TAX ASPECTS OF ALIMONY TRUSTS

All states require a husband to support his wife after divorce or separation. The prevalent methods of satisfying this obligation are direct periodic payments and lump sum settlements. The separate advantages of each of these forms may be united in a third arrangement, a trust for the benefit of the wife. Like periodic payments, the alimony trust enables the husband to limit his obligation to minimal legal requirements, for he may provide that the trust will terminate upon the wife's remarriage, or the death of either party. So also the alimony trust allows the husband to satisfy his obligation out of trust income, while retaining control over the ultimate disposition of the corpus. Like a lump sum settlement, an alimony trust frees the wife from the risks of fluctuations in her husband's income, and the hardships of enforcing compliance with the alimony decree. Furthermore, the trust can relieve the husband from further claims by the wife, and assure both parties that she will have a steady income.

1. At common law the husband's obligation to support his wife did not survive the marital relationship. However, statutes in all American jurisdictions today continue the husband's duty after divorce. See Vernier, American Family Laws 259 (1932); Nelson, Divorce and Annulment 13 (2d ed. 1945); Paul, Five Years with Douglas v. Willcuts, 53 Harv. L. Rev. 1, 8 (1939). In fifteen states the courts can also require the wife to pay "alimony" to her husband. Vernier, op. cit. supra at 304. This Comment will treat the husband as payor and the wife as recipient of alimony. However, where the parties are interchanged the same rules apply. See Int. Rev. Code of 1954, § 7701(a) (17).


3. Nelson states that a court may create a trust of the separate property of the husband for the support of the wife. Nelson, op. cit. supra note 1, at 151. However, the case law authority holds only that the court could confirm a trust created by the parties in a voluntary agreement. See Scott v. Fort Worth Nat'l Bank, 125 S.W.2d 356 (Tex. Civ. App. 1939). Cf. Wiedemann v. Wiedemann, cited in Karl T. Wiedemann, 26 T.C. 565, 566 (1956).


5. In many states divorce courts, either by statute or specific provision of the decree, retain jurisdiction to modify or terminate provisions for periodic alimony payments. A decrease in the earning power of the husband will generally warrant such modification. See Keezer, Marriage and Divorce 714-18 (3d ed. 1946).

6. A wife may enforce an alimony provision by contempt proceedings or execution. Nelson, op. cit. supra note 1, at 284. Aside from the necessary delay and cost they invoke, both methods are ineffective if the husband leaves the jurisdiction and takes his property with him. Id. at 296-97. The wife's only recourse in such a situation is to follow the husband to his new jurisdiction and institute suit there for a debt on a record. Ibid. Such remedies offer little comfort to a woman who has no other means of support. See, e.g., Ostrander v. Ostrander, 190 Minn. 547, 252 N.W. 449 (1934); Haas v. Haas, 183 Misc. 870, 51 N.Y.S.2d 931 (Sup. Ct. 1944); Pokorny, Practical Problems in the Enforcement of Alimony Decrees, 6 Law & Contemp. Prob. 274 (1939).

7. The parties may provide that the creation of the trust terminates the husband's obligation. See, e.g., Helvering v. Fuller, 310 U.S. 69 (1940); Helvering v. Leonard, 310 U.S. 80, 84 (1940).
Because of these features, the alimony trust may serve as an attractive compromise where one party desires a lump sum settlement and the other wishes periodic payments. Nor is the use of an alimony trust limited to the very wealthy. The agreement may obligate the husband to augment the initial corpus by periodic transfers, and give the wife the right to draw a stipulated sum from income or principal. The trust can also be employed solely as security for payments to the wife.

Unless drafted carefully, however, the alimony trust may combine the unfavorable tax consequences of both periodic payments and lump sum settlements. The same alimony trust may subject its grantor to adverse income, gift and estate tax treatment. This Comment will consider the tax problems from the creation of the trust to the death of the husband.

**TAX CONSEQUENCES OF CREATION**

**Realization of Gain**

The transfer of property by the husband to the alimony trust may be deemed a taxable sale. Conventionally, a debtor who satisfies his debt with property is taxed on the difference between his basis for the property and the amount of debt satisfied. By analogy, a husband who transfers property, directly or in trust, to satisfy his marital obligation may realize gain on the transaction. However, the usual measure of gain—value of the debt extinguished less the basis of the property—is unworkable in the marital settlement situation. For the debt, consisting of the marital rights of the spouse, cannot be evaluated accurately. Accordingly, the courts presume that the parties bargained at

---


9. Commissioner v. Halliwell, 131 F.2d 642 (2d Cir. 1942) (direct payments); Commissioner v. Mesta, 123 F.2d 986 (3d Cir. 1941) (same). Cf. Edna W. Gardner Trust, 20 T.C. 885 (1953) (basis of property in alimony trust). If the trust is only security for satisfaction of the husband's obligation, it is arguable that the obligation is not satisfied until corpus is actually paid over to the spouse. This reasoning would defer recognition of gain from creation to the moment of actual satisfaction.

The gain will ordinarily be taxed at capital gains rates. However, if the parties are still husband and wife at the time of the transfer and depreciable property is transferred, Int. Rev. Code of 1954, § 1239(a) requires recognition of the gain as ordinary income. Wiles, *Tax Problems in Connection with Divorce*, 42 A.B.A.J. 528, 531 (1956).

The unusually small number of cases on recognition of gain on creation of a property settlement call for some explanation. A reason may be that taxpayers are not apt to report such transactions in their tax returns and consequently the matter has not come under the scrutiny of auditing revenue agents. See Johnson, *Divorce and Federal Income Taxes*, 37 Minn. L. Rev. 413, 425 (1953). Another possible explanation is that the Commissioner may prefer to levy a gift tax on the settlement and pick up the appreciation when the property is subsequently sold. However, the most logical conclusion seems to be that tax lawyers accept the results of the few decisions and consequently advise their clients either to use cash or to pay the tax without question.

10. "What is the measure of the value of the wife's right to maintenance and support? It is dependent upon many factors—the financial success or failure of the husband, his generosity, the thrift or acquisitiveness of the wife, the length of life of both
arm's length for the settlement and that the considerations exchanged were of equal value.\textsuperscript{11} So viewed, the taxable gain is the difference between the basis of the property and its fair market value at the time of the transfer. The Tax Court has held, however, that if the parties set a value for the property which differs from its fair market value, the agreed-upon valuation will be adopted for tax purposes.\textsuperscript{12} As a safeguard against fraudulent stipulations, this rule should be limited to situations where market value is uncertain and the stipulated value appears reasonable.

If the wife is not the sole beneficiary of the trust, a different approach seems proper. Frequently, the wife is designated income beneficiary only and a third party is named remainderman. In \textit{Edna W. Gardner Trust} \textsuperscript{13} the Tax Court's holding suggested that as long as the husband established such a trust in satisfaction of the wife's marital rights, the transfer should be viewed as a sale of the entire corpus, the husband recognizing gain on any appreciation on the transferred property. This holding would be correct only if the wife caused the husband to funnel part of her settlement off to remaindermen, so that she rather than the husband should be considered donor of the principal. Otherwise the wife receives merely the income from the appreciated property and not the property itself in exchange for the relinquishment of her marital rights. Of course, on the same sale principles, the husband could be held taxable for the transfer of these income rights. It has been held that a person who sells income rights in his property realizes gain in the amount of the consideration less any allocable basis.\textsuperscript{14} But the Code provides that a husband is not taxable on current income assigned through a trust to his wife as alimony.\textsuperscript{15} Thus in the alimony context, even if the transfer of income rights to the wife is considered a sale, this sale represents merely an accelerated realization of income that is not taxable to the husband. Accordingly, the husband should not

\begin{footnotesize}
11. See cases cited note 9 supra; Commissioner v. Patino, 186 F.2d 962 (4th Cir. 1950); Edna W. Gardner Trust, 20 T.C. 885 (1953); Aleda N. Hall, 9 T.C. 53 (1947).
12. Cristina de Bourbon Patino, 13 T.C. 816 (1949), aff'd, 186 F.2d 962 (4th Cir. 1950); Aleda N. Hall, 9 T.C. 53 (1947). If the amount set varies greatly from the market value, the Commissioner can probably upset the parties' figure by arguing that the disparity negates any inference of arm's length bargaining.
13. 20 T.C. 885 (1953). This case involved a dispute over the basis of property in an alimony trust. The trustee claimed that the basis was the fair market value at the time of the transfer, since the transaction was a sale. The Commissioner argued that the transfer was a gift. The holding that the basis was fair market value means that the husband should have realized gain upon the transfer.
15. \textsc{Int. Rev. Code} of 1954, §§ 71, 682. For a discussion see notes 64-66 infra and accompanying text.
\end{footnotesize}
recognize gain on the creation of an alimony trust if the principal of the trust is not given to the wife or her appointee. Even though the principal is given to a third party, the wife may be considered a beneficiary of part of the principal if she has the power to invade corpus in the event of an income deficiency. The consideration given to the wife consists of the property that will be withdrawn as well as the income rights, and, under the sale theory, the husband should be taxed on the appreciation of this portion of the corpus. It will undoubtedly be difficult to assess the amount of principal that will be invaded; only if the wife is assured a stipulated sum annually, and the income of the trust is fixed and demonstrably insufficient, can the amount of property that will be withdrawn be predicted with any accuracy. The mere existence of the power to invade should not be regarded as grounds for charging the husband with gain if the income from the trust seems sufficient to cover payments to the wife. However, if future income is speculative, but considerable invasion seems probable, the amount of corpus sold to the wife should be estimated. The husband owning appreciated property should consider this tax factor in choosing a suitable trust; for the cost of creating an alimony trust with sufficient principal to pay the wife from its income may be little more than the cost of funding a smaller amount and allowing the wife to draw from both principal and income.16

It does not follow that a loss would be allowable to the husband if the basis of the property exceeds its value at the time of the transfer. Where the wife is income beneficiary only, the reasoning that frees the husband from recognition of gain should also preclude his deduction of loss.17 But even if the corpus is transferred to the wife, section 267, disallowing deductions of losses from sales or exchanges between spouses or between the grantor and fiduciary of any trust, will usually bar the recognition of loss.18 In view of this provision, the

16. Assume, for example, that the husband must pay $20,000 a year to a wife with a life expectancy of forty years. Assume also that the trust will earn 4% per year. To pay the wife from income only, the husband must fund $500,000. But no gain need be recognized because invasion is improbable. Now assume that the husband sets up a self-liquidating trust, that is, a trust fund that will be exhausted by payments of $20,000 annually from principal and income for 40 years. The corpus of such a trust must be approximately $395,000. Since the wife will withdraw all the corpus over the life of the trust, appreciation must be recognized. If the appreciation is 100% and the gain is taxable at capital gain rates, the husband must pay a tax of approximately $50,000. This means that the cost of funding a self-liquidating trust is only $55,000 less than the cost of funding a trust whose corpus of $500,000 will be intact at the end of 40 years. Moreover, if the same annual alimony, life expectancy and appreciation are assumed but the interest is fixed at 5% rather than 4%, the cost of a self-liquidating trust will be only $3,000 less than the cost of a trust distributing merely income. The difference in the cost of the two types of trust may be computed on standard annuity tables for any set of variables.

17. See text at notes 13-15 supra.

18. INT. REV. CODE OF 1954, § 267(a), (b) (1), (4), (c) (4). The transfer will escape § 267, if viewed as a sale to the beneficiary who under state law is no longer married to the transferor at the time of transfer. The husband should then be entitled to a loss deduction. Section 165(c) allows an individual to deduct his losses if they are incurred in a transaction
husband seeking a loss deduction should sell his depreciated property in the open market and fund the trust with cash.

**Gift Tax**

The transfer of money or property in settlement of a wife's marital rights may also be classified as a gift for gift tax purposes. Section 2516 of the 1954 Code expressly immunizes some types of marital settlements from the gift tax. However, in order to qualify under this section, a transfer must satisfy the following requirements: (1) there must be a written agreement, (2) relative to marital property rights, (3) in settlement of the spouse's marital or support rights or a reasonable allowance for the support of their minor children; and (4) divorce must occur within two years thereafter. Thus the gift tax consequences of the many types of non-qualifying marital transfers, including those by parties who are legally separated rather than divorced, must be determined by pre-existing law. Prior to section 2516, the only statutory guidepost was a provision defining a taxable gift as any transfer for less than an adequate and full consideration in money or money's worth. Because of the absence of a more precise expression of legislative intent, the treatment of marital settlements, in trust or otherwise, has turned primarily on judicial views of the purposes of the gift tax.

The gift tax initially was viewed as a tax on all inter vivos transfers that would deplete the donor's estate and thus deprive the government of the estate tax. The Code provides that testamentary transfers in consideration of the release of dower or other marital rights in the husband's property are subject to the estate tax. Therefore, inter vivos transfers in satisfaction of these same rights should be subject to the gift tax. By this reasoning, however, transfers in satisfaction of a wife's right to support are not taxable gifts, for these sums are payable during the husband's life and therefore will not be part of his taxable estate. Following this approach, the Commissioner announced in ruling E.T. 19 that marital settlements would be considered taxable gifts entered into for profit. In general, classification as a "transaction entered into for profit" requires only that the property be acquired or held with intent to realize income or make a profit on resale. Weir v. Commissioner, 109 F.2d 996, 998 (3d Cir. 1940). While it has also been held that the disposition itself must meet the "profit" test, an arm's length sale satisfies this condition. Feine v. McGowan, 188 F.2d 738 (2d Cir. 1951); Evans v. Rothensies, 114 F.2d 958, 962 (3d Cir. 1940). See 5 Mertens, Federal Income Taxation § 28.34 (Zimet & Ness ed. 1956).

19. There is no requirement under this section that a settlement be incorporated in a divorce decree or even submitted to the divorce court for approval.


to the extent that they exceeded the reasonable value of the wife's right to support.\textsuperscript{24}

Courts sharing this view of the gift tax as a means of complementing the estate tax carried the rationale underlying E.T. 19 further. Since the Code permits a claim based on a decree of a divorce court to be deducted from the husband's estate without inquiry into the adequacy of consideration,\textsuperscript{25} an inter vivos transfer pursuant to a divorce decree will not deplete the transferor's taxable estate. Thus, a gift tax should not be imposed.\textsuperscript{26} The Commissioner contested this result where the divorce decree merely approved a pre-existing agreement of the parties. Nevertheless, the courts held that the transfer was not a taxable gift as long as the agreement was merged in the divorce decree.\textsuperscript{27} This exception, however, did not cover court-approved agreements that provided for transfers prior to the divorce decree and that survived the decree; and transfers pursuant to such agreements remained taxable as gifts.\textsuperscript{28}

A somewhat altered view of the gift tax can be traced to the Supreme Court's 1950 decision in \textit{Harris v. Commissioner}.\textsuperscript{29} The parties had settled their respective property interests by an agreement made contingent on the granting of an absolute divorce. However, the agreement stipulated that it was to survive any divorce decree. The agreement was submitted for approval to the divorce court, which had the duty of making a fair and equitable disposition of the property of the parties. The settlement was approved and incorporated into the divorce decree. The Commissioner then assessed a gift tax against the wife on the excess of property she gave the husband over what she received. The Supreme Court held no gift tax was due. The reasons given for

\textsuperscript{24} E.T. 19, 1946-2 \textsc{Cum. Bull.} 166. A few earlier estate tax cases had held that the release of support rights was not consideration for estate tax purposes, but the Commissioner declined to follow them. \textit{Id.} at 168. This ruling held that the Bureau would make an allocation of the settlement between support and inheritance rights, in the absence of a "reasonable allocation by the parties." \textit{Id.} at 169.

\textsuperscript{25} \textsc{Int. Rev. Code of 1954}, § 2053(c) (1) (A) requires a showing of consideration for estate tax deductibility of claims against the estate only where the claim is "founded on a promise or agreement." For the proposition that payments pursuant to a divorce decree are not so founded, see Commissioner v. Maresi, 156 F.2d 929 (2d Cir. 1946); Commissioner v. State Street Trust Co., 128 F.2d 618 (1st Cir. 1942); Fleming v. Yoke, 53 F. Supp. 552 (N.D. W. Va.), aff'd, 145 F.2d 472 (4th Cir. 1944); Silas B. Mason Estate, 43 B.T.A. 813 (1941). See notes 104-13 infra and accompanying text.

\textsuperscript{26} Commissioner v. Converse, 163 F.2d 131 (2d Cir. 1947) (settlement modification during trial was litigated in the divorce action).

\textsuperscript{27} William B. Harding, 11 T.C. 1051 (1948); Edward B. McLean, 11 T.C. 543 (1948) (holding E.T. 19 invalid insofar as it embraces such transfers); Albert v. Moore, 10 T.C. 393 (1948); Clarence B. Mitchell, 6 T.C. 159 (1946); Herbert Jones, 1 T.C. 1207 (1943). See also Lasker v. Commissioner, 138 F.2d 989 (7th Cir. 1943). \textit{But cf.} Clarissa H. Thomson, P-H 1947 T.C. Mem. Dec. ¶ 47194.

\textsuperscript{28} Commissioner v. Barnard's Estate, 176 F.2d 233 (2d Cir. 1949) (payment for husband's interest in wife's property); Krause v. Yoke, 89 F. Supp. 91 (N.D. W. Va. 1950) (agreement consummated before entry of divorce decree).

\textsuperscript{29} 340 U.S. 106 (1950).
this conclusion were: the agreement was contingent on divorce; the actual property transfer was effected by the court decree rather than by the parties; the agreement was approved by a court which was obligated to decree a just property settlement; and the circumstances were similar to a bargain and sale in the ordinary course of business.

Subsequent decisions have accented various factors in the *Harris* case as determinative. Thus, the First Circuit follows *Harris* only where the actual property transfer cannot take place until after the divorce decree has been rendered, the Second and Ninth Circuits rest *Harris* on the approval of the agreement by a court which state law required to make an equitable distribution of the parties' property. Apparently, such approval is deemed to be a guarantee that the husband has agreed to transfer to his wife no more than the minimum required by law.

However, the tenor of *Harris* seems to be that the gift tax aims primarily at those lifetime transfers which are likely estate tax avoidance devices. Divorce settlements are too drastic to be attractive for estate depletion purposes, even though they may theoretically be so used. Therefore, whenever a divorce actually occurs, a transfer in settlement of the rights of the parties, like a property division upon the dissolution of a partnership, is not a taxable gift. This philosophy is also inherent in section 2516's exemption of marital settlements occurring within two years of divorce.

The proposed Treasury regulations for section 2516 do not fully implement this philosophy. Although these regulations do not treat 2516 as exclusive, they allow a settlement not within the statutory language to escape the gift tax only when the agreement is conditioned upon the entry of a court decree incorporating its terms. However, taxing all marital settlements not meeting

---

30. Id. at 110.
31. Id. at 111-12. The significance of this factor is diminished by the fact that a $47,650 transfer was not incorporated into the divorce decree. Id. at 119 n.3 (dissenting opinion).
32. Id. at 109.
33. Id. at 112.
34. McMurtry v. Commissioner, 203 F.2d 659, 664-65 (1st Cir. 1953).
35. Newman v. Commissioner, 222 F.2d 131, 136 (9th Cir. 1955); Rosenthal v. Commissioner, 205 F.2d 505, 508 (2d Cir. 1953). See also Estate of Chester H. Bowers, 23 T.C. 911 (1955).

"It may well develop that the cheapest way of making a substantial gift to a member of the opposite sex... would be to enter into marriage with such person, and shortly thereafter make the desired transfer by way of a property settlement incorporated into a divorce decree."

37. The analogy to a partnership dissolution was one of the bases of the *Harris* opinion. 340 U.S. at 112.
38. See text at note 19 supra.
the conditions of section 2516 or its regulations would set an illogical limitation on the rationale underlying the section. Agreements pursuant to legal separation furnish examples. Although legal separation usually does not terminate the inheritance rights of the wife in her husband's property, separation agreements often provide for their satisfaction. And in the majority of states, such agreements cannot be conditioned on the entry of a decree of separation.

There is little danger, however, that separation agreements will be used as estate tax avoidance devices. Apart from the fact that tax savings offer an insufficient incentive to disrupt a marriage, the estate tax now expressly permits the husband to leave half his property to his wife tax-free. Accordingly, if settlements pursuant to legal separation were not taxable, a tax advantage would be gained only if the parties reunited, and the wife received half of the husband's remaining estate tax-free upon his death. But this danger would appear to be no greater than the danger that a divorced husband may remarry and leave half his estate tax-free to his new wife. Therefore, so long as the parties have formalized their decision in a court decree, gift tax liability should not turn on whether they are free to reunite.

The tax cost of failing to qualify under section 2516 or Harris is not offset by any savings in the income tax treatment of the transfer. The classification of the transfer to the wife as a taxable gift does not shelter the husband from income tax liability for appreciation on the property at the time of the transfer. For the relinquishment of inheritance rights, which is not consideration under the gift tax, is consideration for income tax purposes. Therefore if a husband transfers appreciated property to his wife in settlement of dower in a transaction not covered by 2516 or the Harris rationale, he may be deemed to have made both a gift of the property for gift tax purposes, and a sale for income tax purposes. The dual taxation of a marital settlement can be rationalized under orthodox tax theory by viewing the single transaction as two separate transfers. If, instead of donating the appreciated property to his wife, the husband had sold it on the open market and transferred the proceeds of the sale to his wife, he would be liable for an income tax on the gain from the sale, and a gift tax on the transfer of the proceeds. The tax cost of this dual

40. 2 Vernier, American Family Laws 482 (1932).
41. 1 Nelson, Divorce and Annulment 489 (2d ed. 1945).
43. See notes 9-12 supra and accompanying text.
44. Compare Parid-Es-Sultaneh v. Commissioner, 160 F.2d 812 (2d Cir. 1947) (release of dower is considered for income tax purposes), with Merrill v. Fahs, 324 U.S. 308 (1945) (release of dower is not considered for gift tax purposes). See also Frank, J., in Commissioner v. Beck's Estate, 129 F.2d 243, 246 (2d Cir. 1942):

"At the bottom of respondents' contentions is this implied assumption: The same transaction cannot be a completed gift for one purpose and an incomplete gift for another. Of course, that is not true. . . . Perhaps to assuage the feelings and the understanding of affected taxpayers, Congress might use different symbols to describe the taxable conduct in the several statutes, calling it a 'gift' in the gift tax law, a 'gaft' in the income tax law, and a 'geft' in the estate tax law."
classification may be partially mitigated if under state law the parties are deemed husband and wife at the time of the transfer, and if the wife is given more than a life estate. For the Code permits a husband in computing gift tax liability to deduct half the value of an interminable interest given to his wife.

The duality in classification also complicates the problem of assigning a basis to the transferred property. Section 1015(b) provides that the basis of property acquired by a transfer in trust shall be the same as it would be in the hands of the grantor, increased by the amount of gain he recognized on the transfer. Therefore, the beneficiaries of an alimony trust profit from any income tax the husband is forced to pay on creation. However, section 1015(a) provides that property transferred in trust by gift shall retain the basis it had in the hands of the grantor. In view of this provision it is arguable that a transfer of appreciated property which is both a sale for income tax purposes and gift for gift tax purposes does not receive a stepped-up basis. It is more consistent with the policy of 1015(a), however, to hold that if one party has recognized gain for income tax purposes the beneficiaries need pay tax only on the accretion which has not been previously recognized.

Apart from the treatment accorded the settlement of the wife's interest, provisions in an alimony trust for the benefit of the children of the parties may give rise to gift tax liability. Reasonable payments for the support of the children during their minorities, like payments for the support of the wife, are deemed made for a valuable consideration. However, payments in excess of

45. See Keezer, Marriage and Divorce 305 (3d ed. 1946):

"An absolute divorce . . . is a full and complete dissolution of the marriage tie, abrogating all marital rights and obligations and leaving both parties to all intents and purposes, single persons . . . .

"[A] mere legal separation . . . simply . . . [frees] the innocent party from the presence and control of the guilty one until they agree to renew cohabition."

46. Int. Rev. Code of 1954, § 2523. However, this section will be of little help in the trust situation because the interest of the wife must not be a "terminable interest." See Surrey, Federal Taxation of the Family—The Revenue Act of 1948, 61 Harv. L. Rev. 1097, 1140-47 (1948).


48. Id. § 1015(a).

49. See Edna W. Gardner Trust, 20 T.C. 885 (1953), allowing an increased basis for stock in trust, even though the wife had only a life estate and the trust agreement stated it was a "voluntary gift." This decision was acquiesced in only as to pre-1932 transfers. 1953-2 Cum. Bull. 4.

The term "gift" in the basis sections seems to refer to a gift in the common law sense of donative intent, rather than a transfer for less than adequate and full consideration. Lowndes & Kramer, Federal Estate and Gift Taxes 753-57 (1956). Where property is transferred directly to the wife pursuant to a settlement, courts have generally allowed her to use the increased basis. See Commissioner v. Patino, 186 F.2d 962 (4th Cir. 1950); Farid-ES-Sultaneh v. Commissioner, 160 F.2d 512 (2d Cir. 1947); Aleda N. Hall, 9 T.C. 53 (1947); cf. Rouse v. Commissioner, 159 F.2d 706 (5th Cir. 1947); John S. Thompson, 22 T.C. 275 (1954); Gordon R. Edwards, F-H 1954 T.C. Mem. Dec. 8 54117.

the reasonable value of minor children's rights to support or payments for adult children are subject to the gift tax.51 And the amounts which the parties have set out for the support of their minor children will not be taken as a reasonable valuation of these rights, since the parties are not deemed to deal at arm's length where the support of their children is involved.52

If the provision made for the children is a remainder interest, that portion of the trust should ordinarily be deemed a gift. Clearly, if other sums set aside for their support are sufficient, the remainder interest is without consideration.53 If, however, the settlement recites that the remainder is the husband's sole contribution to the children's support, such a designation should be deemed the consideration for the children's rights to support only where the remainder is readily marketable. Since the wife will not be able to use unsaleable property for their support, it is more reasonable to assume that the amounts allocated for the wife's maintenance include a sum for support of the children. Having provided for the children, the husband should not be able to pass a remainder to them under the guise of a provision for their support. One exception to this view seems proper, however. If the husband can show that the wife demanded as part of the consideration for her settlement that the children be designated remaindermen, and if a transfer to the wife is protected by 2516 or Harris, she should be considered donor of the remainder for gift tax purposes.54 Thus the question is not whether any gift tax is due on the remainder, but only who should pay it.

**TAX ON TRUST INCOME**

The provisions for income tax on alimony payments made directly or through a trust represent an effort to shift the liability from the husband to the wife. Prior to 1942, alimony payments were treated like money spent for

---

51. Rosenthal v. Commissioner, 205 F.2d 505 (2d Cir. 1953); Hooker v. Commissioner, 174 F.2d 863 (5th Cir. 1949); Karl T. Wiedemann, 26 T.C. 565 (1956); Edmund C. Converse, 5 T.C. 1014 (1944), aff'd on other grounds, 163 F.2d 131 (2d Cir. 1947).

52. Ronald M. Hooker, 10 T.C. 388, 391 (1948), aff'd, 174 F.2d 863 (5th Cir. 1949). Taxpayers have also argued that there should be no gift tax liability where the provisions for the children were in a settlement agreement incorporated in a divorce decree. This reasoning was accepted in John R. Geary, P-H 1943 T.C. Mem. Dec. ¶ 43259, but it has been repudiated in more recent decisions. Rosenthal v. Commissioner, supra note 51; Ronald M. Hooker, supra. And see Karl T. Wiedemann, supra note 51, where a gift tax was assessed on the designation of an adult child as remainderman of an alimony trust, even though the parties had no agreement and the trust was created by the divorce court upon the “suggestion” of the taxpayer.

53. Hooker v. Commissioner, supra note 52.

54. Cf. Robert Lehman, 17 T.C. 652 (1951), and Ruth L. Lehman, P-H 1955 T.C. Mem. Dec. ¶ 55229 (allowing husband to deduct and requiring wife to report payments made to wife's mother by husband pursuant to marital settlement). See also John R. Geary, P-H 1943 T.C. Mem. Dec. ¶ 42259 (fact that wife requested designation of children as remaindermen stressed in holding husband not liable for gift tax). Viewed as part of the wife's settlement, the remainder to the children should have the same tax consequences as an outright transfer to the wife. Thus if the conditions of Harris or 2516 are not met,
the wife's support during the marriage. The husband could not reduce his income by the amount so expended and the wife did not recognize the alimony as income.\(^{55}\) Similarly, the income from alimony trusts was taxable to the husband rather than the wife,\(^{56}\) unless creation of the trust absolutely discharged his obligation.\(^{57}\) In 1942, however, Congress amended the Code to place the income tax burden of alimony payments on the wife;\(^{58}\) tax liability for payments made to support minor children remained on the husband.\(^{59}\) This congressional purpose was effectuated differently for alimony trusts than for direct payments, and the distinction may be a crucial factor in choosing between these two arrangements.

The scheme for the taxation of direct alimony payments is embodied in complementary provisions for recognition of income by the wife and deduction from income by the husband. The wife is taxed on periodic payments of alimony made pursuant to divorce, separation or support decrees, or pursuant to a written separation agreement.\(^{60}\) Even payments that are derived from the remainder may be a taxable gift from the husband. In theory, the wife would then also pay a gift tax on the remainder since she has donated the husband's gift to the children. But inasmuch as the two gifts are merely constituent parts of one transaction, the imposition of gift tax liability on the husband should bar a claim against the wife.


\(^{56}\) Helvering v. Fitch, 309 U.S. 149 (1940); Douglas v. Willcuts, 296 U.S. 1 (1935); Mary R. Spencer, 20 B.T.A. 58 (1930). The Treasury had first ruled that alimony trust income was taxable to the husband. Within a year it revoked this ruling and stated the wife was to be taxed. Still later, the Treasury returned to its original decision. Gornick, *Taxation of Alimony Trusts*, 20 Taxes 529 (1942).


\(^{59}\) Int. Rev. Code of 1939, §§ 22(k), 171(a), as amended, 56 Stat. 816 (1942) (now Int. Rev. Code of 1954, §§ 71(b), 682(a)). The husband is taxable only where the payment is fixed by decree or agreement as payable for the support of his minor children. The constitutionality of §§ 71 and 682 was upheld in Fairbanks v. Commissioner, 191 F.2d 680 (9th Cir. 1951); Mahana v. United States, 88 F. Supp. 285 (Ct. Cl.), cert. denied, 339 U.S. 978 (1950); Muriel Dodge Neeman, 26 T.C. 864 (1956); Daisy M. Twinam, 22 T.C. 83 (1954).

\(^{60}\) Int. Rev. Code of 1954, § 71. Prior to 1954 the section required that payments be pursuant to a decree of divorce or legal separation. Relief was not extended to husbands making alimony payments under a voluntary agreement. The purpose of this limitation was to prevent income tax evasion by a fraudulent agreement which would divide the income of the husband into two lower tax brackets. See Smith v. Commissioner, 168 F.2d 466, 468 (2d Cir. 1948); Gornick, *Alimony and the Income Tax*, 29 Cornell L.Q. 28, 40 (1943); Note, 47 Mich. L. Rev. 726 (1949). However, this objection to deduction of voluntary payments was removed by passage of the joint return amendments, expressly
husband's principal or tax-exempt securities constitute income to the wife.\textsuperscript{61} On the other hand, the husband can deduct all amounts recognized by his wife.\textsuperscript{62} However, satisfaction of the alimony obligation by installments payable within a ten year period is considered a division of the husband's property rather than a plan for periodic payments from his income, and accordingly the payments are neither taxable to the wife nor deductible by the husband.\textsuperscript{63}

Alimony trusts are divided into two categories for income tax purposes: those created pursuant to the alimony agreement and pre-existing trusts employed to satisfy the alimony obligation. Section 682, dealing with pre-existing trusts, provides that the wife may be taxed only upon distributions from the income of the trust.\textsuperscript{64} Section 71, governing trusts incident to divorce or separation, seems to require the wife to recognize all payments from the trust, including those from principal and tax-exempt securities.\textsuperscript{65} Both sections prescribe the same treatment for the husband: the alimony distributions to his wife are not includible in his income.\textsuperscript{66}


"With tax rates at their present levels, the income-splitting privilege is so valuable that the loss of a wife to upper—and even medium—bracket taxpayers means a very significant increase in tax burden. Even with a deduction for alimony, the parting of the ways entails a substantial tax cost."

\textsuperscript{61} H.R. REP. No. 2333, 77th Cong., 1st Sess. 46 (1942). Although it does not explicitly refer to tax-exempt income, § 71 has been interpreted to include all alimony payments, regardless of source. See Muriel Dodge Neeman, 26 T.C. 864 (1956).

\textsuperscript{62} INT. REV. CODE OF 1954, § 215. Where the payments continue beyond the death of the husband, his estate may deduct them for income tax purposes. This is true even though the estate may have previously deducted the commuted value of the wife's interest for estate tax purposes. Izrastzoff v. Commissioner, 193 F.2d 625 (2d Cir. 1952); Laughlin's Estate v. Commissioner, 167 F.2d 828 (9th Cir. 1948); Young, \textit{Tax Problems Involved in Divorce}, 1949 U. ILL. L. FORUM 670, 692; G.C.M. 25999, 1949-1 CUM. BULL. 116.

\textsuperscript{63} INT. REV. CODE OF 1954, § 71(c) provides that installments discharging an obligation, the principal sum of which is specified in the decree or agreement, are not treated as periodic payments. If, however, the principal sum is or may be paid over more than ten years from the decree date, the wife must include the payments to the extent they do not exceed 10% of the principal sum each year.

It could be argued that § 71(c) would not require the wife to include payments from an alimony trust which is to pay her for only nine years. In that case, § 71(d) would probably apply as well and the husband would have to recognize the trust income under § 677, since it discharges his legal obligation. See Douglas v. Willcuts, 296 U.S. 1 (1935).

\textsuperscript{64} Section 682 declares that the wife shall include "the income of any trust" that she is entitled to receive. See 1942-2 CUM. BULL. 409-10.

\textsuperscript{65} See note 61 supra and accompanying text. Mannheimer, \textit{Tax Consequences of Divorce Decrees}, 40 IOWA L. REV. 543, 546 (1955). Where the trust is created from jointly owned property, the wife must recognize payments attributable to her husband's interest in full, but payments from her own share are taxed only to the extent they are from trust income. This does not apply where the wife received her interest from her husband as a gift in contemplation of divorce. Proposed U.S. Treas. Reg. § 1.71-1(c)(4); Mannheimer, supra at 545.

\textsuperscript{66} INT. REV. CODE OF 1954, §§ 71(d), 682(a).
ALIMONY TRUSTS

The fact that direct periodic payments are included in the husband’s gross income and then deducted, while alimony trust payments are simply excluded, is significant in the light of other deductions. Adjusted gross income will be greater when direct payments are employed, because the alimony deduction is not taken until taxable income is computed. Therefore, a taxpayer desiring to obtain the largest possible charitable deduction should utilize direct alimony payments. One whose charitable contributions are small but who is interested in maximizing his deduction for extraordinary medical expenses will benefit more from the use of a trust. Similarly, a taxpayer who, in the absence of alimony, would use the standard deduction should favor the trust device, since the standard deduction will wipe out an alimony deduction, but not an exclusion.

The deduction-exclusion distinction can be crucial where the husband is beneficiary of a pre-existing trust that distributes corpus or tax-exempt income. If he assigns his interest in such a trust to his spouse, she will receive distributions from tax-exempt income and principal tax-free. If he retains the beneficial interest and pays her a like amount, she will be taxed on these payments. He should then be entitled to deduct that amount from his taxable income. An example will best illustrate this difference: The husband has $20,000 income in one year, $10,000 wages and $10,000 income from a trust funded with tax-exempt securities. His taxable income is $10,000. His estranged wife demands $10,000 a year as alimony. If he assigns her his interest as trust beneficiary, his taxable income remains $10,000 and she need not include the amount in her income. If, however, he remains the recipient of the trust and pays her $10,000 cash, he can presumably deduct the payment and his taxable income is zero. Of course, the wife will never accept the same dollar amount of taxable as non-taxable income; however, she should be willing to accept the same amount after taxes in both situations. If the husband is

69. Section 213(a)(1) allows the deduction of only those medical expenses in excess of 3% of adjusted gross income. See Rich, supra note 68, at 1093.
70. Section 63(b) provides that a taxpayer who elects the standard deduction may deduct only exemptions and the standard deduction to compute his taxable income. See Rich, supra note 68; Mannheimer, supra note 65; McDonald, Tax Aspects of Divorce, Separation, Alimony and Support, 17 U. Pitt. L. Rev. 1, 14 (1955).
73. Section 215 allows the husband to deduct all amounts includible in the wife’s income under § 71. A deduction is disallowed for any amount which is excluded from the husband’s gross income by virtue of §§ 71(d) and 682. But income from tax-exempt securities is excluded from the husband’s gross income by § 103.
in a higher tax bracket than the wife, the added amount of taxable income that she will accept in lieu of tax-exempt income may be less than the sum which he can free by taking the alimony deduction.  

This advantage of a deduction over an exclusion is magnified when the husband creates the trust to satisfy his alimony obligation. The wife must include all payments from a section 71 trust in her income, but the husband gains an exclusion only for the trust income otherwise taxable to him. Thus, insofar as the wife is paid from the trust corpus, the increase in her tax burden is not matched by a corresponding deduction to her husband. In contrast, if the husband named himself beneficiary of the trust and paid his wife a stipulated sum directly, he would recognize only the income, but could deduct the full amount of his alimony payments, including that derived from the distribution of corpus. From an income tax standpoint, therefore, it would be unwise for a husband to set up a trust, which, being insufficiently funded to pay the wife from income, allows her to draw from principal and obligates the husband to replenish the corpus periodically.

For similar reasons the husband should not fund a specially created alimony trust with tax-exempt securities. Section 71 literally requires the wife to include "all payments" in her income, without regard to their source. Trust income from tax-exempt securities should therefore be included in the wife's income, even though prior to 1942 that income would have been taxable to neither husband nor wife. And the husband is not given the offsetting deduction available if he had paid the alimony directly. In Anita Quinby Stewart, however, a case allowing the wife to exclude the tax-exempt income of a pre-existing trust, the Tax Court confused the distinction between sections 71 and 682. While a dictum suggests that a wife may exclude the tax-exempt income from both types of alimony trusts, this result is inconsistent with the language of section 71.

74. Assume that the husband has a taxable income of $20,000 and is, in addition, life beneficiary of a trust yielding $10,000 tax-exempt income annually. Assume also that the wife, having no other income, demands a yearly alimony payment that will yield her $10,000 after taxes. If the husband assigns the trust income to her, his tax will be $7260. If, however, he remains beneficiary of the trust, he will have to pay her $15,000 a year which will be fully deductible. His tax will thereby be reduced to $1100. Thus, the direct payment of $5000 more will save him $6260 in taxes, a net gain of $1260 per year.

75. See notes 64-66 supra and accompanying text.

76. See text at notes 60-62 supra; Starr, Alimony as an Income Tax Deduction, 27 Taxes 975, 983 (1949).

77. In Muriel Dodge Neeman, 26 T.C. 864, 867 (1956), the taxpayer argued unsuccessfully that she should not be taxed on sums that were not taxable to her husband before 1942. Her theory was that § 71 was intended merely to shift the income tax on sums previously taxable to the husband.


79. The Tax Court apparently thought it was dealing with a case arising under § 71 (then Int. Rev. Code of 1939, § 22(k)). It reasoned that the "last sentence" (actually a cross reference provision) of 71 directed that all alimony trusts be covered by § 682(b) (then § 171(b)). And, the court pointed out, § 682(b) required the wife to pay tax only
There is no policy justification for treating section 71 trusts less favorably than pre-existing trusts and direct payments. The requirement that a wife include all distributions from a section 71 trust in her income was patterned after the provision for direct payments. This analogy to direct payments, however, is misleading. For the husband who pays his wife directly from his tax-exempt income or principal is nevertheless entitled to a deduction. Since he may use this deduction to offset other taxable income, it is reasonable to tax the wife on direct alimony payments from the husband's non-taxable sources. But the husband obtains no comparable reduction of taxable income when the wife is paid by a trust from tax-exempt income or principal. Accordingly, the recognition provisions of section 71, intended merely to shift the incidence of the income tax, actually create a new source of taxable income. To align the provision with its original purpose, section 71 should be amended by adopting section 682's provision that the wife recognize only distributions of taxable income from an alimony trust.

Absent such an amendment, however, the husband can create an alimony trust without income tax disadvantage. First, tax-exempt securities, priced to yield a lower rate return than taxable securities, should not be purchased. Second, even if the husband cannot afford to fund the trust adequately, he should allow the wife to be paid only from trust income and bind himself personally to make up income deficiencies to a stipulated sum. This should be acceptable to the wife tax-wise, since her tax consequences will remain the same as if she were satisfied from trust corpus. However, the husband is able

---

80. Indeed, the provisions for alimony trusts created incident to divorce are incorporated in the same section that governs direct periodic payments. Int. Rev. Code of 1954, § 71(a).

81. The improbable case of the husband who has no taxable income to offset against the alimony deduction has arisen. In Muriel Dodge Neeman, 26 T.C. 864 (1956), the taxpayer's income consisted almost entirely of interest from tax-exempt securities. Since, however, such cases are rare, a blanket rule requiring the wife to recognize income on the payments from the tax-exempt income of her husband may be reconciled with the Code's purpose of merely shifting income tax burdens on the ground of administrative convenience.

82. See notes 55-59 supra and accompanying text.

83. The Senate had introduced alimony relief provisions in 1941. These provisions treated all alimony trusts in the same manner, requiring the wife to recognize only trust income. The 1941 revision was dropped in Conference Committee, with the understanding that it would be dealt with in a later bill. 1 SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAWS 1280-85 (1954). When the House later promulgated the 1942 alimony provisions, no reasons were given for the change in treatment of trusts created incident to divorce. See H.R. REP. No. 2333, 77th Cong., 2d Sess. 46 (1942).
not only to exclude all trust income, but also to deduct from his taxable income any deficiencies that may arise.84

Estate Tax

At least part of an alimony trust may be includible in the taxable estate of the husband. Sections 2036 through 2038 provide that inter vivos transfers not actually completed before the transferor's death are subject to the estate tax. Section 2036 condemns transfers in which the transferor has retained a life estate;85 section 2037, transfers in which the transferor has retained a reversionary interest;86 and section 2038, transfers subject to a power of the transferor to alter, amend or revoke.87 These sections do not apply to any transfer that is a "bona fide sale for an adequate and full consideration in money or money's worth."88 However, since section 2043 provides that the relinquishment of dower or other marital rights in the decedent's property is not such consideration,89 only the portion of the alimony trust allocable to the wife's right to support—legal consideration from the tax standpoint90—can

84. DuPont v. United States, 104 F. Supp. 978 (Ct. Cl. 1952) (the husband can deduct payments to supplement trust income under agreement incident to modification of divorce decree).
85. Under the statutory language, he must retain possession and enjoyment of the property himself or the right to determine who shall enjoy it. INT. REV. CODE OF 1954, § 2036. See 1 BEVERIDGE, FEDERAL ESTATE TAXATION 299-331 (1956).
86. The section has a dual requirement: the beneficiary must not be able to enjoy his interest unless he survives the grantor and the grantor must have a reversion that is worth at least 5% of the value of the property just before his death. 1 BEVERIDGE, FEDERAL ESTATE TAXATION 391-408 (1956).
87. This power is condemned whether the settlor possesses it alone or in conjunction with any other person. 1 BEVERIDGE, FEDERAL ESTATE TAXATION 430-36 (1956).
88. This exception is contained in each of the sections.
89. INT. REV. CODE OF 1954, § 2043(b).
90. E.T. 19, 1946-2 CUM. BULL. 166. Early cases had held that support rights were "other marital rights" in the husband's estate and applied the 2043(b) prohibition to them. Helvering v. United States Trust Co., 111 F.2d 576 (2d Cir. 1940); Meyer's Estate v. Helvering, 110 F.2d 367 (2d Cir. 1940). The Commissioner, however, decided not to follow these cases in the divorce or legal separation context. E.T. 19, supra at 166. But where there is no divorce or legal separation, the wife's support rights do not qualify as consideration. Estate of Robert M. McKeon, 25 T.C. 697 (1956).
91. E.T. 19 also provides that the reasonable value of support rights for the children of the parties is consideration in the divorce context. This same result had been previously reached on the ground that the support right of a child is not one of the wife's marital rights and consequently is outside the scope of 2043(b). Helvering v. United States Trust

ALIMONY TRUSTS

qualify as a sale. Thus, a husband who retains the forbidden controls may be forced to include in his estate the value of the alimony corpus in excess of the value of the wife's support right. In computing the tax, however, the estate may take a credit for any gift tax paid on the original transfer, and perhaps also a deduction under section 2053.

Alimony trusts can be considered a main target of section 2037. A common provision in such trusts is: "To wife for life, remainder to children, but if she predeceases husband, or remarries before his death, then to him." If the value of the husband's reversion is five per cent or more, and it will be if they are approximately the same age, the trust is taxable under 2037. And the husband's estate must include the value of the remainder. To avoid a section 2037 pitfall the husband must relinquish any rights to receive the property if he survives the wife.

While a husband may forego the powers condemned by sections 2037 and 2038, it is questionable whether he can escape section 2036. There are no reported cases testing a trust for the support of a divorced or separated wife under section 2036. But in a different context, the Second Circuit held that a husband retained a life estate in a trust by directing that the income be paid

---

91. The taxpayer could argue that all property transferred to the wife pursuant to court decree is for "adequate and full consideration," pointing to cases holding such a claim deductible against the estate. See notes 104-113 infra and accompanying text. The only time this argument was attempted, the court accepted it but ruled against the taxpayer on another ground. Bank of New York v. United States, 115 F. Supp. 375 (S.D. N.Y. 1953). However, the analogy is weak since a claim based on a court decree can be deducted without regard to consideration; only claims based on a "promise or agreement" require proof of consideration. Section 2053(c)(1)(A).

A stronger argument would be that § 2516, dealing with the analogous gift tax problem, shows a congressional intent to view divorce as an exception to the restrictions of 2043(b). See Commissioner v. Watson's Estate, 216 F.2d 941, 945 (2d Cir. 1954); Lowndes & Kramer, Federal Estate and Gift Taxes 322-23 (1956); Taylor, Effect of Property Settlements Incident to Divorce, N.Y.U. 13TH INST. FED. TAX. 305, 313-14 (1955).

92. Section 2012 allows a credit against the estate tax for any gift tax paid on property which is later included in the taxable estate. 2 BEVERIDGE, FEDERAL ESTATE TAXATION 311-15 (1956). The credit, however, does not include interest the transferor has lost on the gift tax payment to the Government. Moreover, § 2012 offers no relief to a husband who used his gift tax exemption for the marital transfer and thereby paid a higher tax on later transfers.

93. See notes 104-13 infra and accompanying text.


95. Thus, where the grantor dies at 72 and his wife is then 65, the value of his reversion is 28.28% of the value of the property. 2 RABKIN & JOHNSON, FEDERAL INCOME GIFT AND ESTATE TAXATION 5621 (1954).
to his wife for her support and maintenance. Since the payments from the trust satisfied the husband's obligation of support, he was regarded the real income beneficiary of the trust. On the same theory, a husband may be considered the income beneficiary of an alimony trust: insofar as the husband's obligation of support survives the creation of the trust, the payments to the wife discharge a continuing indebtedness. However, even under this view of section 2036, a husband should be free from the estate tax if the creation of the trust extinguishes his duty of support. Since the liability of the husband terminates at the trust's creation, he cannot be considered income beneficiary at the time of his death. This argument had an analogue in the income tax field before the 1942 amendments. Reasoning that the husband is constructive beneficiary of an alimony trust only if the income is devoted to the payment of his indebtedness, the Supreme Court held that he is not taxable on income from a trust whose creation extinguished his obligation of support.

Estate tax discrimination against trusts which fail to extinguish the husband's support obligation, however, is unjustified. The policy underlying section 2036 is to tax inter vivos substitutes for testamentary transfers. Tested against this purpose, the fact that the husband remains liable after the creation of a trust is immaterial. Accordingly, all alimony trusts should be similarly viewed under 2036. This consistency should be effected by exempting all alimony trusts from the section. For absent a retention of 2037 or 2038 controls, an alimony trust is no more a substitute for a testamentary transfer than is any inter vivos transfer in which the grantor creates a life estate in one party and a remainder in another. Furthermore, the present income tax provisions afford additional support for not applying 2036 to alimony trusts: the husband is no longer treated as income beneficiary of an alimony trust that fails to extinguish his obligation of support.

---


97. See 1 BEVERIDGE, FEDERAL ESTATE TAXATION 316-17 (1956).

98. See 2 RABKIN & JOHNSON, FEDERAL TAXATION 5241-42 (1954); LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES 146 (1956):

"Although the income from an alimony trust is taxable to the spouse to whom the income is paid, and for income tax purposes is no longer regarded as the income of the spouse who created the trust, it is difficult to see anything which would prevent the trust from being taxed to the estate of the creator of the trust under Section 2036(a) of the estate tax, provided that the creation of the trust did not extinguish his obligation to support the beneficiary of the trust. . . ."

99. In pre-1942 income tax cases, the test used was whether "local law and the alimony trust have given the divorced husband a full discharge and leave no continuing obligation however contingent." Helvering v. Fitch, 309 U.S. 149, 156 (1940). See Paul, supra note 55.


Assuming, however, that an alimony trust falls within sections 2036 through 2038, the husband's estate may not have to pay a tax on the entire affected portion. In addition to excluding the property "sold" for the wife's right of support, the estate may be able to deduct the property allocable to the wife's dower rights or their statutory substitutes. Although the Code expressly provides that the relinquishment of these rights does not constitute consideration section 2053, permitting deduction of claims in computing the taxable estate, requires consideration only for claims founded upon a promise or agreement. Reasoning that this requirement of consideration is exclusive, courts have allowed the deduction of a claim to the husband's property that is based upon court decree rather than the agreement of the parties.

Confusion, paralleling the debate in the gift tax field over the meaning of Harris, has arisen where the parties have negotiated a property settlement and submitted it to the divorce court for approval. The Supreme Court's position on the gift tax in Harris suggests that an estate tax deduction should be allowed where the settlement was arranged in contemplation of divorce, was to become effective only upon approval of the divorce court, and was ratified and incorporated into the divorce decree. To some lower courts, however, the absence of any one of these features bars deductibility. Thus the Tax Court has held that no deduction is permissible if the divorce court did not have power to modify a non-fraudulent agreement between the parties. Similar results have followed where the settlement was enforceable before the divorce decree and remained contractually enforceable thereafter.

On the other hand, the Second Circuit has refused to adopt so restrictive an interpretation. To this court, the prohibition on deduction of claims in consideration of the wife's dower rights was intended merely to deny specious

103. INT. REV. CODE OF 1954, § 2043 (b).
104. Section 2053 (c) (1) (A). The "promise or agreement" limitation was inserted in 1932 to insure the deductibility of "liabilities imposed by law or arising out of torts." H.R. Rep. No. 703, 77th Cong., 1st Sess. (1932), set out in 1939-1 CUM. BULL. Part 2, at 491.
106. See notes 29-42 supra and accompanying text.
107. See Rev. Rul. 54-29, 1954-1 CUM. BULL. 186, where the Harris criteria are set forth as grounds for deduction of wife's claim to life insurance proceeds.

In many states a property settlement that becomes effective only if divorce is obtained is invalid. 1 NELSON, DIVORCE AND ANNULMENT 506-07 (2d ed. 1945). Decisions such as Bank of New York, supra, and Bowers, supra note 108, would make deductibility virtually impossible in those jurisdictions.
claims. The fact of divorce coupled with court approval of the financial terms are sufficient safeguards against fraud. The 1948 amendments to the estate tax enabling a decedent to leave half of his estate tax free to his surviving spouse provide an additional reason for a liberal approach toward deductions of marital settlements. In view of this treatment, the husband who is allowed to deduct a marital settlement no longer has a tax advantage over the husband who remains married.

In sum, an alimony trust may be included in the husband's estate. But a deduction will be allowed for the value of the wife's right to support and, if the transfer is approved by the divorce court, possibly for the value of her dower rights as well. In general, this means that the maximum includible will be the value of the interests given to third parties. If alimony trusts are exempted from 2036, their inclusion in the taxable estate on other grounds is reasonable. Sections 2037 and 2038 cover only the property over which the grantor has retained such control that the transfer is equivalent to a testamentary gift. If, however, 2036 is construed to tax a remainder that has been given outright to a third party, it will only be because income imputed to the wife for income tax purposes has been attributed to the husband for the estate tax. To this extent, the husband can suffer a tax disadvantage from a trust without possessing any of the controls that the estate tax condemns.

**CONCLUSION**

Turning often upon formal distinctions, the tax consequences of alimony trusts are unusually complex. Factors, such as whether a trust has been approved by a court of competent jurisdiction, whether the creation of the trust discharges the support obligation, or whether the parties are divorced rather than separated may be of vital significance for income, gift and estate tax purposes. The parties would be ill-advised to choose an alimony trust without considering these problems. Yet until Congress, the courts or the Commissioner clarify some of the uncertain areas, a choice may have to be based largely upon conjecture about tax consequences.

A few generalizations, however, seem valid. If the husband is the beneficiary of a pre-existing trust, he may satisfy his marital obligations without adverse tax effects by assigning his interest to his wife. If the interest assigned is merely a life estate, he need not recognize gain upon the transfer. Moreover, by fitting within section 2516 or the *Harris* rationale he will be able to avoid

---

110. Commissioner v. Watson's Estate, 216 F.2d 941, 944-45 (2d Cir. 1954) (agreement was not contingent on divorce).
111. Ibid.
113. This is so unless the husband remarries and leaves half of his estate to the new wife. In that case he will be able to exceed the marital deduction by approximately half the value of the settlement with the first wife.
114. See *LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES* 121-23, 171 (1956).
a gift tax. And unless the husband also had control over the remainder follow-
ing his life estate, the trust can not be includible in his estate under section
2036. Only in the income tax field, is there a possibility of tax disadvantages.
If the trust distributes corpus or tax-free income, the wisdom of the assign-
ment will turn upon the relative tax brackets of husband and wife.

The creation of an alimony trust may be more costly. The transfer of appre-
ciated property may result in capital gains tax. While the problem of qualify-
ing under section 2516 and *Harris* is the same as in the case of a pre-existing
trust, a remainder to a third person will always be a taxable gift. Moreover,
unless the husband can fund the trust initially with sufficient property to
satisfy the wife's demand from income alone, he is caught in a dilemma be-
tween the income and estate taxes. For income tax benefits can be maximized
only by remaining personally liable for the income deficiencies of the trust. Yet
such a procedure may bring the trust within section 2036 of the estate tax.