***Fidler v. Commissioner*, 20 T.C. 1097 (1953)**

Payments made to a former spouse under a divorce decree are considered installment payments (and thus not deductible by the payer) if they discharge an obligation with a principal sum specified in the decree, even if the payments are contingent to some degree.

Summary

The case involved the tax treatment of alimony payments and a loss incurred from the sale of literary properties. The court determined that the husband's payments to his divorced wife were partially deductible as alimony, and the loss from the sale of the literary properties were from capital assets. The court decided that certain payments to his former wife constituted non-deductible installment payments because they were part of a specified principal sum. The court found that the loss from the sale of literary properties was a capital loss, not an ordinary business loss. This was because the husband was not in the trade or business of selling literary works.

Facts

Mr. Fidler made monthly payments to his ex-wife as part of their divorce settlement and sought to deduct these payments from his income. The divorce decree adopted a separation agreement requiring Fidler to make payments. This agreement specified the payments to be made as part of the divorce settlement. The payments had two components: a fixed $500 per month payment for 53 months, and an additional $300 per month payment also for 53 months, contingent on his employment as a radio commentator. He also claimed an ordinary loss deduction for the sale of literary properties he purchased years before.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction for the alimony payments and treated the loss from the sale of literary properties as a capital loss. Mr. Fidler petitioned the Tax Court to challenge the Commissioner's decision.

Issue(s)

1. Whether the monthly payments made to Fidler's former wife were "installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument" and, therefore, not deductible by Fidler.

2. Whether the loss sustained by Fidler upon the sale of literary properties was an ordinary business loss or a capital loss.

Holding

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1. Yes, the Tax Court held that the $500 per month component of the payment was a non-deductible installment payment. Yes, The Tax Court held the $300 per month component of the payment was also a non-deductible installment payment, despite its contingent nature.

2. The loss was a capital loss.

Court’s Reasoning

The Tax Court analyzed the deductibility of the alimony payments under Section 23(u) of the Internal Revenue Code, which referenced Section 22(k). The court focused on whether the payments were installment payments related to a specified principal sum. Despite that the $300 monthly payment was contingent, the court found that the separation agreement, which was part of the divorce decree, established a principal sum for those payments. The court noted that the separation agreement explicitly set a principal sum, payable in installments, even though the amount could be reduced based on Fidler’s future employment.

Regarding the literary properties, the court found that Fidler was not in the trade or business of selling these properties. The court reasoned that the fact that Fidler held them for investment purposes was not enough to classify them as inventory or property held for sale in the ordinary course of business. Since the properties were held for more than six months, the court decided the sale resulted in a capital loss.

Practical Implications

This case reinforces the importance of carefully structuring divorce agreements, especially regarding alimony payments, to achieve the desired tax consequences. When creating a settlement, the terms of the settlement agreement are important. Even if the payment amount may vary, it can be treated as a principal sum if the agreement specifies it. The case also clarifies the distinction between ordinary business losses and capital losses. Individuals investing in literary properties or other assets should be aware that they may be treated as capital assets, which could subject them to capital gains tax.

Later courts have cited this case to show that the specific language in divorce decrees and separation agreements determines the tax treatment of payments.

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