BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal

of

UNION BANK & TRUST CO., EXECUTOR)
OF THE WILL OF WILLIAM KLATSCHER,)
DECEASED)

Appearances:

For Appellant: Samuel A. Miller, Attorney at Law

For Respondent: Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Union Bank & Trust Co., Executor of the Will of William Klatscher, Deceased, for refunds of personal income tax in the amounts of $88.57, $115.49 and $231.46 for the taxable years 1943, 1944 and 1945, respectively,

William and Edith Klatschcr were married in 1915 and had resided in this State continuously since that time, at least through the year 1945. In 1927 they separated and had since been living apart. On August 20, 1936, Edith Klatscher was adjudged incompetent, and on the same date a property settlement agreement was entered into between Mr. Klatscher and Edith Klatschcr through her guardians. On October 13, 1936, Mr. Klatscher obtained a divorce in the state of Nevada from Mrs. Klatscher on the ground of her insanity.

The agreement recited that each of the parties had separate property, that there was property held in joint tenancy, and that there was community property standing in the name of Mr. Klatscher. The separate property of Mr. Klatscher and the community property were listed in the total amount of $261,738.44 after allowing for encumbrances on the property. There was no segregation of community property and separate property. Joint tenancy property totalled $4,500.00 after allowing for encumbrances, and, in addition,

one piece of property had an excess encumbrance over value'. Property standing in the name of Edith Klatscher was listed as having a total value of approximately $30,000.00.

Under the terms of the agreement, Mr. Klatscher agreed to pay Mrs, Klatscher $250.00 per month for her lifetime, The question on this appeal is whether Mr. Klatscher is allowed a deduction for these payments.

Sections 7(k) and 8(o) of the Personal Income Tax Act, in effect during the years 1943 and 1944, and their successor sections, Sections 17317.5 and 17104 of the Revenue and Taxation Code, in effect in 1945, are applicable to the question presented. They provide for the deduction by the husband of payments made to his divorced wife which are "in discharge of . . . a legal obligation which, because of the marital or family relationship, is ... incurred by such husband ... under a written instrument incident to such divorce . . .."

Two contentions arc made by the Franchise Tax Board: (1) the payments were made in consideration for the transfer of the wife's interest in community property rather than for her support, and (2) the agreement was not incident to a d i v o r c e .

As to the first contention, it is the rule that periodic payments in settlement of community property interests are not deductible, but where such payments are found to be actually in discharge of an obligation of support they are deductible regardless of the label attached to them. Thomas E. Hogg, 13 T.C. 361; Floyd H. Brown, 16 TC 623; Arletta C. Harris, T.C. Memo. Dec., Docket No. 31089, entered August 25, 1952. See also Julia Nathan, 19 T.C. 865. The Franchise Tax Board argues that since various offers of lump sum payments were tendered and rejected before the monthly payments were agreed upon, it must be assumed that the community property had an ascertained value, for which the payments to the wife are in settlement. However, no attempt was made in the agreement to segregate the community property, nor is there any evidence before us establishing its value, In Thomas E. (Hoggra), where the amount of community property was not established, it was held that the payments were for support, the court stating that "it seems obvious that there was no calculation of the amount of property to which she might be entitled and that such amount was not a factor considered in arriving at the settlement terms."

However, granting that the community property interest has a value, there nevertheless appears to be consideration other than the periodic payments to balance such an interest. Mrs. Klatscher was relieved of liability for accrued debts, her legal expenses and the property loan deficiency in the aggregate amount of approximately $31,000, as well

as a contingent liability of $110,000 on notes owed by Ellis-Klatscher & Co., which notes Klatscher had endorsed and for which the community property would be liable, Klatscher also assumed payment of very substantial encumbrances on the property he received, including a mortgage note for $27,500 which was signed by both Mr. and Mrs. Klatscher and could have resulted in a charge against her separate property. Garthofner v. Edmonds, 74 Cal. App. 2d 15; Hammond Lumber Co. v. Danziger, 2 Cal. App. 2d 197. In addition, Klatscher assumed the obligation of supporting their two children. The assumption of these obligations should be considered in determining the nature of the periodic payments. Floyd H. Brown, supra.

It cannot be said that the parties were interested only in a division of comiiunity property, and that the matter of support was not considered. Not only was a valuation not made of the community property, but the agreement recited that "Both of the parties hereto desire to settle ... their property rights ... and also all rights and obligations for support and maintenance toward each other ...", and it further provided "... excepting only the payments in this agreement provided to be made to Mrs. Klatscher or for her benefit by Klatscher, Mrs. Klatschar hereby forever releases and discharges Klatscher from any claim, demand or obligation to support or provide for any support or maintenance whatsoever." The payments were to be made as long as Mrs. Klatscher lived, In addition, the Nevada statute under which the divorce was obtained shortly after the agreement was entered into provided "... a decree granted on this gound /insanity/ shall not relieve the successful party from contributing to the support and maintenance of the defendant . ..." (§ 9460, Nev. Comp. Laws, Supp. 1931-1941.) Moreover, it would be unrealistic to hold that a right to present support was given up without consideration, namely, the right to future support. Floyd H. Brown, supra. While we do not regard any one factor as conclusive, considering the circumstances as a whole, it is our opinion that the monthly payments were intended to be for the support of Mrs. Klatscher.

Finally, the Franchise Tax Board contends that the agreement was not incident to a divorce.

The agreement expressly stated that it was not made in contemplation of divorce but that it should not prejudice any cause of action for divorce and should be effective regardless of the result of any divorce action that might be commenced, The agreement was not mentioned in the decree. The attorney for Mr. Klatscher, who participated in drafting the agreement, stated that the above-mentioned provision in the agreement was to avoid possible charges of collusion. In California, certainly, where the agreement was executed, it was considered at the time that a contract

in contemplation of divorce was invalid. Brown v. Brown, 8 Cal. App. 2d 364. Similar cautious provisions are apparently not uncommon in settlements of this kind, and do not compel a conclusion that the agreement was not incident to a divorce. Lerner v. C.I.R., 195 Fed. 2d 296. See also Izrastzoff v. C.I.R., 193 Fed. 2d 625, 628; George T. Brady, 10 T.C. 1192; Jane C. Grant, 18 T. C. 1013. Nor is it essential that the agreement be referred to in the decree. George T. Brady, Jane C. Grant, supra.

On the contrary, the sequence of events strongly indicates that the agreement was in contemplation of divorce. It was dated on the same day that Edith Klatscher was adjudged incompetent and her guardians appointed. That judgment established a ground for divorce and the appointment of guardians was necessary to the validity of the agreement. In addition, the facts that the agreement itself carefully provided for the effect on the settlement in case of divorce and that the divorce decree was obtained less than two months later are significant. Izrastzoff v. C.I.R., supra; Lerner v. C.I.R., supra; Jane C. Grant, supra; Feinburg v. C.I.R., 198 Fed. 2d 250. We conclude that the agreement was incident to the divorce as contemplated by the statutes.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 19060 of the Revenue and Taxation Code,, that the action of the Franchise Tax Board in denying tne claim of Union Bank & Trust Co., Executor of the Will of William Klatscher, Deceased, for refunds of personal income taxes in the amounts of $88.57, $115.49 and $231.46 for the years 1943, 1944 and 1945 be and the same is hereby reversed.

Dated at Sacramento, California, this 20th day of January, 1954, by the State Board of Equalization.

Geo. R. Reilly, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

Wm. G. Bonelli, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary