Frank P. Lillard v. Commissioner, 17 T.C. 791 (1951)

Payments made pursuant to a divorce agreement are considered 'installment payments' rather than 'periodic payments' for tax purposes when they represent a fixed sum payable in installments, especially when the agreement distinguishes them from separate alimony payments.

Summary

The Tax Court addressed whether payments made by Frank Lillard to his former wife under a divorce agreement were deductible as alimony. The agreement stipulated both a fixed sum payable in installments (paragraph 1) and a percentage of Lillard's income as ongoing alimony (paragraph 2). The court held that the fixed sum payments were 'installment payments' and not deductible because they represented a division of property, while the percentage-based payments were 'periodic payments' and thus deductible. This decision hinged on interpreting the agreement's terms and applying the distinction between periodic and installment payments under Section 22(k) of the Internal Revenue Code.

Facts

Frank Lillard and his wife entered into a separation agreement incident to their divorce. The agreement had two key payment provisions. Paragraph 1 required Lillard to pay his wife a fixed sum of $2,244.73 in installments. This sum was calculated as one-third of Lillard's net worth, as shown in a statement attached to the agreement. Paragraph 2 stipulated that Lillard would pay his wife one-third of his adjusted gross income from the previous year as alimony. The paragraph 2 payments were explicitly stated to be 'in lieu of alimony.' The Commissioner disallowed Lillard's deduction of the paragraph 1 payments.

Procedural History

Frank Lillard petitioned the Tax Court to review the Commissioner's decision to disallow the deduction of payments made to his former wife under paragraph 1 of their separation agreement. The Commissioner argued that these payments were not deductible because they were installment payments, not periodic payments as defined by Section 22(k) of the Internal Revenue Code.

Issue(s)

Whether payments made by the petitioner to his former wife under paragraph 1 of their separation agreement constitute 'periodic payments' as defined in Section 22(k) of the Internal Revenue Code, thus making them deductible under Section 23(u).

Holding

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No, because the payments under paragraph 1 of the agreement represent installment payments of a fixed sum tied to the petitioner's net worth, and are distinct from the 'periodic payments' intended as alimony under paragraph 2.

Court's Reasoning

The Tax Court distinguished between 'periodic payments' and 'installment payments' under Section 22(k) of the Code, referencing its prior decisions in *Ralph Norton, 16 T.C. 1216* and *Arthur B. Baer, 16 T.C. 1418*. The court emphasized that installment payments of a principal sum are not considered periodic unless they extend over more than 10 years, which was not the case here. The court interpreted the agreement as a whole, noting that paragraph 2 explicitly designated payments as 'in lieu of alimony,' while paragraph 1 provided for a fixed sum based on Lillard's net worth. The court stated that the agreement was 'quite clear' in establishing two separate obligations. It refused to combine the obligations into a single, entirely periodic payment. The court reasoned that because paragraph 1 payments were not 'periodic payments' under Section 22(k), they were not deductible under Section 23(u).

Practical Implications

Lillard clarifies the importance of clearly distinguishing between alimony and property settlements in divorce agreements. Attorneys drafting such agreements should explicitly label payments as either 'alimony' or 'property settlement' and structure payment terms accordingly to achieve the desired tax consequences. The case serves as a reminder that fixed-sum payments representing a division of assets are likely to be treated as non-deductible installment payments unless structured to extend beyond the 10-year threshold. Later cases have cited *Lillard* to emphasize the need to examine the substance of the agreement, not just the labels used, to determine the true nature of the payments. This case highlights how specific language in a divorce settlement can have significant tax implications, affecting both the payor and the recipient.

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