

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
JOEL G. AND RUTH I. CLEUGH)
AND PATRICIA A. CLEUGH)

Appearances:

For Appellants Joel G.
and Ruth I. Cleugh:

J. Robert Maddox
Attorney at Law

For Appellant
Patricia A. Cleugh:

Homer G. Sheffield, Jr.
Attorney at Law

For Respondent:

Paul J. Petrozzi
Counsel

O P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the **Franchise** Tax Board on the protest of Joel G. and Ruth I. Cleugh against proposed assessments of additional personal income tax in the amounts of **\$1,113.80, \$750.00**

I/ Mrs. Ruth I. Cleugh appears in these proceedings only **because she filed a joint personal income tax return with** Joel G. Cleugh for the years in issue.

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and \$950.00 for the years 1968, 1969, and 1970, respectively; and on the protest of Patricia A. Cleugh against proposed assessments of additional personal income tax in the amounts of \$152.00 and \$309.80 for the years 1969 and 1970, respectively. Since these appeals share common issues of **fact and** law they have been consolidated for opinion.

Joel G. Cleugh (Joel) and Patricia A. Cleugh (Patricia) were married in 1936. At the time of the marriage, Joel had a general partnership interest in **Cleugh's** Rhubarb Ranch, a farming partnership. In 1968, Joel and Patricia were separated pursuant to an interlocutory decree of divorce. The interlocutory decree contained! a stipulation representing a negotiated settlement between the parties and their respective counsels which purported to settle their rights to property and support. The stipulation, which was incorporated into the divorce decree, was offered in open court with both parties represented by independent counsel. In the original divorce action Joel was plaintiff and cross-defendant; Patricia was defendant and cross-complainant. In pertinent part, the judgment provides:

In lieu of the division of the community property of the parties, plaintiff (and cross-defendant) shall pay to defendant (and cross-complainant) the sum of **\$100,000.00**, payable as follows:

(a) Within ten days from the date hereof; the plaintiff will pay to defendant in lieu of a portion of the division of the community property, the sum of **\$5,000.00** in cash.

(b) Plaintiff will also pay to defendant, in lieu of said division of the community property, the sum of \$500.00 per month **commencing** on the first day of July 1968, and a like sum on the first day of each and every month thereafter. In addition, plaintiff will pay to defendant one-half of all monies drawn from the partnership business known as **Cleugh's** Rhubarb Ranch

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by plaintiff in excess of the sum of **\$24,000.00** per year. Such excess shall be paid quarterly by plaintiff to defendant at the end of each quarter of the calendar year. The aforementioned payments shall continue until the sum of **\$100,000.00** has been paid to defendant. It is further stipulated that a sum of approximately \$400.00 a month shall be paid by Cleugh's Rhubarb Ranch, and/or Joel Grant Cleugh, on account of an insurance policy premium, which policy will be security for the foregoing payments. Said sum of approximately \$400.00 per month shall be included in, and not increase, the base sum of **\$24,000.00** per year referred to above.

As security for the payment of the said sum of **\$100,000.00**, appropriate changes in the partnership agreement of **Cleugh's** Rhubarb Ranch and an endorsement to a policy of life insurance written by the Commonwealth Life Insurance Company, Policy No. 4102, owned by David Cleugh on the life of Joel Grant Cleugh, in the principal sum of **\$100,000.00**, shall be made providing for payment to defendant, in all events, of the unpaid portion of the **\$100,000.00** in lieu of the community' property referred to above. In addition, plaintiff will secure and file the proper documents with the Commonwealth Life Insurance Company which will enable defendant to receive notice of any non-payment of premium prior to cancellation of said insurance policy. In addition, plaintiff Joel Grant Cleugh undertakes to pay all premiums for said life insurance policy when and if said premiums become due.

It is understood that the settlement previously recited contemplates that the payments **will be** deductible, as made, to

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plaintiff on both his Federal and State Income Tax Returns.

Plaintiff shall pay \$1.00 per **year**, alimony, to defendant as and for the Support of said party commencing January 1, 1969. With regard to said sum of \$1.00 a year alimony, it is agreed that defendant will not apply for modification of said award until the sum of **\$100,000.00**, referred to above, has been paid. In the event that it shall be determined by any court of competent jurisdiction that the agreement on the part of the defendant not to apply for modification is held unenforceable for any reason or cause, and that such court shall undertake to modify said award and order the plaintiff **to pay alimony**, all sums paid by plaintiff in pursuance to said order shall be credited **against** the unpaid portion of the **\$100,000.00** obligation due defendant in lieu of a division of the community property.

Joel treated the payments made by him to Patricia as alimony and deducted them on his returns for the years in issue. Patricia did not include the payments in **income**. Respondent disallowed the deductions claimed by Joel on the basis that the payments were in settlement of property interests and not periodic payments for support. Alternatively, respondent included the payments in Patricia's income on the theory that they were alimony. Respondent maintains a neutral position and requests this board to resolve the controversy. Thus, we must determine whether the payments were periodic payments for support, in which case they were deductible by Joel and includible in Patricia's income, **or**, whether the payments were made in satisfaction of Patricia's property interests and, therefore, neither **includible** in her income nor deductible by Joel. (See generally Rev. & Tax. Code, §§ 17081 and 17263.) For the reasons set out below we conclude that the payments were made in satisfaction of Patricia's property interests. Therefore, the payments were neither includible in **Patricia's income** nor **deductible by** Joel.

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Section 17081 of the Revenue and Taxation Code provides that where a husband makes periodic payments for support to his spouse under a divorce decree, the wife must include the payments in her gross income, Section 17263 provides that the amounts so includible in the wife's gross income are deductible from the gross income of the husband. However, where the husband makes payments in satisfaction of the wife's property rights, the amounts received by the wife are capital in nature and are neither includible in her gross income under section 17081 nor deductible by the husband under section 17263. (See Fidler v. Commissioner, 231 **F.2d** 138 (9th Cir. 1956).) **Furthermore**, in order to be deductible the payments must be "periodic", that is, the payments must be made at intervals, although not necessarily equal intervals, and extend for an indefinite period or be subject to contingencies. (Cal. Admin. Code, tit. 18, reg. 17081=17083(a); see also Roland Keith Young, 10 T.C. 724 (1948); John H. Lee, 10 T.C. 834 (1948)) Although section 17083 of the Revenue and Taxation Code provides that payments which will or could be made for a period longer than ten years are to be considered periodic, the payments must still meet the qualifications that they are in satisfaction of marital support rights. Installment payments which are made in satisfaction of property rights cannot be considered alimony under any circumstances. (**Appeal of Everett S. Shippe**, Cal. St. Bd. of Equal., Oct. 7, 1952) Where the husband **is** required to pay an **ascertainable** **in** installments and the duty to pay is absolute, regardless if either party dies or the wife remarries, the payments are presumed to be in lieu of property and not for support. (**McCombs v. Commissioner**, 397 **F.2d** 4 (10th Cir. 1968).) However, the presumption may be refuted by other facts. (**Riddell v. Guggenheim**, 281 **F.2d** 836 (9th Cir. 1960).)

Initially, Joel argues that the divorce decree states that the parties "contemplated", that the \$100,000 .00 payment to Patricia might be deductible by Joel. However, the agreement does not contain any agreement between the parties on this subject. It does not provide that such payments would be reported as deductible by Joel and as income to Patricia. A mere statement of "contemplation" by the parties does not alter the tax consequences of their agreement. (John Sidney Thompson, 22 T.C. 275 (1954);

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Floyd H. Brown, 1, 16 T.C. 623 (1951); Thomas E. Hogg, 13 T.C. 361 (1949); see also Appeal of Jack Kelly and Mary (Buckley) Kelly, Cal. St. Bd. of Equal., 'Nov. 1f, 1962; Appeal of Cynthia Bias, Cal. St. Bd. of Equal., June 12, 1957.)

Except for the one ambiguous provision referred to above, the property settlement agreement between the parties 'is clear and does not differ materially from the standard form utilized by California attorneys for years. The agreement provides for the payment of \$100,000 .00, a fixed and ascertainable sum. The obligation to pay is absolute. The full amount is payable regardless if either Joel or Patricia dies or if Patricia should **remarry**. Furthermore, the agreement states specifically that the payments are "in lieu of the division of the community property of the parties". That the payments were in lieu of a property distribution is further emphasized by the statement.⁸ made by the parties' independent counsel in open court as reflected by the transcript of the divorce proceedings in 1968. **Addition-**ally, the agreement specifically states that **Patricia** was to receive alimony in the amount of \$1.00 per year.. The usual purpose of a "dollar-a-year" alimony clause is simply to preserve the wife's right to reopen -the alimony question in the event of a material change in circumstances after the divorce decree is entered. If the **\$100,000.00** payment had been intended by the parties **as** alimony, it would not have been necessary under California law to include a "dollar-a-year" clause. (Cf. Cochran v. Cochran, 13 Cal. App. 3d 339 [91 Cal. Rptr. **630**](1970).)

The parties have advanced several arguments concerning the value of the community property. Basically, Joel relies on Pereira v. Pereira, 156 Cal. 1 [103 Pac. 488](1909). In Pereira it was held that where the husband has separate property which increases in value during the marriage, that portion remains separate which is represented by the original capital plus the **equivalent** of a reasonable return from a well secured long-term **investment; the remainder is community property**. Pressing that theory to the ultimate, Joel maintains **that Patricia** had no community interest in the business.

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Patricia, on the other hand, maintains that her community interest in the business was at least **\$100,000.00**. Her claim is based on the fact that the marriage lasted over 30 years, during which time the parties used their community assets and credit to help finance the business. This claim is supported by the couple's tax returns and copies of various chattel mortgages. Additionally, Patricia contends that through a lengthy series of purchases and sales of properties, the parties accumulated significant additional community property, the bulk of which was contributed to the business in the form of capital or **loans**.

Admittedly, the record is such that it would be difficult to attach a precise value to the parties' community property. However, in the absence of fraud or bad faith, we are satisfied that the superior court's prior determination, as reflected by the divorce decree, **that** the couple's community property exceeded **\$200,000.00** was proper.

In view of our determination respondent's action must be modified.

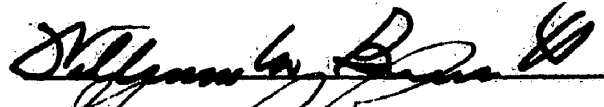
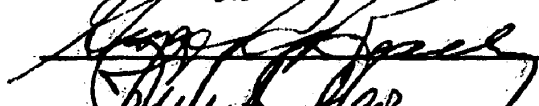
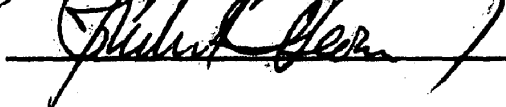
O R D E R

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

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IT IS 'HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Cod-e, that the action of the Franchise Tax Board on the protest of Joel G. and Ruth I. Cleugh against proposed assessments of additional personal income tax 'in the amounts 'of \$1,113.80, \$750.00, and \$950.00 for the -years '1968, 1969 and 1970, respectively, be and 'the same is hereby sustained; and that the action of the Franchise Tax Board on the protest of Patricia A. Cleugh --against proposed assessments of additional personal income tax in the amounts of \$152.00 and \$309.80 for the years 1969 and 1970, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 6th day of April, 1977, 'by the State Board .of Equalization.

 , Chairman
 , Member
 , Member
_____, Member
_____, Member

ATTEST:  , Executive Secretary