endowment, and Annuity Contracts*

The full amount of periodic payments received under the circumstances described in Section 22 (k) is required to be included in the gross income of the wife regardless of whether such payments "are attributable to property placed in trust, to life insurance, endowment, or annuity contracts, or to any other interest in property, or are paid directly or indirectly by the obligor husband from his income or capital."<sup>69</sup> Possibly to make this result clear with respect to those amounts received from life insurance, endowment, and annuity contracts which otherwise would be excluded from gross income under Section 22 (b) (1) and (2) of the Code,<sup>70</sup> Congress amended Section 22 (b) (2) so as to provide that said subsection and subsection 22 (b) (1) "shall not apply with respect to so much of a payment under a life insurance, endowment or annuity contract, or any interest therein, as, under Section 22 (k) is includible in gross income."<sup>71</sup>

This amendment will no doubt present some difficulty in determining what payments from the sources referred to are includible in gross income under Section 22 (k). It would seem clear that if, as in *Pearce v. Commissioner*,<sup>72</sup> in order to meet an alimony obligation of \$500 a month, the husband purchases or assigns for the benefit of his former wife a commercial annuity contract from a life insurance, or other company, paying such amount, the full \$500 a month received by the wife is includible in her income, and no part of such amount is includible or deductible by the husband. The effect is not so clear, however, with respect to life insurance paid to a divorced wife by virtue of the death of the insured. If such insurance is paid in a lump sum it would seem not taxable as income to the wife because it could not be con-

<sup>69</sup>SEN. REP. NO. 1631, 77th Cong., 2d Sess. (1942) 84.

<sup>70</sup>53 STAT. 9 (1939), 26 U. S. C. § 22 (b) (1) and (2) (1940). Section 22 (b) (1) provides generally that amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise, shall be exempt from income taxation. Section 22 (b) (2), on the other hand, provides generally that amounts received other than by reason of the death of the insured, under a life insurance or endowment contract, shall be included in income to the extent that they exceed the aggregate premiums or consideration paid. It also provides that amounts received as an annuity shall be included in income to the extent of three per cent of the aggregate premiums or consideration paid therefor.

<sup>71</sup>56 STAT. 816, 26 U. S. C. 22 (b) (2) (Supp. 1942).

<sup>72</sup>315 U. S. 543, 62 Sup. Ct. 754 (1942). Cf. notes 47 and 48 *supra*.

sidered a "periodic payment" within the meaning of Section 22 (k). If such insurance is payable in installments covering a period of more than ten years, however, such payments appear to be taxable to the wife as "periodic payments" within the meaning of Section 22 (k) and the Regulations of the Treasury Department incorporating the new amendments so provide.<sup>73</sup> It is the writer's opinion that the same result should follow with respect to premiums paid by the husband after the divorce or legal separation on life insurance on his life payable to the divorced wife upon his death where the policy has been transferred to the wife, because such payments appear to be embraced within the concept of "periodic payments."<sup>74</sup>

In taxing the full proceeds of life insurance, heretofore ordinarily exempt from income tax in the hands of a divorced widow although paid in installments, the amendments again introduce a new inequity and a new discrimination—that between widows who are divorced and those who are not. The same observation, of course, may be made with respect to the taxation to a divorced wife, under the above provisions, of the full proceeds derived from endowment and annuity contracts without making any allowance for return of capital.

#### *E. Miscellaneous Amendments*

1. *Dependency Credit.*—As a necessary complement to the provisions in new Sections 22 (k) and 171 (a) respecting taxability of amounts payable

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<sup>73</sup>U. S. Treas. Reg. 103 § 19.22 (b) (1)-1. The amendment appears to have been designed to overrule, at least so far as alimony settlements are concerned, the decision in *Allis v. La Budde, et al*, 128 F. (2d) 838 (C. C. A. 7th, 1942), which held that installment payments under an insurance policy on the life of her deceased husband payable to the wife for ten years certain after her husband's death are exempt from tax under § 22 (b) (1) of the Revenue Act of 1934.

<sup>74</sup>Alimony settlements involving life insurance and annuity contracts open up many new problems and give promise of being the most fruitful source of litigation under the amendments. If a husband transfers a life insurance policy to his divorced wife, is the value of the policy to be treated as a lump-sum settlement or as a gift? Or is the transfer in the nature of a sale or exchange for a valuable consideration? If there is an irrevocable "gift" of a policy, and the husband thereafter pays the premiums, each premium payment may be a taxable gift. U. S. Treas. Reg. 79, Art. 2. Ordinarily where a life insurance policy has been transferred for a valuable consideration, payments on account of the death of the insured constitute income to the assignee to the extent that they exceed the sum of the consideration paid by the assignee and the premiums and other amounts subsequently paid thereon by such assignee. Internal Revenue Code § 22 (b) (2). Does this rule apply in case a policy providing for a single payment on death is transferred to a wife as part of the alimony settlement? See *Commissioner v. Mesta*, 123 F. (2d) 986 (C. C. A. 3d, 1941), *cert. den.* 316 U. S. 655, 62 Sup. Ct. 1290 (1942). Are the full proceeds of such a policy taxable if the insurance proceeds are payable in more than ten yearly installments? Will an outright transfer of a policy result in the realization of a gain by the husband? See *Commissioner v. Mesta, supra*. These and other questions involving settlements of this nature will in all probability be involved in litigation.

for the support of minor children, the dependency credit provisions of the Code have been amended<sup>75</sup> so as to provide that payments made to a wife for the support of minor children which are required to be included in her gross income under Section 22 (k) or Section 171 "shall not be considered a payment by her husband for the support of any dependent." Thus, where the portion of such payments for the support of minor children is not specifically designated, the wife, if actually contributing to the support of the children, is entitled to the credit for dependents, unless, perhaps, it is established that, independently of such amounts paid to the wife the husband or some one else upon whom the children are financially dependent is actually the chief support of such children. It appears that Congress also intended that similar rules should govern as respects the element of financial support in determining who is entitled to the head-of-family exemption.<sup>76</sup> There is nothing in the Act, however, which specifically so provides.

2. *Definitions.*—The new provisions throughout refer to the husband as the payor of the alimony payments and the wife as the recipient. A new definition was, therefore, added by Section 120 (f) of the Act to Section 3797 (a) of the Code (relating to definitions) providing that wherever appropriate the terms "husband" and "wife" shall include "former husband" and "former wife."<sup>77</sup> An important addition was made to this provision, however, to the effect that, if the payments described in such sections are made by or on behalf of the wife or former wife to the husband or former husband instead of vice versa, wherever appropriate to the meaning of such sections, "the term 'husband' shall be read 'wife' and the term 'wife' shall be read 'husband'."

With this rather deft and humorous touch Congress, acknowledging the realities of the situation, has provided that, at least so far as the income tax is concerned, a divorced knight errant of an American heiress receiving "alimony" payments from her, shall be considered a "wife" and, as such, taxable accordingly.<sup>78</sup>

3. *Effective Dates.*—The new amendments are, in general, made applicable only with respect to taxable years beginning after December 31, 1941. How-

<sup>75</sup>56 STAT. 818, 26 U. S. C. § 25 (b) (2) (A) (Supp. 1942), and 56 STAT. 805, 26 U. S. C. § 401 (a) (2) (Supp. 1942).

<sup>76</sup>SEN. REP. NO. 1631, 77th Cong., 2d Sess. (1942) 86; H. R. REP. NO. 2333, 77th Cong., 2d Sess. (1942) 74.

<sup>77</sup>56 STAT. 818, 26 U. S. C. § 3797 (a) (Supp. 1942).

<sup>78</sup>With regard to the granting of alimony to the husband by the laws of some states, see 2 VERNIER, AMERICAN FAMILY LAWS (1932) 303-308; see also Comment, *Alimony Pendente Lite for Husbands* (1923) 32 YALE L. J. 478.

ever, if the first taxable year after December 31, 1941, of the husband does not begin on the same date as the first taxable year, beginning after December 31, 1941, of the wife, such amendments will become applicable in the case of the husband on the first day of the wife's first taxable year beginning after December 31, 1941.<sup>79</sup>

#### F. Constitutionality

The constitutionality of the new provisions will no doubt be questioned in view of the fact that this is the first time that Congress has passed any legislation dealing specifically with the subject of the income taxation of alimony and payments in lieu thereof. Reliance for the position that such provisions are unconstitutional must necessarily be placed upon *Gould v. Gould*, which held that direct alimony payments made to a divorced wife are not "income" within the meaning of the Income Tax Act of 1913.<sup>80</sup> The *Gould* case, therefore, is not authority for the position that alimony payments are not "income" within the meaning of the Sixteenth Amendment.<sup>81</sup> The Court did not hold that alimony was not "income" in the substantive sense, that is, was not in its nature "income" to a recipient; rather, it held that it was not "income" in the definitive sense, that is, as defined, or used, by Congress in the Act of 1913. The case, therefore, is readily distinguishable.

On the other hand, the Supreme Court, in *Helvering v. Fitch*<sup>82</sup> and *Helvering v. Fuller*,<sup>83</sup> perhaps in doubt of the wisdom of the rule it was establishing in those cases, specifically pointed out that Congress, if it chose, might legislate otherwise. In the *Fuller* case, the Court said:

"This is not to imply that Congress lacks authority to design a different statutory scheme applying uniform standards for the taxation of income of the so-called alimony trusts."<sup>84</sup>

There would seem to be, therefore, little reason to doubt the constitutional validity of the new provisions.

<sup>79</sup>Revenue Act 1942 § 120 (g), 56 STAT. 816, 26 U. S. C. § 3797 (a) (Supp. 1942).  
<sup>80</sup>38 STAT. 114 (1913). As has been stated [see note 6 *supra* and text], the real basis for that decision appears to have been the desire on the part of the Court to avoid the double tax burden which would necessarily have resulted from a contrary decision. See also Lowndes, *Community Income and Alimony—Taxation under the Revenue Act of 1941* (1942) 20 TAXES 1, and Note (1918) 31 HARV. L. REV. 494.

<sup>81</sup>U. S. CONST. AMEND. XVI. It provides:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

<sup>82</sup>309 U. S. 149, 60 Sup. Ct. 427 (1940).

<sup>83</sup>310 U. S. 69, 60 Sup. Ct. 784 (1940).

<sup>84</sup>*Id.* at 75, 60 Sup. Ct. at 787.

It is, of course, arguable that alimony is not in its nature taxable income, and, therefore, that Congress cannot by legislation make it so.<sup>85</sup> However, there appears to be nothing in the nature of taxable income that would except alimony from being embraced within its definitive terms. Although, as Justice Holmes once observed in this respect, there is "nothing to be gained by the discussion of judicial definitions,"<sup>86</sup> nevertheless, since alimony is merely the "realization" by the divorced wife of her previously unsevered interest, resulting from the marriage relationship, in the property of her husband, it comes squarely within the classic definition contained in *Eisner v. Macomber*:<sup>87</sup>

"Here we have the essential matter: not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal;—that is income derived from property."

It is true, of course, that payments made during the marriage by a husband to his wife to be used for her maintenance are not considered as part of her taxable income.<sup>88</sup> But it does not follow that the substitute, which the law allows her upon divorce, and which she may use in her sole discretion for any purpose she desires, should deserve a similar tax immunity. The legal distinction, of course, is that she has "realized" income in the one case and not in the other. "A great part of the major decisions of the Supreme Court dealing with the concept of income, from *Eisner v. Macomber* to *North American Oil Consolidated v. Burnet* may be considered as involving various aspects of the problem of realization."<sup>89</sup> It is also true that alimony payments made to a wife may be exempt in her hands from attachment or garnishment by her creditors.<sup>90</sup> But, as pointed out by Mr. Randolph E. Paul, "this only shows that alimony is even better than the ordinary type of income."<sup>91</sup>

It is interesting to note in this connection that alimony is considered taxable

<sup>85</sup>*Eisner v. Macomber*, 252 U. S. 189, 40 Sup. Ct. 189 (1920); *Towne v. Eisner*, 245 U. S. 418, 38 Sup. Ct. 158 (1918); 1 PAUL AND MERTENS, LAW OF FEDERAL INCOME TAXATION (1934) 105.

<sup>86</sup>*United States v. Kirby Lumber Co.*, 284 U. S. 1, 3, 52 Sup. Ct. 4 (1931).

<sup>87</sup>252 U. S. 189, 40 Sup. Ct. 189 (1920).

<sup>88</sup>See *Rosa E. Burkhart*, 11 B. T. A. 275 (1928); O. D. 275, 1 CUM. BULL. 159 (1919); U. S. Treas. Reg. 103 § 19.24-1.

<sup>89</sup>MAGILL, TAXABLE INCOME (1936) 153.

<sup>90</sup>See 2 VERNIER, AMERICAN FAMILY LAWS (1932) 259-325; Munson, *Some Aspects of the Nature of Permanent Alimony* (1916) 16 COL. L. REV. 217.

<sup>91</sup>51 HARV. L. REV. 1, n. 6.

income to a divorced wife under the income tax laws of England<sup>92</sup> and the Netherlands.<sup>93</sup>

### III. CONCLUSION

This review of the alimony and separate maintenance provisions of the Revenue Act of 1942<sup>94</sup> against the inequitable and troublesome situation prevailing before their enactment, leads to the inescapable conclusion that Congress attempted to cover every conceivable payment that might be made as alimony or in the nature of alimony and to subject all such payments to a uniform rule. On the whole, this aim appears to have been achieved. That it has can no doubt be attributed to the opportunity for careful consideration over a period of more than a year which Congress obtained by postponing the enactment of the proposals advanced in 1941.<sup>95</sup> In view of the clearly expressed intent of Congress, and the all-embracing character of the provisions, and particularly in view of the fact that the treatment of all taxpayers in a certain group on an equal basis is fundamental to a just tax system, it is to be hoped that the courts, when called upon to construe the new provisions, will do so in the light of the congressional intent to achieve equality of treatment with respect to all taxpayers receiving, or paying, as the case may be, alimony or separate maintenance payments.

It is regrettable that the new provisions in the case of annuity and endowment settlements tax the full amount of the payments received by a divorced wife from such sources, whereas in the case of other taxpayers, an allowance is made for the amount of premiums or other consideration paid, and, in the case of life insurance paid by reason of the death of the insured, tax such insurance if paid to the divorced wife in certain installments, whereas such payments are exempt in the hands of other beneficiaries. It well may be that Congress did not intend this result, as the Senate Finance Committee Report states that the change in Section 22 (b) (2) of the Internal Revenue Code giving rise to this result was made for the purpose of correlating that provision with amendments made by other provisions of the Revenue Act of 1942.<sup>96</sup>

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<sup>92</sup>KONSTAM, *THE LAW OF INCOME TAX* (1940) 199, 217, 244, 341; Strangman, *Alimony and the British Income Tax* (1941) 19 TAXES 535.

<sup>93</sup>See J. A. L. Van Den Bosch, 26 B. T. A. 679 (1932).

<sup>94</sup>56 STAT. 816 (1942).

<sup>95</sup>See note 1 *supra*.

<sup>96</sup>"Minor technical changes have been made in this section of your committee bill (in subsection (d) which amends section 22 (b) (2), relating to annuities, etc.—) in order to correlate the amendments made by this section with amendments made by sections 164 (b) and 144 (c) of the bill." SEN. REP. No. 1631, 77th Cong., 2d Sess. (1942) 87.

The Treasury Department, however, in its Regulations under the new provisions makes no allowance for return of capital in the stated situations.<sup>97</sup> The result, of course, is inequitable and unjust and should be remedied by Congress.

Definition should also be made by Congress of the term "periodic payments," and of the word "decree," as used in Section 22 (k) of the Code in order to make it clear that "decree" means an official pronouncement of any duly authorized governmental authority, whether preliminary or final, and that a "periodic payment" does not include any payment made from corpus or from other than taxable income of an alimony trust.

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<sup>97</sup>U. S. Treas. Reg. 103 §§ 19.22 (b) (1)-1; 19.22 (b) (2) (A)-4.