***6 T.C. 908 (1946)***

When a taxpayer purchases their spouse's interest in community property as part of a divorce settlement, the basis of the acquired property is the amount paid, not the original cost to the community.

**Summary**

In a Texas divorce, the taxpayer, Rouse, acquired his wife's interest in community property and her separate property for $60,000. The Tax Court addressed whether Rouse's basis in the acquired property should be the original cost to the community or the $60,000 he paid his wife. The court held that Rouse's basis was $60,000 because he purchased his wife's interest in the property via the settlement agreement. This purchase was a taxable event, establishing a new basis reflecting the cost of acquisition.

**Facts**

Rouse and his wife divorced in Texas, a community property state. Pending the divorce, they agreed that Rouse would acquire his wife's interest in their community property and her separate property for $60,000. The wife's share of community property was valued at approximately $45,000, and her separate property, which Rouse had used during the marriage, was valued at $27,000. The divorce decree referenced the property settlement but did not incorporate or modify it. Rouse later sold some of the real estate he acquired and sought to use the original community cost as his basis for calculating gain and depreciation.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in Rouse's income tax for 1940 and 1941, arguing that Rouse's basis in the property should be the amount he paid his wife, not the original cost to the community. Rouse petitioned the Tax Court for review.

**Issue(s)**

Whether the taxpayer's basis in property acquired from his former spouse in a divorce settlement in a community property state is the original cost to the community or the price paid for the spouse's interest in the settlement.

**Holding**

No, the taxpayer's basis is the price paid for the spouse's interest in the settlement because the settlement constituted a taxable event, specifically a purchase of property from the wife.

**Court's Reasoning**

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The court reasoned that under Texas law, each spouse has a vested one-half interest in community property. The settlement agreement acknowledged this. The court emphasized that Rouse purchased his wife's interest in the community property and her separate property for $60,000. This was not simply a division of property; it was a bargained-for exchange. The court cited *Johnson v. United States, 135 F.2d 125 (1943)*, for the proposition that property settlements are taxable events. The court distinguished *Frances R. Walz, 32 B.T.A. 718*, noting that in *Walz* there was an equal division of property, whereas here, Rouse paid consideration to acquire his wife's interest. The Court stated, "But where, as here, there results a virtual sale of one interest, whatever tax consequences flow from the amount of the consideration should be given proper effect."

**Practical Implications**

*Rouse v. Commissioner* clarifies that a transfer of property between divorcing spouses in a community property state can be a taxable event. When one spouse purchases the other's interest, the acquiring spouse's basis in the property becomes the purchase price. This decision impacts how divorce settlements are structured, advising legal practitioners to consider the tax implications of property transfers. It emphasizes the importance of clearly defining whether a property division is a simple partition or a sale/exchange, as the latter will trigger a new basis for tax purposes. Subsequent cases distinguish this ruling based on the specific terms of the settlement agreement and whether the transfer truly constitutes a purchase or merely a division of existing community property interests.

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