UNFINISHED REFORM: THE TAX CONSEQUENCES OF DIVORCE

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Professor Malman examines the tax consequences of divorce in the wake of the Tax Reform Act of 1984. She notes that while the 1984 reforms simplified the tax treatment of divorce, they did not go far enough. Professor Malman argues that although an ideal system would distinguish between payments of future income and payments for property, such a distinction is administratively impractical and is not worth its minimal revenue advantages. She suggests a rule that allows former spouses to designate the nature of cash payments made to one another, with fallback provisions that would operate in the absence of taxpayer election.

INTRODUCTION

Prior to the enactment of the Tax Reform Act of 1984 (1984 Act), federal income tax treatment of marriage dissolution was complex and confusing. While tax rules were intended to rest on state family law, the substantive law concepts on which the rules were based had become outmoded. As a result, federal tax rules increasingly diverged from the principles of modern divorce law. In addition, tax results often turned on the vagaries of particular state rules. Taxpayers in different states received


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disparate treatment with respect to economically similar transactions. This divergence and disparity added uncertainty to an already troublesome area of the income tax laws and led to noncompliance.

In 1984, reacting to these problems, Congress reformed the income tax treatment of transactions related to divorce and separation. The ba-

2 The reform legislation is contained in §§ 421-425 of the 1984 Act. The income tax treatment of transactions related to divorce and separation under the 1984 Act is embodied in I.R.C. § 71 (Supp. 11 1984). Section 71 provides in relevant part:

(a) General Rule.—Gross income includes amounts received as alimony or separate maintenance payments.

(b) Alimony or Separate Maintenance Payments Defined.—For purposes of this section—

(1) In General.—The term “alimony or separate maintenance payment” means any payment in cash if—

(A) Such payment is received by (or on behalf of) a spouse under a divorce or separation instrument,

(B) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under this section and not allowable as a deduction under section 215,

(C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and

(D) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse (and the divorce or separation instrument states that there is no such liability).

(2) Divorce of Separation Instrument.—The term “divorce or separation instrument” means—

(A) a decree of divorce or separate maintenance of a written instrument incident to such a decree,

(B) a written separation agreement, or

(C) a decree (not described in subparagraph (A)) requiring a spouse to make payments for the support or maintenance of the other spouse.

(f) Special Rules to Prevent Excess Front-Loading of Alimony Payments.—

(1) Requirement that Payments Be for More than 6 Years.—Alimony or separate maintenance payment (in excess of $10,000 during any calendar year) paid by the payor spouse to the payee spouse shall not be treated as alimony or separate maintenance payments unless such payments are to be made by the payor spouse to the payee spouse in each of the 6 post-separation years (not taking into account any termination contingent on the death of either spouse or the remarriage of the payee spouse).

(2) Recomputation Where Payments Decrease by More than $10,000.—If there is an excess amount determined under paragraph (3) for any computation year—

(A) the payor spouse shall include such excess amount in gross income for the payor spouse’s taxable year beginning in the computation year, and

(B) the payee spouse shall be allowed a deduction in computing adjusted gross income for such excess amount for the payee spouse’s taxable year beginning in the computation year.

(3) Determination of Excess Amount.—The excess amount determined under this paragraph for any computation year is the sum of—
sic goal of this reform legislation was simplification. Its success, how-

(A) the excess (if any) of—
   (i) the amount of alimony or separate maintenance payments paid by the
       payor spouse during the immediately preceding post-separation year, over
   (ii) the amount of the alimony or separate maintenance payments paid by
       the payor spouse during the computation year increased by $10,000, plus
   (B) a like excess for each of the other preceding post-separation years.
In determining the amount of the alimony or separate maintenance payments paid by the payor spouse during any preceding post-separation year, the amount paid during such year shall be reduced by any excess previously determined in respect of such year under this paragraph.

(4) Definitions.—For purposes of this subsection—
   (A) Post-Separation Year.—The term “post-separation year” means any calendar year in the 6 calendar year period beginning with the first calendar year in which the payor spouse paid to the payee spouse alimony or separate maintenance payments to which this section applies.
   (B) Computation Year.—The term “computation year” means the post-separation year for which the excess under paragraph (3) is being determined.

(5) Exceptions.—
   (A) Where Payments Cease by Reason of Death or Remarriage.—Paragraph (2) shall not apply to any post-separation year (and subsequent post-separation years) if—
       (i) either spouse dies before the close of such post-separation year or the payee spouse remarries before the close of such post-separation year, and
       (ii) the alimony or separate maintenance payments cease by reason of such death or remarriage.
   (B) Support Payments.—For purposes of this subsection, the term “alimony or separate maintenance payment” shall not include any payment received under a decree described in subsection (b)(2)(C).
   (C) Fluctuating Payments Not Within Control of Payor Spouse.—For purposes of this subsection, the term “alimony or separate maintenance payment” shall not include any payment to the extent it is made pursuant to a continuing liability (over a period of not less than 6 years) to pay a fixed portion of the income from a business or property or from compensation for employment or self-employment.


In addition, Congress eliminated the requirement that the divorce or separation instrument provide that payments terminate at the death of the payee. Compare I.R.C. § 71(b)(1)(D) (Supp. II 1984) and text accompanying note 197 infra with I.R.C. § 71(b)(1)(D) (West Special Pamphlet 1987). Payments, however, must actually terminate at the death of the payee. Id.

ever, was limited because Congress left unclear the tax consequences of certain transactions and created new complexities with respect to other transactions. Two factors undercut the reform effort: Congress's failure to use modern concepts of marriage and divorce as the basis of its tax legislation, and its overemphasis on minor abuses at the expense of a coherent, comprehensive overhaul of the area.4

This Article discusses the income tax treatment of divorce after the 1984 Act,5 focusing on the appropriate tax treatment of alimony payments.6 It explores the question of who should be taxed on alimony payments and, after discussing various tax alternatives in light of family law concepts, concludes that the model currently used by the Internal Revenue Code is appropriate. Thus, alimony should be included in the recipient's income and should be deductible by the payor.

The Code's model, however, leads to problems of application because cash may be paid to a former spouse for different purposes: either as a way of sharing the marital property acquired prior to divorce, or as alimony, the sharing of an ongoing stream of income. This Article argues that ideally, the tax laws should not allow cash paid in a property settlement to be deducted by the payor and included in the recipient's

ABA Memorandum]. The fallback rules were intended to conform as closely as possible to the consequences normally expected from a reasonable system. Id. In addition, the Task Force's proposal aimed to establish a tax treatment of support which was as uniform among states as possible. Id. at 20.


6 Under modern divorce laws, spousal support generally is referred to as maintenance. See, e.g., N.Y. Dom. Rel. Law § 236, pt. B (McKinney 1981 & Supp. 1986). Because historically such payments were called alimony, and tax lawyers are familiar with that label, this Article will use the word alimony to denote maintenance, spousal support, and similar payments.
income, and thus a distinction should be made between alimony and cash paid in a property settlement.

Nonetheless, given the complicated nature of marital property under family law, there is no administratively practical way for the tax system to draw the alimony/property distinction. Because the alimony/property characterization does not have a significant revenue impact, this Article concludes that Congress should abandon its attempt to make the distinction. Instead, the Code should allow divorced spouses to designate which payments represent payments for marital property and which represent a shared income stream. A simple fallback rule should operate in the absence of the taxpayer's election.

Part I of this Article reviews the history leading to the 1984 reforms. Since tax rules are intended to rest on concepts employed by substantive state law, Part I discusses the development of state law principles and examines in particular the concept of marriage as a shared enterprise that is the basis for recent reforms dealing with the economics of divorce under state law. Part II discusses the conceptual underpinnings for the tax treatment of alimony. Because these concepts evidence fundamental and competing principles of tax policy, Part II examines the bases for their reconciliation and suggests how principles that emerge from state law, including the marital partnership model, can help formulate tax rules. Part III reviews specific sections of the 1984 Act in light of these underlying principles and concludes that while Congress's 1984 reforms substantially simplified the tax treatment of divorce, the statute remains complex without valid reason. Accordingly, Part III suggests how Congress may complete the reform process begun by the 1984 Act.

I

HISTORY OF THE ECONOMICS OF DIVORCE: SUBSTANTIVE LAWS AND FEDERAL TAX RULES

Unless the federal tax rules applicable to divorce and separation proceed from an understanding of current rather than outmoded concepts, the resulting tax treatment of divorce transactions can have unintended consequences. Moreover, in the absence of overriding tax policy, modern family law concepts may be useful in formulating basic tax rules. Thus, this discussion begins with a brief examination of family law concepts concerning the economics of divorce, exploring traditional concepts of property and alimony and then examining more modern concepts such

7 Although the 1986 Act simplified § 71, it retained rules that can fail to distinguish cash payments of property settlements from income-sharing arrangements, see notes 181, 194, 199 infra. Thus, even after the 1986 Act, the statute remains complex without valid reason.

8 The history of alimony and marital property rules has been well documented elsewhere.
as equitable distribution of marital property.

A. Traditional Concepts

1. Marital Property Rights Under Common Law

Under English common law, a husband became the owner of essentially all personal property owned by the wife at the time of marriage. Although the wife retained title to her real property, the husband had the exclusive right during marriage both to possess and manage the property and to receive income from it. The husband’s interest was alienable and subject to the claims of creditors. If the marriage produced a child, the husband also acquired the right to curtesy, a life estate in the wife’s realty.

In contrast, during the marriage, the wife’s only economic right was the right to support. She gained no vested property by virtue of marriage. She did receive an inchoate right to dower, which entitled her to a life estate in one-third of her husband’s realty if she outlived him. Dower followed the husband’s real property through all transfers he made but became possessory only upon his death.

Divorce terminated the rights to dower and curtesy. Alimony was regarded as an extension of the wife’s right to support after termination of the marriage. It prevented the supported spouse from becoming a...
public charge and compensated her for service during the marriage. In addition, alimony enabled the supported spouse to care for her children. Because under traditional common law the allocation of property followed title, alimony was the only means for providing an economic settlement between the spouses.

During the 1800s, Married Women's Property Acts modified the common law rules of most American states. These Acts gave a wife the right to own, manage, and control real and personal property; to enter into contracts; to conduct a separate business; and to keep her own earnings. The result was a separation of the spouses' assets: one spouse acquired an interest in the other spouse's property only at the latter's death; no property rights arose by virtue of the marriage itself. Upon dissolution of the marriage, property was still to be allocated to the titled spouse, and, theoretically, a court adjudicating the rights of contesting spouses could not transfer title from one spouse to another.

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18 K. Davidson, R. Ginsburg & H. Kay, Sex-Based Discrimination 271-72 (2d ed. 1981) (alimony was substitute for common law duty of support); see also H. Clark, supra note 8, § 14.5, at 442 (compensation for wife's services was another, though less recognized, rationale for alimony). Alimony was also a device for punishing guilty husbands. K. Davidson, R. Ginsburg & H. Kay, supra, at 271-72; see also Vernier & Hurlbut, supra note 17, at 197-201 (indicating also that "guilty" wife was not entitled to any support, despite fact that her needs were as great as those of innocent wife).

19 While child support payments were designed specifically to care for the children, alimony sustained the custodial parent. H. Clark, supra note 8, § 14.5, at 441.


22 Krauskopf, A Theory for "Just" Division of Marital Property in Missouri, 41 Mo. L. Rev. 165, 167-68 (1976). In this regard, commentators often point to New York law and the case of Wirth (Fischer) v. Wirth, 38 A.D.2d 611, 326 N.Y.S.2d 308 (1971) (mem.). In Fischer, both spouses were employed. At the husband's suggestion, the couple used the wife's earnings to support the family, and saved and invested the husband's earnings in assets held in his name but stated to be for the benefit of both spouses. The court held that the wife was not entitled to any portion of the assets since she knew that they were held solely in the husband's name. Id. at 612, 326 N.Y.S.2d at 311. A court could avoid the hardship of such rules through a lump sum award of alimony. See M. Glendon, State, Law and Family 265 (1977). A court might find instead that traditional equitable or legal principles required a transfer and therefore
Many states also eventually abolished dower and curtesy and enacted forced share statutes that limited the testamentary power of a spouse over a portion of his or her property.\textsuperscript{24} A widow continued to have greater property rights than did a divorced spouse because the latter lost all rights to a forced share.\textsuperscript{25} The divorced wife, however, may have been entitled to receive alimony.\textsuperscript{26}

2. Community Property

Marital property rights in traditional common law jurisdictions differed greatly from those in the eight community property states.\textsuperscript{27} The principle underlying a community property system is equality of property rights between husband and wife in property acquired during the marriage.\textsuperscript{28} Thus, under traditional community property rules, marriage
is viewed as an economic partnership and the property acquired during marriage is generally presumed to be community property. Although some states have departed from a rule of strict equality, in theory, each spouse is entitled to receive one-half of the community’s assets upon divorce.

B. Modern Concepts

This Section discusses two modern concepts: property allocations through equitable distribution and spousal support/alimony. Initially, it describes them as distinct concepts. This Section concludes, however, that state law often does not maintain a clear distinction between property allocations and spousal support/alimony.

1. Equitable Distribution of Property

Historically, dissolution of a marriage was typically grounded on fault and granted to the “innocent” spouse against the “guilty” one. Alimony was awarded not only as a substitute for the husband’s support obligation, but also as punishment for the “guilty” husband (or, if little alimony was awarded, as punishment for the “guilty” wife). Fault concepts provided the economically disadvantaged spouse, typically the wife, with her strongest economic bargaining chip: she could threaten to prevent a divorce by demonstrating her husband’s fault.

household tasks for which he or she is uncompensated. Hence, a spouse who is helplessly bedridden is entitled to a share of community property in the same way as a spouse who is a homemaker or one who earns a substantial income. See id. § 67.

29 W. De Funiak & M. Vaughn, supra note 28, § 60. This presumption is rebuttable. Id. § 60, at 118. There was a further presumption in California and New Mexico that property conveyed in writing to a married woman in her name was her separate property. Id. § 60.1. This presumption, however, has been eliminated by statute with respect to property acquired after July 1, 1973, in New Mexico, see N.M. Stat. Ann. § 40-3-12 (1986), and January 1, 1975, in California, see Cal. Civ. Code § 5110 (Deering 1984). W. Reppy & C. Samuel, supra note 28, at 38. Historically, the theory of equality was undercut in practice by rules that gave the husband the right to manage and effectively control the community’s assets. In Kirchberg v. Feenstra, 450 U.S. 455 (1981), the Supreme Court held that the Louisiana head and master statute which gave a husband the unilateral right to dispose of property without his wife’s consent unconstitutionally violated the equal protection clause of the fourteenth amendment. Rules giving the husband the right to effectively control the community’s assets have been eliminated in most jurisdictions. E.g., compare Cal. Civ. Code § 5125 (West Supp. 1970) (husband designated manager) and La. Civ. Code Ann. art. 2404 (West 1971) (husband designated head and master of community of gains) with Cal. Civ. Code § 5125 (West 1983) (either spouse has management and control of community property) and La. Civ. Code Ann. art. 2347 (West 1985) (repealing head and master statute).

30 See, e.g., Idaho Code § 32-712 (1983) (allocation subject to judge’s discretion based on variety of factors including duration of marriage, need, and earning capacity); Nev. Rev. Stat. § 125.150 (1985) (allocation subject to just and equitable discretion of judge).

31 Krauskopf, supra note 20, at 395.

32 H. Clark, supra note 8, § 14.5, at 442; Krauskopf, supra note 20, at 395-96.
Beginning with the revision of California's family laws in the late 1960s and the adoption of the Uniform Marriage and Divorce Act in the early 1970s, a major aim of divorce reform has been the elimination of fault as the sole or primary ground for divorce. However, with the advent of "no fault" divorce the wife lost a significant bargaining tool in divorce proceedings. As a result, a different mechanism was needed to effectuate fair economic settlements. Equitable distribution rules were designed to provide such a mechanism.


R. Levy, Uniform Marriage and Divorce Legislation: A Preliminary Analysis 165 (1968) (prepared for the Special Committee on Divorce of the National Conference of Commissioners on Uniform State Laws); Krauskopf, supra note 20, at 396.

All common law jurisdictions have adopted some form of equitable distribution rules to deal with the allocation of property upon the dissolution of marriage. See 1985 BNA Survey, supra note 23, at 3021. These rules operate only at dissolution of the marriage and therefore do not otherwise affect property rights. The minority of states that have not adopted equitable distribution statutes have developed substantial bodies of case law utilizing equitable distribution principles. In South Carolina, for example, equitable distribution is premised upon one spouse's "special equity" in the property of the other spouse. Wilson v. Wilson, 270 S.C. 216, 221-22, 241 S.E.2d 366, 368-69 (1978). A spouse acquires a special equity interest when he or she makes a material contribution of industry or labor to the acquisition and maintenance of property during marriage, thereby contributing to the financial success of the family. This interest arises even absent a showing that the spouse made a financial contribution to the specific property awarded. Id. at 221-22, 241 S.E.2d at 368-69. In Glass v. Glass, 276 S.C. 625, 281 S.E.2d 221 (1981), the court acknowledged that it had first recognized the doctrine of equitable distribution in Wilson, and noted that the General Assembly had since adopted the doctrine by statute. Id. at 627-28, 281 S.E.2d at 222. The statute referred to gives the Family Court of South Carolina jurisdiction for settlement of "all legal and equitable rights of the parties" in divorce actions as well as jurisdiction over the real and personal property of the marriage, and is currently codified at S.C. Code Ann. § 20-7-420 (Law. Co-op. 1985). See Jeffords v. Hall, 276 S.C. 271, 273-74, 277 S.E.2d 703, 704 (1981); Simmons v. Simmons, 275 S.C. 41, 42-44, 267 S.E.2d 427, 428-29 (1980). South Carolina courts have broadened the principle of equitable distribution, so that it may now be premised on a spouse's contribution as a homemaker. See Parrott v. Parrott, 278 S.C. 60, 63, 292 S.E.2d 182, 182-84 (1982) (homemaker services in marriage of long duration where spouse had foregone career opportunities gave rise to equitable property rights); see also Shaluly v. Shaluly, 284 S.C. 71, 74, 325 S.E.2d 66, 66-68 (1985) (factors set forth in determining equitable distribution include duration of marriage, respective ages, backgrounds and earning abilities of partners, and standard of living during marriage).

In Florida, a similar special equity doctrine gives rise to vested property rights. Canakaris v. Canakaris, 382 So. 2d 1197, 1200 (Fla. 1980). In addition, equitable distribution is achieved through alimony awards of cash or property that may take into account homemaker services. See id. at 1200-01 (examining appropriate criteria for award of different types of alimony set forth in Fla. Stat. Ann. § 61.08 (West Supp. 1985)); see also Tronconi v. Tronconi, 466 So. 2d 203, 204-05 (Fla. 1985) (judge may award lump sum alimony as vehicle to ensure the goal of equitable distribution of jointly held property acquired during marriage); Walter v. Walter, 464 So. 2d 538, 539 (Fla. 1985) (reiterating Canakaris proposition that permanent periodic alimony may be awarded to balance inequities resulting from allocation of income-generating properties acquired during marriage). See generally Comment, Special Equities in Dissolution Proceedings, 27 U. Miami L. Rev. 177 (1972) (discussing special equity doctrine prior to...
A number of factors led to the development of equitable distribution rules. One impetus to their adoption was dissatisfaction with the results of using title-holding schemes to adjudicate property rights upon divorce. As previously described, in a pure title jurisdiction, spouses gained no property rights by virtue of the marriage. A spouse obtained an ownership interest in the other’s property only upon the latter’s death through the operation of dower, curtesy, or a statutory forced share. Thus, through chance or calculated title holding, one spouse could emerge from divorce owning all the property acquired during marriage. Title-holding principles could ignore a spouse’s actual financial contributions to the marriage unless that spouse gained title to assets during the marriage. Such principles could also fail to credit a traditional wife’s contribution to a family’s economic welfare as housewife and mother—a contribution that may have left the husband free to amass assets with title in his own name. In contrast, equitable distribution rules enable a court to allocate property upon dissolution of marriage without regard to title.

Another factor leading to development of equitable distribution rules was dissatisfaction with traditional compensation in the form of periodic alimony. If awarded, alimony might not be paid. In addition, recurring payments required the spouses to maintain a relationship rather than allowing them to make a “clean break.” By adopting equitable distribution statutes, states empowered courts to provide for the economically dependent spouse through property awards.

Finally, equitable distribution rules also flow from sharing principles that many commentators perceive as fundamental to modern marriage. The conceptual rationale of equitable distribution is that a marriage is a shared enterprise or partnership and, since each spouse contributes to the marital enterprise, assets of the enterprise should be allocated on bases

Canakaris). The Florida Supreme Court Commission on Matrimonial Law has proposed the adoption of an equitable distribution statute that would more clearly identify property to be divided in divorce proceedings. 1985 BNA Survey, supra note 23, at 3022.

37 See text accompanying notes 9-23 supra.
38 See R. Levy, supra note 35, at 165; see, e.g., Wirth (Fischer) v. Wirth, 38 A.D.2d 611, 326 N.Y.S.2d 308 (1971) (mem.). For a discussion of Fischer, see note 23 supra.
40 Krauskopf, supra note 20, at 399.
Advocates of equitable distribution-type statutes argue that spouses in functioning marriages generally pool their assets and earnings to satisfy the family's needs. Commentators suggest further that spouses in both one- and two-earner marriages typically make decisions with the understanding that marriage is a joint enterprise. Thus, one spouse may temporarily put aside individual career goals for the sake of the family, use individual earnings to finance the other's education or career, interrupt a career or switch jobs to follow the other spouse, or stop working to stay at home with children. These situations give rise to an expectation that assets will be shared during the marriage. The law should protect that expectation when the marriage dissolves.

The concept of marriage as partnership that has emerged from state equitable distribution laws, however, is not directly analogous to a business partnership. A marital partnership is usually not a joint undertaking for profit, and the partners do not always make the kind of economic contribution to the enterprise that is associated with business partners. In theory, however, each marital partner contributes to the well-being of the marriage, including its economic gains. Thus, upon dissolution, each partner is entitled to share in the gains of the marital enterprise and no partner has the right to appropriate partnership assets to himself or herself (except as the marital partners agree), regardless of who holds title.

This has been referred to as the "family as firm" theory. Krauskopf, supra note 20, at 386-88, 396. Under this theory, the welfare of each member is integrated into a unified family welfare function and the family makes decisions in order to maximize the welfare of the family as a whole.


Prager, supra note 43, at 7-10.

Prager, supra note 43, at 11, 18-19.

The concept of a marital partnership or sharing model is not universally accepted, however. Economic as well as legal scholars have questioned the view that marriage is a partnership in light of the frequency of divorce and the prevalence of short term marriages. See, e.g., Glendon, Is There a Future for Separate Property?, 8 Fam. L.Q. 315, 327 (1974); Munnell, supra note 43, at 266. Scholars have also expressed concern that certain aspects of the marital partnership concept may perpetuate the wife's economic dependence. See Glendon, supra, at
The standard for equitable distribution statutes is equity. Courts are empowered to allocate property in a manner which is "just and reasonable,"47 "just and equitable,"48 or in accordance with a similar standard.49 Although equity does not necessarily mean equality, some statutes provide a rebuttable presumption that equal distribution is equitable or require equal distribution unless the challenging party can demonstrate that equal is inequitable.50 Furthermore, most jurisdictions use an aggregate approach to allocate property and do not require courts to divide each asset in the marital estate.51 Thus, a number of jurisdictions provide for a monetary award to adjust equities rather than actually requiring the transfer of title.52 In other jurisdictions, courts can implement equitable distribution through alimony awards.53

One major problem with many equitable distribution statutes is their failure to establish clearly what constitutes "property" for equitable distribution purposes. For example, it is sometimes not clear whether a professional degree54 or a spouse's pension rights55 constitute property.

321, 322 nn.21-22, 326; see also id. at 322 (suggesting that true economic independence of women may lead back to a separation of assets). Nevertheless, the concept of marriage as a partnership retains widespread appeal and may be necessary for equitable reasons in order to recognize each spouse's contributions to the marriage. See, e.g., Gann, supra note 43, at 47-49. In fact, valid criticism has been aimed at the inadequate application of partnership notions rather than at the notions themselves. See, e.g., L. Weitzman, The Divorce Revolution: The Unexpected Social and Economic Consequences for Women and Children in America (1985). This failure occurs because the concept of property sometimes has been defined narrowly so that the most valuable assets of the marriage, such as a professional degree, have been excluded from allocation under the statute. Id. at 110-42. For examples of instances in which spouses' professional degrees were treated as marital assets, see note 76 infra. Furthermore, the contributions of the nontitled spouse, typically the wife, may be undervalued. See L. Weitzman, supra, at 371-74.

subject to equitable distribution. Even though the standards for equitable
distribution are often vague, a number of states provide criteria to
guide courts in making distributions. Among the factors to be consid-
ered in making equitable distributions are: the parties’ ages, and physical
and mental health; duration of the marriage; prior standard of living;
vocational skills and employability; respective estates and incomes; liabil-
ities and needs; past contributions of each spouse to the family’s assets
and homemaker contributions; overall economic circumstances of the
parties; and each party’s opportunity for future acquisition of assets.  

2. Spousal Support/Alimony

Under modern divorce law, alimony generally provides financial
support rather than moral justice. Most states base awards on eco-
nomic factors: the supported spouse’s need for support coupled with the
supporting spouse’s ability to pay. Ideally, after the separation of as-

56 Foster & Freed, supra note 23, at 233. For an example of a statute, see N.Y. Dom. Rel.
Law § 236, pt. B(5) (McKinney 1981). Fault is not a factor in many states but is taken into
account in some jurisdictions. See, e.g., Nickerson v. Nickerson, 467 So.2d 260, 262 (Ala. Civ.
see 1985 BNA Survey, supra note 23, at 3021-26. The factors taken into consideration in
making alimony awards similarly may include: (1) length of marriage; (2) parties’ ages, physi-
cal and mental health; (3) vocational skills and employability; (4) educational qualifications;
(5) likelihood that a party seeking alimony can, with increased training, increase his or her
earning capacity; (6) custodial or child-rearing responsibilities; (7) prior standard of living; and
(8) contributions of each spouse to the family. See, e.g., N.Y. Dom. Rel. Law § 236, pt. B(6)

In view of the considerations underlying equitable distribution, it is not surprising that a
number of states take into account a spouse’s contribution as homemaker. See, e.g., Colo. Rev.
§ 31-1-11.5-11 (Burns 1980); Mo. Ann. Stat. § 452.330 (Vernon 1986); Mont. Code Ann. § 40-
4-202 (1984); see also UMDA, supra note 34, § 307 (alternatives A & B). Similarly, alimony
statutes in at least eight states take homemaker contributions into account. See Fla. Stat.


58 See L. Weitzman, supra note 46, at 149 (discussing financial needs for support); Weitz-
man & Dixon, supra note 57, at 147-50 (discussing rationales for alimony under no-fault di-
vorce); see also UMDA, supra note 34, § 308 (requiring finding that recipient “is unable to
support himself through appropriate employment” as predicate to alimony award). In this
Article, the husband will be presumed to be the payor, since this has historically been the case.
sets, the spouses are to be self-supporting; however, given the realities of life and the typical inadequacy of marital assets, alimony continues to have a role.\textsuperscript{59} The thrust of modern law may be best exemplified by the Uniform Marriage and Divorce Act,\textsuperscript{60} which authorizes the division of property belonging to either spouse or both as the primary means for providing for the future financial needs of the spouse, and which authorizes the payment of maintenance where the property is insufficient to meet these needs.\textsuperscript{61}

A number of factors have led to modern concepts of spousal support. First, there is the policy of encouraging a newly divorced woman to become self-supporting.\textsuperscript{62} Where possible, transitional support—short-term payments designed to enable the recently divorced recipient to acquire new skills or revive old ones—is preferred over long-term payments.\textsuperscript{63} The term “transitional support” incorporates a variety of concepts, including rehabilitative alimony, severance pay, and unemployment insurance. These concepts stem from the notion of marriage as a career that, once ended, necessitates a period of retraining or readjustment for a spouse.\textsuperscript{64}

Another accepted rationale for modern alimony, like that for equitable distribution, is the concept of marriage as a shared enterprise.\textsuperscript{65} A number of statutes provide that the amount of alimony awarded may be

\textsuperscript{59} See M. Glendon, supra note 23, at 263.

\textsuperscript{60} UMDA, supra note 34. Although adopted in full in only 8 states, 9A U.L.A. 56 (West Supp. 1986) (preface to UMDA), the Uniform Act has had a strong influence on recent legislation.

\textsuperscript{61} UMDA, supra note 34, §§ 307-308. For a discussion of how a spouse's need for compensation or recompense can be viewed as “reasonable needs” under UMDA § 308, see Krauskopf, supra note 20, at 403-04.

\textsuperscript{62} Weitzman & Dixon, supra note 57, at 148.

\textsuperscript{63} For example, New York provides, “In determining the amount and duration of maintenance the court shall consider . . . the period of time and training necessary to enable the person having need to become self-supporting.” N.Y. Dom. Rel. Law § 235, pt. B(6)(a)(4) (McKinney Supp. 1986). Florida also provides, “In determining a proper award of alimony or maintenance, the court shall consider . . . the time necessary for either party to acquire sufficient education or training to enable such party to find appropriate employment.” Fla. Stat. § 61.08(e) (1985). California similarly directs the court to consider “[t]he time required for the supported spouse to acquire appropriate education, training, and employment.” Cal. Civ. Code § 4801(a)(6) (West Supp. 1986). Tennessee law provides, “It is the intent of the general assembly that a spouse who is economically disadvantaged . . . be rehabilitated whenever possible by the granting of an order for payment of rehabilitative, temporary support and maintenance.” Tenn. Code Ann. § 36-5-101(d) (West Supp. 1985). See also 1985 BNA Survey, supra note 23, at 3017-18 (indicating that 24 states seek to encourage the supported spouse to become self-supporting). A minority of states specifically limit the term of alimony payments. See, e.g., Del. Code Ann. tit. 13, § 1512(a) (1981) (two-year limit unless parties were married for more than 20 years or the marriage was “characterized by mental illness”).

\textsuperscript{64} Weitzman & Dixon, supra note 57, at 149.

\textsuperscript{65} See id. at 152 (with respect to California law). It has been suggested that some state alimony statutes historically treated marriage as a shared enterprise. See Comment, The De-
Commentators have urged that alimony should compensate a spouse for lost earning capacity occasioned by his or her contributions to the marital enterprise. Although statutes typically list various factors, such as need, rehabilitation, age, duration of the marriage, and the presence of children, to be considered in making alimony awards, these factors are consistent with the theory that alimony functions as a means of compensating the recipient for contributions made to the marital enterprise. For example, both the duration of the marriage and the presence of children may imply that a spouse has devoted his or her time and energies to the marital enterprise.

Some critics of current alimony rules argue that although many state statutes incorporate the marriage-as-partnership ideal, actual awards suggest that the ideal is not being applied uniformly. They contend that many awards are based on minimal need rather than on sharing concepts—with the result that a spouse would have been better off investing in himself or herself rather than in the marital partnership.
3. **Alimony Versus Property Distributions**

Often there is not a clear distinction between alimony awards and property distributions. As a result of the adoption of equitable distribution principles, the law in a number of states requires that financial provision for a spouse be made through a property distribution, and that alimony be awarded only if the property that can be divided is insufficient. Other states provide that both alimony awards and property distributions may be used for similar purposes—to provide for support and to provide for an equitable allocation of assets.

The similar criteria used by courts to make both alimony awards and property distributions illustrate the lack of clear distinction between the two. In both situations, courts may consider the parties' ages, needs, and employment skills; the duration of the marriage; and the presence of children.

In particular, cases where on divorce one spouse, typically the wife, seeks compensation for financial contributions made toward the other's education or attainment of a degree or professional license illustrate the blurring of alimony awards and property distributions. Courts may consider the wife's contributions to the earning of the degree (or the husband's resulting increased earning capacity) as a factor in determining a property division and/or an award of alimony. Alternatively, the

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72 See, e.g., Practice Aid No. 15, Guidelines for Property Division (Ohio Law), Fam. L. Rep. (BNA) Reference File 515:0001-0002 (May 19, 1981) (directing courts to divide property first and then award alimony if necessary); UMDA, supra note 34, § 308 (alimony should be awarded only if property available for distribution is insufficient to meet needs of supported spouse).

73 A number of state statutes contemplate the use of property distributions as a means of providing support for the needy spouse. See, e.g., N.Y. Dom. Rel. Law § 236, pt. B(5)(d)(1), (5)(d)(8) (McKinney Supp. 1986) (directing courts in determining equitable distribution of property to consider "the income and property of each party . . . at the time of the commencement of the [divorce] action" and "the probable future financial circumstances of each party"); Wis. Stat. Ann. § 767.255(8) (West 1981) (property division statute takes into account any alimony payments and further considers "whether the property division is in lieu of such payments"); UMDA, supra note 34, § 307 (directing courts in determining equitable distribution of property to consider economic circumstances of each spouse when division of property becomes effective). In addition, states that limit alimony give the courts broad discretion in dividing property so that the courts may award a large share of property to the needier spouse. See Schwartz, Divorce and Earning Ability, 1982 Det. C.L. Rev. 69, 75. Similarly, alimony may be awarded to achieve an equitable distribution of property. See note 36 supra (discussion of Florida law).

74 See notes 56, 67-69, and accompanying text supra.

courts may formally identify the degree, license, or education as an asset subject to equitable distribution. Recently, the New Jersey courts introduced the concept of reimbursement alimony, which is designed specifically to compensate a spouse for financial contributions to the other spouse's attainments. The choice of a mechanism may affect the amount of compensation. Nonetheless, the results produced by the various approaches are similar because each may be said to stem from the vision of marriage as a partnership or shared enterprise and each compensates a spouse for contributions to the other spouse's career.

(6)(a)(8) (McKinney Supp. 1986) (directing courts in distributing property and awarding alimony to consider spouse's contributions "to the career or career potential of the other party"); see also, e.g., In re Marriage of Janssen, 348 N.W.2d 251, 253-54 (Iowa 1984) (treating increased earning capacity from medical license and degree as factor in awarding periodic alimony). Some states, however, refuse to take into account any contributions by the other spouse. See, e.g., Wright v. Wright, 469 A.2d 803, 806 (Del. Fam. Ct. 1983) (rejecting alimony award based on property characterization of husband's dental degree); Frausto v. Frausto, 611 S.W.2d 656, 659 (Tex. Ct. App. 1980) (finding award of future monthly payments based on future earnings or contributions to education improper since not, as required by Texas law, referable to specific community property), writ dismissed for want of juris.

See, e.g., Woodworth v. Woodworth, 126 Mich. App. 258, 260-69, 337 N.W.2d 332, 334-37 (1983) (law degree treated as marital asset; trial court to award share of present value of earnings attributable to degree); O'Brien v. O'Brien, 66 N.Y.2d 576, 584-85, 489 N.E.2d 712, 715-16, 498 N.Y.S.2d 743, 747 (1985) (medical degree treated as marital asset subject to state's equitable distribution scheme). Other courts allow the supporting spouse to recover only the cost of his or her investment in the other spouse's career. See In re Marriage of Horstmann, 263 N.W.2d 885, 891 (Iowa 1978) (law degree not property, but increased earning capacity treated as marital asset; amount awarded determined by reference to cost of education or amount contributed by supporting spouse). But see, e.g., Graham v. Graham, 194 Colo. 429, 432, 574 P.2d 75, 77 (1978) (finding degree does not have attributes of property).

Reimbursement alimony attempts to compensate fairly the supporting spouse by permitting recovery of all financial contributions to the other spouse's education and of the loss of or reduction in the past and future standard of living. In support of its award of reimbursement alimony, the New Jersey court stated that a supporting spouse generally contributes earnings with the expectation that both spouses will enjoy the material fruits of the education, degree, or license. Id. at 500, 453 A.2d at 533. In addition, the supporting spouse may have foregone a higher standard of living while earnings were funneled to the other spouse's career. Id. at 500-01, 453 A.2d at 534. The court noted that the compensatory purpose of reimbursement alimony may also be served by other means, such as equitable distribution, where the parties acquired substantial assets during the marriage, or by rehabilitative alimony, where a lump sum is required in order for the spouse to achieve economic self-sufficiency. Id. at 503-04, 453 A.2d at 535-36; see also Reiss v. Reiss, 200 N.J. Super. 122, 127, 490 A.2d 378, 380 (Ch. Div. 1984) (when neither alimony nor equitable distribution of marital assets can rectify an unaddressed suffering, reimbursement alimony should be awarded), aff'd, 205 N.J. Super. 41, 500 A.2d 24 (App. Div. 1985); Saint-Pierre v. Saint-Pierre, 357 N.W.2d 250, 262 (S.D. 1984) (dictum) (approving reimbursement alimony); cf. DeLa Rosa v. DeLa Rosa, 309 N.W.2d 755, 758-59 (Minn. 1981) (supporting spouse compensated by equitable award); Lehmicke v. Lehmicke, 339 Pa. Super. 559, 566-68, 489 A.2d 782, 786-87 (1985) (supporting spouse compensated for contribution; award based on same equitable principles on which Mahoney court relied).
C. Pre-1984 Alimony Tax Rules

Today's pattern for taxing divorced spouses, even after the Tax Reform Act of 1984, is the product of legislation originally enacted in 1942. The Revenue Act of 1942 (1942 Act) generally provided that periodic payments made in satisfaction of the obligation of support were income to the recipient and deductible by the payor. Congress enacted this inclusion/deduction scheme primarily as a relief measure for husbands pressured by high wartime taxes. The legislation also created tax parity between husbands who could afford to shift income through lump sum awards and those who had to make periodic payments out of current income or property, and promoted a uniform set of federal tax rules.

The 1942 Act was designed to allow a form of income splitting for husbands who were required to use their earnings to pay for their former wives' living expenses. In order to implement this design, the 1942 Act required that payments of taxable alimony be periodic (with the assumption that periodic payments made over a long number of years are more likely to come from income than from capital), and that they fulfill the husband's support obligation (with the aim of distinguishing between actual support and payments extracted from the wife's property).

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83 § 22(k) (of the 1939 Code).
84 Id.
85 Steines, supra note 82, at 226-27.
The statute denied a deduction for a lump sum payment, apparently because the lump sum was viewed as previously taxed capital rather than as current income that the husband was required to share with the wife. The lump sum payment was considered a capital transfer with which the recipient would generate her own income to meet expenses, including any future tax liability arising from such income.\textsuperscript{86}

Both the "support" and "periodic" requirements were retained in section 71 of the 1954 Internal Revenue Code\textsuperscript{87} and were widely litigated.\textsuperscript{88} The support requirement caused uncertainty and created federal income tax consequences that varied dramatically depending on state law. For example, consider a divorce agreement that required $H$, the husband, to pay $W$, the wife, $60,000 over twelve years ($5,000 per year), payable in all events. While these payments were technically "periodic,"\textsuperscript{89} an issue arose as to whether they were made "because of the family or marital relationship in recognition of the general obligation to support" (deductible),\textsuperscript{90} or were made to compensate $W$ for a property right, such as a right to $H$'s land or business (nondeductible).

The courts used a number of tests in deciding whether such payments were for support. Some courts focused on the parties' intent.\textsuperscript{91} However, different courts used different factors to determine intent and weighed similar factors differently.\textsuperscript{92} Other courts focused on relevant state law in order to determine whether $W$ in fact had any property rights for which she could be said to be compensated.\textsuperscript{93} Thus, federal courts found themselves opining on the nature of various state marital

\textsuperscript{86} The 1939 Code did not distinguish payments of capital from payments of income by tracing the source. H.R. Rep. No. 2333, supra note 79, at 72; S. Rep. No. 1631, supra note 79, at 84. Thus, despite the rationales for these Code sections, a periodic transfer of capital could be treated in exactly the same manner as a periodic transfer of income: taxed to the recipient and deducted by the payor. See H.R. Rep. No. 2333, supra note 79, at 72; S. Rep. No. 1631, supra note 79, at 84.

\textsuperscript{87} I.R.C. §§ 71, 215 (1982). Prior to the 1984 amendments, § 71 and § 215 of the 1954 Code provided that payments made pursuant to a decree of divorce or separate maintenance, a separation agreement, or a temporary support order were includible in the wife's income if the payments were "periodic" and were made "because of the marital or family relationship." I.R.C. § 71(a)(1)-(3) (1982). Section 215 of the 1954 Code provided, "In the case of a husband described in section 71, there shall be allowed as a deduction amounts includible under section 71 in the gross income of his wife, payment of which is made within the husband's taxable year." I.R.C. § 215 (1982).

\textsuperscript{88} See notes 91-93 and accompanying text infra.

\textsuperscript{89} See text accompanying notes 94-96 infra.

\textsuperscript{90} Treas. Reg. § 1.71-1(b)(4) (1957).

\textsuperscript{91} See, e.g., Wright v. Commissioner, 543 F.2d 593, 598 (7th Cir. 1976); Schatz v. Commissioner, 42 T.C.M. (CCH) 292, 296-97 (1981).

\textsuperscript{92} Compare Wright, 543 F.2d at 598 (receipt of property award with lump sum payment is determining factor) with Schatz, 42 T.C.M. (CCH) at 296-97 (receipt of property award not dispositive of interest).

property rights, aware that the federal tax results could differ as state rights differed.

Similarly problematic was the requirement that payments be periodic.\(^9\) Elaborate rules defined periodicity. While a lump sum was not periodic, installment payments of a lump sum, if paid over a period ending more than ten years after divorce, were treated as periodic to the extent of ten percent of the principal sum each year.\(^9\) Payments that ended within the ten-year period were not periodic. However, without regard to the payout period, payments were treated as periodic if subject to certain contingencies.\(^6\)

**D. The Davis Problem**

In addition to defining deductible alimony inadequately, the 1942 legislative scheme failed to address successfully property transfers in satisfaction of marital rights. This shortcoming became especially problematic after the 1962 Supreme Court decision *United States v. Davis*,\(^7\) in which the federal tax consequences of property transfers incident to divorce were found to turn on state marital property laws.

In *Davis*, the husband, *H*, transferred appreciated securities to his wife, *W*, for the release of her marital rights, including dower and the rights of succession. *H* argued that he should not be taxed on the appreciation in the transferred securities because the transfer was analogous to a nontaxable division of property between co-owners.\(^8\) Case law had long held that an equal division of community or jointly owned property was a nontaxable event.\(^9\) The government, on the other hand, argued

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See generally Feinzeig & Schreiber, supra note 5, at 15-19 (discussing actual ownership analysis).

\(^{94}\) See, e.g., Wright, 543 F.2d at 600; Joslin v. Commissioner, 424 F.2d 1223, 1227 (7th Cir. 1970).

\(^{95}\) I.R.C. § 71(c) (1982); Treas. Reg. § 1.71-1(d)(1) to (2), -1(d)(5) ex. (4) (1957).

\(^{96}\) Treas. Reg. § 1.71-1(d)(3)(i)(a), -1(d)(4) to (5) ex. (1)-(2) (1957) (contingencies of death of either spouse, remarriage of wife, or change in economic status of either spouse).

\(^{97}\) 370 U.S. 65 (1962).

\(^{98}\) Id. at 69. The transfer was characterized in the settlement agreement as a “division in settlement of their property.” Id. at 66. Under the settlement, *H* agreed to transfer to *W*, inter alia, 1000 shares of stock “in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower, and all rights under the laws of testament and intestacy).” Id. at 66-67.

that the transfer was made for an independent legal obligation and was therefore taxable.\textsuperscript{100}

The Court looked to Delaware law, which governed the rights of the parties, to determine the nature of the property transfer. The Court found that in Delaware, one spouse's inchoate rights to the other's property did "not even remotely reach the dignity of co-ownership."\textsuperscript{101} The Court thus found \( W \)'s interest to be a burden on \( H \)’s property rather than an independent property right, and taxed \( H \) on the appreciation in the transferred property.\textsuperscript{102} In so deciding, the Court recognized that its holding would result in disparate tax consequences for property settlements, depending on substantive state law.\textsuperscript{103} In a common law jurisdiction, a transfer of property incident to divorce could be a taxable event. In a community property jurisdiction, the same transfer could be nontaxable.

The \textit{Davis} decision also failed to articulate a standard for determining which interests rise to the "dignity of co-ownership." It was unclear whether the Court adopted a series of factors that, if present, established the existence of a property right in the untitled spouse, or whether state law governed.\textsuperscript{104} Assuming the latter, the decision raised questions concerning the appropriate standard to be applied by federal courts interpreting state laws. Federal courts might apply the standard expressed in the state statute, or might look beyond the statutory label to the actual property interest.

After the \textit{Davis} decision, an inordinate amount of tax litigation wrestled with the nature of each spouse's property interest under state law. A frequent issue was whether, under equitable distribution statutes, a nontitled spouse’s interest was similar to that of the wife in the \textit{Davis} case, or whether it was a vested interest similar to that of a nontitled spouse in community property jurisdictions. For example, in both

\textsuperscript{100} \textit{Davis}, 370 U.S. at 69.

\textsuperscript{101} Id. at 70.

\textsuperscript{102} \( H \) was transferring to \( W \) his own property in satisfaction of a personal obligation to her, rather than jointly owned property in satisfaction of a property right. See id. at 70-71. It is well established that a transfer of property in satisfaction of an obligation is a taxable event. See, e.g., Montana Power Co. v. United States, 171 F. Supp. 943, 945 (Ct. Cl. 1959); see also United States v. General Shoe Corp., 282 F.2d 9, 12 (6th Cir. 1960), cert. denied, 365 U.S. 843 (1961); Commissioner v. Sisto Fin. Corp., 139 F.2d 253, 255 (2d Cir. 1943); International Freighting Corp. v. Commissioner, 135 F.2d 310, 313 (2d Cir. 1943); Elverson Corp. v. Helvering, 122 F.2d 295, 297-98 (2d Cir. 1941); Kenan v. Commissioner, 114 F.2d 217, 219-20 (2d Cir. 1940); Estate of Delman v. Commissioner, 73 T.C. 15, 27 (1979). The Court stated in \textit{Davis} that the wife's release of marital rights was not considered a taxable event. The wife had no gain or loss on the transaction and her basis in the transferred property was its fair market value. \textit{Davis}, 370 U.S. at 73 (dictum); see also Rev. Rul. 67-221, 1967-2 C.B. 63.

\textsuperscript{103} \textit{Davis}, 370 U.S. at 71.

\textsuperscript{104} Id. at 69-70.
Collins v. Commissioner\textsuperscript{105} and Imel v. United States\textsuperscript{106} the Tenth Circuit held that a transfer of appreciated property to a spouse pursuant to a property settlement was a nontaxable division of property. The court found that under the applicable state equitable distribution statutes,\textsuperscript{107} the nontitled spouse had a “species of common ownership”\textsuperscript{108} in the property of the titled spouse that “vested” upon commencement of the divorce action. In contrast, in Wiles v. Commissioner,\textsuperscript{109} the Tenth Circuit found that a nontitled spouse’s interest under Kansas’s equitable distribution statute was an inchoate right; hence, the husband was taxed on a transfer of appreciated property in satisfaction of that right. Ironically, the Oklahoma law at issue in Collins was adapted from the Kansas law at issue in Wiles.\textsuperscript{110}

Following these decisions, a number of states adopted equitable distribution statutes or amended the language of existing statutes to mirror those at issue in Imel and Collins. The new or amended statutes provide that rights of a nontitled spouse to a share of marital property vest at the commencement of the divorce action.\textsuperscript{111} Thus, simply by changing the

\textsuperscript{105} 412 F.2d 211 (10th Cir. 1969).
\textsuperscript{106} 523 F.2d 853 (10th Cir. 1975).
\textsuperscript{108} Collins, 446 P.2d at 295; In re Questions Submitted by United States Dist. Court, 184 Colo. at 8, 517 P.2d at 1335. Subsequent cases decided by the Oklahoma Supreme Court raised questions with respect to its earlier decision in Collins, concerning the nature of the wife's property interest in the absence of divorce. See McDaniel v. Oklahoma Tax Comm’n, 499 P.2d 1391, 1393 (Okla. 1972) (stating that Collins did not purport to construe wife's vested interest in property beyond statutory disposition of property in divorce action); Sanditen v. Sanditen, 496 P.2d 365, 367 (Okla. 1972) (also limiting applicability of Collins to jointly acquired property under divorce statute); see also Kalcheim, supra note 41, at 338-39.
\textsuperscript{109} 499 F.2d 255 (10th Cir.), cert. denied, 419 U.S. 996 (1974).
\textsuperscript{111} E.g., Ill. Ann. Stat. ch. 40, § 503(e) (Smith-Hurd Supp. 1985); Kan. Stat. Ann. § 23-201(b) (1981); Minn. Stat. Ann. § 518.54(5) (West Supp. 1985); Mo. Rev. Stat. § 452.330.3 (Supp. 1982); N.C. Gen. Stat. § 50-20(k) (1981); Or. Rev. Stat. § 107.105(f) (1981). In re Marriage of Engle, 52 Or. App. 561, 629 P.2d 397 (1981), rev’d, 293 Or. 207, 646 P.2d 20 (1982), is particularly interesting. The Oregon Court of Appeals, construing Oregon’s equitable distribution statute, found that the wife did not have an ownership interest in property transferred to her by her husband. The Oregon Supreme Court granted review, but before the case was heard, the Oregon legislature amended part of its equitable distribution statute. The amendment provided that upon filing a petition for divorce, “the rights of the parties in the marital assets shall be considered a species of co-ownership, and a transfer of marital assets pursuant to a decree of annulment or dissolution of marriage or of separation entered on or
wording of the statute the legislature affected the income tax consequences of a property settlement without making any substantive changes in property rights.

The state of the law regarding property settlements was reminiscent of attempts by common law states in the 1940s to establish community property systems in order to achieve income splitting between spouses. The states were unsuccessful in these attempts, however, unless they made fundamental substantive changes in their property law principles.\textsuperscript{112} The confusion caused by such efforts was a factor in the enactment of the joint return provisions in 1948.\textsuperscript{113} Similarly, the confusion caused by the \textit{Davis} rule provided the impetus for the 1984 divorce tax legislation.\textsuperscript{114}

\textbf{I. Impetus for Reform—Policy Concerns}

Even before the \textit{Davis} decision, commentators had recommended repeal of a \textit{Davis}-type rule.\textsuperscript{115} The passage of equitable distribution laws only aggravated the disparate treatment of property settlements among the states and added the plea for uniformity to the already existing cry for reform.\textsuperscript{116} The \textit{Davis} rule was criticized as bad policy; divorce is not an event from which the public fisc should derive a benefit. In the absence of significant revenue benefit, the legal system was adding tax concerns to the financial and emotional strains of divorce.\textsuperscript{117} In addition,
the Davis rule promoted tax controversy, which exacerbated the problems of an overburdened court system and resulted in non-compliance.\textsuperscript{118}

The most persuasive argument advanced for the repeal of the Davis rule was based upon the belief that tax laws should reflect changing views of marriage. Modern divorce laws supported the perception that marriage creates a community of interests economically similar to those of a partnership or joint venture.\textsuperscript{119} Accordingly, commentators argued that the termination of a marriage should be treated like the termination of a joint venture or partnership.\textsuperscript{120} Thus, when each marital partner receives property as part of a divorce settlement, the transferee spouse should be viewed as receiving property that he or she previously owned, albeit in a different form.

In response to these arguments, the 1984 Act repealed the Davis rule and added section 1041 to the Code. This section provides that transfers

\textsuperscript{118} Tax lawyers believed that many taxpayers did not comply with the Davis rule. See 1981 ABA Memorandum, supra note 3, at 2; 1983 N.Y.S. Bar Ass'n Report, supra note 116, at 3; 1978 N.Y.S. Bar Ass'n Report, supra note 116, at 13. The transfer in Davis was technically a realization event. See I.R.C. § 1001(a) (1982) (gain or loss is measured upon “the sale or other disposition of property”). Nevertheless, critics of the Davis rule argued that imposing a tax on the transferor spouse in the context of divorce resulted in taxing a theoretical gain. They argued that the triggering event, the transfer of property, resulted in a reduction, rather than an increase, of the transferor’s wealth. See, e.g., 1966 ABA Report, supra note 116, at 66. If the transfer is viewed as a satisfaction of the transferor’s obligation, his wealth is the same before and after the transfer; assets and liabilities have been reduced by an equal amount. Critics also emphasized that the tax system usually recognizes income where there has been a realization event, a disposition. See I.R.C. § 1001(a) (1982); Eisner v. Macomber, 252 U.S. 189 (1920) (imposing realization requirement). There are a limited number of exceptions to the realization rule. See, e.g., I.R.C. § 1256 (Supp. II 1984 & West Special Pamphlet 1987). Generally, the realization event coincides with the time when the taxpayer has liquidated an investment so that he has sufficient cash or disposable property to pay the tax. While a property transfer pursuant to a divorce is, under Davis, a realization event, it does not coincide with the transferor’s liquidity. In fact, imposition of a tax at divorce depletes the transferor’s already strained liquidity. See 1978 N.Y.S. Bar Ass’n Report, supra note 116, at 2, 10-11. On the other hand, if taxation is deferred until the transferee’s disposition, taxation and liquidity are more likely to coincide. The most commonly proposed alternative to the Davis rule was a rule similar to that applied to an equal division of community property on divorce; namely, that the transfer of property is not a taxable event, and the recipient spouse retains the community’s basis in the property received. Applying this rule, any inherent gain in the transferor’s hands will be taxed to the transferee when the property is disposed of. While critics of reform argued that the transferee would be taxed on the transferor’s gain, see 1966 ABA Report, supra note 116, at 66, their criticism rested on a view of marriage that considers title to property to be critical.

\textsuperscript{119} See notes 42-46 and accompanying text supra.

\textsuperscript{120} See Note, Capital Gains Taxation on the Transfer of Appreciated Property from Husband to Wife Pursuant to a Divorce Settlement, 38 Ind. L.J. 494, 504-05 (1963); see also 1978 N.Y.S. Bar Ass’n Report, supra note 116, at 11 (property transfers at divorce “are akin to a distribution in kind upon the termination of a partnership, which does not result in the recognition of gain or loss”).
of property between a husband and wife or between former spouses "inci-

dent to the divorce" are tax free events\textsuperscript{121} and that the trans süre's basis

in the property received is the same as the transferor's.\textsuperscript{122} Congress

noted that adoption of section 1041 "reflects the fact that a husband and

wife are a single economic unit."\textsuperscript{123}

2. Reforming Sections 71 and 215

Like the movement to change the \textit{Davis} rule, the impetus to reform

the income tax treatment of alimony, stemmed from a desire to provide

clarity, certainty, and uniformity at the federal level.\textsuperscript{124} As early as 1966,

commentators called for amending the ten-year rule\textsuperscript{125} and eliminating

the support requirement.\textsuperscript{126} Again, in 1981, the American Bar Associa-

tion called for abandonment of the support rule.\textsuperscript{127} The ABA also rec-

ommended that section 71 be amended to allow taxpayers to tailor the

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\textsuperscript{121} I.R.C. \$ 1041(a) (Supp. II 1984). Under the 1984 Act, \$ 1041(a) also covers transfers in

trust for the benefit of a spouse or former spouse but does not apply if the recipient spouse is a

nonresident alien. I.R.C. \$ 1041(d) (Supp. II 1984). The Code now provides that a transfer of

property in trust is taxable to the extent that the sum of the amount of liability assumed plus

the amount of liabilities to which the property is subject exceeds the adjusted basis of the

transferred property. I.R.C. \$ 1041(e) (West Special Pamphlet 1987).

\textsuperscript{122} I.R.C. \$ 1041(b)(2) (Supp. II 1984).


1134. Much of the Code treats the husband and wife as an economic unit. See, e.g., I.R.C.

\$ 1(a) (Supp. II 1984 & West Special Pamphlet 1987) (joint return table imposes tax on

spouses' combined income); I.R.C. \$ 163(d) (Supp. II 1984 & West Special Pamphlet 1987)

(same dollar limitation on deductible investment interest applies both to single individuals and
to combined income of spouses filing jointly); I.R.C. \$ 213(a) (1982 & West Special Pamphlet

1987) (limitation on medical expense deduction applies to combined income of spouses filing

jointly); I.R.C. \$ 417 (Supp. II 1984 & West Special Pamphlet 1987) (added by the Retirement


written consent to waive joint and survivor annuity form of other spouse's pension benefit);

I.R.C. \$ 1211(b)(2) (1982 & West Special Pamphlet 1987) (same limitation on capital losses

applies both to single individuals and to combined income of spouses filing jointly); I.R.C.

\$ 1272(a)(2)(E)(iii) (Supp. II 1984) (husband and wife treated as one person for purpose of

exception to original issue discount rules for loans of \$10,000 or less between natural persons);

I.R.C. \$ 2056 (1982) (allowing unlimited marital deduction for estate tax purposes); I.R.C.

\$ 2523 (1982 & West Special Pamphlet 1987) (allowing unlimited tax-free transfers by gift

between spouses); see also S. Rep. No. 940, 96th Cong., 2d Sess. 34 (1980); Tax Reform Stud-

ies, supra note 116, at 119. In some instances, however, the Code takes a contrary viewpoint.


exemption amount is higher for spouses filing jointly than for single individuals); I.R.C.

\$ 1244(b) (1982) (ordinary loss limitation on \$ 1244 stock applied to spouses filing jointly is

twice amount applied to single individuals or spouses filing separately).


1137.

\textsuperscript{125} See 1966 ABA Report, supra note 116, at 62-63.


\textsuperscript{127} 1981 ABA Memorandum, supra note 3, at 11-20. The ABA also called for the elimina-
th of the principal sum rule discussed at note 193 infra. 1981 ABA Memorandum, supra

note 3, at 18-19.

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income tax consequences of alimony payments. It proposed private ordering rules permitting spouses to elect whether cash payments would be included in the recipient’s income and deducted from the payor’s income (includible/deductible) or excluded from the recipient’s income and not deducted from the payor’s income (excludible/nondeductible). The 1984 Act amended section 71 in accordance with a number of the recommended changes. It adopted a limited form of private ordering so that cash payments that qualify as taxable alimony under the statute may be designated in the divorce or separation instrument as either includible/deductible or excludible/nondeductible. It eliminated the support requirement, thereby effectuating a uniform federal rule governing the tax consequences of cash payments made pursuant to a divorce or separation. Finally, the 1984 Act modified the ten-year periodic rule and replaced it with a six-year rule.

II

CONCEPTUAL UNDERPINNINGS OF THE TAX TREATMENT OF ALIMONY

While the 1984 Act amended sections 71 and 215 to clarify the income tax treatment of alimony, it retained the basic pattern of inclusion/deduction. Thus, before considering the statute’s reforms, it is worthwhile to examine whether the inclusion/deduction scheme is the appropriate tax treatment of alimony payments.

A. Alternatives as to Whom to Tax

The issue of the proper tax treatment of alimony should be framed

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128 1981 ABA Memorandum, supra note 3, at 11-12.
129 See I.R.C. § 71(a), (b) (Supp. II 1984); text accompanying notes 191-93 infra.
131 I.R.C. § 71(a) (Supp. II 1984) was amended to provide, “Gross income includes amounts received as alimony or separate maintenance payments.” I.R.C. § 215(a) (Supp. II 1984) was amended to provide, “In the case of an individual, there shall be allowed as a deduction an amount equal to the alimony or separate maintenance payments paid during such individual’s taxable year.” The 1986 Act also retains the basic pattern of inclusion/deduction, making no amendments to I.R.C. §§ 71(a), 215(a) (Supp. II 1984).
132 When Congress considered the 1984 Act, there were rumors that the Senate would propose abandonment of the inclusion/deduction pattern, presumably reverting to pre-1942 law. See Daily Tax Rep. (BNA) No. 107, at G-1 to -3 (June 4, 1984); see also M. Graetz, Federal Income Taxation: Principles and Policies 473 (successor ed. 1985).

For purposes of this analysis, the term alimony refers to payments which are made out of H’s future income stream. Part III of this Article addresses the issue of distinguishing payments that represent an allocation of marital capital from those that represent a sharing of future income.
in the following way: Who should be taxed on any alimony payment? From a tax policy perspective, there are three plausible choices.

The first choice is to tax both H and W. The justification for this double taxation model is that while alimony is taxable as a nondeductible, personal expense to H, it is an accession to W’s wealth and should therefore be included in her income.

The two remaining choices are single taxation models. One imposes the tax only on H (exclusion/no deduction model); the other, only on W (inclusion/deduction model). As between these two alternatives, some commentators would argue that it is more appropriate to tax H because he is the earner or source of the income (the “source” rule). Conversely, others would argue that it is more appropriate to tax W as she benefits from the use of the income (the “benefit” rule).

Because each choice is plausible from a tax policy point of view, the decision of which to adopt should also take into account nontax considerations. The family law concepts developed in Part I are particularly relevant. These concepts provide a reasoned basis for choosing among competing tax models and lead to the conclusion that the single taxation model which taxes only W (inclusion/deduction) is the most appropriate.

B. Family Law Concepts and Rejection of a Double Taxation Model

A double taxation model (denying H a deduction and requiring inclusion in W’s income) is supported by the Haig-Simons definition of income. Although the Haig-Simons definition is not suitable for all purposes, it provides a touchstone for modern debate and represents an outer limit for identifying potential items of inclusion or exclusion for any income tax base. This definition provides that income is the sum

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133 See text accompanying notes 155-62 infra.
134 See text accompanying notes 146-54 infra.
135 See notes 163-67 and accompanying text infra.
136 The 1939 Code, the 1984 Act, and the 1986 Act all use this model. See §§ 22(k), 23(u) of the 1939 Code; §§ 71, 215 (Supp. II 1984 & West Special Pamphlet 1987).
137 For example, under this definition, income would include the unrealized appreciation on assets, an inclusion generally viewed as administratively infeasible. But see I.R.C. § 1256 (Supp. II 1984 & West Special Pamphlet 1987) (marked to market rules).
138 U.S. Treasury Dep’t, Blueprints for Basic Tax Reform 22 (1977) [hereinafterBlueprints]. While the Haig-Simons model defines income in terms of its uses, measurement of income by reference to uses is impractical. Id. at 3. All of the taxpayer’s individual purchases of consumer goods and services as well as the change in value of assets would have to be computed annually. The model may be accommodated, however, by measuring income indirectly. Using the accounting identity that the sum of receipts from all sources over a given period must equal the sum of all uses, a taxpayer’s income may be determined by adding up all receipts from all sources and deducting from that sum those expenditures which represent neither consumption, savings, nor additions to net worth. Id.
of consumption plus accumulation (savings) over a given time period,\textsuperscript{139} and thus defines income in terms of the uses to which resources are put rather than in terms of its sources.

To illustrate, consider the following example in light of the Haig-Simons definition. $H$ earns $100 which he pays as alimony to $W$ who then saves it or uses it to pay rent. The $100 alimony payment either increases $W$'s net worth or is available for personal consumption. The alimony paid to $W$ may also represent a form of voluntary consumption for $H$. Although the $100 does not belong to $H$ because of his legal obligation to pay $W$, $H$'s obligation to $W$ can be said to be self-imposed, because it results from $H$'s previous decision to marry.\textsuperscript{140} Hence, amounts paid as alimony are similar to amounts spent as a result of any other personal choice, such as buying a meal or clothing.\textsuperscript{141} These amounts are income to both the buyer and the seller and thus both should be taxed.

Notwithstanding the Haig-Simons definition, the central principle underlying the economics of divorce under substantive family law, the concept of marriage as a joint enterprise or economic unit, leads to rejection of a double taxation model. Under state law, each marriage partner is said to contribute to the well-being of the marital enterprise. Thus, at dissolution, each is entitled to share the wealth of the enterprise without regard to title and, if they can agree, the spouses may elect the structure of this sharing. Optimally, at the dissolution of marriage, marital wealth is distributed and the joint enterprise terminates. However, where the marital assets are insufficient and one spouse (typically $W$) remains economically dependent, $H$ may be required to pay $W$ alimony. In effect, family law requires the spouses to continue their economic unit to the extent that one spouse pays alimony to the other.

The Code has largely tracked family law by treating a married couple as a single unit. For example, the Code allows married couples to be taxed on their aggregate income by means of the joint return tables.

\textsuperscript{139} The definition articulated by Henry Simons is:

[T]he algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question. In other words, it is merely the result obtained by adding consumption during the period to "wealth" at the end of the period and then subtracting "wealth" at the beginning.


\textsuperscript{140} This is the "marriage-as-consumption" theory. Under this theory, alimony, even when required by law, is a form of personal consumption by the payor because it flows from the voluntary decision to marry. See Bittker, Income Tax Deductions, Credits, and Subsidies for Personal Expenditures, 16 J. Law & Econ. 193, 211 (1973) [hereinafter Bittker, Tax Deductions]; see also H. Groves, Federal Tax Treatment of the Family 94 & n.2 (1963); Bittker, Taxation and Family, supra note 43, at 1421.

\textsuperscript{141} Bittker, Tax Deductions, supra note 140, at 211.
Similarly, the Code ignores property transactions between spouses. To the extent that family law continues the former spouses' economic unit through alimony payments, the tax laws should also treat the former spouses as a continuing, single tax unit after divorce. The unit should be taxed only once on monies earned or received by a member of the unit from sources outside the unit; it should not be taxed on those monies again until they pass outside the unit.

Proponents of a single inclusion model, taxing either $H$ or $W$ but not both, would also argue that double inclusion of alimony overstates the amount of money actually used or consumed in the economy. Reference to the tax treatment of gifts supports the argument. For example, consider $A$ who earns $100 and gives it as a gift to $B$ who then spends it on rent. Under the double inclusion approach, the $100 gift creates $200 of consumption—$A$'s $100 gift to $B$ and $B$'s $100 rent payment. The total amount actually spent or consumed in the economy, however, is only $100. Similar overinclusion results when the double-inclusion model is applied to alimony. $H$'s $100 alimony payment to $W$ results in only $100 being spent in the economy. Thus, while the Haig-Simons definition represents a theoretical ideal, its strict application requiring a double inclusion model is unacceptably harsh in the alimony context and is inconsistent with the view of husband and wife as a continuing single unit.

C. Benefit Principle

Two theoretically plausible alternatives remain after rejecting the double inclusion model. Both are single taxation models. One imposes the tax only on $H$ (exclusion/no deduction); the other, only on $W$ (inclusion/deduction). The continuing single unit tax model suggests that the latter approach is more appropriate.

The inclusion/deduction model largely rests upon the benefit princi-
ple,\textsuperscript{146} and allocates the income tax burden of alimony payments between $H$ and $W$ by focusing on who actually benefits from the funds rather than on their source or theoretical consumption.\textsuperscript{147} Advocates of the benefit rule argue that $H$ does not use an alimony payment for his own benefit. Thus, under the benefit rule, the alimony payment should appear only in $W$'s tax base.\textsuperscript{148} Moreover, assuming that $W$ and $H$ are in different tax brackets, a progressive rate structure should tax the alimony payment at rates appropriate for $W$'s income level.\textsuperscript{149}

Like the inclusion/deduction model, the continuing single tax unit

\textsuperscript{146} The benefit principle was advanced in McIntyre & Oldman, Taxation of the Family in a Comprehensive and Simplified Income Tax, 90 Harv. L. Rev. 1573, 1592-94 (1977). McIntyre and Oldman used the benefit principle to justify income splitting among family members. They did so by distinguishing the family context, where enjoyment and earnings often do not coincide, from the individual context, where they usually coincide. Thus, a child enjoys the earnings of his or her parents and a husband enjoys the earnings of his wife. Id. The benefit principle has prompted both praise and criticism. Compare Andrews, Comments to McIntyre & Oldman, Treatment of the Family, in Comprehensive Income Taxation 234 (J. Pechman ed. 1977) [hereinafter Andrews, Comments to McIntyre & Oldman] (praising McIntyre and Oldman but maintaining that difference between one-earner and two-earner households in terms of consumption must be pursued further) with Brazer, Comments to McIntyre & Oldman, Treatment of the Family, in Comprehensive Income Taxation 237 (J. Pechman ed. 1977) [hereinafter Brazer, Comments to McIntyre & Oldman] (disagreeing with McIntyre and Oldman's analysis and conclusions). For criticism of the application of the benefit rule to married couples, see also Gann, supra note 43, at 25-26. There is a substantial body of literature discussing the pros and cons of income splitting among family members, the joint return, and the treatment of the family as the taxable unit. For a list of references, see Bittker, Taxation and Family, supra note 43, at 1391 n.1; Gann, supra note 43, at 2 n.1. For discussions of a marriage-neutral tax system, see Brazer, Income Tax Treatment of the Family, in The Economics of Taxation 223 (H. Aaron & H. Boskin ed. 1980) [hereinafter Brazer, Income Tax Treatment]; Munnell, supra note 43, at 247. Generally, advocates of marriage neutrality in filing status adhere to a source rather than a benefit rule. See, e.g., Gann, supra note 43, at 4. Since our tax system employs progressive income tax rates, the answer to the question posed by these competing rules (i.e., who pays the tax) also determines the rate at which the income will be taxed. For a discussion and criticism of the justifications for a progressive rate structure, see Blum & Kalven, The Uneasy Case for Progressive Taxation, 19 U. Chi. L. Rev. 417 (1952).

\textsuperscript{147} The benefit rule defines taxable consumption as a taxpayer's utilization of economic resources for his or her own benefit. McIntyre & Oldman, supra note 146, at 1577; see also Andrews, Personal Deductions supra note 142, at 356, 375-76.

\textsuperscript{148} McIntyre, supra note 43, at 474.

\textsuperscript{149} McIntyre & Oldman, supra note 146, at 1594-95; cf. Andrews, Personal Deductions, supra note 142, at 357 (taxing alimony to $W$ reassigns taxability to person whose consumption it supports). A comparison of alimony payments with charitable gifts supports the inclusion/deduction model. Some commentators suggest that the ideal income tax scheme would allow the donor a deduction for a gift to a charitable organization and tax the recipient (subject only to a general exemption for very low incomes). Blueprints, supra note 138, at 95-96; see also Andrews, Personal Deductions, supra note 142, at 344-75 (in-depth discussion of charitable contribution deduction). But see id. at 354-56 (denying charitable contribution deduction because any exercise of power over disposition of funds represents personal consumption, even if that exercise operates to benefit others); see also H. Simons, supra note 139, at 57, 139. They argue that in many cases the gift is essentially a transfer between the donor and the ultimate individual beneficiaries, with a charitable organization merely serving as a conduit. The gift enhances the beneficiary's standard of living rather than the donor's. See Andrews, Personal...
approach suggests reliance on the benefit principle. During marriage, through the mechanism of the joint return, the spouses are taxed essentially on a benefit principle; income is allocated as if it were shared equally, roughly approximating actual consumption. At divorce, H and W may actually continue to share income through alimony payments. To the extent that an economic arrangement similar to marriage continues after divorce, H and W should continue to be taxed in substantially the same manner as they were taxed during marriage. Therefore, after divorce, the Code should continue to tax each spouse on a benefit principle, based on their actual sharing arrangement. The extent to which sharing or pooling occurs during a functioning marriage is questionable and therefore the joint return may overstate the extent of such sharing. Nevertheless, sharing does occur after divorce—and in amounts that are easily discernable.

Deductions, supra note 142, at 357. Proper treatment under benefit principles, therefore, would tax the donee rather than the donor.

In the case of charitable contributions, however, it is often impractical or impossible to tax the beneficiaries because they cannot be identified. Id. at 358-60; Blueprints, supra note 138, at 96. For example, benefits from a museum or a medical research facility are so broad that specific beneficiaries cannot be identified. Id. Consequently, denial of the donor's deduction may be a practical alternative to taxing the beneficiaries on their benefits. Id.; see also Andrews, Personal Deductions, supra note 142, at 356. But see id. at 360-62 (rejecting taxation of donor as substitute for taxing beneficiaries, because donor is often in a higher bracket than beneficiaries and because taxing donor results in reduced gifts with same economic effect as taxing donee at donor's higher rate). In contrast, the beneficiary of alimony payments is clearly identifiable and thus in the alimony situation, the recipient is a viable and appropriate party to tax.


Congress authorized joint returns primarily to equalize the tax treatment of couples living in common law jurisdictions with those living in community property jurisdictions. S. Rep. No. 1013, supra note 113, at 22-25, 1948 U.S. Code Cong. Serv. at 1184-87. The concept of the marital unit as a basic unit for income taxation also supports the joint return. See, e.g., The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity 15 (1985) (abandonment of joint return would ignore fact that married couples pool incomes and benefit from shared living expenses and would reintroduce questions concerning allocation of couple's income and deductions). The debate over this issue continues. See note 43 supra.

See Gann, supra note 43, at 7, 26 n.97; id. at 26 ("[H]ard data does not generally substantiate the assumption that married persons equally share their income.").

See Bittker, A "Comprehensive Tax Base" as a Goal of Income Tax Reform, 80 Harv. L. Rev. 925, 976 (1967) (fact that alimony payments are fixed in amount distinguishes them
Critics argue that the benefit principle is inequitable in its operation. Indeed, if it is an appropriate measure for allocating income tax burdens, the principle should logically extend to any situation where two or more people share income, including sharing relationships among unmarried individuals. Inequality is thus founded on the fact that the system limits application of the benefit principle to those who are or have been legally married. The traditional response to this argument is a practical one: extending the benefit principle to every situation in which taxpayers split or pool income would necessitate complex filing rules and Internal Revenue Service inspections. Moreover, boundaries based on legal characterizations, such as marital status or the legal obligation to support another individual, provide readily verifiable, objective bases for administering the tax laws.

D. Source Rules

While the Haig-Simons definition identifies a theoretical tax base, the definition does not identify who should be taxed. Moreover, in a progressive rate system, strict adherence to the benefit principle could legitimize tax avoidance through income shifting devices.

Unlike the Haig-Simons definition, "assignment of income" principles identify who should be taxed. They do so by determining the source of income rather than its uses or consumption. There are two basic assignment of income principles, or "source rules": (1) income derived from services rendered is taxed to the earner, and (2) income derived from property is taxed to the owner of that property. Thus, under the

from cost of supporting spouse during marriage where no reliable basis exists for allocating part of earner's income to spouse); see also McIntyre, supra note 43, at 473 (advocates of individual filing favor alimony deduction).


155 Bittker, Tax Deductions, supra note 140, at 976-77. This approach, which limits the application of the Haig-Simons definition, has been characterized as the "traditional viewpoint." Sunley, Summary of the Conference Discussion, in Comprehensive Income Taxation 261, 271 (J. Peehman ed. 1977).

156 See Blueprints, supra note 138, at 36-38 (discussing tax treatment of gifts); S. Surrey & P. McDaniel, supra note 144, at 200-01 (allowing deduction to donor of gift while including gift in income of donee could give rise to tax avoidance).

source rules, $H$ would be taxed on the $100 he earns and pays to $W$ who then saves it or uses it to pay rent.

Outside the familial context, source and benefit rules usually coincide. The individual who earns the income typically enjoys or consumes it and thus is the appropriate taxpayer under both rules. In the alimony situation, however, enjoyment and earning, in the traditional sense, are split. Yet, family law principles suggest ways in which $W$ could be viewed as both the earner and the consumer of alimony payments. They should thus be examined to determine whether they provide a mechanism for reconciling the source and benefit rules.

Under some circumstances, alimony payments could be viewed as income generated by an expanded notion of marital property. A spouse's earning capacity, typically $H$'s, may be viewed as an income-producing asset even if it cannot be valued and distributed for purposes of equitable distribution laws. If $W$ contributed to the enhancement of $H$'s earning capacity, upon divorce she may have a proprietary interest in it. Thus, the alimony $W$ receives under these circumstances could be viewed as income generated from her property. Unfortunately, this analysis, even if acceptable for tax purposes, applies only to situations where $W$ has made identifiable contributions that enhanced $H$'s earning capacity and therefore is compensated for them at divorce. These situations are too few to provide the basis of a uniform rule.

Likewise, the construct of alimony as compensation for contributions to the marital enterprise could result in taxing $W$ as both earner and consumer. However, once $H$ and $W$ are considered a continuing single tax unit, this construct is not useful for tax purposes because it supports taxing both spouses. If alimony represents compensation for $W$'s services to the marriage enterprise, both $H$ and $W$ can be viewed as earners of particular alimony payments. For example, $H$ earns the funds

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160 See generally Beninger & Smith, supra note 67, at 203.

161 Alimony may be awarded for many other reasons. For example, a needy spouse who contributed little to the marriage might still be awarded alimony simply to avoid the need for public assistance. See text accompanying notes 57-58 supra. Similarly, alimony might be awarded even though $H$'s contributions to the marriage enterprise did not enhance $H$'s earning capacity or enhanced it only to a small degree.

162 See notes 65-69 and accompanying text supra.
TAX CONSEQUENCES OF DIVORCE

at his job and \( W \) earns the funds by caring for the home; thus, both \( H \) and \( W \) should be taxed.

Rather than trying to reconcile the source and benefit principles, the conclusion that \( W \) and not \( H \) should be taxed on alimony payments is best supported by the concept of \( H \) and \( W \) as a continuing single tax unit as well as by notions of fairness and ability to pay. To illustrate, consider the dependency exemption, which provides a deduction for children whom the taxpayer supports. Theoretically, the support of children is a form of voluntary consumption that the tax laws should ignore. However, the obligation to support children differs from other voluntary expenditures because the decision to have a child is irreversible and, after birth, the parent is legally obligated to support the child. It follows, therefore, that the consequent reduction in taxpaying capacity should be reflected in a reduction of the parent’s tax liability. Similarly, \( H \)’s alimony obligation, which also arises from familial and consequent legal obligations, should reduce his tax liability. Thus, fairness indicates that \( W \), rather than \( H \), should be taxed.


\[164\] Bittker, Taxation and Family, supra note 43, at 1448; see also Blueprints, supra note 138, at 106; Musgrave, In Defense of an Income Concept, 81 Harv. L. Rev. 44, 55 (1967) (arguing that exemptions are proper means by which to control rate progressions and measure taxable unit’s ability to pay taxes). The dependency exemption is also justified as a means of excluding from the tax rolls persons whose incomes do not exceed a minimum subsistence level and who are therefore without capacity to pay taxes. See Schenk, Simplifying Dependency Exemptions: A Proposal for Reform, 35 Tax L. 855, 866 (1982). Exemptions also can be viewed as an integral part of a graduated tax structure, providing the primary source of progression at the lowest income level. Id. at 867. Even Henry Simons might favor a deduction for child support expenditures if accompanied by the dependent’s concomitant inclusion. See Bittker, Taxation and Family, supra note 43, at 1449-50.

\[165\] Typically, the obligation to pay alimony results from a negotiated settlement. See Mnookin & Kornhauser, Bargaining in the Shadow of the Law: The Case of Divorce, 88 Yale L.J. 950, 951 & nn.2-3 (1979). Where the welfare of the children is not a settlement consideration, a court will usually respect an agreement reached by the parties. Id. at 954. Presumably, because the parties must reach an agreement that comports generally with the legal rules of the jurisdiction, a settlement agreement should take into account the level of alimony payments that a court would apply in the absence of an agreement. Id. at 968.

\[166\] See Commissioner v. First Sec. Bank of Utah, 405 U.S. 394, 405 & n.21 (1971), in which the Supreme Court found that it would be unfair to tax an earner on alimony he paid to his wife because he could not legally use the funds. This equity issue has consistently concerned Congress. “A principal purpose for the...[inclusion/deduction scheme]...is to relieve the payor of the burden of paying tax on the income which is transferred to the payee spouse as alimony and to impose that burden on the spouse receiving the alimony.” H.R. Rep. No. 432, supra note 114, at 1495, 1984 U.S. Code Cong. & Admin. News at 1136; see also 88 Cong. Rec. 6377 (1942) (statement of Rep. Disney) (“The amount of a husband’s income which [pursuant to a court order] goes to the wife as alimony...is in reality not income to him at all since he has no control over...the use to which it is to be put.”); H.R. Rep. No. 2333, supra note 79, at 71-72.

\[167\] Of course, taxing \( W \) does not necessarily determine whose rate should be used, \( H \)’s or
E. The Alimony Deduction as a Revenue Drain

Equities aside, the government's concern with the alimony deduction and income shifting arises from the fear of potential revenue losses due to rate arbitrage.\(^{168}\) Statistics indicate, however, that the revenues at stake in the alimony deduction are not large.\(^{169}\) For example, only 0.6\% of all returns filed claimed a deduction for alimony payments. In contrast, 48.3\% of all returns filed took advantage of the joint return tables.\(^{170}\)

Moreover, the potential for a significant revenue impact is more hypothetical than real. Although divorced women are generally in lower tax brackets than their male counterparts,\(^{171}\) studies indicate that cash

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\(^{169}\) In 1982, for example, approximately $3 billion was deducted under § 215 for alimony paid in that year. IRS, 1982 Statistics of Income, Individual Income Tax Returns 53 (1984) [hereinafter 1982 IRS Statistics]. Compare this amount with the more than $127 billion deducted as a dependency exemption for children living at home and with the almost $7 billion deducted for children living away from home. Id. at 63. Moreover, in contrast to these two latter allowances, a deduction taken under § 215 is offset by an inclusion under § 71 (albeit at a different rate). Thus, although approximately $3 billion was deducted as alimony paid in 1982, approximately $2 billion was reported in income as alimony received during that year. Id. at 43. The discrepancy may reflect a failure to report alimony income that should have been reported. To the extent that it does, the 1984 Act should reduce such discrepancies in the future. The 1984 Act amends § 215 to provide for regulations under which (1) any individual receiving alimony or separate maintenance payments is required to furnish his or her taxpayer identification number to the individual making the payments, and (2) the individual making the payments is required to include the recipient's taxpayer identification number on his or her individual return. I.R.C. § 215(c) (Supp. II 1984). The 1986 Act made no further amendments to § 215.

\(^{170}\) In 1982, 95,337,432 returns were filed. 1982 IRS Statistics, supra note 169, at 3. Alimony deductions were claimed on only 582,477 returns. Id. at 53. Of the total number of returns filed, 46,050,287 were joint returns. Id. at 3.

awards to former spouses are relatively few in number and small in size, and often remain uncollected. Even where substantial annual payments are made, the resulting increase in the recipient’s income narrows the difference between the former spouses’ marginal tax rates and thus lessens the revenue impact.

Nevertheless, rate arbitrage continues to trouble Congress and the Treasury Department. To the extent, however, that the prior discussion justifies characterizing alimony as W’s income rather than H’s, no “shift” has occurred and any “revenue loss” occasioned by the payment of alimony is appropriate.

III

SECTION 71 TODAY

In the 1984 Act, Congress essentially adopted both the inclusion/deduction scheme and the concept of private ordering proposed by the ABA. New sections 71 and 215 provide that certain cash payments...
made to a former spouse are includible/deductible unless the divorce or separation instrument provides that such payments are excludible/non-deductible. The Code limits the types of payments that fall within the scheme, but allows the parties to elect to treat payments, otherwise includible/deductible, as excludible/nondeductible.

The Code's definition of taxable alimony (i.e., payments that fall within the inclusion/deduction scheme) is designed largely to deny deductions for cash payments ensuing from a property settlement. The Code does not, however, provide an effective mechanism for distinguishing between cash payments of alimony and cash payments for property. Its definition of taxable alimony provides traps for the unwary and precludes legitimate alimony from the inclusion/deduction scheme. Moreover, while ideally the Code should draw the alimony/property distinction, given the complex treatment of marital wealth under modern family law, there is no administratively feasible way to do so. Because of administrative problems and the lack of a significant revenue impact, this Part argues that Congress should abandon the attempt to draw such distinction. Spouses should be allowed to designate which cash payments represent payments for property and which represent a shared income stream. In the absence of the taxpayer's election, the Code should adopt a simple fallback rule.

A. The Statute

Section 71, as amended by the 1984 Act, provides that all cash payments other than child support received by (or on behalf of) a spouse are includible in the income of the payee and, under section 215, deductible by the payor, as long as (a) the payments are made under a "divorce or separation instrument"; (b) the payments are made at a time when the spouses do not reside in the same household (if they are legally divorced or separated); (c) the liability for payment ceases upon the

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178 I.R.C. §§ 71(a)-(b), 215(a)-(b) (Supp. II 1984).
180 See I.R.C. § 71(b) (Supp. II 1984); notes 191-95 and accompanying text infra. The definition of taxable alimony in the 1986 Act is similarly designed to deny deductions for cash payments ensuing from a property settlement. See I.R.C. § 71(b) (West Special Pamphlet 1987).
181 See § 71(b) (Supp. II 1984). The 1986 Act made only one minor amendment, see § 71(b)(1)(D) (West Special Pamphlet 1987); note 192 infra, and thus retains the basic flaws of the 1984 Act.
182 See notes 220-22 and accompanying text infra.
payee's death;\textsuperscript{186} (d) the payments are not designated by the parties as excludible/nondeductible;\textsuperscript{187} (e) the payments, where applicable, are made over a six-year period;\textsuperscript{188} and (f) the payments meet certain prohibitions against front-loading.\textsuperscript{189}

Both the support and "periodic" requirements of prior law have been eliminated so that income splitting is no longer contingent on the vagaries of state law.\textsuperscript{190} Congress has, however, tried to limit taxable alimony to payments that resemble alimony or support payments under state law.\textsuperscript{191} Thus, for example, qualifying alimony must cease on the death of the recipient.\textsuperscript{192}

Similarly, the anti-front-loading rules of section 71(f) evidence Congress's attempt to distinguish support payments from property settlements. Section 71(f)(1) essentially replaces the old ten-year rule\textsuperscript{193} with a six-year rule. Thus, to the extent that any annual payment exceeds $10,000, it will not be treated as taxable alimony unless payments are to be made in each of six consecutive calendar years.\textsuperscript{194} Concern that taxpayers could "draft around" the six-year rule prompted Congress to in-

\textsuperscript{190} See text accompanying notes 87-93 supra.
\textsuperscript{191} See H.R. Rep. No. 432, supra note 114, at 1495, 1984 U.S. Code Cong. & Admin. News at 1137 (new § 71 "attempts to define alimony in a way that would conform to general notions of what type of payments constitute alimony as distinguished from property settlements").
\textsuperscript{192} I.R.C. § 71(b)(1)(D) (Supp. II 1984). The Code no longer requires the divorce or separation instrument to provide that payments terminate at the death of the payee. I.R.C. § 71(b)(1)(D) (West Special Pamphlet 1987). Liability for payments, however, must actually terminate at death. Id. This amendment will make governmental enforcement of the rule more difficult.
\textsuperscript{193} I.R.C. § 71(c) (1982) provided that installments of a principal sum were not taxable alimony. However, if the principal sum were to be paid over a period of more than 10 years, payments could fit within the definition of taxable alimony. See note 86 supra. Most commentators agreed that the 10-year rule needed to be eliminated. See, e.g., 1983 N.Y.S. Bar Ass'n Report, supra note 116, at 19, 21-23 (recommending private ordering rules regardless of length of payout period); text accompanying note 125 supra. Treasury, although advocating the shortening of the 10-year period, sought to maintain something akin to periodicity and the 10-year rule in the Code as "safeguards for preventing nondeductible property settlements from being treated as [deductible] alimony." Statement of Pearlman, supra note 168, at 9. Treasury saw such safeguards becoming even more important because Congress was eliminating the requirement that a deductible payment be "made in satisfaction of a 'marital obligation.'" Id.
\textsuperscript{194} I.R.C. § 71(f)(1) (Supp. II 1984) provides,

Alimony or separate maintenance payments (in excess of $10,000 during any calendar year) . . . shall not be treated as alimony or separate maintenance payments unless such payments are to be made by the payor spouse to the payee spouse in each of the six post-
clude recapture rules in section 71(f).195 Under these rules, if a payment made during any one year in the six-year period is more than $10,000 less than the payment made in any prior year of the period, the payor must include the excess in, and the recipient may deduct the excess from, income.

To illustrate, assume that payments of the following amounts are made over a six-year period: Year 1, $25,000; Year 2, $12,000; Year 3, $1,000; Year 4, $1,000; Year 5, $1,000; and Year 6, $1,000. Because the payment made in Year 2 is more than $10,000 less than the payment made in Year 1, the excess of $3,000 is treated as income to the payor and is deductible by the recipient in Year 2. Next, consider Year 3. Because a payment made in any year must be compared to the payment made in each prior year, the payment made in Year 3 must be compared to the payments made in Years 1 and 2. The $1,000 payment made in Year 3 following the $12,000 payment made in Year 2 gives rise to $1,000 of income for the payor and a $1,000 deduction for the recipient in Year 3.196 The $1,000 payment made in Year 3 must also be compared to the payment in Year 1. An amount previously recaptured will not be recaptured again.197 Thus, the $1,000 payment made in Year 3 is compared to the remaining $22,000 of the payment in Year 1 ($25,000 less the $3,000 recaptured in Year 2), producing an excess of $11,000 that (when added to the $1,000 previously calculated) is also includible by the payor and deductible by the recipient in Year 3.198 Therefore, in Year 3, when the payor pays $1,000 to the recipient, the recapture rules separation years (not taking into account any termination contingent on the death of either spouse or the remarriage of the payee spouse).

Under the 1986 Act, § 71(f)(1) no longer explicitly requires that payments be made in every year of the specified time period. However, the 1986 Act retains the prohibition against front-loading. While the calculation is quite different under the 1986 Act, see note 199 infra, in effect, the 1986 Act has replaced the six-year rule with a three-year rule and the $10,000 amount with a $15,000 amount. I.R.C. § 71(f)(1) (West Special Pamphlet 1987).


198 Temp. Treas. Reg. § 1.71-1T(d), Q/A 24 (1984). Section 71(f)(5) also provides exceptions to the recapture rules where payments cease due to the death of either spouse or the remarriage of the payee spouse, and for payments made pursuant to temporary support decrees described in § 71(b)(2)(C). I.R.C. § 71(f)(5)(A)-(B) (Supp. II 1984 & West Special Pamphlet 1987). Section 71(f)(5) provides a further exception for any payment made pursuant to a
require the payor to include $12,000 in income and allow the recipient a $12,000 deduction. Payments made during Years 4 through 6 must be similarly analyzed.\(^{199}\)

As the recapture rules of section 71(f) demonstrate, in attempting to define taxable alimony in a way that reflects state law definitions of alimony or support payments, Congress created complex tax laws. The complexity of these rules raises questions as to the success of the reform legislation. One particularly serious problem is that the complexity may penalize taxpayers who lack adequate representation.\(^{200}\) For example, taxpayers may inadvertently trigger recapture. Consider a settlement where \(H\) agrees to pay \(W\) $20,000 per year plus medical costs for a period of six years. In the third year, \(W\) has a medical emergency for which \(H\) provides an additional $25,000 for a total of $45,000. As a result, in the fourth year, \(H\) will be required to recapture $15,000 and \(W\) will have a $15,000 deduction, because the decrease from $45,000 in the year of the emergency to $20,000 in the subsequent year exceeds the permitted decrease of $10,000 by $15,000.\(^{201}\)

In addition, the recapture rules apply to amounts paid rather than to amounts payable.\(^{202}\) Thus, recapture could be triggered when a spouse fails to make payments because of financial hardship, or when a January payment is made in December or vice versa.\(^{203}\) Similarly, the

\(^{199}\) While the 1986 Act retains the prohibition against front-loading, it changes the formula for computing front-loading by replacing the six-year rule with a three-year rule, I.R.C. § 71(f)(1) (West Special Pamphlet 1987); by raising the de minimus amount to $15,000, I.R.C. § 71(f)(3)(B)(ii), (f)(4)(B)(ii) (West Special Pamphlet 1987) and by requiring recapture only in the third post-separation year, I.R.C. § 71(f)(1) (West Special Pamphlet 1987). The following example illustrates how the recapture rules operate under the 1986 Act. Assume that \(H\) pays \(W\) $50,000 in Year 1, $20,000 in Year 2, and $0 in Year 3. The recapture computation is made only in Year 3, I.R.C. § 71(f)(1) (West Special Pamphlet 1987), and in that year, \(H\) will be required to include $32,500, and \(W\) will be entitled to deduct $32,500. The recaptured amounts are computed as follows. First, \(H\) recaptures $5,000, the excess of the (i) $20,000 paid in Year 2 over (ii) the sum of $0 paid in Year 3 plus $15,000 ($20,000 minus $15,000). I.R.C. § 71(f)(2)(B), (f)(4) (West Special Pamphlet 1987). Next, \(H\) must recapture $27,500, the excess of the (i) $50,000 paid in Year 1 over (ii) $22,500, which is the sum of $7,500 (the average of the amount paid in Year 3, $0, and the amount paid in Year 2 which has not been recaptured, $15,000) plus $15,000. I.R.C. § 71(f)(2)(A), (f)(3) (West Special Pamphlet 1987).

\(^{200}\) See Statement of Pearlman, supra note 168, at 8.

\(^{201}\) A similar problem could arise under the 1986 Act if, for example, \(H\) agreed to pay \(W\) $20,000 per year for three years and in Year 2 a medical emergency requires \(H\) to pay \(W\) $50,000. In this case, \(H\) would recapture $15,000 in Year 3 ($50,000 less $35,000 ($20,000 paid in Year 3 plus $15,000)).

\(^{202}\) The recapture amounts are determined by reference to "alimony or separate maintenance payments paid by the payor spouse" during the year in which recapture occurs and prior years. I.R.C. § 71(f)(3) (Supp. II 1984) (emphasis added); I.R.C. § 71(f)(3) (West Special Pamphlet 1987) (emphasis added).

\(^{203}\) Temp. Treas. Reg. § 71-1T(d), Q/A 25 (1984) provides that the recapture rules apply to
payment of arrearages could give rise to recapture in subsequent years. The recapture rules also provide an opportunity for friendly and clever spouses to manipulate the progressive rate structure. The spouses, for example, might reduce payments to generate an excess payment during a year in which the payor's marginal rate bracket is low and the recipient's is high.

B. Lump-Sum Versus Periodic Payments

Congress's desire to prevent the deduction of large lump-sum property settlements, payments typically viewed as distributions of existing capital rather than as the sharing of future income, caused much of section 71's complexity.\textsuperscript{204} However, even assuming that the distinction that Congress has sought to make is appropriate, the Code's definition of taxable alimony should be abandoned. Its complexity provides traps for the unwary and is unjustified because it fails to achieve its goal. It excludes from the inclusion/deduction scheme legitimate short-term alimony, such as rehabilitative alimony, and includes in the scheme cash payments of property settlements structured in accordance with the requirements of section 71.

One problem arises because the statute incorrectly assumes that all short-term or front-loaded payments are property settlements. Rehabilitative alimony, which is favored by modern law and is designed to provide support for an ex-spouse during the transitional period after divorce,\textsuperscript{205} often extends for periods of less than six years.\textsuperscript{206} A typical community college education, for example, takes only two years. Given a decline or cessation of payments for any reason other than those specifically excepted, "including a failure by the payor to make timely payments, a modification of the divorce or separation instrument, a reduction in the support needs of the payee, or a reduction in the ability of the payor to provide support."


\textsuperscript{205} See notes 62-64 and accompanying text supra.

\textsuperscript{206} Rehabilitative alimony may also extend for less than three years. In California, for example, the median duration of transitional awards in 1977 was approximately two years. Weitzman & Dixon, supra note 57, at 162. As a result, a portion of such awards may not qualify for inclusion/deduction treatment under § 71. This is particularly disturbing because Congress believed it was defining taxable alimony in a way that would cover typical alimony under state law. H.R. Rep. No. 432, supra note 114, at 1495, 1984 U.S. Code Cong. & Admin. News at 1137.

On the other hand, rehabilitative alimony may be awarded for a period extending beyond six years where the recipient requires a longer period of time to become self-supporting. See, e.g., Dominik v. Dominik, 390 So. 2d 81, 83 (Fla. Dist. Ct. App. 1980) (upholding 10-year rehabilitative alimony award to wife who was caring for young children). In this case, the entire amount of each payment would qualify for inclusion/deduction treatment. Thus, the six-year rule might result in different tax treatment of conceptually identical awards. The 1986 Act's change to a three-year rule is an improvement because it does not exclude from the ambit of taxable alimony many short-term payouts. I.R.C. § 71 (West Special Pamphlet 1987).
the costs of living and tuition, annual payments could easily exceed $10,000 during the two-year period of rehabilitative alimony, but only the portion of the rehabilitative payments up to $10,000 a year would be deductible.

The problem is exacerbated when the six-year rule is combined with the front-loading rule. If the parties extend the payout period to six years by providing minimal payments for an additional two years, the transaction could run afoul of the front-loading rules and hence result in recapture. Alternatively, the parties could spread the payments evenly over the six-year period. By structuring the payout this way the transaction might satisfy the six-year and front-loading rules, but the recipient could be denied the use of some funds when they are most needed. Thus, in conforming the payments to the tax rules, the parties may undermine the purpose of rehabilitative alimony, which is to mitigate the economic hardship of entering or reentering the workforce.

C. Bases for the Alimony/Property Distinction

As previously noted, the current definition of taxable alimony is designed to limit the possibility that cash paid in a property settlement will be disguised as alimony or an income-sharing arrangement. Yet the current statute is only partially successful because it may deny deductions for legitimate and often highly desirable income-sharing arrangements.

While ideally the Code should not permit cash payments for property to be included in the inclusion/deduction scheme, the discussion that follows questions the feasibility of any statutory mechanism designed to make this distinction. It concludes that Congress should abandon the attempt to make the distinction and leave it to taxpayers to identify the amount of cash that represents a division of existing wealth. It therefore proposes the adoption of a simple rule, the “One-Year Cash Election Rule,” under which all cash payments made within a short pe-

\[\text{Temp. Treas. Reg. § 1.71-IT(d), Q/A 23 (1984).}\]

\[\text{Similar criticism applies to the front-loading rules under the 1986 Act, see note 199 supra, even though they are a marked improvement. For ways of circumventing the 1984 rules, see Asimow, supra note 5, at 151-52. For a similar but more detailed discussion of the problems of qualifying rehabilitative alimony under § 71, see I. Alpern, Alimony Issue Paper: A Case Study of Rehabilitative Alimony (prepared for American Bar Association 1985 Annual Meeting, seminar entitled The Federal Role in Domestic Tax Issues) (unpublished paper on file at New York University Law Review). While the payments of rehabilitative alimony may be fixed at level amounts (or increased amounts, for example, as tuition rises), it probably is more logical to decrease them as W's ability to work during the transition period increases. Although an argument might be made that the $10,000 floor allows a deduction for the typical transitional payment regardless of the payout period, and that therefore only unusually large payments made over a short period of time will run afoul of the rules, as a matter of policy, the Code should treat all payments of rehabilitative alimony similarly regardless of size.}\]
period of divorce or separation—for convenience, one year—are exclud-
able/nondeductible (unless the parties elect otherwise) and all payments
made thereafter are includible/deductible (unless the parties elect
otherwise).

Various principles justify the statute's exclusion of cash payments
for property from the inclusion/deduction scheme. The exclusion flows
directly from the view of marriage as an economic unit. In theory, the
marital wealth that exists at divorce has already been appropriately taxed
to the unit. As a result, an allocation of assets in-kind at divorce is a
nontaxable transaction governed by section 1041 of the Code because
each spouse is viewed as receiving, in a different form, that which he or
she previously owned.\textsuperscript{209} Even if cash, rather than the in-kind asset, is
transferred, \( W \) (as the recipient) can be viewed as receiving her own
property and therefore should not be taxed. Thus, the inclusion/deduc-
tion scheme should be limited to payments that divide the spouses' future
income stream. If, after divorce, \( H \) and \( W \) continue as a single tax unit,
\( W \) should be taxed on payments from \( H \) (and \( H \) should be entitled to a
deduction for those payments) only to the extent that \( H \) and \( W \) share
new income rather than divide wealth that was previously taxed and ac-
counted for during their marriage.

Another justification for the exclusion of cash paid in a property
settlement from the inclusion/deduction scheme is the concern that sec-
tion 1041 in combination with an expanded use of deductible alimony
payments might lead to transactions motivated solely by the tax laws.
For example, rather than retain property, \( W \) would have an incentive to
transfer it tax free to \( H \) who, in return, would make deductible alimony
payments to \( W \). In the absence of statutory restrictions, the spouses
could structure \( H \)'s deductible payments to take advantage of rate arbi-
trage. Thus, if after divorce \( H \) were in a higher bracket than \( W \), the
inclusion/deduction scheme could save \( H \) more in taxes than it would
cost \( W \). If the payments were stretched out sufficiently, \( W \)'s marginal
tax rate would remain low, and \( W \) would end up in essentially the same
economic position as she would have been in had she received property.
In this situation, only the fisc would lose.\textsuperscript{210}

Although these are sound reasons for distinguishing between ali-
mony and property settlements in establishing tax policy, the previous
discussion demonstrates that current laws fail to do so adequately.\textsuperscript{211} In
order to distinguish cash payments of a property settlement from a
shared income stream, Congress could amend section 71 and replace the

\textsuperscript{209} See text accompanying notes 119-23 supra.
\textsuperscript{210} See 1981 ABA Memorandum, supra note 3, at 15-17.
\textsuperscript{211} See notes 200-08 and accompanying text supra.
restrictions of current law with tracing rules. These rules would directly address the alimony/property distinction but would be inadministrable. For example, the Code could adopt a "50/50 Tracing Rule" providing that no payment of cash fits into the inclusion/deduction scheme unless it exceeds fifty percent of the cash and fifty percent of the fair market value of other property owned by the spouses at divorce. The rule would be based on a presumption that each spouse has a fifty percent interest in marital property. The ABA proposed a similar rule, but Congress rejected the proposal presumably because it would have been too complicated to administer.

Congress was undoubtedly correct in its determination that the 50/50 Tracing Rule is too complicated. It would require a federal definition of property; all such property would have to be valued at divorce, even those assets not valued for state law purposes. More importantly, the 50/50 Tracing Rule assumes that no payments for a so-called property interest reflect the kind of income-sharing arrangement appropriate for the inclusion/deduction scheme. This assumption becomes troublesome where the line between property and income blurs. Consider again the situation in which H's professional degree or license is treated as property subject to a state's equitable distribution law. If W is awarded a portion of the value of the degree or license, to be paid over a specified period of time, in all likelihood the payments will be made out of earnings from H's practice. This arrangement results in the sharing of H's income to the same degree as would an arrangement requiring H to pay W a fixed percentage of his earnings from the practice. The percentage payout arrangement would probably qualify for the inclusion/deduction scheme, while the 50/50 Tracing Rule would preclude such treatment for a division of the value of the degree.

Such inconsistencies could be remedied by eliminating the fair mar-

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212 Reference to each spouse's actual property interests under state law would run contrary to the goal of federal uniformity. The 50/50 presumption, while uniform, is problematic because equal distribution is not the rule in states with equitable distribution laws that mandate equity rather than equality. See notes 47-53 and accompanying text supra.

213 See 1981 ABA Memorandum, supra note 3, at 15-17.

214 See 1983 N.Y.S. Bar Ass'n Report, supra note 116, at 15-16 (rejecting ABA proposal); see also Feinzeig & Schreiber, supra note 5, at 37-39 (proposing that courts use source and any previous taxation of divorce-related payments as factors in determining tax consequences of transfers).

215 See note 76 and accompanying text supra.

216 These cases often arise at the beginning of H's career when there is little cash or property. See note 76 supra. There are situations in which a court may condition an award on the life of the recipient, in which case payments could easily be deductible. See I.R.C. §§ 215(a)-(b); 71(b)(1)(D) (Supp. II 1984); § 71(b)(1)(D) (West Special Pamphlet 1987). For an argument that such payments should not be deductible, based on the support/property dichotomy, see Feinzeig & Schreiber, supra note 5, at 28-29.
ket value of certain assets from the limitation formula. For example, assets without a basis for federal tax purposes could be eliminated. Alternatively, the inclusion/deduction scheme could be limited by the basis of assets on hand at divorce, rather than by their fair market value. Under this scheme, the 50/50 Tracing Rule would limit the inclusion/deduction scheme to payments in excess of fifty percent of the cash and fifty percent of the basis of assets on hand at divorce. Using tax basis as the limiting factor is also appropriate if one views the distinction between arrangements where spouses share untaxed income and arrangements where they divide income previously taxed to both of them (presumably through the joint return) as the fundamental goal of the 50/50 Tracing Rule.

However, even if some confusion could be eliminated by using the proposed modification, the 50/50 Tracing Rule would still frustrate the desire for tax simplicity. A federal definition of marital property would still be needed. Such definition should distinguish between property purchased by the spouses during marriage and property purchased before the marriage or acquired otherwise. Funds used to acquire assets during marriage presumably have been taxed to both spouses. Funds used by one spouse to purchase property acquired before marriage, however, may have been taxed only to that spouse; no portion of those amounts should reappear in his or her tax base. The 50/50 Tracing Rule would be further complicated by the need to distinguish additions to basis made during marriage, such as improvements made to the family home, from additions to basis made prior to marriage.

These complications could be eliminated by adopting a "Cash Rule" which provides that marital cash alone is the determinative factor in deciding what is a property settlement for tax purposes. Under the Cash Rule, to the extent that any payment is equal to or less than fifty percent of the cash on hand at divorce, the payment would not be includible/deductible. However, because this rule excludes property from the limitation formula, many classes of taxpayers may be prejudiced. For example, compare couple number one who owns two buildings, each valued at $50,000, but has no cash on hand, with couple number two who owns one building worth $50,000 and has $50,000 of cash on hand. If HI pays W1 $25,000 (presumably from borrowings), he will be entitled to a deduction under the Cash Rule; H2, however, would not be entitled to deduct a similar payment. Arguably, neither or both HI and H2 should

217 See 1981 ABA Memorandum, supra note 3, at 7, 15-17.
218 Using tax basis, however, does not completely satisfy the concept that the marital wealth that exists at divorce already has been appropriately taxed to the unit. See text accompanying note 209 supra.
obtain a deduction because the substance of the transactions is the same. Thus, losses to equity may offset the simplicity gained by the Cash Rule.

Another problem would arise under the Cash Rule. To ensure a deduction for future spousal payments, a taxpayer with cash might convert the cash to assets—most likely liquid ones, such as stock or securities. The limitation formula could be expanded to cover particular types of assets or conversions within a fixed period of time before divorce, but means of eluding this type of rule would remain.

Alternatively, the Code could establish a "One-Year Nondeductible Rule" which would provide that all cash payments made within a short time after divorce constitute a nondeductible division of capital. Any cash payment made thereafter would fit within the inclusion/deduction scheme. The rationale for a One-Year Nondeductible Rule is that to the extent that cash is a marital asset, it should be on hand at divorce; thus, presumably, \( W \) can obtain it from \( H \) at that time. This approach is problematic, however, because it would deny deductions to a large class of taxpayers who have little or no capital and who make payments to former spouses, albeit for a short time period, out of current earnings.

As the discussion of the One-Year Nondeductible Rule, the Cash Rule, and the 50/50 Tracing Rule demonstrates, rules that attempt to trace the source of payments will probably fail: they will either be too complicated or will prejudice a class of taxpayers. Because the tax statute cannot reasonably distinguish arrangements that share income from those that divide existing wealth, and because the revenues at stake are relatively small, the Code should abandon the attempt to make the property/alimony distinction. Instead, the Code should permit spouses to identify the amount of cash that represents a return of existing wealth rather than a sharing of future income and thus to elect whether \( H \) or \( W \) will be taxed on cash payments.

The Code should also provide a fallback rule in the absence of an election. The rule should be simple and have as its goal the avoidance of undue hardship to taxpayers. Thus, the fallback rule should conform as closely as possible to the consequences that can be reasonably expected from the transaction, so that uninformed taxpayers do not face unexpected tax consequences. It would be reasonable to presume that payments made within a short time after divorce reflect a division of marital wealth. Thus, the goal can be met, albeit not perfectly, with a One-Year Cash Election Rule that provides that, in the absence of an election by

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219 See Steines, supra note 82, at 250 ("wife’s ability at divorce to extract existing wealth tax-free suggests strongly that future payments come from the husband’s future receipt"). Presumably a wife would also be able to extract cash payments for her interest in property existing at divorce, because the husband could borrow against the property.

220 The proposed One-Year Cash Election Rule could be subject to restrictions similar to
the spouses to the contrary, cash payments made within a year of divorce are excludible/nondeductible and cash payments made thereafter are in-
cludible/deductible.

Although no uniform federal rule is perfect, the proposed One-
Year Cash Election Rule has several advantages. First, its simplicity re-
solves many of the problems caused by the complexities of the 1984 Act. Second, it defines taxable alimony in a way that conforms more closely to current state law concepts. Finally, it gives the recipient spouse, usually W, some leverage against being taxed on the receipt of marital capital.222

D. Taxable Alimony Versus Property Settlements: Revenue Concerns

While the revenue impact of the inclusion/deduction scheme is not
large, statutory limitations on that scheme are based on a concern for the
fisc.223 Thus, the proposed One-Year Cash Election Rule should be com-
pared to current law in terms of its potential for revenue loss.

Arguably, increased flexibility will enable the spouses to take advan-
tage of rate arbitrage.224 However, current rules already give higher
bracket spouses who are able to obtain more sophisticated tax advice am-
ple opportunity for rate arbitrage. For example, under the proposed
One-Year Cash Election Rule, even a single lump sum payment for prop-
erty would be includible/deductible if the parties so elect. Under current
law, however, property payments can be deducted if the recipient is will-
ing to accept a series of contingent payments made over a period of at
least six years.225 A sophisticated recipient, precisely the person whose

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221 The present treatment of the marital unit operates through approximations. For example, the joint return rules tax married spouses as if they share their incomes equally, even though not all couples do so. Because it is not feasible to tax spouses on their actual sharing arrangement, the presumption of equality is a practical alternative. A rule which allows some divisions of marital capital to be taxed as income splitting arrangements is no less perfect than the current joint return mechanism.

222 Admittedly, the One-Year Cash Election Rule does not prevent H from converting a purchase of property into deductible payments. If the parties elect, H can even deduct a lump sum payment. Any provision that attempts to distinguish a lump sum from periodic payments can be drafted around unless it provides complicated rules like those in section 71(f) (Supp. II 1984 & West Special Pamphlet 1987).

223 See text accompanying notes 168-74 supra.

224 See text accompanying note 210 supra.

year period to a three-year period. See I.R.C. § 71 (f) (West Special Pamphlet 1987); note 199
supra. Section 1041 (Supp. II 1984) contains no exception for cash payments made in consid-
eration of the transfer of property, and the temporary regulations provide that nonrecognition
treatment applies to a sale of the property by one spouse to the other. See Temp. Treas. Reg.
arrangements the present complicated rules seek to curb, might agree to such an arrangement because a property interest can be valued and expressed either as a lump sum payment of cash or as an equivalent series of contingent payments made over time. Thus, under the proposed One-Year Cash Election Rule, $H$ may substitute the deduction of a lump-sum payment for the deduction of a series of annual (contingent) payments, which is already permitted by the Code.

In addition, recall that in the divorce context, any deduction by the payor is offset by an equal inclusion by the recipient, and that the government traditionally has been concerned with revenue losses occasioned by the difference between $H$’s and $W$’s marginal rate brackets. If, under the proposed One-Year Cash Election Rule, $H$ makes a large, lump-sum payment, however, $W$’s income will be increased substantially, so that any difference between $H$’s and $W$’s marginal rate brackets should be decreased if not virtually eliminated. Thus, due to the progressive rate structure, the transfer of a lump sum may produce a smaller revenue loss than would the transfer of periodic payments.

§ 1.1041-1T(a), Q/A-2, Examples (1)-(2) (1984). This treatment is generally the same under the 1986 Act. See I.R.C. § 1041 (West Special Pamphlet 1987).

226 This type of arrangement might be particularly attractive if the payor is required to pay premiums on a life insurance policy for the recipient’s life. Under I.R.C. § 71(b)(1)(D) (Supp. II 1984) and Temp. Treas. Reg. § 1.71-1T(b), Q/A-14 (1984), the divorce instrument may not provide any substitute payment (in cash or property) for spousal payments foregone because of the recipient’s death. Furthermore, under I.R.C. § 71(b)(1)(D) (West Special Pamphlet 1987), the payor’s liability for substitute payments must terminate at the recipient’s death. The legislative history indicates that the requirement that the payor pay premiums on a life insurance policy for the recipient’s life will not be considered such a substitute. See H.R. Rep. No. 432, supra note 114, at 1496, 1984 U.S. Code Cong. & Admin. News at 1138.

227 Economists suggest that the value of an asset at equilibrium, and therefore the price that a purchaser would be willing to pay, is equal to the present value of the expected income stream from the asset over its anticipated useful life. See e.g., P. Samuelson & W. Nordhaus, Economics 651-52, 667-69 (12th ed. 1985). The general formula for computing the present value of SX payable $t$ years from now is SX (1.00 + $i^t$) where $i$ equals the market rate of interest. Id. at 677 n.1. The current value of a contingent income stream can also be computed. For a discussion about equating lump sum and periodic payments, see Mnookin & Kornhauser, supra note 165, at 962-63, 963 n.50; see also Treas. Reg. § 20.2031-7(f) (as amended in 1984).

228 Assume rather simplistically that $H$ will always be in the 50% marginal rate bracket and that he transfers $60,000 to $W$ who has no other income. Using the 1984 tax tables, on a lump sum transfer, $H$ will save $30,000 in taxes (50% of $60,000), and $W$ will pay $18,371 ($16,115 plus 48% of excess of $60,000 over $55,300) in taxes, a loss to the fisc of $11,629 ($30,000 - $18,371). If, instead, $H$ pays $W$ $13,776.44 a year for six years (which has the same present value as a $60,000 lump sum payment, using a 10% annual discount rate), $H$ will save a total of $41,329 in taxes ($6 x 50% x $13,776.44), which, using the same 10% discount rate, has a present value of $30,000. $W$ will pay only $10,537.73 in taxes ($6 x $1581 plus 20% of excess of $13,776.44 over $12,900), which has a present value, using the same discount rate, of $7,649.10. The result is a loss to the fisc, on a present value basis, of $22,350.90 ($30,000 - $7,649.10)—a larger loss than the one produced by a lump sum transfer. By decreasing the applicable tax rates, the 1986 Act lessened the impact of the loss in many cases. See I.R.C. § 1
Finally, as long as the alimony deduction is limited to the payor’s gross income, there is a built-in restraint on any abuse of the inclusion/deduction scheme under the proposed One-Year Cash Election Rule. If in any year $H$ transfers payments in excess of his income (before the deduction), the rules impose more tax on $W$ than would be saved by $H$. As long as the alimony deduction cannot create a net operating loss, a payment of taxable alimony that exceeds $H$’s income (prior to the section 215 deduction) creates income in $W$’s hands.

CONCLUSION

The tax treatment of divorce-related transactions is structured to further important, yet often competing, goals. On one hand, the tax system is intended to embody specific economic theories and conceptual models. On the other hand, the ordinary taxpayer should be able to understand the system and to rely on its fair and efficient administration. Furthermore, the tax laws should employ current principles and ideas underlying state substantive laws of divorce while providing for uniformity in their application. These are not easy goals to attain.

In 1984, Congress sought to reshape the tax treatment of divorce to accommodate at least some of those goals. In particular, Congress sought to make the tax consequences of divorce both flexible and predictable. Congress made great strides by repealing the Davis rule and removing section 71’s dependence on state law. Unfortunately, backward steps were also taken, so that the specific amendments to section 71 created new complexities.\textsuperscript{229} While complexity may be necessary to achieve conceptual purity or technical consistency, much of the complexity of section 71 accomplishes neither.\textsuperscript{230} The complex treatment of marital wealth under modern family law makes the administration of conceptual purity infeasible. Thus, Congress should abandon its attempt to distinguish payments of future income from payments for property. Instead, it should adopt a simple rule that permits former spouses to designate the nature of cash payments made to one another and that provides for fallback provisions to operate in the absence of taxpayer election.

\textsuperscript{229}To a great extent, the 1986 Act also failed to address these complexities. Although having recapture only in the third year simplifies the front-loading rules, the statute remains complex without sufficient justification.

\textsuperscript{230}The complexity of the 1986 Act also fails to accomplish either conceptual purity or technical consistency because a payor can still easily convert a lump sum property settlement into includible/deductible alimony by paying the sum evenly over a three-year period.