

Gerlach v. Commissioner, 55 T. C. 156 (1970)

Payments received in divorce settlements may be considered property division rather than alimony when they represent the sale of the wife's interest in jointly owned property.

Summary

Edith Gerlach received \$125,000 in annual installments as part of her divorce settlement from Norman Gerlach, alongside other assets and weekly alimony. The IRS sought to include the \$125,000 as taxable income under alimony provisions. The Tax Court, however, found that the payment was more akin to the sale of Edith's interest in jointly owned CO-5 Co. stock, which she and Norman had developed together. The decision hinged on evidence that the payment was negotiated as a property settlement and was directly tied to the stock's value, rather than a support obligation arising from the marital relationship.

Facts

Edith and Norman Gerlach, married in 1947, co-founded CO-5 Co. , which manufactured a game called Aggravation. They owned CO-5 Co. stock jointly. During divorce proceedings, Edith's attorney sought half of all marital property, including the CO-5 Co. stock. The divorce decree awarded Edith the family home, personal effects, weekly alimony of \$100, and a \$125,000 payment in installments over 12.5 years, secured by the CO-5 Co. stock. The decree's language was ambiguous regarding whether the \$125,000 was alimony or property settlement. Edith reported this payment as a capital gain from selling her stock interest, while the IRS argued it was taxable alimony.

Procedural History

Edith filed a petition with the Tax Court contesting the IRS's determination of a \$1,458.96 deficiency in her 1966 income tax due to the \$10,000 installment she received from the \$125,000. The IRS argued the payment was alimony, taxable under IRC Section 71. The Tax Court heard the case and decided that the payment was not alimony but rather payment for Edith's interest in the CO-5 Co. stock.

Issue(s)

1. Whether the \$125,000 payment received by Edith Gerlach from her former husband, Norman Gerlach, pursuant to their divorce decree, was taxable as alimony under IRC Section 71?

Holding

1. No, because the payment was not alimony but rather payment for Edith's interest in jointly owned CO-5 Co. stock, which she sold to Norman as part of the property

settlement.

Court's Reasoning

The Tax Court analyzed the nature of the \$125,000 payment, looking beyond the ambiguous language of the divorce decree to the substance of the transaction. They noted that the payment was directly linked to the CO-5 Co. stock, evidenced by the stock being used as security and the payment amount being contingent on the stock's earnings. The court cited IRC Section 71 and related regulations, which exclude from income payments attributable to a spouse's interest in jointly owned property. The court found that Edith's contributions to CO-5 Co. and the negotiations centered on the stock supported the conclusion that the payment was for her interest in the stock, not alimony. The court rejected the IRS's argument that the decree's language alone determined the payment's nature, distinguishing this case from those involving clear contractual allocations.

Practical Implications

The Gerlach decision underscores the importance of examining the substance over the form of divorce settlements in tax disputes. For practitioners, it highlights the need to clearly document and negotiate the intent behind property division to avoid adverse tax consequences. The ruling suggests that payments tied to the value of jointly owned assets may be treated as property division, not alimony, even if the divorce decree labels them otherwise. Subsequent cases have cited Gerlach in distinguishing between property settlements and alimony, particularly in cases involving business assets owned by both spouses. This case informs legal practice in ensuring that divorce agreements accurately reflect the parties' intentions regarding property and support.