Getty v. Commissioner, 91 T. C. 160 (1988)

Settlement proceeds from an inheritance dispute are taxable if received in lieu of taxable income, not as an outright bequest.

Summary

Jean Ronald Getty sued the J. Paul Getty Museum, the residuary beneficiary of his father's estate, claiming a promised equalizing bequest. The lawsuit was settled for $10 million, which Getty excluded from his taxable income, arguing it was a nontaxable inheritance. The Tax Court held that the settlement was taxable because it was received in lieu of income that would have been taxable had it been received directly from a trust. The court's decision hinged on the nature of the claim being for lost income rather than a specific nontaxable asset.

Facts

Jean Ronald Getty (petitioner) was the son of Jean Paul Getty (JPG), who established a trust in 1934 that treated Getty unequally compared to his half-brothers. JPG promised to equalize this treatment in his will, but upon his death in 1976, Getty felt the bequest was inadequate. He sued the J. Paul Getty Museum, the residuary beneficiary of JPG's estate, for a constructive trust over assets equivalent to the income his brothers received from the 1934 Trust. The lawsuit was settled for $10 million, which Getty did not report as income, claiming it was a nontaxable inheritance.

Procedural History

Getty filed a complaint against the museum in 1979, seeking to impose a constructive trust. The case was settled in 1980 for $10 million. The Commissioner of Internal Revenue determined a deficiency in Getty's 1980 federal income tax, leading to the case being heard by the United States Tax Court.

Issue(s)

1. Whether the $10 million received by Getty in settlement of his claim against the museum was exempt from taxation as a gift, bequest, devise, or inheritance under section 102(a) of the Internal Revenue Code.
2. Whether Getty's receipt of the $10 million was attributable to the sale or exchange of a capital asset.

Holding

1. No, because the settlement proceeds were received in lieu of income from the 1934 Trust, which would have been taxable under section 102(b).
2. No, because Getty did not receive a capital asset; the settlement was measured by income that would have been taxable.

Court’s Reasoning

The court applied the principle from *Lyeth v. Hoey* that the form of the action is not controlling, focusing instead on what the settlement was in lieu of. The court found that Getty’s claim was for income he should have received from the 1934 Trust, not a specific nontaxable asset like a bequest of stock. The court emphasized that the settlement agreement itself suggested Getty was seeking an “inheritance” which could include income. The court also noted that exemptions from tax are narrowly construed and that the burden of proof was on Getty to show the settlement was nontaxable. The court rejected Getty’s argument that the lump-sum settlement was akin to a bequest, citing cases where similar claims for income were found taxable.

Practical Implications

This case clarifies that settlements in inheritance disputes are taxable if they are in lieu of taxable income. Attorneys should advise clients that the nature of the underlying claim (whether for income or a specific asset) will determine the tax treatment of any settlement. This decision impacts estate planning and litigation strategies, as parties may need to consider the tax consequences of different settlement structures. The ruling also affects how beneficiaries and trustees negotiate settlements, as the tax treatment can significantly influence the net amount received. Subsequent cases have followed this principle, focusing on the nature of the claim rather than the form of the settlement.

