25 T.C. 1204 (1956)

A lump-sum payment made in a divorce settlement, even if calculated by reference to prior periodic payments, does not qualify as a periodic payment for purposes of alimony taxation, and is neither includible in the wife's gross income nor deductible by the husband.

Summary

The case concerns the tax treatment of payments made by a former husband to his ex-wife following a divorce. The couple had a separation agreement that provided for payments from the husband's grandparents' estates to the wife. The agreement also stipulated that if the wife divorced and remarried, the husband would make a cash payment to her. The Tax Court addressed whether this lump-sum payment was considered "periodic" income to the wife and deductible by the husband under the Internal Revenue Code. The court held that the lump-sum payment made after the divorce and remarriage was not a periodic payment and was, therefore, not taxable as alimony to the wife nor deductible by the husband.

Facts

Anthony McKissick (husband) and Susan Ballinger (wife) were married. They separated in 1948, and the wife sued for legal separation and support. The husband and wife entered a separation agreement, which was incorporated into a decree of legal separation. The agreement stipulated that the wife would receive one-third of the income from the husband's grandparents' estates for support and maintenance, and the payments would cease if the wife divorced and remarried. If this happened, the husband would make a cash payment equal to the total amount the wife had received from the estates or three times the average annual payment. The wife divorced and remarried. The husband made a final cash payment to the wife in accordance with the agreement, which was not reported as income by the wife, nor deducted by the husband. The IRS assessed deficiencies, disallowing the husband's deduction and including the payment in the wife's income.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies for both the husband and the wife. The wife was assessed for failing to include the lump-sum payment in her gross income, and the husband was assessed because he had claimed a deduction for the payment. Both the husband and the wife separately filed petitions with the United States Tax Court, challenging the Commissioner's determinations. The Tax Court consolidated the cases for trial and rendered its decision.

Issue(s)

1. Whether the lump-sum payment of $43,485.27 made by the husband to the wife

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after their divorce and her remarriage constituted a “periodic payment” includible in the wife’s gross income under Section 22(k) of the Internal Revenue Code of 1939.

2. Whether the husband was entitled to deduct the $43,485.27 payment under Section 23(u) of the Internal Revenue Code of 1939.

Holding

1. No, because the payment was not a periodic payment as defined by the statute and established case law.

2. No, because the payment was not a periodic payment, and the husband could not deduct it.

Court’s Reasoning

The court focused on the nature of the payment. The first three payments were considered periodic as they were for the wife’s support and came from the trust income. However, the final payment was a lump-sum payment triggered by the divorce and remarriage, and not a continuation of the earlier periodic support. The court cited prior cases, particularly *Ralph Norton* and *Arthur B. Baer*, which held that lump-sum payments did not qualify as periodic payments even if made in addition to, or as a substitute for, periodic alimony. The court emphasized the importance of the payment being made at fixed intervals. Furthermore, the court noted that the payment was characterized in the agreement as a “cash settlement,” which further supported its conclusion. The court stated, “The word ‘periodic’ is to be taken in its ordinary meaning and so considered excludes a payment not to be made at fixed intervals but in a lump sum.”

Practical Implications

This case is a reminder that attorneys must carefully structure divorce settlement agreements to achieve desired tax consequences. Payments characterized as a lump sum are not treated as periodic payments for tax purposes, even if the amount is determined with reference to previous periodic payments. It is critical to distinguish between lump-sum and periodic payments within divorce decrees. The case underscores that the substance of the payment, not merely its characterization, determines its tax treatment. This impacts how taxpayers report income and deductions related to divorce settlements. This case continues to be cited in tax litigation, especially concerning the distinction between lump-sum and periodic payments in divorce and separation agreements. Lawyers advising clients on divorce settlements must be precise in drafting the agreement and understand that payments are not considered periodic if they are made in a lump sum.

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