12 T.C. 692 (1949)

Payments made at intervals to a widow from her deceased husband's estate, pursuant to a prenuptial agreement and will, constitute taxable income to the extent such payments are made from the estate's income, regardless of whether the payments are considered a gift or bequest.

Summary

This case addresses whether monthly payments to a widow from her deceased husband's estate, as stipulated in a prenuptial agreement, are taxable income. The Tax Court held that to the extent these payments were made out of the estate's income, they are considered a gift or bequest of income and are taxable to the widow under Section 22(b)(3) of the Internal Revenue Code. This ruling clarified the tax implications of payments made under prenuptial agreements, especially in light of the 1942 amendment to Section 22(b)(3).

Facts

W.B. Townsend and Alice Morier entered a prenuptial agreement where Townsend agreed to pay Alice $300 monthly for fifteen years post his death, and a $20,000 lump sum thereafter, in exchange for waiving all other claims to his estate. Townsend died testate, confirming the prenuptial agreement in his will but not leaving Alice anything else. His estate paid Alice $300 monthly from the estate's income during 1942 and 1943. Alice did not report these payments as income.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Alice's income tax for 1943, arguing the $3,600 annual payments were taxable income. The Commissioner also disallowed corresponding deductions taken by the estate for the payments, taking the position that the payments were taxable to Alice. The Tax Court consolidated the cases for review.

Issue(s)

Whether monthly payments received by a widow from her deceased husband's estate, pursuant to a prenuptial agreement requiring such payments regardless of the estate's income, constitute taxable income under Section 22(b)(3) of the Internal Revenue Code to the extent they are paid from the estate's income.

Holding

Yes, because under Section 22(b)(3) of the Internal Revenue Code, as amended in 1942, a gift or bequest payable at intervals is considered a gift of income to the extent that it is paid out of income from property. Thus the payments are taxable income to Alice.

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Court’s Reasoning

The court relied on Section 22(b)(3) of the Internal Revenue Code, as amended by the Revenue Act of 1942, which explicitly addresses gifts and bequests payable at intervals. The court noted that Congress amended the law to ensure that such payments, to the extent paid out of income, are taxable to the recipient, reversing prior case law. The court stated, “The provision is that a gift payable at intervals shall be considered a gift of income for the purpose of the paragraph to the extent that it is paid out of income from property. That provision covers the present case precisely… since the gift was payable at intervals and the payments material hereto were all made out of income from the property constituting the corpus of the estate of the donor.” The court distinguished pre-1942 cases where such payments were not considered income to the recipient if payable regardless of income availability.

Practical Implications

This decision clarifies the tax treatment of payments made under prenuptial agreements and wills. It confirms that even if payments are structured as gifts or bequests, they are taxable to the recipient if they are paid out of income from property and are made at intervals. Attorneys drafting prenuptial agreements and wills must consider the tax implications for both the payer (estate) and the recipient, and advise clients accordingly. This case illustrates the importance of understanding the interplay between estate law, contract law, and tax law. It has been cited in subsequent cases involving similar issues, reinforcing the principle that the source of the payment (i.e., income vs. principal) is determinative of its taxability.

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