Abramo v. Commissioner, 78 T. C. 154 (1982)

Amounts specifically designated in a separation agreement as payable for child support are fixed under section 71(b) of the Internal Revenue Code, even if designated "for tax purposes. "

Summary

In Abramo v. Commissioner, the U. S. Tax Court clarified that a separation agreement's allocation of payments for child support, labeled "for tax purposes," was sufficient to fix those amounts under IRC section 71(b). The case involved Arnold and Mary J. Abramo, who had agreed to allocate portions of Arnold's payments to Mary Louise for child support. The court ruled that these allocations were fixed, thus not deductible by Arnold nor includable in Mary Louise's income. The decision emphasized the importance of clear and specific allocations in separation agreements, overruling prior case law that suggested otherwise. The court also addressed the issue of late filing penalties, holding that Mary Louise was liable for such penalties due to lack of evidence showing reasonable cause for late filing.

Facts

Arnold and Mary J. Abramo entered into a separation agreement with Mary Louise Abramo, Arnold's former spouse. The agreement specified that Mary Louise would receive $9,600 annually from Arnold for her support and that of their four children. The agreement allocated $200 monthly to Mary Louise and $150 monthly to each child, stating this allocation was "for tax purposes. " Additionally, if Arnold's income exceeded $26,000, Mary Louise and the children were to receive 25% of the excess, with half going to Mary Louise and the remainder split among the children. The Commissioner of Internal Revenue challenged the tax treatment of these payments, asserting they should be fully deductible by Arnold and taxable to Mary Louise.

Procedural History

The Abramovs filed motions for summary judgment in the U. S. Tax Court. The Commissioner determined deficiencies in their federal income taxes for the years 1974, 1975, and 1976, and also assessed late filing penalties against Mary Louise. The Tax Court granted summary judgment on the issue of the tax treatment of the payments, finding no genuine issue of material fact. The court also addressed the late filing penalties, determining that Mary Louise was liable for them due to insufficient evidence to support a claim of reasonable cause for late filing.

Issue(s)

1. Whether the allocation of payments in the separation agreement, labeled "for tax purposes," fixes the amounts payable for child support under IRC section 71(b).
2. Whether Mary Louise is liable for late filing penalties under IRC section 6651(a)

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for the tax years 1974 and 1975.

Holding

1. Yes, because the agreement specifically designated the amounts payable for child support, meeting the requirements of IRC section 71(b), even though the allocation was prefaced with the phrase “for tax purposes. “
2. Yes, because Mary Louise failed to provide evidence of reasonable cause for the late filing of her tax returns for 1974 and 1975.

Court’s Reasoning

The Tax Court reasoned that IRC section 71(b) requires only that an amount be fixed as payable for child support, not that it be used for that purpose. The court emphasized the plain language of the statute and the regulations, which stress the importance of a specific designation in the agreement. The court overruled its prior decision in Talberth v. Commissioner, stating that the phrase “for tax purposes” does not negate the fixity of the allocation. The court also noted that the legislative history and the Supreme Court’s decision in Commissioner v. Lester supported the view that parties could allocate tax burdens through specific designations in separation agreements. The court rejected Arnold’s argument that the payments under paragraph ninth (d) of the agreement were not fixed because they varied with his income, finding that a specific percentage allocated to child support was sufficient to meet the requirement of section 71(b). Regarding the late filing penalties, the court found that Mary Louise’s failure to present evidence of reasonable cause meant that the Commissioner’s determination of liability for the penalties was correct.

Practical Implications

This decision has significant implications for the drafting of separation agreements, as it clarifies that allocations designated “for tax purposes” can be treated as fixed for the purposes of IRC section 71(b). Attorneys should ensure that such allocations are clearly and specifically stated in agreements to achieve the desired tax treatment. The ruling also affects how similar cases should be analyzed, emphasizing the importance of the language in the agreement over the actual use of the funds. The decision may encourage more precise drafting to avoid ambiguity and potential tax disputes. For legal practice, this case underscores the need for careful consideration of tax implications in family law matters. Businesses and individuals involved in divorce or separation should be aware of the tax consequences of their agreements and seek legal advice to structure them appropriately. Subsequent cases, such as Brock v. Commissioner, have followed this ruling, reinforcing its impact on the interpretation of section 71(b).

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