***Hesse v. Commissioner, 7 T.C. 304 (1946)***

A separation agreement is considered 'incident to divorce' for tax purposes under Section 22(k) of the Internal Revenue Code if it is connected to a subsequent divorce, even if divorce was not contemplated at the time of signing, but payments under agreements not 'incident to divorce' are not taxable to the recipient spouse.

**Summary**

This case addresses whether payments received by a wife under a separation agreement are taxable income under Section 22(k) of the Internal Revenue Code, which taxes payments from agreements 'incident to divorce.' The Tax Court found that despite a later divorce, the separation agreement in Hesse was not 'incident to divorce' because divorce was not contemplated by either party when the agreement was signed. The court emphasized the lack of evidence suggesting a planned divorce at the agreement's inception, relying on testimony and the agreement's context to conclude the payments were not taxable to the wife.

**Facts**

1. The petitioner and her husband signed a written separation agreement on December 8, 1941.
2. The agreement provided for periodic payments to the petitioner.
3. The agreement stipulated that payments would cease upon the petitioner's remarriage.
4. At the time of signing, the petitioner testified she did not contemplate divorce and hoped for reconciliation after her husband addressed his drinking problem.
5. Witnesses, including the petitioner's sister and the drafting attorney, corroborated that divorce was not discussed during the agreement's creation.
6. The husband initiated divorce proceedings in April 1944, shortly after a two-year separation period that began with the agreement.
7. The husband remarried soon after the divorce in April 1944.
8. The divorce decree did not mention the separation agreement or alimony.

**Procedural History**

1. The Commissioner of Internal Revenue determined that the payments received by the petitioner under the separation agreement were taxable income under Section 22(k) of the Internal Revenue Code.
2. The petitioner appealed this determination to the Tax Court of the United States.

**Issue(s)**

1. Whether the written separation agreement dated December 8, 1941, was 'incident to' the divorce of the petitioner and her husband within the meaning of Section 22(k) of the Internal Revenue Code, thus making the periodic payments taxable income to the petitioner.

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## Holding

1. No, because the separation agreement was not made in contemplation of or incident to a divorce. The court found no evidence that either party intended to obtain a divorce when the agreement was signed, and therefore, the payments were not includible in the petitioner's gross income under Section 22(k).

## Court's Reasoning

The court reasoned that for a separation agreement to be 'incident to divorce' under Section 22(k), there must be a connection or relationship between the agreement and the divorce. While circumstantial deductions could be drawn from the cessation of payments upon remarriage and the timing of the divorce shortly after the separation agreement's two-year mark, these were insufficient to prove the agreement was incident to divorce. The court emphasized the petitioner's testimony and corroborating witness accounts stating that divorce was not contemplated at the time of the agreement. The court distinguished cases where a clear intent for divorce existed at the time of the agreement, stating, "The connection is obvious when there is an express understanding or promise that one spouse is to sue promptly for a divorce after signing the settlement agreement…" In Hesse, the court found no such intent or surrounding circumstances indicating a planned divorce at the agreement's inception. Furthermore, the divorce decree's silence on the separation agreement and alimony reinforced the conclusion that the payments were not made pursuant to the divorce but rather solely under the independent separation agreement.

## Practical Implications

This case clarifies that for a separation agreement to be considered 'incident to divorce' under Section 22(k) for tax purposes, there needs to be a demonstrable connection to a planned or contemplated divorce at the time of the agreement. The mere fact that a divorce occurs after a separation agreement is not sufficient to automatically make the agreement 'incident to divorce.' Legal practitioners must consider the intent of the parties at the time of drafting separation agreements, especially concerning potential tax implications. This case highlights the importance of evidence showing the parties' contemplation (or lack thereof) of divorce when the agreement was created. Later cases distinguish Hesse by focusing on evidence of intent surrounding the agreement, looking for explicit links to divorce proceedings or implicit understandings within the circumstances of the separation and agreement.

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