
Marion A. Cowell Jr.
NOTES AND COMMENTS

scope, and extensive use of the available discovery procedures. In view of the fact that in some instances even the combination of extensive investigation and artfully drawn pleadings and discovery procedures may not supply the ultimately effective proof of these elements, a statute expressly shifting the burden of proof to defendant may be required.

MACK B. PEARSSALL


The 1961 decision of the United States Supreme Court in Commissioner v. Lester provides for simplicity of interpretation and certainty of tax consequences where property settlement agreements incident to divorce or separation are subject to contingent alteration. Prior to 1942, a taxpayer who was divorced or legally separated from his wife was generally not entitled to deduct alimony from gross income. The Revenue Act of 1942 changed this by requiring a wife to include in gross income "periodic" payments received from her husband made in discharge of a marital duty. A complimentary or falsity of the same, and the same are therefore denied." Record, p. 4, Knight v. Associated Transp., Inc., 255 N.C. 462, 122 S.E.2d 64 (1961). Conceivably, if the plaintiff had alleged ownership, agency, and scope in separate paragraphs an admission of one or more then might have been forced.

2. Douglas v. Willecots, 296 U.S. 1, 8 (1935); Gould v. Gould, 245 U.S. 151, 153 (1917). Alimony was deductible from gross income when the divorce decree, settlement agreement, and state law operated as a complete discharge of liability for support. Helvering v. Fitch, 309 U.S. 149, 156 (1940); Helvering v. Fuller, 310 U.S. 69 (1939).
4. For purposes of simplicity it is assumed the husband is paying alimony or support; however, the statute covers a situation in which a wife is required to pay alimony to the husband. Elinor Stewart Sokol, 7 T.C. 567 (1946); Int. Rev. Code of 1939, §3797(a)(17) (now Int. Rev. Code of 1954, §7701(a)(17)).
5. Int. Rev. Code of 1939, §22(k), added by ch. 619, 56 Stat. 816 (1942) (now Int. Rev. Code of 1954, §71), provided "periodic payments... received... in discharge of... a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under... a written instrument... shall be includible in the gross income of such wife... This subsection shall not apply to that part of any such periodic payment which the terms of the... written instrument fix, in terms of... a portion of the payment, as a sum which is payable for the support of minor children of such husband."
provision allowed a husband to deduct from gross income payments his wife was required to include.⁶

If the decree or agreement provides for a single sum payable to the wife for the support of herself and minor children of the marriage, with no allocation of the payment between the parties, no difficulty is experienced. The wife is clearly taxable on the entire sum.⁷ Where the agreement or decree makes a provision for the minor children in a definite sum or proportion, it is just as clear that the wife is not taxable on this amount.⁸ However, in agreements where the husband attempts to make flexible provision for both a wife and minor children, subject to reduction as the wife's household becomes smaller, the payments have not always been clearly allocable between alimony and child support. The _Lester_ decision settled this problem by holding that before any of the payment is excluded from the wife's income the agreement must specify a sum certain or a percentage of the payment which is fixed for child support.⁹

... The _Tax Court_,¹⁰ with supporting decisions in the First,¹¹ Seventh,¹² and Ninth¹³ Circuits, held that if there were a reasonable indication or inference that any portion of a payment was intended to be payable for child support then such portion was not includible in the gross income of the wife. In _Eisinger v. Commissioner_,¹⁴ a decision exemplary of the Tax Court approach, the agreement pro-

---

⁶ _Int. Rev. Code of 1939, § 23(u),_ added by ch. 619, 56 Stat. 816 (1942) (now _Int. Rev. Code of 1954, § 215_). The statute was enacted to relieve the husband from the burden of paying alimony plus the higher taxes which were anticipated during the war. It was envisioned that in many instances the husband would not have enough money to make both payments. _H.R. Rep. No. 2333, 77th Cong., 2d Sess. 46 (1942)_.

⁷ _Joslyn v. Commissioner_, 230 F.2d 871 (7th Cir. 1956); _see_ Richard P. Prickett, 18 T.C. 872 (1952). The same result follows regardless of the amount actually expended on the minor children by the wife. Constance B. Kirby, 35 T.C. 306 (1960); Frances Hummel, 28 T.C. 1131 (1957); Henrietta S. Seltzer, 22 T.C. 203 (1954); Dora H. Moitoret, 7 T.C. 640 (1946).


¹¹ _Metcalf v. Commissioner_, 271 F.2d 288 (1st Cir. 1959).

¹² _Mandel v. Commissioner_, 185 F.2d 50 (7th Cir. 1950).


¹⁴ _Supra_ note 13.
vided for specified reductions in weekly payments when a child reached his majority or died. The agreement also provided that all payments should cease upon the wife's remarriage and, in lieu thereof, the husband was to pay the wife a certain amount for the support of each child until he attained his majority or died. The court held that the agreement "earmarked" with sufficient clarity the portions intended for the support of minor children and alimony, and that when such amounts could be readily determined without reference to contingencies which might never occur, then such part of the periodic payment was sufficiently "fixed" within the meaning of section 22(k) of the Internal Revenue Code of 1939.\textsuperscript{16}

The Second Circuit adopted a stricter view in \textit{Weil v. Commissioner}.\textsuperscript{18} The only reduction there was contingent upon the wife's remarriage. The court held that such a contingency did not sufficiently allocate an amount payable for the support of minor children, and that "sums are 'payable for the support of minor children when they are to be used for that purpose only' . . . \textit{[T]}he wife must have no independent beneficial interest therein."\textsuperscript{17}

\textit{Baker v. Commissioner}\textsuperscript{18} was a forecast of how the Second Circuit would rule when a computation based on contingencies was involved. In that case the taxpayer was obligated to pay his wife a stipulated monthly sum, with no principal sum named in the agreement. The payments were to cease in six years or if the wife should remarry or die before the end of that period. The Commissioner and the Tax Court disallowed a deduction for periodic alimony payments on the theory that they could calculate the principal sum.\textsuperscript{19} The Second Circuit reversed, and held that arriving at a principal sum by calculation might be a sound principal if there were no contin-

\textsuperscript{16} See note 5 \textit{supra}.

\textsuperscript{18} 205 F.2d 369 (2d Cir. 1953); \textit{accord}, Burton v. United States, 139 F.Supp. 121 (D. Utah 1956).

\textsuperscript{19} Only "periodic" payments are considered alimony under the statute. Payments which are considered "installments" on a principal sum, dischargeable in 10 years or less, are not considered alimony. See Barrett v. United States, 296 F.2d 309, 310 (5th Cir. 1961); \textit{Int. Rev. Code of 1939, § 22(k) (now Int. Rev. Code of 1954, § 71(c))}. 

\textsuperscript{17} Id. at 588; \textit{accord}, Hirshon's Estate v. Commissioner, 250 F.2d 497 (2d Cir. 1957) (per curiam). As a result of \textit{Weil} and \textit{Eisinger}, Rev. Rul. 59-93, 1959-1 \textit{Cum. Bull.} 22, was issued, stating that the Internal Revenue Service would follow the \textit{Weil} decision only in situations factually similar (reductions contingent only upon wife's remarriage). To determine if a portion of the payments made in accordance with a divorce decree or separation agreement is alimony or payable for child support, the rationale of \textit{Eisinger} would be followed.

\textsuperscript{18} 240 F.2d 584 (2d Cir.), \textit{cert. denied}, 353 U.S. 958 (1957).
gencies involved; however, there was present a stipulated cessation of the payments if the wife remarried or died. The possibility that either of these contingencies might occur before termination was sufficient reason to doubt the validity of the calculation.

In accord with the Second Circuit is the Sixth Circuit decision of Deitsch v. Commissioner, in which the court held that the term “fix” as used in section 22 (k) was not ambiguous and that “It therefore must be construed in its usual sense of ‘to assign precisely . . . to make definite and settled.’ ” Thus the decisions in the Second and Sixth Circuits clearly departed from the view of the Tax Court and the First, Seventh, and Ninth Circuits.

In order to resolve this conflict in the circuits, the Supreme Court granted certiorari in Commissioner v. Lester. The agreement there provided for a monthly sum payable to the wife for both alimony and child support, subject to reduction on occurrence of specified contingencies. All payments were to cease on the death of either husband or wife, or upon her remarriage. Should either of the children die, become emancipated, or marry, the payments were to be reduced by one-sixth. The husband had deducted the entire payment as alimony.

The Commissioner disallowed a portion of that deduction on the grounds that a reasonable inference could be drawn that one-sixth of each payment was intended to be “payable for” support of a minor child. The Tax Court agreed with the Commissioner and held that if it is clear from the terms of the agreement that a portion of the payment is to be applied for the support and maintenance of minor children, then such amount should be considered as a sum “fixed” as payable for child support.

On appeal, the Second Circuit looked to the complete discretion

---

20 Compare Davidson v. Commissioner, 219 F.2d 147 (9th Cir. 1955) with Eisinger v. Commissioner, 250 F.2d 303 (9th Cir. 1957). In Davidson the Ninth Circuit cited Baker and arrived at the conclusion that since no principal sum was stated the payments were periodic and includible in the wife's gross income.

21 249 F.2d 534 (6th Cir. 1957). The agreement here provided for reductions in monthly payments as each child reached the age of 18. Payments were to cease altogether if both children should die or become emancipated. Accord, Ashe v. Commissioner, 288 F.2d 345 (6th Cir. 1961) (wife had discretion in use of entire payment) (decided under both the 1939 and 1954 Codes). But see Budd v. Commissioner, 177 F.2d 198 (6th Cir. 1947) (per curiam).

22 Deitsch v. Commissioner, supra note 21, at 536.


24 Jerry Lester, 32 T.C. 1156 (1959).

25 Lester v. Commissioner, 279 F.2d 354 (2d Cir. 1960).
the wife retained in the use of the money and held the entire payment to be alimony. The fact that, as the size of the family diminished, the periodic payments were reduced in a fixed amount did not necessarily mean that the wife's discretionary power had been diminished. In reversing, the court held that if the agreement itself did not declare a portion of the payment to be for the support of minor children, then Congress intended to tax the wife on the entire payment.

The Supreme Court agreed with the Commissioner and the Tax Court that the contingent reductions relating to the death, emancipation, or marriage of the children might be a reasonable indication of an intention by the parties to provide for the minor children, but found that such a view is inconsistent with the further provision for a complete cessation of the payments should the wife remarry. The Court felt that this provision raised an equally sufficient indication that the parties intended the entire payment to be alimony. To resolve this inconsistency, the Court resorted to the Committee Reports of the House and Senate on the Revenue Act of 1942. As originally proposed, section 22(k) provided that for the husband to be taxable on any part of the payment, such part must be "specifically designated" as payable for child support. This was changed to "fixed" in the final draft of the statute in order to obtain more "streamlined language." The Court held that it was the intention of Congress that "the agreement must expressly specify or 'fix' a sum certain or percentage of the payment for child support before any of the payment is excluded from the wife's income."

The Court has devised two tests to determine if any or all of a periodic payment is "payable for" child support. The agreement

---

28 She retained control over the disposition of the payments, and could allocate the money between herself and the minor children as she thought best. "Indeed such a construction [the Tax Court's] would defeat what is the basic meaning of such an agreement, for the mother is to be free to use her judgment in allocating the collective unit among her children and herself." *Id.* at 357.

27 H.R. Rep. No. 2333, 77th Cong., 2d Sess. 71, 73 (1942); S. Rep. No. 1631, 77th Cong., 2d Sess. 83, 86 (1942). The Court found that the statute was enacted to resolve inconsistencies and uncertainties in the application of the federal revenue laws because of varying restrictions on the use of unspecified child support money among the several states, and to relieve the husband of the burden of paying both alimony and the tax thereon.

must either (1) expressly state a sum certain or (2) give a percentage of the payment which is payable for child support. The determination of the sum allocated for this purpose cannot be left to inference or conjecture.\(^{30}\)

The decision will probably result in a reduction in the quantity of tax litigation in the alimony-support area since it is now clear to the draftsman how agreements must be drawn to include periodic alimony payments in a wife's gross income, or to exclude a portion from her gross income if that is desirable.\(^{31}\) The decision is also a guide for construction of agreements drawn in the past, since it is clear that contingent provisions in property settlement agreements are no longer subject to the "reasonable indication" approach of the Commissioner.\(^{32}\) Hardships will be created since *Lester* does apply to agreements drawn when there was confusion as to the correct manner of placing the tax burden on the intended party. The tax burden has undoubtedly shifted in many instances, entitling the husband to a refund, while creating a tax deficiency for the wife. This deficiency will be limited to the period open under the statute of limitations, usually three years.\(^{33}\) The husband may file a refund claim for the period open under the statute as applicable to him.\(^{34}\)

---

\(^{30}\) "It is not enough to say that the sum can be computed." Commissioner v. Lester, *supra* note 29, at 307 (concurring opinion).

\(^{31}\) If none of the payment to the wife is fixed as child support, none of it can be applied to determine if the husband is entitled to a dependency exemption deduction. *Int. Rev. Code* of 1954, § 152(b)(4).

\(^{32}\) *Lester* has been followed by the Tax Court in Lindley S. Bettison, 30 P-H Tax Ct. Mem. 946 (1961); Robert E. Dolan, 30 P-H Tax Ct. Mem. 898 (1961); Estelle D. Deininger, 30 P-H Tax Ct. Mem. 1153 (1961). In *Bettison* the payments were reduced upon the wife's remarriage. The Tax Court held that the agreement did not "fix" the amount remaining after reduction as payable for child support. Even though the inference was present that the husband was paying the money to support minor children, the agreement did not expressly state a sum certain or percentage which was payable for child support. In *Bettison* the reduced payments were made under the same provision as the full payment. *Quaere*, if the agreement provided, as in *Eisinger*, that all payments of alimony to the wife were to cease, and in lieu thereof, a stipulated smaller sum to be paid for the support, maintenance, and education of minor children? A more equitable solution might be to include the full payment in the wife's gross income until the contingent reduction provisions mature. At this time if the reduced payment is more clearly identified as payable for the support of minor children, it should not be deductible by the husband.

\(^{33}\) *Int. Rev. Code* of 1954, § 6501(a). However, if the taxpayer has omitted from gross income an amount in excess of 25% of the amount stated in the return, the government's allowable period for assessment is extended to six years. *Int. Rev. Code* of 1954, § 6501(e)(1)(A). The period may be extended by agreement of the parties before expiration of the statutory period. *Int. Rev. Code* of 1954, § 6501(e)(4).

\(^{34}\) *Int. Rev. Code* of 1954, § 6511(a).
For closed years, if any are involved, it would seem that the husband's possibility of redress is only that available through mitigation of the statute of limitations.\(^3\)

While *Lester* creates some problems of hardship, the benefits of simplicity of interpretation and certainty of tax consequences are much to be desired in applying the federal revenue laws. The decision has also settled a confusing conflict of circuit court authority in construing property settlement agreements containing contingent reduction provisions in the event of death or remarriage of the wife, death of the husband, or because minor children become of age, die, or marry. These factors may justify the triumph of form over substance *in this instance*, but no extension of that approach is advocated, either in the federal tax field or other branches of the law.\(^8\)

Marion A. Cowell, Jr.

**Federal Income Taxation—Leases—Amortization of Ground Rents**

Not infrequently a taxpayer will purchase real property subject to an outstanding lease. In many instances the lessee will have erected improvements on the leased land. By virtue of having made a capital investment in those improvements and avowedly retaining ownership of them until the termination of the lease, the lessee is entitled to an annual depreciation deduction.\(^1\) In cases where both these fac-

---

\(^3\) In cases where the parties are "related taxpayers" under the statute, for instance when the wife is beneficiary under an alimony trust, there appear to be possibilities of mitigation. Eleanor B. Burton, 1 T.C. 1198 (1943); Katharine C. Ketcham, 2 T.C. 159 (1943); aff'd, 142 F.2d 996 (2d Cir. 1944); INT. REV. CODE OF 1954, §§ 1311-1314. See generally 2 MERTENS, FEDERAL INCOME TAXATION ch. 14 (rev. 1961); Scheifly, *The Operation of Sections 1311-1314*, 13 U. So. Cal. 1961 Tax Inst. 509; Annot., 54 A.L.R.2d 538 (1957).


\(^8\) No cases have been found construing the applicable North Carolina statutes. However, since the laws are extremely similar, especially in the provisions relating to deductibility of child support payments, the need for clarity, certainty, and conformity in the construction and application of revenue laws, both state and federal, should lead the courts of North Carolina to adopt the rule in *Lester*. See N.C. GEN. STAT. §§ 105-141(a), -141.2, -147(21) (1958).

\(^1\) Duffy v. Central R.R. of N.J., 268 U.S. 55 (1925); Hotel Kingkade v. Commissioner, 180 F.2d 310 (10th Cir. 1950).