Godlewski v. Commissioner, 90 T. C. 200 (1988)

The basis in property transferred between former spouses incident to divorce is the transferor's adjusted basis, not the fair market value or amount paid by the transferee.

Summary

Godlewski v. Commissioner addresses the tax implications of property transfers incident to divorce under Section 1041 of the Internal Revenue Code. Michael Godlewski received his former residence from his ex-spouse as part of a divorce settlement and paid her $18,000. He then sold the residence and sought to include the $18,000 in his basis for calculating gain. The U. S. Tax Court held that under Section 1041, Godlewski's basis was limited to the transferor's adjusted basis of $32,200, not increased by the $18,000 he paid. This ruling clarifies that transfers of property between former spouses incident to divorce are treated as gifts for tax purposes, with the transferee's basis being the same as the transferor's basis at the time of transfer.

Facts

Michael J. Godlewski and Elizabeth Godlewski purchased a residence in 1973 for $32,200, with Elizabeth as the sole titleholder. They divorced in 1983, with the property division reserved for later determination. In July 1984, they executed an agreement whereby Elizabeth transferred the house to Michael, who paid her $18,000. Michael sold the house in October 1984 for $64,000. He did not report this on his 1984 tax return, claiming the $18,000 payment should increase his basis in the property for gain calculation.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Godlewski's 1984 tax return, leading Godlewski to petition the U. S. Tax Court. The court assigned the case to a Special Trial Judge, whose opinion was adopted by the Tax Court. The key issue was whether Section 1041, enacted in 1984, applied to the property transfer and how it affected Godlewski's basis in the property.

Issue(s)

1. Whether Section 1041 of the Internal Revenue Code applies to the transfer of the residence from Elizabeth to Michael Godlewski.
2. Whether Michael Godlewski can increase his basis in the residence by the $18,000 he paid to Elizabeth for purposes of computing gain realized on the subsequent sale.

Holding

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1. Yes, because the transfer occurred after the enactment of Section 1041 and was not made under any instrument in effect before the enactment date.
2. No, because under Section 1041, the transferee's basis in property transferred incident to divorce is the transferor's adjusted basis, not increased by any payment made by the transferee.

Court's Reasoning

The court determined that Section 1041 applies because the transfer occurred after July 18, 1984, and was not governed by any pre-existing instrument. The court emphasized that under Section 1041, property transfers incident to divorce are treated as gifts, with the transferee's basis being the transferor's adjusted basis. The court cited the temporary regulations under Section 1041, which explicitly state that even in a bona fide sale, the transferee's basis does not include the cost paid. The court rejected Godlewski's argument that the payment increased his basis, holding that his basis remained $32,200, the original purchase price of the house. The decision was supported by the legislative history and the clear language of the statute and regulations.

Practical Implications

This decision clarifies that under Section 1041, property transferred between former spouses incident to divorce retains the transferor's basis, regardless of any payment made by the transferee. Practitioners advising clients on divorce settlements must consider this when calculating potential tax liabilities on future sales of transferred property. The ruling impacts how attorneys structure divorce agreements to optimize tax outcomes, emphasizing the importance of understanding the tax basis rules under Section 1041. Businesses and individuals involved in property transfers during divorce must account for these tax implications. Subsequent cases, such as *Hayes v. Commissioner*, have followed this precedent, reinforcing the application of Section 1041's basis rules in divorce-related property transfers.

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