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Taxation - Joint Tenancy - Tenancy by the Entirety - Federal Taxation Aspects

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TAXATION—JOINT TENANCY—TENANCY BY THE ENTIRETY—FEDERAL TAXATION ASPECTS—Property owners have utilized the estates of joint tenancy and tenancy by the entirety in order to avoid probate and administration expenses. The right of survivorship, a characteristic of both of these estates,[1] has appealed to an increasing number of persons in recent years[2] as a means of accomplishing the transfer of title at death. Another reason for the large number of jointly held estates is the partial immunity which such tenants enjoy from the claims of creditors.[3] There is a third major reason for the increased popularity of joint tenancy and tenancy by the entirety. That reason is the expectation of effectuating a tax saving. This article is concerned with the taxation problems which may confront the property owner who is contemplating either of the two methods of concurrent ownership. More specifically, the following material is a discussion of joint tenancy and tenancy by the entirety under the federal gift tax, the federal income tax, and finally the federal estate tax.

THE GIFT TAX[4]

The creation of a tenancy by the entirety[5] in property owned solely by one of the spouses subjects the donor-spouse to gift tax liability[6] because the donee receives title and substantial economic rights at the time.[7] In jurisdictions retaining the rigid common law view that the husband has control of the rents and profits, the courts may be required to decide if a title, devoid of economic benefits, which is conferred upon the wife, is a gift within the meaning of the federal gift tax statute.[8] The purchase of property may also entail tax liability when, though title is taken by the entirety, the consideration is furnished by only one of the spouses.[9] The gratuitous transfer of property to husband and wife as tenants by the entirety by a third party is much more desirable from a tax-saving view than a transfer to one of the spouses who later creates the tenancy.

The value of the gift which results from the purchase or outright creation of a tenancy by the entirety in property already owned by one of the spouses is not measured by the value of the property which

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1 4 Thompson, Real Property § 1804 (2d ed. 1939). However, Mr. Thompson states as follows in regard to tenancy by the entirety, "Upon the death of either during coverture the survivor does not take by right of survivorship, as in the case of joint tenants, but continues to hold the whole by virtue of the original title." Despite this theoretical distinction, the effect is the same; that is, to vest full legal title in the survivor.

2 Moodie, *Some Dangers of Joint Tenancy*, 29 Neb. L. Rev. 235 (1949-50).

3 People's Trust & Savings Bank v. Haas, 328 Ill. 468, 160 N.E. 85 (1927).

4 Int. Rev. Code § 1000.

5 There is no authority sustaining the existence of tenancy by the entirety in North Dakota. N.D. Rev. Code § 47-0205 (1943) seems to limit by inference the recognition of concurrent ownership to joint tenancy, partnerships, and tenancy in common.

6 U.S. Treas. Reg. 108, § 86.19 (h) (1942).

7 Comm'r. v. Hart, 106 F.2d 269 (3rd Cir. 1939); Comm'r. v. Logan, 109 F.2d 1014 (3rd Cir. 1940).

8 *See* Comm'r. v. Hart, *supra note* 7, at 271.

9 Lilly v. Smith, 96 F.2d 341 (7th Cir. 1938), *Cert. denied*, 305 U.S. 604 (1938).

the donee received; but rather it is measured by the value of the property which the donor retained.[10]

Of course, if the donee-spouse contributes consideration in money or money's worth toward the creation of the estate by the entirety, the value of the gift which that spouse receives is correspondingly reduced and the gift tax is thereby diminished.[11] The common law concept of consideration, however, has been rejected by the government and the courts; the consideration furnished must benefit the donor regardless of the detriment suffered by the donee.[12]

Gift tax liability results from the creation of a joint tenancy where the joint tenants do not furnish consideration commensurate with the interests which they receive.[13] As in the case of tenancy by the entirety, here also a direct creation of the joint estate by a third person effects a tax saving as compared to a gratuitous transfer by a third person to one who later creates the joint tenancy in himself and others. The treasury regulations treat joint bank accounts separately. Gift tax liability is incurred there only when the donee draws upon the fund to the extent of his withdrawals.[14]

In 1948 Congress created a marital deduction to the extent of one-half of the value of property bestowed upon a spouse of the donor.[15] As a result only one-half of the value of the interest which a wife, or husband, receives from her, or his, spouse is actually taxed when the donor spouse creates a joint tenancy or tenancy by the entirety out of property separately owned, or property purchased out of funds owned by the donor individually. The marital deduction will not be allowed if a person other than the donor and his spouse receives an interest in the property which may cut off the interest of the donee spouse.[16] Thus no marital deduction will be allowed if a husband transfers property to his wife and son as joint tenants with right of survivorship because in the event that the tenancy is not severed, there is a possibility that the son will survive the wife

[10] U.S. Treas. Reg. 108, § 86.19 (h) (1942): ". . . the value of the gift is the value of such property less the value of the right, if any, of the donor spouse to the income or other enjoyment of the property, or share thereof, during the joint lives of the spouses, and the value of the right of the donor spouse to the whole of the property should he or she be the survivor of them. The value of each of such rights is to be determined in accordance with the Actuaries' or Combined Experience Table of Mortality, as extended." The Board of Tax Appeals has expressly rejected the contention of a taxpayer that the depreciation of property during the joint lives of the tenants should be deducted from the value of the property taxed. J. C. Gutman v. Comm'r, 41 B.T.A. 816 (1940).

[11] Int. Rev. Code § 1002.

[12] U.S. Treas. Reg. 108, § 86. 8 (1942); Comm'r v. Wemyss, 324 U.S. 303 (1945).

[13] U.S. Treas. Reg. 108, § 86.2 (a) (5) (1942).

[14] U.S. Treas. Reg. 108, § 86.2 (a) (4).

[15] Int. Rev. Code § 1004 (a) (3). Subsection (B) (i) of this section excepts transfers under which the donor retains an interest which may blossom into full legal title upon the failure of the donee spouse's interest; but subsection (D) expressly removes from the exception the interest of a joint tenant or tenant by the entirety retained by the donor spouse. The effect is to permit the marital deduction upon the creation of a joint tenancy or tenancy by the entirety.

[16] Int. Rev. Code § 1004 (a) (3) (B).

and her interest will terminate in favor of the son by the right of survivorship.[17]

The Revenue Act of 1948 alleviated the gift tax burdens for married persons by enacting a fiction that a gift by one spouse to any person other than his spouse shall be considered as made one-half by each spouse for the purposes of the gift tax.[18] However, both spouses must consent to the free transfer in accordance with the law and regulations pertaining thereto.[19] It should be noted that the beneficial fiction will not be introduced to reduce the gift tax when the spouse of the donor receives an interest in the property transferred. Thus a gratuitous conveyance by a husband to his wife and son as joint tenants with the right of survivorship will not call the section into play as far as the interest received by the wife, but the fiction will be applied as to the interest received by the son.[20]

THE INCOME TAX

The income tax advantages arising from joint tenancy and tenancy by the entirety as to husband and wife have been virtually eliminated by the institution of the joint tax return in 1943.[21] However, if the tenants are not husband and wife, or if being husband and wife it is impractical, improvident, or impossible for them to file a joint return, a considerable tax saving may be accomplished through the means of joint ownership.

The federal income tax law looks to the state law to determine what interest is created in the tenants, and the profits arising from the estate are taxed accordingly.[22] Profits arising from an estate held in joint tenancy are taxable to each tenant according to his proportionate interest in the estate,[23] and tenants by the entirety may split the profits in their tax returns.[24] Should one of the tenants die, the survivor is not liable for an income tax deficiency upon profits received by the decedent before death from the joint estate. In *Irvine v. Helvering*, the court exonerated the surviving joint tenant from liability for the income tax assessed against the profits received by the deceased joint tenant although the estate of the deceased was unable to pay the tax; and the court gave as its reason the following rule: "The rule is that a surviving joint tenant becomes the absolute owner of the property held in joint tenancy, upon the death of the co-tenant, free of the claims of the heirs or creditors of the deceased."[25] However, after the death of a joint tenant, the income from the jointly held property is taxable to the survivor or survivors.[26] If the state law clings to the old common law rule that the husband is entitled to all of the income from property held with his wife as

[17] 2 P-H Fed. Tax Guide 26,202 (1950). However, if the husband creates a tenancy in common in his wife and son, the marital deduction will be allowed because there is no possibility that the son will succeed to his mother's interest by right of survivorship.

[18] Int. Rev. Code § 1000 (f) (1).

[19] Int. Rev. Code § 1000 (f) (1) (B); § 1000 (f) (2) (A) and (B); U.S. Treas. Reg. 108, § 86.3a (1948).

[20] 2 P-H Fed. Tax Guide 26,113-A (4) (1950).

[21] Int. Rev. Code § 51 (b) (1); U.S. Treas. Reg. 111, § 29.51-1 (1943).

[22] Haynes v. Comm'r., 7 B.T.A. 465 (1927).

[23] I.T. 3825, 1946-2 Cum. Bull. 51.

[24] Morgan v. Finnegan, 87 F. Supp. 274 (E.D. Mo. 1949).

[25] 99 F.2d 265 (8th Cir. 1938) at 269.

[26] Edmonds v. Comm'r., 90 F.2d 14 (9th Cir. 1937), *cert. denied*, 302 U.S. 713 (1937).

tenants by the entirety, there can be no division of profits on the tax returns, unless of course the parties file a joint return.[27]

Interest and taxes paid upon property held under either of the two concurrent methods of ownership under discussion are deductible by the tenant who pays them provided that the other tenant or tenants do not take the deduction.[28] But the profits from the estate may be reported according to the interests of the tenants regardless of which tenant receives them.[29] At least one writer[30] has noted an inconsistency in this situation. Although it may be conceded that the right to deduct interest and taxes paid does not have a relation to the right to rents and profits,[31] the justification for the deduction of all of the interest and taxes by one tenant has been stated as the theory that all tenants own an undivided interest in the entire estate.[32] It is submitted that this theory may be used just as effectively to hold one tenant who collects all of the profits liable for all of the income tax thereon.

Contribution of capital or services toward the acquisition of property held as tenants by the entirety or joint tenants is immaterial providing that state law recognizes the existence of the estate.[33] Tax authorities will not permit the profits from property held under a partnership to be segregated in several tax returns unless there is proportionate contribution of capital or services, or both.[34] It is often difficult to determine whether the property interest from which the profits are accruing is a form of joint tenancy or a partnership,[35] but the Tax Court has recently said, "In instances like the present one, where the income consists entirely of rentals and not from the conduct of any business enterprise, there could be no reason for taxing either spouse on more than his or her half."[36] One member of the Tax Court has vigorously attacked the use of the old property concept of tenancy by the entirety in the solution of modern tax questions.[37] He favors the same test as is used in the determination of partnership tax problems; that is, the extent of contribution of services and capital measures the proportion of profits taxable to an individual partner.

Profits and losses from the sale of property held under joint tenancy or tenancy by the entirety may be split among the tenants.[38]

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[27] Cooley v. Comm'r, 75 F.2d 188 (1st Cir. 1935), (husband retains control over property held by the entireties in Massachusetts); I.T. 3878, 1947-2 Cum. Bull. 57 (also in North Carolina). It is interesting to note that the Bureau has taken the stand that the income is taxable wholly to the husband where state law gives him complete control over it, but the gains or losses from the sale of the property may be split between husband and wife.

[28] G.C.M. 15530, XIV-2 Cum. Bull. 107 (1935); I.T. 3785, 1946-1 Cum. Bull. 98.

[29] Morgan v Finnegan, 87 F. Supp. 274 (E.D. Mo. 1949); William R. Tracy v. Comm'r., 25 B.T.A. 1055 (1932).

[30] Rudnick, *Federal Tax Problems Relating to Property Owned in Joint Tenancy and Tenancy by the Entirety,* 4 Tax L. Rev. 3 (1948).

[31] G.C.M. 15530, XIV-2 Cum. Bull. 1107 (1935).

[32] I.T. 3785, 1946-1 Cum. Bull. 98.

[33] Alfred Hafner v. Comm'r., 31 B.T.A. 338 (1934).

[34] McIntyre v. Comm'r., 37 B.T.A. 812 (1938).

[35] First National Bank of Duluth v. Comm'r., 13 B.T.A. 1096 (1928).

[36] H.D. Webster v. Comm'r., 4 T.C. 1169 (1945), at 1174.

[37] *See* The dissenting opinion in George K. Brennen v. Comm'r, 4 T.C. 1260 (1945).

[38] I.T. 3825, 1946-2 Cum. Bull. 51; G.C.M. 3111, VII Cum. Bull. 112 (1928).

However, the court will not countenance a framed transfer of a joint interest to another in order to reduce the income taxes upon a later sale, the negotiations for which have been completed before the joint estate is created.[39] A very significant factor to consider upon the sale of jointly held property, is the basis to be used in determining the gain or loss upon the sale.[40] The basis is the cost of the property. This is true even though one of the tenants has died, his interest being included in his gross estate for federal estate tax purposes, and his interest taxed at its fair market value.[41] The Bureau of Internal Revenue has justified this rule in the following manner: "The common law view, and the view still obtaining in the great majority of States which recognize the common law joint tenancy, is that a conveyance to two persons as joint tenants gives to each tenant the entire estate, so that, on the death of one tenant, nothing passes from the decedent to the survivor, but the interest of the decedent merely ceases, and the survivor has the entire estate that he already had from the beginning."[42] The result of the use of the cost basis is a heavy income tax upon the sale of the property where the value has materially increased. It has been recommended that a joint tenancy or tenancy by the entirety in property which has materially increased in value be severed to avoid the tax consequences upon sale of the property.[43]

THE ESTATE TAX

Congress has treated the interests of joint tenants and tenants by the entirety in a similar manner under the federal estate tax statute.[44] The Supreme Court of the United States has sanctioned the identical treatment of the two estates.[45] The constitutionality of the joint interest provision of the estate tax law, which was first enacted in 1926, is now beyond question; and the courts have repeatedly sustained the applicability of the tax to estates created prior to the enactment of a federal estate tax statute.[47] Section 811 (h) of the Internal Revenue Code expressly states that the joint interest section, 811 (e), shall apply to estates whenever created. The basic theory of the taxation of joint interests is that the shift in economic benefit

[39] McInerney v. Comm'r., 82 F.2d 665 (6th Cir. 1936).
[40] Int. Rev. Code § 113.
[41] Helen G. Carpenter v. Comm'r., 27 B.T.A. 282 (1932); I.T. 3754, 1945-1 Cum. Bull. 143. In the former case the husband had died and ½ of the market value of the estate (totaling $125,000) was taxed in his estate. Later the surviving wife sold the property for $125,000 and she attempted to report ½ of the difference between the total cost and the selling price because she contended that she had received no profit upon the ½ acquired by her upon the death of her husband. The court rejected her theory by stating that the interest of the husband merely ceased upon his death while that of the survivor continued.
[42] G.C.M. 6677, VIII-2 Cum. Bull. 172 (1929).
[43] Rudnick, *Federal Tax Problems Relating to Property Owned in Joint Tenancy and Tenancy by the Entirety*. 4 Tax L. Rev. 3 (1948).
[44] Int. Rev. Code § 811 (e).
[45] In United States v. Jacobs, 306 U.S. 363, 369 (1939), the court rejected the contention of the taxpayer that joint tenancies and tenancies by the entirety should be taxed differently by stating, "The constitutionality of an exercise of the taxing power of Congress is not to be determined by such shadowy and intricate distinctions of common law property concepts and ancient fictions."
[46] Tyler v. United States, 281 U.S. 497 (1930).
[47] United States v. Jacobs, 306 U.S. 363 (1939);Gwinn v. Comm'r., 287 U.S. 224 (1932); Phillips v. Dime Trust & Safe Deposit Co., 284 U.S. 160 (1931).

which occurs upon the death of one of the tenants is a suitable event for the imposition of a federal levy. In the case of *Tyler v. United States,*[48] the United States Supreme Court rejected the necessity of a transfer of the property by death and asserted that the test should be, "whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result, to be measured in whole or in part by the value of such rights."[49]

The entire value of the joint estate or the estate by the entirety may be included in the gross estate of the decedent for tax purposes if the decedent provided the whole consideration used in the acquisition of the estate,[50] or the property in the estate is traceable to the decedent remotely.[51] There is authority for the proposition that the value of the jointly held property is not includible in the estate of the decedent despite the fact that the decedent paid for the property for the reason that decedent was never owner of the property.[52] But this view has been severely criticized by a later case[53] which appears to embody the correct interpretation.[54]

Conversely no part of the value of the joint estate or the estate by the entirety may be included in the gross estate of the decedent for tax purposes if the decedent provided nothing toward the acquisition of the property.[55] Similarly if the surviving tenant originally received the entire property by way of gift from a third person and then indirectly created the joint estate, none of the value of the jointly held property is included in the gross estate of the decedent.[56]

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[48] See note 46 *supra.*

[49] *Id.* at 503: "Until the death of her co-tenant, the wife could have severed the joint tenancy and thus have escaped the application of the estate tax of which she complains. Upon the death of her co-tenant she for the first time became possessed of the sole right to sell the entire property without risk of loss which might have resulted from partition or separate sale of her interest while decedent lived. There was—at his death—a distinct shifting of economic interest, a decided change for the survivor's benefit. This termination of a joint tenancy marked by a change in the nature of ownership or property was designated by Congress as an appropriate occasion for the imposition of a tax." United States v. Jacobs, 306 U.S. 363, 371 (1939).

[50] Hornor's Estate v. Comm'r., 130 F.2d 649 (3rd Cir. 1942); Kelley v. Commissioner, 22 B.T.A. 421 (1931).

[51] In Dimock v. Corwin, 99 F.2d 799 (2d Cir. 1938), the court held that the entire value of jointly held property should be included in the gross estate of the decedent despite the fact that the decedent had transferred the property to his wife who later created the tenancy. The court stated on page 802, "Congress has placed this tax on all joint estates because they accomplish the result of transferring the decedent's property to the surviving spouse. But Congress has excluded any portion of the property which does not represent such a transfer. Upon the husband's death, every part of the joint estate which first belonged to him becomes the sole property of the widow and the test for determining the property excluded is whether it ever belonged to the decedent. If it did, and was parted with for less than adequate consideration, it is not to be excluded. Congress has provided that all such transactions be included without causing an inquiry in each case, whether the particular gift was designedly made to evade the tax."

[52] McCrady v. Heiner, 19 F.Supp. 575 (W.D. Pa. 1937).

[53] Stuart v. Hassett, 41 F. Supp. 905 (D. Mass. 1941).

[54] Bowditch v. Comm'r, 23 B.T.A. 1266 (1931).

[55] Estate of Koussevitsky v. Comm'r., 5 T.C. 650 (1945).

[56] Old Colony Trust Co. v. Comm'r., 39 B.T.A. 871 (1939).

Section 811 (e) provides that the proportion of the contribution of the survivor to the joint estate shall be excepted from the estate of the decedent. The dictates of that provision have been followed by the courts.[57] The courts have also applied that portion of the joint interest section providing for the taxation of jointly held property originally acquired by the tenants by way of gift.[58] In that case the fractional part of the value of the property to be included in the estate of a given decedent is determined by dividing the value of the property by the number of joint tenants.

The burden of proving the fact of contribution by the surviving joint tenants, or the surviving tenant by the entirety, and the extent of that contribution is upon the surviving tenant or tenants.[59] Although state law controls the interest in the various tenants,[60] the federal taxation law need not follow the state law in the presumption that each tenant contributed equally.[61] In the absence of evidence of the contribution by the survivor, the entire amount of the jointly held property may be included in the gross estate of the decedent constitutionally.[62]

The provision in the estate tax statute which excepts from inclusion in the gross estate of the decedent that portion of the joint property which was never received from the decedent "for less than an adequate and full consideration in money or money's worth" has been the subject of much litigation. The release of the rights of a wife in the estate of her husband have been held not a consideration in money or money's worth.[63] In *Fox v. Rothensies*[64] the court of appeals for the third circuit rejected the presumption that the wife meant to make a loan to her husband by expending her money for the maintenance of the household and thereby the court struck down the theory of the petitioner that the conveyance by the husband of the house into an estate by the entirety was a repayment to the wife for advances. The court expressed the fear that a different rule would lead to domestic strife. Services and capital devoted to a business may constitute a consideration in money or money's worth within the meaning of the provision of the statute indirectly through the ownership of profits derived from the business and invested in the joint estate.[65]

Since the Revenue Act of 1948 decedents may substantially reduce their estate taxes by properly taking advantage of the marital deduction. However the creation in a will of a joint tenancy between a spouse of the decedent and another does not qualify for the deduction since there is a possibility that the other person may survive the spouse and take the entire property.[66]

The fact that the entire value of jointly held property is included in the gross estate of a decedent does not change the basis to be used in the later sale of the property by the decedent.[67] As was

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[57] Richardson v. Helvering, 80 F.2d 548 (App. D.C. 1935).
[58] Drummond's Estate v. Paschal, 75 F. Supp. 46 (E.D. Ark. 1948).
[59] Reese v. Comm'r., 25 B.T.A. 38 (1931).
[60] Allen v. Henggeler, 32 F.2d 69 (8th Cir. 1929).
[61] Butzel v. Comm'r., 21 B.T.A. 188 (1930).
[62] Foster v. Comm'r., 90 F.2d 486 (9th Cir. 1937).
[63] Sheets v. Comm'r., 95 F.2d 727 (8th Cir. 1938).
[64] 115 F.2d 42 (3rd Cir. 1940).
[65] Berkowitz v. Comm'r., 108 F.2d 319 (3rd Cir. 1939).
[66] U.S. Treas. Reg. 105, § 81.47b (d) (1949).
[67] Lang v. Comm'r., 289 U.S. 109 (1933).

stated before, the effect of using this basis may be an extremely high income tax if the property has materially advanced in value. Although the solution to this dilemma may be the severance of the joint tenancy into a tenancy in common, this transfer may be taxed as one made in contemplation of death.[68] As the author in 1 Stanford Law Review 365 stated, "The non-contributing tenant can reduce the other tenant's taxable estate 50 per cent by unilaterally severing the joint tenancy in contemplation of the latter's death; yet he cannot join the contributing joint tenant in a transfer of the same kind without subjecting the decedent's estate to tax upon the entire amount."

The probability that injustice may result from the imposition of a gift tax upon the creation of a joint tenancy or a tenancy by the entirety and the later inclusion of the entire value of the estate in the gross estate of the sole contributor is alleviated by the provisions in the estate tax statute permitting a credit against the estate tax for the gift tax paid.[69] However, at least one authority has pointed out that the relief provided by these sections may not be adequate in the case where the non-contributing joint tenant dies before the contributor.[70]

CONCLUSION

It is manifestly impossible to abstractly recommend the creation or destruction of a joint tenancy or a tenancy by the entirety. Each fact situation must be carefully scrutinized to determine whether the tax disadvantages of a joint estate are as weighty as the advantages gathered in other fields. On the other hand the converse may be the case; that is, the tax advantages may preponderate over the other disadvantages. The foregoing article is merely an attempt to point out a few of the taxation aspects, both favorable and unfavorable, of joint tenancy and tenancy by the entirety.

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[68] Estate of Frank K. Sullivan v. Comm'r, 10 T.C. 961 (1948).

[69] Int. Rev. Code §§ 813 (a) and 936 (b).

[70] *See* Comm'r., v. Hart, 106 F.2d 269, 271 (3rd Cir. 1939).