5 T.C. 1014 (1945)

A lump-sum payment made by a husband to his wife pursuant to a court-ordered divorce settlement is not considered a gift for gift tax purposes.

Summary

This case addresses whether a lump-sum payment made by a husband to his former wife as part of a divorce settlement constitutes a taxable gift. The Tax Court held that such a payment, when mandated by a court decree, is not a gift. The court followed its prior decision in *Herbert Jones*, distinguishing cases involving antenuptial agreements. The dissenting judges argued that Supreme Court precedent had undermined the *Jones* decision and that transfers incident to divorce should be treated as gifts unless the transferor receives adequate consideration in money or money's worth.

Facts

Edmund and Velma Converse entered into a separation agreement in March 1941, where Edmund agreed to pay Velma $1,250 per month and establish a $100,000 trust for their daughter, Melissa. Velma subsequently obtained a divorce in Nevada. Edmund contested the initial agreement, advocating for a lump-sum settlement. The divorce court ordered Edmund to pay Velma $625,000 in lieu of the monthly payments, discharging him from further claims for support. Edmund also established the trust for Melissa.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Edmund Converse's gift tax for 1941 and 1942, based on the $625,000 payment to his former wife and a portion of the trust established for his daughter. Converse petitioned the Tax Court, contesting these determinations. The Tax Court ruled in favor of Converse regarding the payment to his wife, but against him regarding a portion of the trust for his daughter.

Issue(s)

1. Whether a lump-sum payment from a husband to his wife pursuant to a court-ordered divorce settlement constitutes a taxable gift.
2. Whether the portion of a trust established for a minor daughter, exceeding the amount required for her support, constitutes a taxable gift.

Holding

1. No, because the payment was part of a court-ordered settlement related to a divorce, following the precedent set in *Herbert Jones*.
2. Yes, because to the extent the trust exceeded the amount needed for the

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daughter's support, it was considered a gift.

Court's Reasoning

The Tax Court relied on its decision in *Herbert Jones*, which held that a lump-sum payment incident to a divorce is not a gift. The court distinguished Supreme Court cases like *Commissioner v. Wemyss* and *Merrill v. Fahs*, noting that those cases involved antenuptial agreements. The court acknowledged the Commissioner's argument that *Jones* was no longer good law but declined to depart from its holding. Regarding the trust for the daughter, the court held that to the extent the trust exceeded the amount legally required for her support, the excess constituted a gift.

The dissenting judges argued that the Supreme Court in *Wemyss* and *Merrill* had effectively overruled the *Jones* decision by holding that the relinquishment of marital rights is not adequate consideration for gift tax purposes, regardless of whether the transfer occurs before or after marriage. Judge Arnold, in dissent, stated, "if we are to isolate as an independently reviewable question of law the view of the Tax Court that *money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct*."

Practical Implications

This case highlights the importance of court approval in structuring divorce settlements to avoid gift tax implications. Although the Tax Court followed *Herbert Jones*, the strong dissent and subsequent Supreme Court cases suggest that the IRS may continue to challenge such settlements, especially if they appear disproportionate. Attorneys should carefully document the negotiations and the court's rationale for approving the settlement. Later cases have often distinguished *Converse*, emphasizing that the transfer must be directly related to the satisfaction of marital or support rights to avoid gift tax. The degree to which the transfer benefits the donor is a key consideration. Practitioners should also be aware of the potential gift tax implications of trusts established for children as part of a divorce settlement and ensure that the amount is reasonable for support purposes.

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