***22 T.C. 1327 (1954)***

In community property states, a divorced spouse is taxed on their community share of partnership income earned by the other spouse during the marriage, even if the partnership's tax year extends beyond the divorce date.

**Summary**

This case concerns the tax liability of a divorced spouse in a community property state (Texas) for income earned by the former spouse through a law partnership. The ex-wife, Lois Hockaday, argued that she was not liable for a portion of her former husband's partnership income because the partnership's fiscal year ended after their divorce. The Tax Court held that because the income was earned during their marriage, and thus was community property, Lois was liable for her share, proportionate to the period of the marriage within the partnership's fiscal year, regardless of the timing of the divorce and the partnership's fiscal year end. The court emphasized that her community property rights were not extinguished by the divorce and were taxable in the appropriate year, as defined by the Internal Revenue Code.

**Facts**

Lois Hockaday divorced Hubert Green on May 31, 1948, in Texas, a community property state. Green was a partner in a law firm that used a fiscal year ending June 30. Lois and Hubert had a property settlement agreement. Lois changed her tax year to a fiscal year ending May 31. The IRS determined that Lois owed additional income tax, calculated by including her share of Green's partnership income for the portion of the partnership's fiscal year that occurred before the divorce. Hubert reported his share of the partnership income on his calendar-year return. Lois did not report any of the partnership income on her tax returns.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Lois Hockaday's income tax. The deficiency was due to the inclusion of a portion of her former husband's partnership income. Hockaday challenged the Commissioner's determination in the United States Tax Court.

**Issue(s)**

1. Whether Lois Hockaday was taxable on a portion of her former husband's partnership income for the period of their marriage within the partnership's fiscal year, even though the divorce occurred before the end of the partnership's tax year.

**Holding**

1. Yes, because under Texas community property law, the income earned by Hubert

 

during the marriage was community property and taxable to Lois in proportion to the period during which they were married.

### Court's Reasoning

The court applied Texas community property law, emphasizing that income earned during the marriage is community property, regardless of when the partnership's fiscal year ended. The court stated that the divorce did not extinguish Lois's right to her share of the community property income earned during the marriage. The court relied on 26 U.S.C. § 188 (1939), now 26 U.S.C. § 706, which governs the taxation of partnership income and states that a partner must include their share of partnership income for the partnership's tax year ending within or with the partner's tax year. The court also cited Treasury Regulations 111, section 29.182-1, which states that if separate returns are made by spouses in a community property state, and the husband is a partner, the wife reports her share of community income from the partnership.

The court distinguished the fact that there was a property settlement. The court reasoned that even if the property settlement did not specifically allocate the partnership earnings, Lois was still entitled to her share and that the property settlement agreement's terms, or lack thereof, did not absolve her of her tax liability. The court referenced *Keller v. Keller*, 141 S.W.2d 308 (Tex. Comm'n App. 1940), which supported that her community share should have been included.

### Practical Implications

This case reinforces the importance of understanding community property laws in tax planning and divorce settlements. It clarifies that income earned during a marriage, even if not fully realized until after a divorce, is subject to community property rules. Attorneys and tax professionals in community property states must carefully consider the timing of income recognition and the impact of partnership tax years when advising clients on divorce and property settlements. Specifically, it underscores the necessity of explicitly addressing partnership interests and earnings in settlement agreements to ensure proper tax treatment and avoid future disputes. The court's ruling highlights that community property rights are not necessarily extinguished by divorce and can have ongoing tax consequences, irrespective of the actual receipt of funds.