Okerson v. Commissioner, 123 T. C. 258 (2004)

In *Okerson v. Commissioner*, the U. S. Tax Court ruled that payments made by John Okerson to his ex-wife Barbara Buhr Okerson did not qualify as alimony for federal tax deductions due to substitute payment obligations upon her death. The decision underscores the strict application of I. R. C. § 71(b)(1)(D), which disallows alimony deductions if the payor remains liable for payments after the payee's death, impacting how divorce settlements are structured for tax purposes.

Parties

John R. and Patricia G. Okerson, Petitioners, challenged the Commissioner of Internal Revenue, Respondent, in the U. S. Tax Court over a disallowed alimony deduction. John Okerson was the payor and Barbara Buhr Okerson was the payee in the divorce settlement, with Patricia G. Okerson being John's current spouse at the time of the tax dispute.

Facts

John Okerson was ordered by a Tennessee State court to pay Barbara Buhr Okerson $117,000 as alimony in monthly installments over several years, per a 1995 decree. Additionally, a 1997 decree required him to pay $33,500 to her attorney as further alimony. Both decrees specified that the alimony payments would terminate upon Barbara's death, but John would then be obligated to make equivalent payments either for their children's education or to Barbara's attorney. In 2000, John paid $12,600 under the 1995 decree and $9,000 under the 1997 decree, totaling $21,600, which he claimed as a tax-deductible alimony payment on his federal income tax return. The Commissioner disallowed the deduction, leading to the present litigation.

Procedural History

The case originated from a notice of deficiency issued by the Commissioner on April 10, 2003, disallowing John Okerson's $21,600 alimony deduction for the year 2000. John and Patricia Okerson filed a petition with the U. S. Tax Court on May 23, 2003, to redetermine the deficiency. The case was submitted to the court without trial based on stipulated facts. On September 9, 2004, the Tax Court issued its opinion, deciding in favor of the Commissioner.

Issue(s)

Whether John Okerson's payments to Barbara Buhr Okerson, as required by the divorce decrees, qualify as alimony deductible under I. R. C. § 71, given his obligation to make substitute payments upon Barbara's death?

Rule(s) of Law

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I. R. C. § 71(b)(1)(D) states that payments qualify as alimony for federal income tax purposes only if "there is no liability to make any such payment * * * as a substitute for such payments after the death of the payee spouse. " Temporary Income Tax Regulations § 1. 71-1T(b), Q&A-14, define substitute payments as those that would begin as a result of the payee's death and substitute for payments that would otherwise qualify as alimony but terminate upon the payee's death.

Holding

The court held that John Okerson's payments did not qualify as deductible alimony because the divorce decrees mandated substitute payments upon Barbara's death, which contravened the requirements of I. R. C. § 71(b)(1)(D).

Reasoning

The court's reasoning hinged on the unambiguous terms of the divorce decrees, which required John to make payments to Barbara's attorney or for the education of their children if Barbara died before the full alimony amount was paid. This obligation to make substitute payments violated the statutory requirement that alimony payments must terminate upon the payee's death without any substitute liability. The court emphasized that the intent of the state court or the parties in labeling payments as alimony is irrelevant to their tax treatment under federal law. The court also rejected the argument that the non-occurrence of substitute payments due to Barbara's survival should affect the tax treatment of the payments, as the potential liability for such payments was sufficient to disqualify the payments as alimony. The court's decision was further supported by legislative history and examples from the Temporary Income Tax Regulations, which illustrate that any obligation for substitute payments disqualifies corresponding pre-death payments as alimony.

Disposition

The U. S. Tax Court entered its decision for the Commissioner, upholding the disallowance of John Okerson's alimony deduction.

Significance/Impact

Okerson v. Commissioner is significant for its strict interpretation of I. R. C. § 71(b)(1)(D), reinforcing that federal tax law governs the deductibility of alimony, irrespective of state court intentions or the actual occurrence of substitute payments. The decision has broad implications for divorce settlements, requiring careful drafting to ensure compliance with federal tax requirements for alimony deductions. It underscores the importance of ensuring that alimony obligations terminate completely upon the payee's death without any substitute payment liability to maintain tax deductibility. Subsequent cases have cited *Okerson* to support similar holdings, affecting how attorneys structure divorce agreements to

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optimize their clients’ tax positions.

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