1951 Tax Ct. Memo LEXIS 153 (T.C. 1951)

Payments received by a divorced wife are considered taxable income if they are made under a written agreement that is incident to the divorce, meaning the agreement was executed in contemplation of the divorce.

Summary

The Tax Court addressed whether payments received by the petitioner from her former husband under a separation agreement were taxable income under Section 22(k) of the Internal Revenue Code. The court found the agreement was executed in contemplation of divorce and incident to it, making the payments taxable. The decision rested on the extensive negotiations leading to the agreement, its placement in escrow contingent on a divorce, and the swiftness with which the petitioner sought a divorce after the agreement's execution. This case clarifies the conditions under which separation agreements are considered 'incident to divorce' for tax purposes.

Facts

The petitioner and her former husband negotiated a property settlement for ten months, frequently discussing divorce. The petitioner signed a separation agreement on August 31, 1937. The agreement was placed in escrow, and its operation was contingent upon the petitioner obtaining a divorce. Only 12 days after the agreement was delivered to the husband's attorney, the petitioner established residency in Nevada and began divorce proceedings.

Procedural History

The Commissioner of Internal Revenue determined that payments received by the petitioner under the separation agreement were taxable income. The petitioner contested this determination in the Tax Court. The Tax Court sustained the Commissioner's determination, finding the payments includable in the petitioner's gross income.

Issue(s)

Whether payments received by the petitioner from her former husband under a written separation agreement are includable in her gross income under Section 22(k) of the Internal Revenue Code as payments received under a written instrument incident to a divorce.

Holding

Yes, because the separation agreement was executed in contemplation of the divorce and was incident to it, making the payments taxable income to the petitioner.

Court's Reasoning

The court reasoned that the separation agreement was incident to the divorce based on several factors. First, the parties engaged in extensive negotiations about the property settlement and divorce for months before the agreement was signed. Second, the agreement was held in escrow, and its operation was contingent upon the petitioner securing a divorce. The court stated, "No agreement can be more incident to a divorce than one which does not operate until the divorce is secured and would not operate unless the divorce was secured." Third, the petitioner initiated divorce proceedings immediately after the execution of the agreement. The court distinguished this case from prior cases such as *Joseph J. Lerner, 15 T.C. 379*, where there was no talk of divorce before the separation agreement, no escrow agreement, and the divorce action was not begun until more than a year after the agreement's execution.

Practical Implications

This case provides guidance on determining whether a separation agreement is 'incident to divorce' for tax purposes. It emphasizes the importance of examining the circumstances surrounding the agreement's execution, including pre-agreement negotiations, contingency clauses linking the agreement to a divorce, and the timing of divorce proceedings. Attorneys drafting separation agreements must consider these factors to ensure the intended tax consequences for their clients. This case also demonstrates that agreements held in escrow pending a divorce are strong indicators of being incident to divorce, affecting the taxability of payments made under the agreement. Later cases often cite *Guggenheim* when analyzing the relationship between separation agreements and divorce decrees to determine tax implications.