Balding v. Commissioner, T. C. Memo. 1990-13

Payments received in settlement of a claim to a community property share of military retirement pay are not includable in gross income under section 1041 of the Internal Revenue Code.

Summary

In Balding v. Commissioner, the Tax Court addressed whether payments received by a divorced woman in settlement of her claim to a share of her ex-husband's military retirement pay should be included in her gross income. The court ruled that these payments were not taxable under section 1041 of the Internal Revenue Code, which treats property transfers between spouses incident to divorce as non-taxable gifts. The case involved a settlement reached after changes in California law allowed for the division of military retirement benefits as community property. The court's decision emphasized the broad application of section 1041, ensuring uniform federal tax treatment of divorce-related property transfers regardless of state property laws.

Facts

Petitioner and Joe M. Balding were married in 1962, shortly after Balding entered the military. They divorced in 1981, with the divorce court initially ruling Balding's military retirement pay as his separate property. In 1984, following changes in California law, the petitioner sought to reopen the divorce judgment to claim a share of the retirement pay. Before the court could act, the parties settled, with the petitioner relinquishing her claim in exchange for payments of $15,000, $14,000, and $13,000 over three years. The IRS determined these payments were taxable, leading to the dispute.

Procedural History

The IRS determined deficiencies in the petitioner's federal income tax for 1986, 1987, and 1988, asserting that the settlement payments should be included in her gross income. The case was submitted to the Tax Court without trial, under Rule 122. The court issued its decision in T. C. Memo. 1990-13, ruling in favor of the petitioner.

Issue(s)

1. Whether payments received by the petitioner in settlement of her claim to a community property share of her ex-husband's military retirement pay are includable in her gross income.

Holding

1. No, because the payments were received incident to divorce and thus fall under section 1041, which treats such transfers as non-taxable gifts.

Court's Reasoning

The court applied section 1041 of the Internal Revenue Code, which was enacted to provide uniform federal tax treatment to property transfers incident to divorce, regardless of varying state property laws. The court emphasized that section 1041 treats these transfers as non-taxable gifts, regardless of the nature of the consideration received, whether it be the relinquishment of marital rights, cash, or property. The court found that the settlement payments were received incident to the divorce, and thus should be treated as non-taxable gifts under section 1041. The court also noted the legislative history of section 1041, which aimed to simplify tax treatment of divorce-related property transfers and reduce litigation. The decision was supported by the relevant regulations, which confirm that the transferee recognizes no gain or loss upon receipt of property under section 1041.

Practical Implications

This ruling clarifies that payments received in settlement of a claim to a share of military retirement pay, or similar property, incident to divorce are not taxable under section 1041. Legal practitioners should consider this when advising clients on the tax implications of divorce settlements involving property transfers. The decision underscores the broad applicability of section 1041, ensuring that such transfers are treated as non-taxable gifts, which simplifies tax planning in divorce proceedings. It also impacts how attorneys structure divorce agreements to optimize tax outcomes. Subsequent cases, such as those involving other types of property transfers incident to divorce, may reference Balding to support the application of section 1041.