

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
FRANCESCA L. KAHN }

Appearances:

For Appellant: Robert Kahn

For Respondent: Burl D. Lack, Chief Counsel;  
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 Francesca L. Kahn for refund of personal income tax in the amounts of \$82.23 and \$84.72 for the years 1950 and 1951, respectively,

On December 4, 1924, Appellant and her former husband, Irving H. Kahn, entered into a written agreement in contemplation of a divorce. As provided in the agreement, Mr. Kahn thereafter established four trusts, in one of which he placed 700 shares of stock in a corporation of which he was a substantial shareholder. The income of this trust was to be paid to Appellant during her lifetime. Upon her death the corpus of the trust was to be distributed to the three children born of the marriage. The three other trusts were for the benefit of the children and presumably provided for their support and maintenance. The agreement was subsequently ratified and approved in the decree of divorce.

Under the terms of the agreement Mr. Kahn had an option to purchase the shares of stock at anytime and was obligated to purchase \$5,000 worth at par value on December 15, 1936, and a like amount annually thereafter. He also guaranteed to Appellant the payment of annual dividends on the stock in the amount of \$4,200, or at the rate of 6% of the par value of the shares of stock remaining in trust, whichever was lower. In anticipation of dividends he agreed to pay Appellant \$350 per month for which he was to be reimbursed by the trust from the dividends it received. In the event of the remarriage of Appellant the guaranty was to be reduced to \$2,100 per year

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or 6% of the par value of the shares of stock remaining in trust, whichever was the lower.

On her part Appellant agreed to **accept** the contractual obligation of her husband in full satisfaction of "**all** her marital claims of whatever kind or nature" and she **specifically** waived any further rights to support or maintenance.

In later years the stock held in trust failed to yield the **expected** dividends and by 1942 Mr. Kahn had paid Appellant \$23,014.04 under his guaranty. Appellant states that Mr. Kahn was insolvent in that year. He owed Appellant additional money under the guaranty, he had failed to purchase shares of stock as required by the **agreement**, and he was in arrears on notes that he had given Appellant as a result of transactions prior to the divorce.

In an effort to settle their mutual financial affairs, Appellant and her former husband in 1942 entered into a second agreement in which Appellant forgave all defaults under the original agreement and released Mr. Kahn both from his guaranty to her and his obligation to purchase shares of stock from the trust. In consideration of this modification of the 1924 agreement, Mr. Kahn gave Appellant a new note for the balance then due on the original notes and agreed to make monthly payments to her in the amount of \$350, which were to include interest on the new note. It was further agreed that Mr. Kahn should receive future dividends on the shares of stock held in trust until he had recovered the amount which he had paid Appellant under his guarantee. Thereafter, all dividends were to be paid to Appellant. This agreement recites that "**it is** the intent hereof that the party of the first part (Appellant) shall have an income, monthly, of \$350.00 over and above any principal payment, for her maintenance and support until she remarry."

During the ensuing war years the stock began to pay substantial dividends, and by 1950 Mr. Kahn had recovered the amount he had paid on his guaranty. Prior to that time the note and the interest thereon had been paid in full. In 1950 and 1951 **Mrs.** Kahn received all of the dividends on the stock in addition to the monthly payments of \$350,

Mrs. **Kahn** paid the tax on both the dividends and the monthly payments for the years in question, 1950 and 1951. She now contends that she is entitled to a refund of the tax upon the monthly payments. The basis for her contention is that the original agreement was not in discharge of a marital obligation within the meaning of former Section 17104 of the

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Revenue and Taxation Code (now Section 17081), and therefore that the payments under the second agreement, which was only a modification of the original, were not in discharge of such an obligation,

Section 17104, as it existed during the years involved, provided:

"In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be **includible** in the gross income of such wife. Such amounts received as are attributable to property so transferred shall not be **includible** in the gross income of such husband."

Appellant argues that the 1924 agreement was a property settlement in which she waived her right to support that the guaranty of dividends was **for** the purpose of upholding the value of the stock and that this obligation arose from her former husband's position of control of the corporation rather than from the marital relationship. Appellant also suggests that the agreement could represent a division of community property.

It does not appear that at the time of the original agreement there was any attempt to compute the amount of property to which Appellant was entitled. There has been no evidence presented to this Board to indicate that she had any property rights to relinquish. On the other hand, as the wife of Mr. Kahn she had a present right to support. It would be unrealistic to assume that she gave up this right to support without consideration, (Floyd H. Brown, 16 T.C. 623.)

We are not impressed with Appellant's contention that the agreement was not in discharge of a legal obligation incurred "because of the marital or family relationship" merely **because** the 1924 agreement did not specifically declare the payments guaranteed to the wife to be for her support. In so far as this requirement of the statute is concerned, it is sufficient if the payments are in discharge of an agreement entered into

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in recognition of the general obligation to support. Newton v. Pedrick, 212 Fed. 2d 357; Cox v. Commissioner, 176 Fed. 2d 226; Floyd H. Brown, 16 T.C. 623. Although we have not been furnished with a copy of the 1924 agreement, the excerpts therefrom which have been presented to us clearly demonstrate not only that Appellant's right to support was recognized, but also that the relinquishment of that right was a major element of the contract,

Appellant has cited Frederick S. Dauwalter, 9 T.C. 580, in support of her position that periodic payments made under the second agreement are not taxable to her. In that case the husband, not in default, acceded to a request of his former wife and increased the amount of the payments made to her under an earlier written agreement incident to the divorce. The tax court disallowed the deduction by the husband of the increase on the ground that the additional payments were gratuitous since they were not in discharge of a presently existing obligation arising from the marital relationship. The court also found, however, that the additional payments were not imposed or incurred under a decree of divorce or a written instrument, as required by the statute,

Since the Dauwalter case is distinguishable upon its facts, we are not called upon to determine whether its reasoning as to the gratuitous nature of the payments there in question is in accord with other and more recent decisions. In the appeal before us, the husband was far in arrears in 1942 and the forgiveness of past and future obligations under the original agreement furnished ample consideration for the obligations which he assumed under the new agreement entered into in that year. Upon these facts the contention of Appellant is answered by the statement of the court in Newton v. Pedrick, supra, that "There is nothing in the statute or its legislative background which suggests that it was intended that the equitable distribution of the tax burdens resulting from the adjustment of marital or family financial obligations in connection with a dissolution of the marriage relationship, which the statute aimed to achieve, should be limited to those arrangements effected at the time of a decree of divorce or separation, without regard to their possible future rearrangement in consequence of later and perhaps unforeseen vicissitudes." See also Smith v. Commissioner, 192 Fed. 2d 841, and Holahan v. Commissioner, 222 Fed. 2d 82.

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O P I N I O N

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 the claims of Francesca L. Kahn for refund of personal income tax in the amounts of \$82.23 and \$84.72 for the years 1950 and 1951, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 16th day of May, 1956, by the State Board of Equalization.

Paul R. Leake, Chairman

Robert E. McDavid, Member

J. H. Quinn, Member

Geo. R. Reilly, Member

                                , Member

ATTEST: Dixwell L. Pierce, Secretary