19 T.C. 401 (1952)

A written agreement modifying alimony payments can be considered incident to a divorce, even if executed years after the divorce decree, if it resolves disputes arising from the original decree and related agreements.

Summary

The Tax Court addressed whether alimony payments received by Rowena Barnum pursuant to a 1941 agreement with her former husband were taxable income. The agreement was made 19 years after their divorce and was the fourth agreement concerning alimony. The court held that the 1941 agreement was 'incident to' the divorce because it settled a dispute over alimony stemming from the divorce decree and prior agreements. The court also determined that a loss claimed on stock in a cooperative apartment corporation was not deductible because the apartment was primarily a personal residence, not a transaction entered into for profit.

Facts

Rowena and Walter Barnum divorced in Paris in 1922. Prior to the divorce, they entered into a separation agreement regarding alimony, which was followed by additional agreements. The divorce decree itself stipulated alimony payments in French francs. Subsequent disagreements over the amount and currency of alimony led to a lawsuit in New York. In 1941, to settle this dispute, they entered into a fourth agreement, which reduced the monthly alimony payments to $150. Rowena Barnum also owned stock in a cooperative apartment building where she resided. She occasionally sublet the apartment. The cooperative experienced financial difficulties, and the building was foreclosed in 1943. The cooperative was later declared bankrupt, rendering her stock worthless.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Rowena Barnum's income tax for 1943, including the alimony payments as taxable income and disallowing a deduction for the worthless stock. Barnum petitioned the Tax Court, contesting these determinations.

Issue(s)

1. Whether the 1941 agreement providing for alimony payments was "incident to" the divorce under Section 22(k) of the Internal Revenue Code, thus making the payments taxable income to Rowena Barnum.

2. Whether Rowena Barnum was entitled to a deduction under Section 23(e) of the Internal Revenue Code for a loss on stock in a cooperative apartment corporation that became worthless in 1943.

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Holding

1. Yes, because the 1941 agreement was a compromise of a dispute over obligations arising from the divorce decree and prior related agreements, making it "incident to" the divorce.

2. No, because the stock was acquired primarily to obtain a personal residence, and the occasional subletting did not convert it into a transaction entered into for profit.

Court's Reasoning

Regarding the alimony issue, the court emphasized the series of agreements between the Barnums, all related to the original divorce and its financial implications. The court noted that the 1941 agreement settled a dispute arising directly from the divorce decree and the prior alimony agreements. Despite being executed 19 years after the divorce, the court found this agreement to be "incident to" the divorce because it resolved uncertainties and claims stemming from the original divorce settlement. The court reasoned that this fourth agreement was "in lieu of the third one which, as we have explained, was 'incident to' the divorce."

Regarding the stock loss, the court focused on the primary purpose for which Barnum acquired the stock: to secure a personal residence. Although she occasionally sublet the apartment, the court deemed this incidental and insufficient to transform the transaction into one entered into for profit. The court cited *E. F. Fenimore Johnson*, 19 T. C. 93, stating that "[t]he receipt of a small amount of rental income from certain portions of the residential property prior to sale was insufficient to constitute a transaction appropriating the premises to property used in a trade or business or to constitute a transaction entered into for profit."

Practical Implications

This case provides guidance on what constitutes a written agreement "incident to" a divorce for tax purposes, particularly when agreements are modified or created long after the divorce decree. It clarifies that agreements resolving disputes connected to the divorce and prior agreements can be considered incident to the divorce, impacting the taxability of alimony payments. This ruling highlights the importance of examining the history and context of alimony agreements. It also demonstrates that the primary purpose of acquiring an asset is crucial in determining whether a loss is deductible as a business expense or a loss incurred in a transaction entered into for profit. Later cases would need to distinguish facts where the intent to make a profit was more evident.

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