17 T.C. 344 (1951)

Payments made pursuant to a written agreement incident to a foreign annulment decree can be considered alimony for federal income tax purposes under Section 22(k) of the Internal Revenue Code if the annulment is treated as a divorce under foreign law for purposes of support.

Summary

The Tax Court addressed whether payments received by Lily Reighley from her former husband, Reginald Parsons, pursuant to a German annulment decree and related support agreement, were taxable as alimony under Section 22(k) of the Internal Revenue Code. The court held that the German annulment, which German law treated as a divorce for support purposes due to Parsons' knowledge of the marriage's nullity, qualified as a "divorce" under Section 22(k). Therefore, the payments Reighley received were taxable as alimony. The court also ruled that arrearages paid in 1945 for prior years were taxable in 1945, the year of receipt.

Facts

Lily Reighley, a German citizen, married Reginald Parsons, an American citizen, in Berlin in 1935. In 1936, Reighley sued for annulment in Germany, alleging she was unaware of Parsons' defects at the time of marriage. While the suit was pending, Parsons agreed in writing to pay Reighley $1,000 per month for life, regardless of remarriage. To secure payments, Parsons deposited stock with a Chicago bank, directing the bank to pay Reighley from the dividends. The Berlin District Court annulled the marriage in August 1936. Reighley remarried in 1938, and Parsons stopped payments. Reighley sued in Illinois to enforce the support agreement.

Procedural History

Reighley sued Parsons and the Chicago bank in Illinois state court to enforce the Berlin support contract. The Superior Court of Cook County ruled in Reighley's favor in 1942, which was affirmed by the Appellate Court of Illinois in 1944. The Supreme Court of Illinois affirmed in 1945. The bank then paid Reighley arrearages from 1939, including amounts for 1942-1944. The Commissioner of Internal Revenue determined a deficiency in Reighley's 1945 income tax. Reighley petitioned the Tax Court, contesting the taxability of the support payments and the inclusion of arrearages in 1945 income.

Issue(s)

1. Whether periodic support payments received under a written contract incident to a German annulment decree are taxable to the recipient under Section 22(k) of the Internal Revenue Code.

2. If the support payments are taxable, whether arrearages for 1942, 1943, and

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1944, which were paid in 1945 following a court judgment, are includible in the recipient's taxable income for 1945.

Holding

1. Yes, because the German decree is treated as a decree of divorce under Section 22(k) as German law allowed the innocent spouse to treat the annulment as a divorce for support purposes, and the support contract was incident to the decree.

2. Yes, because the taxable year for including the arrearages of Section 22(k) periodic payments is 1945, the year the payments were actually received.

Court's Reasoning

The court reasoned that Section 22(k) was enacted to create uniformity in the treatment of alimony, regardless of state law variances. The court noted that under Sections 1345 and 1347 of the German Civil Code, Reighley, as the innocent spouse, had the right to elect to treat the annulment as a divorce for support purposes, given Parsons' knowledge of the marriage's nullity. By entering into the Berlin support contract, Reighley effectively exercised this right. The court deferred to the Illinois Supreme Court's view that the German annulment was similar to a divorce under Illinois law, entitling the innocent party to alimony. The court also emphasized that the payments were made due to the marital relationship and under a written instrument incident to the decree. As to the arrearages, the court cited Treasury Regulations stating that periodic payments are includible in the wife's income only in the taxable year received. It rejected Reighley's argument that the payments should be taxed under trust principles, as Parsons retained title to the stock, and the bank was merely acting as his agent.

Practical Implications

This case provides guidance on the tax treatment of support payments arising from foreign decrees, particularly annulments. It emphasizes that the substance of the foreign law, and its treatment of annulments versus divorces for support purposes, will be considered. The ruling clarifies that even if a marriage is annulled, payments can still be considered alimony if the foreign jurisdiction treats the annulment similarly to a divorce regarding support obligations. It also reinforces the principle that alimony arrearages are generally taxable in the year received, unless specific trust provisions dictate otherwise. Practitioners should analyze foreign law carefully in determining the tax implications of support payments tied to foreign decrees.

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