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Alimony Taxation

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qualified as business entertaining, the cost of his own meals must be directly related to the active conduct of his practice. If such were not the case, the club dues could not qualify as a facility expenditure.⁴⁰

The implications of *LaForge* are clear. Section 274(d) will be understood to provide disjunctive substantiation requirements. If "adequate records" are not maintained, oral testimony coupled with other evidence will provide an alternative proof. A facility expense deduction will be allowed if the taxpayer can quantifiably substantiate the portion directly related to the conduct of his business.⁴¹

ALIMONY TAXATION

Section 71(a) of the Internal Revenue Code of 1954 provides that a divorced wife shall include in her gross income a payment, incurred by her former husband under a divorce decree or settlement agreement incident to such a decree, which she receives as one of a series of periodic payments in discharge of the husband's obligation to support his wife.⁴² Payments includible in a wife's gross income are deductible by her divorced husband.⁴³

⁴⁰ *Id.*

⁴¹ *But see Steel v. Commissioner*, 437 F.2d 71 (2d Cir. 1971), wherein the taxpayer claimed a deduction for the cost of entertaining his clients and other guests in his apartment and the cost of air travel, food, lodging and miscellaneous expenses incurred on trips to New Orleans. No expense account, cancelled checks, receipts or other documentary evidence by which to substantiate the oral claim was maintained. The court upheld the Commissioner's denial of the deduction, distinguishing the case from *LaForge* in that *Steel* offered no evidence whatsoever to corroborate his oral statement. 437 F.2d at 73.

⁴² INT. REV. CODE OF 1954 § 71(a). Under section 22(k) of the 1939 Code only the payments attributable to a divorce or legal separation or a written instrument incident thereto were taxed to the wife. To be includible in the wife's gross income, the payment may not be designated by the decree, instrument or agreement as for support of the husband's minor children. Amounts to be divided between wife and children will be applied first to satisfy the children's share in case of an insufficiency. INT. REV. CODE OF 1954 § 71(b). Periodic payments are payments of a fixed amount over an indefinite period or payments of an indefinite amount over a fixed or indefinite period. While section 71 does not define periodic, it provides that installment payments discharging a part of the obligation shall not be treated as periodic. *Id.* § 71(c)(1). However, payments may qualify as periodic if the payment schedule is fixed by decree, instrument or agreement, and it will take more than ten years to discharge the fixed obligation. *Id.* § 71(c)(2). Where the ten-year payment schedule is followed the total sum of payments which may be treated as periodic in any one taxable year of the wife may not exceed ten percent of the fixed sum that such payments are to discharge. *Id.* See *Treas. Reg.* § 1.71-1(d)(2) (1963) as to delinquent payments. Payments may be periodic whether or not they are received at regular intervals. INT. REV. CODE OF 1954 § 71(a). See also *Knowles v. United States*, 290 F.2d 584 (5th Cir. 1961); *Commissioner v. Senter*, 242 F.2d 400 (4th Cir. 1957); *Grant v. Commissioner*, 209 F.2d 430 (2d Cir. 1953); *Bernatschke v. United States*, 364 F.2d 400 (Ct. Cl. 1966).

⁴³ INT. REV. CODE OF 1954 § 215. The deduction is available only for the year in which payment is actually made. *Treas. Reg.* § 1.215-1(a) (1960). Only the obligor spouse may take the deduction. It is not allowed to any other person who may pay the alimony obligation of such other spouse. *Treas. Reg.* § 1.215-1(b) (1960). The obligor spouse

Under a decree of divorce or a settlement agreement, a husband is often required to pay premiums on life insurance policies which name the spouse as beneficiary. Whether or not the premiums are deductible by him depends upon the rights granted to the wife under the policy and the divorce or settlement agreement incident thereto.⁴⁴ If the wife constructively received a taxable benefit from the payment of premiums by the husband, such receipt is taxable to her and deductible by the husband. The Second Circuit adheres to the position that the wife's ownership of the policy is a prerequisite to a determination that the premiums were constructively received by her and therefore deductible by the husband.⁴⁵ However, while absolute assignment of the policy is a condition necessary to constructive receipt of any benefit purchased by premium payments, absolute assignment alone is not a sufficient basis for deductibility. A second requirement for deductibility must also be met, *i.e.*, the irrevocable designation of the wife as beneficiary and their children as contingent beneficiaries of the policy.⁴⁶ In *Stevens v. Commissioner*⁴⁷ the court ruled that an assignment of a life insurance policy to the wife, with all rights incident to ownership made subject to the divorce decree, was an irrevocable transfer sufficient to establish constructive receipt. An additional provision of the assignment, stipulating that the death of the wife prior to the husband's death would entitle

is not allowed a deduction for any periodic payment includible in the income of the other spouse attributable to property transferred in discharge of his obligation whose income is not includible in the income of the obligor spouse. INT. REV. CODE OF 1954 § 215. Such income is excludible under the provisions of sections 71(d) and 682 [income of an estate or trust in case of divorce]. See also Treas. Reg. § 1.215-1(c) (1960); 5 MERTENS § 31A.02 *et seq.*

⁴⁴ *Griffith v. United States*, 360 F.2d 210 (3d Cir. 1966). See also note 45 *infra*.

⁴⁵ *Hyde v. Commissioner*, 301 F.2d 279 (2d Cir. 1962). In *Hyde* the husband paid premiums on policies irrevocably assigned to the divorced spouse pursuant to a separation agreement incorporated into the divorce decree. The wife had exclusive possession of the policies and received all benefits accruing from the premium payments. The deductibility of premium payments was denied, however, in *Piel v. Commissioner*, 340 F.2d 887 (2d Cir. 1965). In *Piel* the decree required the husband to pay premiums on an alimony-protection policy. The cost of the premiums paid by him reduced his monthly alimony obligation. The husband retained title to the policies and also kept the right to borrow against the policy, as well as the rights to surrender the policy for its cash surrender value and to designate a contingent beneficiary in the event his divorced wife remarried or predeceased him. The wife was left with the right to choose the settlement option for the distribution of the insurance proceeds. The court held that "ownership of the policies [by the wife] is necessary to support a deduction." *Id.* at 890.

The Internal Revenue Service also subscribes to this position. See Rev. Rul. 70-218, 1970-1 CUM. BULL. 19, superseding I.T. 4001, 1950-1 CUM. BULL. 27.

⁴⁶ Rev. Rul. 70-218, 1970-1 CUM. BULL. 19. See also *Hyde v. Commissioner*, 301 F.2d 279 (2d Cir. 1962), and *Piel v. Commissioner*, 340 F.2d 887 (2d Cir. 1965), discussed in note 45 *supra*.

⁴⁷ 439 F.2d 69 (2d Cir. 1971).

their children to the policy proceeds, did not alter the wife's status as irrevocable beneficiary.⁴⁸

The taxpayer and his former wife were divorced in 1962. In 1963 he and his divorced spouse executed a special settlement agreement wherein a straight life policy owned by the taxpayer was assigned to her. The agreement revoked the designation of the taxpayer's present wife as beneficiary and provided that upon his death the former wife would receive that portion of the face amount that equalled the total remaining unpaid alimony payments.⁴⁹ If the former wife predeceased the taxpayer their children would receive the entire death benefit. All rights of ownership of the policy were assigned to the former wife, subject to the provisions of the divorce decree.⁵⁰ On his 1964 tax return the taxpayer deducted the premium paid for the policy⁵¹ and the spouse did not report it in her gross income. The Commissioner took inconsistent positions, disallowing the taxpayer's deduction and including the premium payments in the alimony income of the spouse accordingly. The Tax Court held that no portion of the premium was deductible since the premium payment did not confer a taxable benefit on the former wife. It indicated that only unconditional ownership by the wife would be sufficient to establish constructive receipt. Such unconditional ownership is not present here since approval of the divorce court was needed.⁵² Furthermore, the Tax Court suggested that, as the former wife's rights in the policy would be valid only while she remained single and during her lifetime, the assignment could not be considered irrevocable.⁵³

⁴⁸ *Id.* at 72. The court rejected the approach taken by the Seventh Circuit that an interest in proceeds which is contingent upon the wife out-living her former husband will forestall operation of the doctrine of constructive receipt. *See* Mandel v. Commissioner, 229 F.2d 382 (7th Cir. 1956); Seligmann v. Commissioner, 207 F.2d 489 (7th Cir. 1953); *Contra*, 1949-1 CUM. BULL. 2, *acquiescing in Estate of Boies C. Hart*, 11 T.C. 16 (1948). *See also* Note, *Alimony Taxation of Indirect Benefits: A Critique and a Proposal*, 66 COLUM. L. REV. 1118, 1132-35 (1966).

⁴⁹ The difference between the amount payable to the former wife and the face amount was payable to their children.

⁵⁰ The husband retained the right to receive dividends and to apply dividends received against premiums owing. The total premium paid in 1964 was \$1,949.55. At the Tax Court proceeding the husband claimed only \$850 as deductible. By limiting the deduction claimed to \$850 he presupposes that he had purchased an annual renewable term insurance policy with a reducing face amount, instead of the ordinary life policy he did buy. The cost of such term insurance is computed by multiplying the face amount of the policy by the percentage possibility that the insured will die during the term for which protection is purchased. Unlike the premiums of an ordinary life policy, term insurance premiums include no increment by which a reserve accumulates with the insurance company. By claiming only that portion of the premiums equal to that of a term insurance policy, the husband discounted all benefit from dividends received.

⁵¹ The deduction claimed in his return was for \$1,785.05. However, only \$850 was claimed at the consolidated proceeding before the Tax Court. *See* note 50 *supra*.

⁵² 69 P-H Tax Ct. Mem. 763, 769 (1969).

⁵³ *Id.*

In reversing the Tax Court decision, the Court of Appeals maintained that all contractual rights incident to ownership had been transferred. It cannot be assumed that the divorce court would prohibit exercise of ownership powers where occasion required.⁵⁴ Therefore the first requirement to premium deductibility — assignment of policy ownership to the divorced spouse — had been fulfilled. The provision of the agreement terminating the former spouse's interest in the proceeds if she predeceased the taxpayer is not the kind of contingency which will forestall operation of the constructive receipt principle where the children are irrevocably designated contingent beneficiaries.⁵⁵ As assignee and irrevocable beneficiary of the policy the former spouse constructively received a taxable benefit. Accordingly, the premium payments are includible as part of her gross income and deductible by the husband.⁵⁶

As a result of *Stevens* the constructive receipt doctrine will now be scrutinized more practically. If, in fact, a current economic benefit has been rendered to the former wife, it is now more likely that that benefit will be taxable to her and deductible by her former husband.

CONTROLLED CORPORATIONS — ALLOCATION OF INCOME

Section 482 of the Code provides that the Secretary of the Treasury or his delegate may allocate among two or more commonly controlled businesses "gross income, deductions, credits, or allowances" if he determines that such allocation is necessary in order "to prevent evasion of taxes or clearly to reflect the income" of the business.⁵⁷ A determina-

⁵⁴ 439 F.2d at 72.

⁵⁵ *Id.* In acknowledging that such an interpretation differs from that of the Seventh Circuit (see note 48 *supra*), the court said:

To deny constructive receipt of benefit whenever the wife's interest in the proceeds is contingent on her surviving her former spouse is to presume that an insurance policy's only value to the beneficiary lies in receipt of the face amount upon death of the insured. If this analysis were correct, premiums paid on a term insurance policy could never qualify as alimony payments because the protection of term insurance to an irrevocable beneficiary extends only for a specified period rather than over the life of the insured. . . . Rather the contingencies which will deny deductibility are those which might operate to thwart the wife's receipt of the economic benefit the premium payments conferred, that is, the protection, during a limited term, of the wife's right to receive alimony over the full alimony period. Such contingencies include the husband's retention of the power to borrow against the policy, to withdraw its cash surrender value or to substitute himself as beneficiary if the wife predeceases him.

Id.

⁵⁶ Only \$850, the amount claimed by the husband in the Tax Court proceedings, was includible or deductible. See note 49 *supra*.

⁵⁷ INT. REV. CODE OF 1954 § 482. The purpose of this section is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer. This is done by determining the net income of the property and business of a controlled taxpayer, according to the standards of an uncontrolled taxpayer. *Tennessee Life Ins. Co. v. Phinney*, 280 F.2d 38 (5th Cir.), cert. denied, 364 U.S. 914 (1960); *Simon J. Murphy Co. v. Commissioner*, 231 F.2d 639