Bernard v. Commissioner, 87 T. C. 1029 (1986)

A lump-sum payment for past and future child and spousal support is allocated first to past support obligations, with the tax treatment determined by the original support payments, and the remainder to future obligations, which may not be taxable if non-periodic.

Summary

William Bernard made a $60,000 lump-sum payment to his ex-wife, Beth Ann Bernard, to discharge past and future child and spousal support obligations. The court held that $17,888 of the payment was attributable to past support arrearages, taxable to Beth Ann as alimony and deductible by William. The remaining $42,112 was for future support, deemed non-taxable to Beth Ann and non-deductible by William as it was a non-periodic payment. This decision emphasizes the need to first allocate lump-sum payments to past support obligations before addressing future obligations, impacting how attorneys should structure and tax such agreements.

Facts

William and Beth Ann Bernard were divorced in 1975, with William ordered to pay child support of $200 monthly until their daughter Kristen turned 18, and spousal support starting at $1,300 monthly for two years, then reducing to $950 monthly until Beth Ann's death or remarriage. By March 1977, William owed $11,788 in arrears. In August 1977, they agreed that William would pay Beth Ann $60,000 to settle all past and future support obligations. William paid the lump sum in 1977, and Beth Ann did not report it as income.

Procedural History

The Commissioner determined deficiencies in the Bernards' 1977 taxes, asserting that Beth Ann had unreported alimony income and William was not entitled to an alimony deduction. The case was brought before the United States Tax Court, where the Bernards contested the tax treatment of the $60,000 payment.

Issue(s)

1. Whether a portion of the $60,000 lump-sum payment is attributable to past child and spousal support obligations?
2. Whether the portion of the lump-sum payment attributable to past support obligations is taxable to Beth Ann and deductible by William?
3. Whether the portion of the lump-sum payment attributable to future support obligations is taxable to Beth Ann and deductible by William?

Holding

1. Yes, because $17,888 of the lump-sum payment was attributable to past support

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arrearages as of August 1977.
2. Yes, because this portion retained the tax character of the original support payments, making it taxable to Beth Ann and deductible by William.
3. No, because the remaining $42,112 was for future support, a non-periodic payment under Section 71(c), making it non-taxable to Beth Ann and non-deductible by William.

Court’s Reasoning

The court applied the framework from *Olster v. Commissioner*, stating that without an unequivocal allocation, lump-sum payments must first satisfy past support obligations. The $17,888 in arrears as of August 1977 was treated as past support, retaining the tax character of the original payments under Sections 71(a) and 215. The remaining $42,112 was for future support, which was not periodic under Section 71(c) because it was a specified amount payable in less than 10 years and not contingent on events like death or remarriage. The court also applied *Commissioner v. Lester*, holding that without a specific allocation, the entire payment is deemed for spousal support. The court’s decision was influenced by the need to maintain consistent tax treatment of support payments and to align the tax consequences with the economic reality of the settlement.

Practical Implications

This decision guides attorneys in structuring and allocating lump-sum payments in divorce settlements, ensuring that past support obligations are addressed first for tax purposes. It impacts how such payments should be reported and deducted, with clear implications for tax planning in divorce agreements. The ruling underscores the importance of specific allocations in settlement agreements to achieve desired tax outcomes. Subsequent cases have cited *Bernard* to allocate lump-sum payments between past and future obligations, influencing tax treatment in similar scenarios. Practitioners must consider these principles when advising clients on the tax consequences of lump-sum payments for support obligations.

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