Swaim v. Commissioner, 50 T. C. 336 (1968)

In divorce settlements, the recipient's basis in property received is the fair market value of that property at the time of the transfer.

Summary

Mildred Swaim received a promissory note as part of her divorce settlement from Harry Swaim. The issue before the court was whether Mildred should report income from the note's payment under the installment method. The court held that Mildred's basis in the note was its fair market value at the time of the divorce settlement, thus she did not realize income from the payment. This decision clarifies the tax treatment of property received in divorce settlements, establishing that the recipient's basis is the property's fair market value at the time of transfer.

Facts

Mildred and Harry Swaim sold their property in 1959, receiving payment in installments. Mildred initiated divorce proceedings in 1960. In 1962, the Jefferson Circuit Court ordered Mildred to transfer one note to Harry and awarded her another note as part of her alimony. In 1964, Mildred received the final payment on this note but did not report it as income, claiming it was a non-taxable divorce settlement.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Mildred's 1964 income tax, asserting she should have reported the note's payment as income. Mildred petitioned the U. S. Tax Court, which dismissed claims related to earlier tax years for lack of jurisdiction. The court then focused on the 1964 tax year and the tax treatment of the note's payment.

Issue(s)

1. Whether Mildred Swaim received income under section 453(a) in 1964 when she received payment on the installment obligation awarded to her in the divorce settlement?

Holding

1. No, because Mildred's basis in the note was its fair market value in 1962, the year of the divorce settlement, and thus she realized no income upon receiving the final payment in 1964.

Court's Reasoning

The court applied the principle from the U. S. Supreme Court's decision in Davis v.

United States, which established that in divorce settlements, the recipient's basis in property received is the fair market value of that property at the time of transfer. The Tax Court reasoned that since Harry was treated as having a gain under section 453(d)(1) when the note was awarded to Mildred, Mildred's basis in the note should be its fair market value at that time. The court assumed the note's fair market value equaled its face value, as no evidence was presented to the contrary. Therefore, Mildred did not realize income upon receiving the final payment on the note in 1964.

Practical Implications

This decision has significant implications for the tax treatment of property received in divorce settlements. It establishes that the recipient's basis in such property is its fair market value at the time of transfer, which can affect the tax consequences of subsequent sales or payments. Practitioners should advise clients to carefully document the fair market value of assets at the time of divorce to accurately determine their basis. This ruling also impacts how similar cases are analyzed, emphasizing the importance of the timing of property transfers in divorce proceedings. Later cases have followed this precedent, reinforcing its application in determining tax basis in divorce-related property transfers.

