

Michigan Law Review

Volume 64 | Issue 5

1966

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Recommended Citation

John E. Riecker, *Joint Tenancy: The Estate Lawyer's Continuing Burden*, 64 MICH. L. REV. 801 (1966).

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JOINT TENANCY: THE ESTATE LAWYER'S CONTINUING BURDEN

*John E. Riecker**

SURELY the ultimate Valhalla of any tax lawyer would be the complete correspondence of the English common law of property and the codified law of taxation. How much simpler analysis of the tax consequences of our daily business and personal acts would be if the annual exactions of government followed the well-travelled roads of property-law jurisprudence! This result, so devoutly to be wished, is not, however, within the grasp of today's courts and practitioners. Indeed, as a few uncharitable clients will always ruefully claim, we lawyers make our fortunes by educating taxpayers on the divergency between what "seems to be" and what "is" ownership of property under the tax laws.

The estate and gift tax consequences of joint ownership, with which this article will deal, are a classic example of the public delusion caused by this divergency. In this writing the author proposes to join the swelling ranks of estate lawyers and commentators already busy stoking the fire under the myth that to hold property in joint or entireties tenancy is to save it from the hands of avaricious executors and voracious taxing authorities. One of our number has put the issue rather nicely:

Joint ownership with a right of survivorship has been a very appealing concept to many people. They have supposed that it is relatively simple, that it avoids probating wills and administering property in the probate court, that it narrows the basis for executors' commissions and attorneys' fees and hence is economical, and that it even saves taxes.

This long list of supposed advantages has caused many ill-advised persons to use joint ownership as an alleged complete answer to their estate planning problems. After examining these advantages, however, some are real, some are more apparent than real, and some are complete illusions.¹

There has been a plethora of work on the evils of joint ownership, much of it with considerable depth and merit; the writer fervently hopes that the following discussion will not be "just another article." The trouble is that much of our profession's proselytizing

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1. Powell, *Joint Ownership in Estate Planning*, 22 *Ohio St. L.J.* 292, 293-94 (1961). For an excellent summary of the pitfalls of joint and entireties tenancy, written for lawyers and laymen both, see Wormser, *What It Means To Forget About a Will*, *U.S. News & World Report*, March 4, 1963, p. 68.

with respect to joint ownership has been directed at theorists, and far too little attention has been given to the attorneys in general practice—those persons who are in daily contact with the ever-expanding host of joint owners. Generally, such practitioners have a vague notion of why joint and survivorship ownership has certain drawbacks, but are at a loss to understand its tremendous popularity or to offer equally attractive but more economical alternatives. Salient, viable, and convincing arguments are needed to explain: (1) the reason joint ownership has attained its present level of esteem, (2) the disadvantages associated with this form of property ownership, and (3) some better and more economical alternatives for estate tax purposes. It is submitted that the first and third points have been particularly neglected and are even now overlooked in attorney-client will and estate planning conferences. Therefore, this writer has devoted considerable attention to these two problems in the hope that if the will-making public not only understands the “reasons for” but also the “alternatives to” joint ownership, then conversion to separate ownership will be both happy and meaningful.

The discussion which follows will be divided into three major parts. First, it will be important to see why so much real and personal property remains in joint tenancy between husband and wife or in entireties tenancy. It has been almost eighteen years since Congress eliminated the necessity of holding property in this form in order to split income therefrom for income tax purposes.² Is inertia the only reason for the popularity of joint ownership, or are there other reasons? Second, we shall review the familiar but false assumptions most laymen (and even a few attorneys) commonly make regarding the advantages of joint ownership. Space limitations will prevent an exhaustive review, but, as we have noted, the tax problems of joint ownership are the constant and continuing subject of excellent treatises and articles.³ Third, an investigation and appraisal will be made of some alternatives to joint ownership which are more favorable from the standpoint of estate taxes.

2. In the Revenue Act of 1948, Congress attempted to equate the income tax treatment of married persons in common-law states with that in community-property states, by abandoning the earlier requirement that couples in common-law jurisdictions must hold their property in joint tenancy or entireties tenancy in order to enjoy income-splitting privileges. The same legislation introduced the marital deduction privilege as another equalization measure intended to apply to gift and estate taxation.

3. For additional background, the reader should see 1 CASNER, *ESTATE PLANNING* 400 (1962); Effland, *Estate Planning: Co-Ownership*, 1958 WIS. L. REV. 507; Hartwig, *Estate Tax Consequences of Various Kinds of Property Holding by Husband and Wife: Joint and Reciprocal Wills; and Intestacy*, N.Y.U. 23d INST. ON FED. TAX 1093 (1965); Stacy, *Joint Tenancy in Estate Planning Can Have Serious Tax Disadvantages*, 20 J. TAXATION 98 (1964); Young, *Tax Incidents of Joint Ownership*, 1959 U. ILL. L.F. 972.

A cautionary word about such "alternatives" is in order, since they may not give to clients the same, much-heralded attributes of joint and survivorship ownership—such as the avoidance of probate, the escape from some state inheritance tax statutes, or the psychological aid to marital unity. Although admittedly lacking in one or more of these merits, certain alternatives to joint ownership can offer other long-term advantages and more flexible administration. However, most people are reluctant to spend present money on the development of elaborate schemes and the drafting of costly instruments to satisfy an attorney's dreams of tax economy in the distant future. Thus, the attorney's job of educating and persuading his client is indeed difficult.

I. RECENT CONGRESSIONAL ENCOURAGEMENT OF JOINT OWNERSHIP

A. *Background Before 1954*

It may be a surprise to some to note that since 1948—the year in which Congress attempted to equate the income tax treatment of married persons in common-law states with the treatment in community-property jurisdictions by allowing marital income-splitting for separately owned property—joint owners have actually *benefited* from changes in the Internal Revenue Code. A brief historical sketch of what is now section 2040 of the 1954 Code will aid our understanding of these changes.⁴ The requirement that all jointly held property⁵ be included in a decedent's estate for estate tax purposes first appeared in the Revenue Act of 1916.⁶ Carried down to the present day without significant change as section 2040, this provision compels the inclusion of all joint or entireties property "to the extent of the interest therein held as joint tenants by the decedent," except such part "as may be shown to have originally belonged to such other person [the surviving joint tenant] and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth."

Two provisos to the section were added by the Revenue Act of 1921.⁷ The first proviso states that if the survivor's interest was acquired by him from the decedent for "less than an adequate and full consideration," there shall be excluded from the decedent's gross

4. Unless otherwise stated, all future references to Internal Revenue Code sections in this article shall mean the 1954 statute.

5. References to "jointly held," "jointly owned," or "joint" property herein shall assume a right of survivorship, unless the contrary is indicated.

6. Ch. 463, § 202(c), 39 Stat. 778.

7. Ch. 136, § 402(d), 42 Stat. 278.

estate only the value of that interest which is proportionate to the consideration which the survivor himself furnished. The proviso applies both to property which the decedent placed in joint tenancy and to property his survivor may have placed in joint tenancy *after* it was given to him by the decedent. Thus, for example, a surviving wife cannot claim an exclusion from her husband's estate for any contribution she made to the joint tenancy if the contribution consisted of property he had previously given her—even if the previous gift had been reported and had resulted in the payment of a gift tax.⁸ The second proviso contains the rather obvious qualification that if the entireties property had been acquired by both spouses as a gift or an inheritance from a third person, one half (or other appropriate fraction in the case of multiple joint tenants) of its value can be excluded from the decedent's gross estate. Section 2040 thus affords the surviving joint tenant only two escapes from complete and full inclusion of the property in the estate of the decedent: the survivor must either prove a proportionate contribution from his originally owned separate property, or must prove a joint gift or inheritance from a third person.

The theory that the entire value of survivorship property could be pulled back into the estate of the first joint tenant to die was difficult to accept at first and was, of course, soon challenged in the courts. However, in *Tyler v. United States*,⁹ the United States Supreme Court stated that the death of one joint tenant was a sufficient taxable incident for the estate tax to apply:

The question . . . [is] not whether there has been, in the strict sense of that word, a "transfer" of the property by the death of the decedent, or a receipt of it by right of succession, but 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 result¹⁰

In *United States v. Jacobs*,¹¹ upon the taxpayer's assertion that such an inclusion of joint property violated due process of law concepts, the Supreme Court defined the estate tax as an excise on the peculiar change in ownership of the *whole* property caused by death. Thus, once again traditional notions of property law were superseded

8. The gift tax credit against the estate tax guaranteed by § 2012 could be claimed by the surviving wife, but this relief provision is frequently inadequate. See note 37 *infra* and accompanying text.

9. 281 U.S. 497 (1930). This case sustained the relevant provisions of the Revenue Acts of 1916 and 1921 as well as § 811(e) of the Internal Revenue Code of 1939.

10. 281 U.S. at 503.

11. 306 U.S. 363 (1939). The *Jacobs* decision involved § 302 of the Revenue Act of 1924 and a joint tenancy which was severable under the applicable state law.

by the principle of "economic change" in the control and enjoyment of property—a change which has come to be known as a taxable "incident" or "event." The Court noted in a later decision:

[T]he power of Congress to impose death taxes is not limited to the taxation of transfers at death. It extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property, and when any of these is occasioned by death, it may as readily be the subject of the federal tax as the transfer of the property at death.¹²

Despite the pervasive reasoning of the Court, however, the seeds of the popular delusion that jointly held property either descended without an estate tax or with a tax on only half of the property continued to take root and grow.

B. The 1954 Changes

Just as tax and estate attorneys were beginning to make some headway with their clients by teaching that joint ownership was not required after 1948 for marital income-splitting, Congress wrote into the Revenue Act of 1954 at least five "palliatives" which modified the former estate tax penalties confronting joint owners. Because these provisions have succeeded in breathing renewed life into the persistence of survivorship-property holding, some discussion of them is now appropriate.¹³

Prior to 1954, a factor which adversely affected survivorship property was that it could not be included in the federal estate tax return as any part of the value of property subject to claims against the estate.¹⁴ The resultant diminution of this base for estate tax deductions caused considerable hardship. If normally allowable debts and administration expenses exceeded the amount of probate property (that is, property solely owned by the decedent), the excess deduction was wasted, for jointly-owned property included in the taxable estate could not be used as an offset. Section 2053(c)(2) of the 1954 Code continued this disability of jointly-owned property *except* in cases where all such debts and expenses were paid before the due date for the filing of the return. Since most debts and expenses are usually paid by the executor or administrator within the fifteen-month estate return filing period after death and, in fact, are commonly provided for on or before the adjudication of claims in probate court, the new

12. *Fernandez v. Wiener*, 326 U.S. 340, 352 (1945).

13. See generally 1 CASNER, ESTATE PLANNING 409-11 (1961).

14. Int. Rev. Code of 1939, § 812(b), 53 Stat. 123, as amended, ch. 619, § 405(a), 56 Stat. 945 (1942), as amended.

1954 provision definitely tended to remove this disadvantage of survivorship property.

A second and related palliative was section 2053(b) of the 1954 Code, a wholly new provision at the time. Under this section a spouse or other owner by survivorship is entitled to have the decedent's representative deduct the expenses of administering "property not subject to claims" in the same manner as for property subject to claims and passing through probate administration. Thus survivorship property, even though it avoids probate procedure and costs, may now give rise to deductible administration expenses, so long as the property was included in the adjusted gross estate and the administration expenses were paid within the three-year period of assessment after the filing date for the estate tax return.¹⁵ Since there are no probate proceedings in situations involving joint or entireties tenancies, there may be some uncertainty as to what is encompassed by the term "administration expenses." A plausible argument can be made that this class of expenses should at least include the cost of tracing the survivor's contribution to the original purchase price of the property. This approach would remove some of the sting of the pervasive provisions of section 2040.

An even greater boon accrued to survivorship owners by virtue of another 1954 Code provision, and as a result one of the most effective arguments against this mode of ownership is no longer available to the tax practitioner. Until 1954 the basis of property received from a decedent was its fair market value at the date of the decedent's death (or the date of optional valuation) only if such property had been "acquired by bequest, devise, or inheritance."¹⁶ In *Lang v. Commissioner*,¹⁷ this method of computing the basis was held inapplicable to surviving joint tenants and tenants by the entireties. Thus in the days before 1954 many surviving joint owners incurred a substantial capital gains levy when they ultimately sold the property. Under section 1014 of the 1954 Code, the same rule is still applicable to property acquired by survivorship as a result of a death occurring prior to January 1, 1954. With respect to all persons dying since that date, however, section 1014(b)(9) states that the post-death basis shall be the fair market value at the date of the decedent's death or the date of optional valuation, provided that the property was acquired from the decedent "by reason of death, *form of ownership*, or other conditions . . . if by reason thereof the property is required to be included

15. The assessment is provided for in INT. REV. CODE OF 1954, § 6501.

16. Int. Rev. Code of 1939, § 113(a)(5), 53 Stat. 41.

17. 289 U.S. 109 (1933).

in determining the value of the decedent's gross estate."¹⁸ Thus, once more the survivorship owner, who indeed takes by "form of ownership," seems to keep his non-probate privileges and eat of the same cake as the testamentary legatee or devisee as well. The one qualification written into the new provision is that the basis of the property shall be reduced by any depletion, obsolescence, or amortization deductions allowed the decedent for income tax purposes prior to his death. Obviously designed to prevent the surviving joint tenant from getting a double deduction for such write-offs, this qualification is the one remaining disadvantage to such owners under section 1014 of the 1954 Code.

A fourth measure of alleviation attributable to the 1954 Code involves a change in the estate taxation of property previously taxed in successive death situations. Under the 1939 Code the estate tax deduction for property previously taxed within five years did not apply to transfers from one spouse to the other.¹⁹ The 1954 legislation removed this deduction entirely and substituted a declining ten-year credit for property previously taxed. Either inheritance or succession by survivorship now entitles the remaining spouse's estate to a credit for the first estate tax paid on the basis of the same property's inclusion in the prior decedent's estate.²⁰ While this credit is often not equitable and does not provide the same tax relief as inter vivos gifts which equalize the separate estates of the spouses, we can see again a renewed equation of treatment between separately held and jointly held property which buoys up the arguments in favor of joint ownership.

The fifth palliative introduced by the 1954 Code concerns the gift tax aspects of joint ownership. Section 2515 of the 1954 Code permits a donor spouse to convey his home into survivorship tenancy without any immediate liability for gift tax. This privilege is limited to real property, and the gift tax normally assessable is payable only if the tenancy is later terminated by an event other than death. As the Senate committee said at the time of enactment: "Many couples who elect this method of buying a home have no intention of making a gift at the time of the creation of the tenancy . . . or any knowledge that they are considered as having done so."²¹ Under section 2515 the

18. Emphasis added. Suppose joint property is "required to be included" in a decedent's estate, but through inadvertence or design it is not included. The writer has not found authority as to which basis would apply, but it would seem that after expiration of the period for assessment the survivor would have to take his decedent's basis.

19. See Int. Rev. Code of 1939, § 812(c), 53 Stat. 124, as amended, ch. 168, § 362, 62 Stat. 121 (1948).

20. INT. REV. CODE OF 1954, § 2013.

21. S. REP. NO. 1622, 83d Cong., 2d Sess. 128 (1954).

donor spouse may elect *not* to come within the nonrecognition provisions by filing a gift tax return, which he must do whether or not the value of the gift exceeds the statutory exclusion for transfers to individual donees. The election is complicated, however, by the necessity of its repetition every time an addition or improvement is made to the real property or an indebtedness on it reduced with the donor's funds. Nevertheless, this most popular of all methods of survivorship ownership has now been placed outside the normal gift reporting requirements.²² The modification wrought by section 2515 seemingly put the icing on the cake as far as joint owners were concerned.

In fairness to Congress it should be repeated that the 1954 changes just reviewed constituted an attempt to bring joint ownership privileges in common-law states more into line with the treatment of community property under the existing federal estate tax law. In community-property jurisdictions no gift tax consequences flow from the creation of community property by just one spouse even though half of the community is later excludable from the estate of the first spouse to die.²³ Moreover, since 1947 a surviving spouse in a community-property state has received a stepped-up basis on his own share of the community property as well as on the decedent's.²⁴ The first spouse to die may also bequeath his share of the community by will, a feature which allows the giving of a life estate in this share to the surviving spouse with a consequent tax-free remainder to the children of the marriage. In the life estate situation, only the surviving spouse's half of the community will be taxed at the latter's death. All this is in quite favorable contrast to the situation in common-law jurisdictions, where the half interest of a joint or entireties owner

22. Some of the complications of § 2515 are reviewed in A.L.I. Fed. Income Tax Stat. § X1071 (Tent. Draft No. 10, 1955), where it is pointed out that co-owners of dwellings are not apt to realize that the termination of the tenancy during their lifetimes results in a gift. Moreover, any periodic improvements in a residence made by the donor spouse might come within his annual gift tax exclusion, yet unless he reports these by filing a gift tax return there will still ultimately be a gift tax payable. The same result would apply to his reduction of mortgage indebtedness on the residence. One wonders if the statutory reform justifies these resulting complexities.

23. See *Joint Tenancy and the Federal Tax Law*, 101 TRUSTS & ESTATES 1151, 1188-89 (1962). But § 1000(d) of the Int. Rev. Code of 1939 (effective January 1, 1943) (added by ch. 619, § 453, 56 Stat. 953 (1942), as amended) made a husband liable under the gift tax for the whole value of community property donated to a third person (where the property was attributable to the husband), and a division of the community between spouses led to a taxable gift of one half of the value. With the Revenue Act of 1948 the law reverted to its prior status so that gifts to a third party were taxable one half to each spouse, and inter-spousal division of community property did not result in a taxable gift. The reader unacquainted with community property should see DE FUNIAK, COMMUNITY PROPERTY §§ 1-53 (1943); Griffith, *Community Property in Joint Tenancy Form*, 14 STAN. L. REV. 87 (1961).

24. INT. REV. CODE OF 1954, § 1014(b)(6).

may be included in the gross estate twice (upon both deaths), and on the second death such interests may be included at higher estate tax brackets so that the section 2013 credit on prior transfers has a lessened effect.

Finally, the surviving owner in a common-law jurisdiction often finds to his dismay that the large amount of survivorship property, together with his receipts from a simple reciprocal will, results in uneconomical use of the marital deduction privilege.²⁵ His counterpart in a community-property state is allowed to subtract community property from the gross estate, leaving a relatively smaller adjusted gross estate and causing a more efficient use of the marital deduction if the decedent happened to own a substantial amount of separate property. These disparities between the two types of jurisdictions in our country are partly responsible for some of the amelioration shown common-law joint owners by the 1954 Code.

There are of course some non-tax reasons and motives behind this method of holding property. Such ownership avoids the costs and delays of probate, and in some states it precludes the imposition of an inheritance tax, a levy usually amounting to a small fraction of comparable federal estate tax rates.²⁶ Many people choose this form of ownership on the understanding that jointly held property is safe against some types of creditors. Frequently the spouses simply feel that holding property in this manner tends to cement the marital

25. See full discussion in I CASNER, *ESTATE PLANNING* 400 *et seq.* (1962), where the author indicates some of the points of inflexibility of jointly owned property in any dispositive estate scheme.

26. The state inheritance tax statutes which do tax survivorship property are divided into those which apply what may be called the "federal rule" (taxing such property on the basis of the provable contribution from assets originally owned by the surviving spouse or other joint tenant) and those which apply a strict fractional rule according to the number of joint owners. Both rules may be applicable in states where tenancies by the entirety are recognized. The following state statutes exempt either entireties or joint tenancies from inheritance taxes: IND. ANN. STAT. § 7-2401 (1953) (entireties property exempt, joint tenancies taxed similarly to IRC § 2040); MD. ANN. CODE art. 81, § 151 (1957) (entireties property exempt, joint property taxed according to fraction of undivided interest held by decedent); MASS. ANN. LAWS ch. 65, § 1 (1964) (decedent's jointly owned dwelling exempt, all other joint and entireties property taxed similarly to IRC § 2040); MO. ANN. STAT. § 145.090 (Supp. 1965) (no tax on either tenancy); N.J. STAT. ANN. § 54:34-1(f) (1960) (joint property taxable under a provision similar to IRC § 2040, entireties property exempt by Comptroller's Ruling 6-1-28); PA. STAT. ANN. tit. 72, § 2485-241 (1964) (all joint spousal property exempt); UTAH CODE ANN. § 59-12-5 (1963) (spousal or parent-child survivorship property exempt up to \$40,000); VT. STAT. ANN. tit. 32, § 6543(b) (1959) (all joint spousal property exempt); WYO. STAT. ANN. § 39-337 (1957) (neither type of tenancy taxed; see also 1941-1947 Wyo. Att'y Gen. Ops. 470 (1944)). In Michigan, neither type of tenancy is taxed. See Mich. Att'y Gen. Ops. 8-6-23, 5-29-40; Mich. Dep't of Rev. Rul. 1-22-54. Nevada has abolished the inheritance tax by constitutional provision. See NEV. CONST. art. 10, § 1. In the remaining thirty-nine states, survivorship tenancies are subject to state inheritance taxes, either on a basis identical to IRC § 2040 or on a strict fractional-share theory.

union and give the passive or non-contributing member the sensation of being an owner. However, in jurisdictions where one spouse cannot unilaterally sever the tenancy, occasionally the "cement" can be all too strong. These non-tax reasons cannot be discounted when they are earnestly pleaded; the attorney's function is simply to assure that the disadvantages of survivorship tenancy—which will be expounded in the following discussion—are also considered by the parties.

II. THE COMMON MYTHS OF JOINT OWNERSHIP

We have reviewed the history behind the concept of joint ownership which may explain some of its present popularity. It is now appropriate to explore some of the false assumptions regarding this method of property ownership which are open to iconoclastic disavowal by attorneys in an effort to achieve gift and estate tax minimization. Such assumptions are often encountered by attorneys seeking to advise clients, many of whom are encouraged to consult an attorney as a result of reading articles on "estate planning" in popular periodicals.²⁷ Some of the following points overlap parts of the previous discussion, but it may be helpful to have them reiterated in a slightly different context.

A. *Common Tendency To Underestimate the Scope of the Estate Tax Provisions*

1. *Surviving Spouse's Contribution to the Jointly Held Property*

The most common misconception concerning joint and entireties tenancies is the belief that only half of a married couple's jointly held property will be included in the estate of the first spouse to die. However, the applicable treasury regulation clearly refutes this erroneous assumption:

The entire value of jointly held property is included in a decedent's gross estate unless the executor submits facts sufficient to show that property was not acquired entirely with consideration furnished by the decedent, or was acquired by the decedent and the other joint owner or owners by gift, bequest, devise, or inheritance.²⁸

What kinds of facts are sufficient to show that the surviving tenant originally owned all or a part of the property in question? The problem is obviously one of tracing. Some courts permit a fairly general

27. Some of these articles are well worthy of study by attorneys. See, e.g., Wormser, *supra* note 1.

28. Treas. Reg. § 20.2040-1(a)(2) (1958).

showing of the income and earnings of the surviving spouse during the marriage which, for equitable reasons, can be considered as invested in the joint property,²⁹ and the celebrated decision in *Cohan v. Commissioner*³⁰ gives some basis for an equitable approximation. The apparent liberality of these courts, however, does not recognize that any value is conferred by "housewifery" or by services contributed to the marital partnership out of "love and affection."³¹ Some "exchange" in money or money's worth which transcends mere marital duties must be recorded. The courts find a significant distinction between a wife's direct participation in a joint family business as a partner, which entitles her to an exclusion,³² and the situation where she merely spends her own funds on maintenance of the home or the children, and receives no exclusion, since in the latter case her participation is unrelated to the cost of the acquisition or tangible improvement of the home.³³

Obviously there is little difficulty where the survivor has transferred his own securities into joint tenancy, provided that he either earned or inherited his contribution.³⁴ Such contribution, if proved, is clearly excludable. Similarly, if the survivor has furnished and can prove *some* consideration, even though less than "full," the ratio test of the regulations will be applied.³⁵ On balance, the Commissioner, as well as most courts, will be far more exacting than is suggested by the "equitable share" doctrine of the *Cohan* decision. Clients must be warned repeatedly that clear evidence of the relative contributions of the joint owners, as well as the dates of contribution, will be required.³⁶

29. See, e.g., *Richardson v. Helvering*, 80 F.2d 548 (D.C. Cir. 1935).

30. 39 F.2d 540 (2d Cir. 1930). This case is valid only as an analogy, for it dealt with an estimation of business expenses for income tax purposes. See also *Estate of Ethel M. Bullock*, 29 P-H Tax Ct. Mem. 1203 (1960); *Estate of Harriet M. Harris*, 33 P-H Tax Ct. Mem. 699 (1964).

31. See *Bushman v. United States*, 8 F. Supp. 694 (Ct. Cl. 1934), *cert. denied*, 295 U.S. 756 (1935). Even though the wife had rendered services to her husband in his law practice and in managing family real estate, the court found her services were rendered out of love and affection, and were not an ascertainable contribution to the entireties property.

32. See *Richardson v. Helvering*, 80 F.2d 548 (D.C. Cir. 1935); cf. *Charles A. Trafton*, 27 T.C. 610 (1956); *Estate of Mary Louise Selecman*, 19 P-H Tax Ct. Mem. 898 (1950). See also *Singer v. Shaughnessy*, 198 F.2d 178 (2d Cir. 1952) (agreement between spouses to share the profits of a business was inferred and exclusion of the survivor's share was permitted); *Berkowitz v. Commissioner*, 108 F.2d 319 (3d Cir. 1939).

33. *Fox v. Rothensies*, 115 F.2d 42 (3d Cir. 1940). See the excellent summary in *Hartwig*, *supra* note 3, at 1104.

34. See *Estate of Nathalie Koussevitsky*, 5 T.C. 650 (1945); *Old Colony Trust Co.*, 39 B.T.A. 871 (1939).

35. Treas. Reg. § 20.2040-1(a)(2) (1958).

36. See, e.g., *Estate of Joseph H. Heidt*, 8 T.C. 969 (1947), *aff'd mem.*, 170 F.2d 1021 (9th Cir. 1948).

2. Interspousal Gifts

A second misconception shared by many married couples is the belief that interspousal gifts of property subsequently placed in joint tenancy are excluded from the estate of the donor spouse. This misconception is also clearly refuted by the regulations under section 2040.³⁷

Typically a husband will have made a gift (even a reported gift) to his wife, placing the gift *res* in her sole name and thus divesting his taxable estate of the donated property. Then, for some reason—often a feeling that her husband should be the manager—the wife places the property in joint ownership. Since the full value of the property must be subsequently included in the husband's estate, the whole transaction is reduced to a meaningless exercise from the standpoint of the tax laws. Any avoidance of probate costs in such an instance is often a paltry offset to the increased estate tax; furthermore, if a gift tax was originally paid on the gift by the husband, the gift tax credit against the estate tax afforded by section 2012 will be inadequate if the joint property has appreciated in value.³⁸

Attorneys should emphasize to their clientele that the payment of a gift tax upon the creation of a survivorship tenancy does not prevent the subsequent assessment of an estate tax on the same property, and that the gift tax credit is at best only a partial benefit.³⁹ Moreover, if the donee spouse should die first, the credit for the gift tax paid is apparently not allowed upon the later death of the donor.⁴⁰ Finally, the gift tax credit is totally inadequate with respect to gifts made in years when part or all of the lifetime thirty thousand dollar gift tax exemption, or the annual three thousand dollar gift tax exclusion, is claimed, because no tax is payable on the excluded portion of the gift in those years and thus there is nothing upon which the credit can operate.

The situation becomes even more intricate when the donee spouse places into joint or entireties tenancy either income produced by the donated property or amounts realized from market appreciation since the date of the gift. In this event a Pandora's Box of tracing problems can be opened, not only in common-law jurisdictions but

37. See Treas. Reg. § 20.2040-1(c), ex.(4)-(5) (1958).

38. To eliminate this apparent inequity, § 2012 should perhaps be amended so that the value of the reported gift for gift tax purposes upon the creation of a joint tenancy or tenancy by the entireties would be fully excludable from the first decedent spouse's gross estate.

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

40. See PAUL, *FEDERAL ESTATE & GIFT TAXATION* 1099 (1942).

also in community-property states when the couple has previously converted part of the community into joint tenancy.⁴¹

This point can be elaborated by a consideration of the example of ordinary income (such as dividends or rent) from property given by a husband to his wife. Treasury Regulation 20.2040.1(c)(5) makes it clear that when such income from the donated property is put back into joint tenancy by the wife, it may be considered as her "contribution," and the portion of the joint property attributable to that income is excluded from the decedent spouse's gross estate. Furthermore, the case of *Harvey v. United States*⁴² allowed exclusion of profits and capital gains from the donee's sale of the original gift property, to the extent that these amounts were realized before they were contributed to the joint tenancy. If, however, such profits and capital gains were not realized and remained merely represented "on paper" as part of the appreciation in value of the donated property in the hands of the donee spouse, they would suffer the taint of section 2040 even after contribution.⁴³

It should be emphasized that authority for exclusion of the donee's realized capital gains from the gross estate of the original donor rests entirely on cases, for the regulations are ambiguous on this point.⁴⁴ Moreover, problems of tracing a donee contributor's realized profits into some reinvestment will be difficult when, as survivor, he is trying to prove an exclusion from the decedent's gross estate. The tentative regulations under section 2040 were designed to equate the treatment of both realized and unrealized appreciation in the surviving spouse's contributed property, holding both *not* to be later excludable.⁴⁵ Had this rule been adopted, only realized ordinary income would have remained excludable from the estate of the deceased tenant.

So far there has been at least a semblance of design in the Code's

41. Because of the dire consequences following the inclusion of jointly held property in a decedent's estate, careful records should be kept of separate and community property, particularly in those states where the *income* from separate property is treated as community property—Idaho, Louisiana, and Texas. See 2 AMERICAN LAW OF PROPERTY § 7.12 (Casner ed. 1952).

42. 185 F.2d 463 (7th Cir. 1950); *accord*, *Swartz v. United States*, 182 F. Supp. 540 (D. Mass. 1960); *Estate of Ralph Owen Howard*, 9 T.C. 1192 (1947), *acq.*, 1948-1 CUM. BULL. 2. See also *First Nat'l Bank v. United States*, 223 F. Supp. 963 (W.D. Mo. 1963).

43. Treas. Reg. § 20.2040-1(c)(4) (1958).

44. Textual authorities too seem in conflict. Compare 4 RABKIN & JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 52.06(3) (1963), with LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES § 11.4 (2d ed. 1962). See also Giljum, *Estate Taxation and Jointly Held Property—Appreciation as Adequate Consideration*, ST. LOUIS B.J. 5 (Winter 1964).

45. See 26 C.F.R. § 20.2040-1(a)(2) (1954).

treatment of income from property donated by one spouse to the other and then later given back into survivorship tenancy. One may use the familiar fruit-of-the-tree analogy; whenever the fruit has been severed, its contribution to joint tenancy is a "true" contribution and is excludable if the contributor is the surviving spouse. However, some problems still remain with respect to the classification of stock dividends which accrue to the donee while the property is held separately. In *English v. United States*,⁴⁶ the Court of Appeals for the Seventh Circuit held that stock dividends did not "represent an increment to what . . . [the donee] already owned but [were] merely evidence thereof in a new form."⁴⁷ The stock dividends were very much a part of the "tree" in that court's thinking.⁴⁸ A judicial exception was carved out of this rule of includibility in *McGehee v. Commissioner*,⁴⁹ in which the Court of Appeals for the Fifth Circuit stated that if the stock dividend represented a capitalization of that part of the corporation's surplus *earned while the stock was separately held*, then the dividend should be regarded as the separate contribution of the spouse. The need to determine whether it is current or prior earnings which have been capitalized is simply one more item in the surviving joint tenant's burden of proof of excludability from the estate of the deceased tenant.

Finally, it is important to consider the consequences that can result when a donee wife predeceases her husband. The Tax Court has indicated that, except for section 2035 transactions in contemplation of death, Code sections other than section 2040 will not be applied to include any jointly held property in the donee's estate.⁵⁰ Thus if the husband gives property to the wife outright and the latter creates with it a tenancy by the entireties, no part of the property will be included in the wife's estate under any theory that the transfer into entireties was with a retained life estate (section 2036) or was intended to or did take effect only at the death of the contributing spouse (section 2037).

3. Problems Peculiar to Joint Bank Accounts

Joint bank accounts that are payable to either depositor or the survivor constitute a third area of joint ownership which is frequently

46. 270 F.2d 876 (7th Cir. 1959).

47. *Id.* at 881.

48. *Accord*, *Tuck v. United States*, 282 F.2d 405 (9th Cir. 1960), *affirming* 172 F. Supp. 890 (N.D. Cal. 1959).

49. 260 F.2d 818 (5th Cir. 1958), *reversing* 28 T.C. 412 (1957). See also *Tuck v. United States*, *supra* note 48; *Estate of Schlosser v. Commissioner*, 277 F.2d 268 (3d Cir.), *cert. denied*, 364 U.S. 819 (1960).

50. *Estate of Nathalie Koussevitsky*, 5 T.C. 650 (1945), *acq.*, 1945 CUM. BULL. 4.

misunderstood and which in most jurisdictions is a somewhat arcane law unto itself. Since each depositor usually has complete withdrawal rights, these accounts are most like severable joint tenancies. However, they too are made specifically subject to section 2040 by the statutory language, and the survivor must prove his contributions. Indeed, where evidence shows that a wife has deposited in a joint account money acquired from her separate property, she may be still unable to prove an exclusion from her decedent husband's gross estate because of lack of evidence as to the amount of the parties' respective *withdrawals* from the account.⁵¹

Clients should be warned that neither state banking legislation nor any presumption will necessarily change the rules of evidence when a section 2040 issue arises over an "either or survivor" account.⁵² Moreover, many persons are probably unaware that if *A* creates a joint bank account for himself and *B*, there may be a gift to *B* when the latter draws upon the account for his own benefit, and that the gift is measured by the extent of *B*'s obligation under state law to account to *A*.⁵³ To be caught in this manner between the pincers of the gift and estate taxes is just as typical a predicament with joint bank accounts as it is with other survivorship property.

4. *Surviving Joint Tenant's Personal Liability for Estate Taxes*

After a skeptical client has been informed of the foregoing disadvantages associated with joint ownership, he may then take refuge in the supposition that survivorship property, not being a part of the probate estate, is immune from the mechanics of estate tax assessment. However, the Treasury has ruled, to the taxpayers' dismay, that if the federal estate tax is not paid when due, a surviving joint tenant is personally liable to the extent of the entire value of the joint property at the time of the decedent's death.⁵⁴ In *Schuster v. Commissioner*⁵⁵ it was held that since the three-year assessment statute had run, transferee liability for the estate tax could not be asserted against either the trustee or the beneficiary of an inter vivos trust set up by the decedent. Nevertheless, the decedent's widow was a transferee of jointly held property, and the estate tax attributable to the trust was held collectible from her to the full extent of the included value of the transferred property, even though that property fully

51. Estate of Elwood Mead, 46 B.T.A. 1281 (1942) (mem.).

52. See Henry M. Butzel, 21 B.T.A. 188 (1930); cf. *Robinson v. Commissioner*, 63 F.2d 652 (6th Cir.), cert. denied, 289 U.S. 758 (1933).

53. Treas. Reg. § 25.2511-1(h)(4) (1958).

54. Rev. Rul. 56-144, 1956-1 CUM. BULL. 563.

55. 312 F.2d 311 (9th Cir. 1962).

qualified for the marital deduction.⁵⁶ Avoidance of probate, therefore, does not carry with it any avoidance of liability for estate taxes on survivorship property.

5. *Need For Assets Available Immediately After Death*

Despite the additional estate tax liability that may result from holding property in joint tenancy, many clients may still prefer this form of ownership on the ground that it will provide their spouses with immediate cash and other liquid assets free of probate procedures. Sound estate planning most certainly should guarantee a surviving spouse some immediately available assets to cover last expenses, to run the household, and to provide for other necessities until the first partial probate distribution. This protection can best be accomplished by an adequate joint bank account or by a modicum of life insurance. However, this cash need of the surviving spouse should not be a basis for wholesale conversion of separately owned assets into survivorship tenancy. Since joint bank accounts and life insurance payable to named beneficiaries do not pass into the probate estate, the executor may find that without appropriate amounts of these quick assets the estate lacks the necessary liquidity for convenient payment of probate expenses, state death levies, and federal estate taxes. In the absence of a "tax clause" in the decedent's will, state law may give the executor the right to obtain reimbursement for such expenses and taxes from the recipients of the non-probate property. The heirs may thus find that they must advance funds to the estate for this purpose—a situation hardly comforting to unsuspecting estate beneficiaries.

III. COMPLEXITIES ASSOCIATED WITH DISSOLUTION OF JOINTLY HELD ESTATES

There are two kinds of joint tenancies: those which are severable by one joint tenant during the lives of the parties and those which are not. In those states where they are recognized, tenancies by the entirety are not severable inter vivos except by the action of both spouses. Thus, this form of ownership is similar to a nonseverable joint tenancy.⁵⁷ Even joint tenancies "with right of survivorship" are

56. See generally Stacy, *Joint Tenancy in Estate Planning Can Have Serious Tax Disadvantages*, 20 J. TAXATION 98 (1964), where it is pointed out that this assessability of survivorship property can result in an extension of the normal three-year statutory period for assessment.

57. 1 CASNER, ESTATE PLANNING 400 (1961). This type of tenancy exists in some twenty-one states and usually can be created only with respect to realty.

in some states as indestructible as entireties tenancies.⁵⁸ This distinction based upon "severability" has important consequences when joint owners decide to split up their holdings into separate parts. Unless the particular rules of each type of tenancy are carefully observed, the client will find himself running afoul of the Scylla of the gift tax while attempting to avoid the Charybdis of an estate tax levy on the same joint property.

If the originator or earner of the joint property takes it back in his own name (with the consent of the co-owner where necessary), there are not, and of course should not be, any gift tax incidents;⁵⁹ the contributor is merely recovering his own property. If, however, the joint tenancy is severable under state law, and if it is converted into equal but separate holdings among the tenants (or into a tenancy in common), there is a recognized gift transaction measured by the value of the fractional interest received by each non-contributing tenant, less any proportionate value attributable to his contributions.⁶⁰ More simply, if *H* pays \$50,000 for property which he then puts into joint ownership with himself, *W*, and *S* as joint tenants, and if this transfer occurs when the property is worth \$100,000, he will be deemed to have made a taxable gift of \$33,333.33 to both *W* and *S*.⁶¹

Note the difference in treatment, however, if *H* had instead created a tenancy by the entirety or other nonseverable joint ownership. The neat laws of mathematical division can no longer be used in assessing the value of what he has given. Because of the element of nonseverability, each spouse or title holder *viewed separately* has a life estate with contingent remainder in fee simple. Any later act of division by *H* (with *W*'s consent) constitutes a taxable gift of the value of *H*'s then remaining life estate plus the value of his contingent remainder in fee—a gift which must be determined according to actuarial principles based upon the relative ages of the respective co-tenants.⁶² To say the least, not many married couples are aware of

58. See, e.g., *Ballard v. Wilson*, 364 Mich. 479, 110 N.W.2d 751 (1961).

59. See *Stacy*, *supra* note 56, at 100. But in cases involving dwellings this statement assumes that no election was made under IRC § 2515 to treat the original creation of the joint tenancy as a gift.

60. See Treas. Reg. § 25.2515-2(b)(1) (1958).

61. This hypothetical is based on the assumptions that all three joint tenants have the right to partition and that all have an equal right to income. The simple arithmetic can become complicated where a married couple places their home in joint or entireties tenancy and elects under § 2515 not to report the transaction as a gift. If the spouses originally opt for such postponement of the gift tax, the amount of the gift from one spouse to the other on a later termination of the tenancy is determined by comparing each spouse's percentage of the total *proceeds received* with such spouse's percentage contribution to the total consideration furnished by both spouses. This has been called the "contribution ratio" test. See *Joint Tenancy and the Federal Tax Law*, *supra* note 23.

62. See Treas. Reg. §§ 25.2515-2(b)(1), (c), (d) (1958). See also 1 CASNER, ESTATE PLANNING 417 (1961). Where the tenancy is indestructible and is divided by consent of both

this computational complexity. Moreover, if the donee spouse had contributed a part of the original value, the complexity is even further compounded.

A similar distinction based upon severability is made when the joint owners seek to break up their cotenancy by a conveyance to a third person, such as a son, daughter, or grandchild. If the joint tenancy of the donors is severable, each must report a gift of half the property which has been conveyed. If instead they are husband and wife holding by the entireties, then values based upon actuarial life expectancies must again be reported on the gift return of each.

As the following examples will illustrate, gift-reporting requirements and the method by which they are carried out are quite important. In the case of a severable joint tenancy between husband and wife, if the husband transfers his half-interest to a son or daughter, and if he had originally contributed seventy-five per cent of the value of the joint property, he will be treated as having made a gift of twenty-five per cent of the total value of the jointly held property to his wife and the remaining fifty per cent to his child. On the other hand, *both* husband and wife might make a transfer of joint property originating entirely with the husband. If the husband files a gift tax return (in which his wife consents to split the gift according to section 2513) reporting the entire gift to the child, and if the wife's gift tax return shows that she is reporting half her husband's gift, there is no gift from the husband to the wife. However, if the husband had furnished only half of the original consideration for the joint property, a gift to him of the other half of the property from his wife would be assumed to have taken place before his gift of the entire value to the child.⁶³ We shall not delve further into these intricacies, but it should be noted that they demonstrate the extreme importance of conformance between the manner of reporting the gift and the law relating to splitting a joint tenancy.

Aside from these gift tax complications implicit in the mechanics of splitting up jointly held property or conveying it to outside persons, there may also be valid reasons militating against these maneuvers from an estate tax standpoint. Probably the most common example of unfavorable estate tax results wrought by adherence to a joint tenancy occurs when a husband places a residence or some other property in joint ownership with his wife and a son or daughter. While his wife may of course mitigate the effect of the gift tax by

joint tenants, the younger tenant has enriched the elder by giving the latter an indefeasible interest.

63. See *Joint Tenancy and the Federal Tax Law*, *supra* note 23.

indicating her consent on the gift tax return, she will be disappointed (if she lives in a state recognizing indestructible entireties tenancies) when she finds, upon her husband's death, that she gets no marital deduction from his estate for the value of the joint property.⁶⁴ Her interest after her husband's death remains a terminable one, since it is subject to divestment by the survivorship of her child. Only where such joint interests are severable unilaterally would the interest qualify for the marital deduction.

IV. ALTERNATIVES TO JOINT OWNERSHIP IN ESTATE PLANNING

As missionaries penetrating the inner reaches of the citadel of the institution of joint ownership, attorneys often harangue their clients with one or more of the foregoing arguments, and then all too often discontinue the discussion, leaving the clients without the tools to fashion their joint holdings into more economical means of devolution. We leave them "hanging," as the colloquialism goes, bereft of alternatives except either the payment of an enormous gift tax or the maintenance of a status quo leading to increased estate taxes. Since the rates of both taxes are progressive, simple logic if nothing else dictates the formulation of an estate plan employing the lowest common denominator of rates. Simply recommending a division of the joint ownership into proportionate separate pieces will not win acceptance by every client. In addition to being fraught with complexity and misunderstanding, this approach often seems wholly negative to a person seeking constructive alternatives. The time has come to explore a wider range of alternatives to joint ownership, and it is this task which will occupy the remainder of this article.

Alternatives to, or substitutes for, joint ownership have varying degrees of effectiveness as well as of legal stature. Some are legally sound and as old as Blackstone, but others are new and somewhat risky when studied against the varying backdrop of federal circuit court cases. The sequence in which they are suggested and discussed here implies neither a descending nor an ascending order of merit. Moreover, individual practitioners may have a favorite alternative, more viable than some other because of their particular experience, applicable state law, or federal circuit court interpretation. The intent here is simply to point out that the real or imagined advantages and attributes of joint ownership can be surpassed by other property-holding vehicles of a less delusory and more economical design.

64. See Treas. Reg. § 25.2523(e)-1(g)(2) (1958).

A. *Tenancy in Common*

One of these vehicles involves the simple expedient of converting a joint tenancy into a tenancy in common. This transaction involves no capital gains tax,⁶⁵ and, even in a "nonseverable" jurisdiction, apparently no gift tax is involved if the joint or entireties tenants are of the same life expectancy.⁶⁶ However, in a state such as Massachusetts, where the husband has a common-law right to receive all the income from joint property, one half of the actuarial value of the husband's right to such income would have to be computed.⁶⁷ Any such calculation may be well worth the trouble, however, if the donor joint tenant is in a high estate tax bracket, for the one-half undivided interest received by the donee no longer comes under the estate tax taint of section 2040 of the Code. Moreover, with respect to the one-half interest which the donor retains, a donee spouse gets the advantage of any marital deduction clause in the donor's will and of any other planned allocation and tax-saving features which the will may contain. Thus, three fourths of the original value of the property may escape estate taxation, instead of the usual marital half where survivorship tenancy is involved.⁶⁸

Tenancy in common affords similar advantages to the man who wishes to put family property in the name of himself, his wife, and a child, for upon his death the wife would be entitled to a marital deduction. As noted earlier, this contrasts with the joint tenancy situation, since in the latter case the wife's interest would terminate if she were survived by her child.⁶⁹

It should be noted parenthetically that the gift tax rule generally applicable to joint tenancies outside the scope of section 2515 is not imposed upon joint bank accounts where the donor joint owner has the power under state law to regain possession of his entire contribution.⁷⁰ To avoid gift tax treatment when the account is to be divided up between spouses, it is suggested that the funds be used to defray household or other living expenses—a course of action under which no gift is usually held to take place unless the wife was the originator

65. See Rev. Rul. 56-437, 1956-2 CUM. BULL. 507. See also *Harris v. United States*, 193 F. Supp. 736 (D. Neb. 1961).

66. If the parties are of different ages, the transaction is taxed as a gift from the younger to the older on an actuarial basis.

67. See generally WARREN & SURREY, *FEDERAL ESTATE AND GIFT TAXATION* 488 (1956).

68. For a more complete comparison of the tax differences between joint tenancies and tenancies in common, see Rudick, *Federal Tax Problems Relating to Property Owned in Joint Tenancy and Tenancy by the Entirety*, 4 TAX L. REV. 3, 20-22 (1948).

69. See note 64 *supra* and accompanying text.

70. Treas. Reg. § 25.2511-1(h)(4) (1958).

of the account and the husband could have provided such support out of his own funds.⁷¹

B. *Inter Vivos Trusts*

Another substitute for joint property-holding lies in the creation of an irrevocable lifetime trust for the non-contributing owner. If legitimate escape from federal and state death taxes, as well as probate charges, is desired, there is hardly a better vehicle than the creation of a trust for the life of the spouse (or other non-contributor) with an objective, ascertainable standard for invasion of principal. Either a limited power of appointment of principal by the donee spouse or a remainder over to the children or heirs of the donor can be included. This relatively simple and quite popular alternative involves the payment of a gift tax only if the amount donated exceeds the donor's lifetime exemption. Moreover, the annual gift tax exclusion, available under section 2503(b) of the Code, will also apply to the income beneficiary's interest because it is a present interest capable of being valued, even if the trustee has power to pay principal to that beneficiary.⁷² If one includes the possibility of invasion of principal, the life tenant of such a trust has substantial beneficial ownership of the trust assets. Moreover, the life beneficiary will not be responsible for future estate or gift taxes. His donor satisfies the gift tax liability upon creation of the trust, whereas the joint owners in the counterpart situation face both a potential gift tax liability if the tenancy is severed and a certain estate tax liability upon death.

Of course, the settlor of the irrevocable trust must pay a price for the tax benefits accruing to the beneficiary. Unlike his counterpart joint owner, he cannot reserve any life income right to himself because such a reservation would cause the whole value of the trust to be included in his taxable estate under section 2036. Even the reservation of a fixed dollar value of income will cause later estate taxation of the amount of trust principal needed to produce such income. However, there is authority to the effect that a completely discretionary power to pay income to a settlor of an irrevocable trust, exercisable by an objective trustee with no possibility of collusion, will not be considered a retained interest because such a settlor has no "right" to the income.⁷³

71. See WARREN & SURREY, *op. cit. supra* note 67, at 488 n.8.

72. See I CASNER, ESTATE PLANNING 236-39 (1961). If a transfer to a minor is involved, care must be taken to observe the steps of § 2503(c), thereby avoiding a future interest that would not qualify for the annual exclusion.

73. See *In re Estate of Uhl*, 241 F.2d 867 (7th Cir. 1957), reversing 25 T.C. 22 (1955); cf. *Skinner v. United States*, 316 F.2d 517 (3d Cir. 1963), affirming 197 F. Supp. 726

Many clients seeking alternatives to joint ownership will be troubled by the irrevocability of such a trust. The question will arise whether it is possible to avoid probate procedures and still retain flexibility and power to cancel or nullify the vehicle created. The obvious answer lies in the revocable inter vivos trust—a receptacle for property during the donor's lifetime which becomes fixed and irrevocable only upon his death. The price of the power to revoke is the inclusion of the trust corpus in the donor's estate,⁷⁴ a seemingly nullifying feature of this type of structuring. Yet, in conjunction with the familiar "pour-over" will, this trust vehicle carries with it all the so-called benefits of jointly held property, including the avoidance of probate and the preservation of the estate tax deduction for debts and expenses of administration exceeding the value of other property subject to claims in probate court.⁷⁵ Moreover, on the death of the second spouse, or the surviving life beneficiary of the revocable trust, the trust provisions can effect avoidance of a second estate tax altogether.

All too often lay advocates of joint and entireties ownership think only of quickly and smoothly vesting title in the survivor, quite willingly accepting the risk of a potential estate tax. However, attorneys are effectively countering this consequence by the use of such revocable trusts. They are convincing their clients that, while the corpus of a revocable trust will be taxed in the estate of the first spouse to die, the trust can embody a scheme of life income with a remainder over that nevertheless insulates the estate of the surviving spouse from any such tax. By retaking at least half of the jointly-owned property into his own name (that is, by evenly dividing the tenancy), a husband, for example, can place such property in a revocable trust and attain basically the same tax advantages as the familiar two-trust, or Trust A and Trust B, marital deduction will. This simple act will confer a marital deduction upon his wife equal to half of the original value of the joint tenancy and will prevent her estate from incurring a tax on the other half.

It is important to note that this plan requires that the original contributing joint tenant first retake the jointly owned property into his own name, or such portion of it as he wishes to have qualify for the marital deduction. That this is an essential primary step was demonstrated in *Estate of William Macpherson Hornor*,⁷⁶ where both

(E.D. Pa. 1961); *Commissioner v. Vander Weele*, 254 F.2d 895 (6th Cir. 1958), *affirming* 27 T.C. 340 (1956). See also Rev. Rul. 62-13, 1962-1 CUM. BULL. 180.

74. See INT. REV. CODE OF 1954, § 2038.

75. See INT. REV. CODE OF 1954, § 2053.

76. 44 B.T.A. 1136 (1941), *aff'd*, 130 F.2d 649 (3d Cir. 1942).

husband and wife transferred entireties property, all of which had originally been purchased by the husband, to a revocable trust. The trust instrument directed payment of the income to the settlors "for their joint lives and the life of the survivor";⁷⁷ upon the death of the survivor, a remainder over to the settlors' sons was provided. It was held that the full value of the property was includible in the estate of the first decedent (the husband), under section 302(e) of the Revenue Act of 1926⁷⁸—a predecessor of section 2040 of the 1954 Code. The most unfortunate aspect of the arrangement was that on the subsequent death of the wife, half of the trust property was also included in her estate, on the premise that the original transfer in trust was valid and therefore gave rise to a retained-income interest in the wife.⁷⁹

Finally, it is not necessary in all cases of joint ownership to create an express irrevocable trust in order to obtain an estate tax exclusion. In *Estate of Brockway v. Commissioner*,⁸⁰ a father and son held all the stock of a family corporation. The son had paid for his stock and then had entered into a written, businesslike joint tenancy agreement with his father to ensure continuity of ownership and control of the business. On the father's death, the Commissioner predictably attempted to include all the stock in the estate, but the court excluded half of the stock on the basis of the son's absolutely provable contribution. In the argument before the court, counsel for the estate made the ingenious contention that the father-son agreement created either a tenancy in common for life with cross remainders for life and a remainder in fee to the ultimate survivor, or a tenancy in common in fee simple with an executory limitation in favor of the survivor. If the court had accepted either of these plausible theories, it could have decided the case without giving any attention to the joint ownership problems arising under section 2040. Indeed, in situations involving a definite written agreement similar to the one in the *Brockway* case, an argument for excludability based on such theories would seem to be a worthy supplement to the reasoning adopted by the court.

C. Gifts of Joint Property "In Contemplation of Death"

After the foregoing review of two alternatives to joint ownership whose limits are fairly well defined by the law, it is proper to con-

77. 44 B.T.A. at 1137.

78. 44 Stat. 71.

79. *Estate of Julia Crawford Hornor*, 36 T.C. 337 (1961), *aff'd*, 305 F.2d 769 (3d Cir. 1962). For a more extensive discussion of retained life interests, see *Commissioner v. Estate of Church*, 335 U.S. 632 (1949).

80. 219 F.2d 400 (9th Cir. 1954), *affirming* 18 T.C. 488 (1952).

sider more imaginative but lesser known methods for solving the estate tax problems created by joint tenancy. None of the devices to be discussed has achieved anything like general success. In truth, their conception has been due to expediencies dictated by particular facts and circumstances, and their repetition is due to quirks, inconsistencies, and lacunae in the applicable sections of the Internal Revenue Code.

One example of the results produced by this method of *ad hoc* estate planning is a scheme for converting the tax liability of jointly held property into the lesser liability of property given in contemplation of death. In *Sullivan's Estate v. Commissioner*,⁸¹ a husband and wife, quite evidently motivated by the imminent death of the husband, transferred a portion of their jointly held property, which had originated with the husband, to their son. Subsequently, they divided the remainder of the property by converting it into a tenancy in common between themselves. After the husband's death a mere two months later, his estate contended that only half of the property formerly held in joint tenancy was taxable to the estate. Ultimately the Court of Appeals for the Ninth Circuit agreed, finding that only half of the property transferred to the son could be taxed as property given by the decedent in contemplation of death because, under applicable state law, that was the only interest he had a right to transfer. With respect to the balance of the property which had been transferred into a tenancy in common, the court held that only the interest owned by the decedent at his death—a one-half common interest—was subject to tax. Section 811(e) of the 1939 Code (the predecessor to section 2040) simply did not apply, because there remained no jointly held property after the creation of the tenancy in common. As to the one-half common interest owned by the wife, the court decided that the transfer to her of that interest had been bona fide and in return for an adequate consideration—the relinquishment of the wife's former joint interest.⁸²

Several Tax Court opinions have followed the liberal result in *Sullivan*, and after each case the Commissioner announced his acquiescence.⁸³ Eventually the reasoning underlying the decision was reaf-

81. 175 F.2d 657 (9th Cir. 1949), *reversing* 10 T.C. 961 (1948).

82. Twelve years later a federal district court reached an opposite conclusion, holding that the conversion of a joint tenancy to a tenancy in common did not involve adequate consideration. See *Harris v. United States*, 193 F. Supp. 736 (D. Neb. 1961).

83. See *Baltimore Nat'l Bank v. United States*, 136 F. Supp. 642 (D. Md. 1955); *Estate of A. Carl Borner*, 25 T.C. 584 (1955), *acq.*, 1957-2 CUM. BULL. 4; *Estate of Edward Carnall*, 25 T.C. 654 (1955), *acq.*, 1956-2 CUM. BULL. 5; *Estate of Don Murillo Brockway*, 18 T.C. 488 (1952), *acq.*, 1955-2 CUM. BULL. 4. See also proposed Treas. Reg. § 20.2041-1(d), 21 Fed. Reg. 7879 (1956).

firmed, and indeed broadened, by the Court of Appeals for the Seventh Circuit in *Glaser v. United States*.⁸⁴ Mr. Glaser, who had been the original purchaser of certain property he later conveyed into entireties tenancy with his wife, joined with her in giving the property to their children, reserving a life estate for the joint lives of himself and his wife and the survivor. Since the husband died more than three years after this gift, the relevance of the case to section 2035, dealing with gifts in contemplation of death, is questionable. However, the decision of the district court (and the Tax Court before it) drew a parallel with the *Sullivan* decision by equating section 2036, which taxes retained interests, with section 2035, and by holding that these sections take precedence over section 2040. As was held in *Sullivan* with respect to a gift in contemplation of death, the *Glaser* court viewed the decedent as retaining a life income interest in only half of the formerly jointly owned property. Section 2040 was again circumvented, because both the decedent and his wife had conveyed a one-half entireties interest to their children, and the decedent was left with only a life estate in his one-half ownership share. Thus, even though the *Glaser* decision involved a section 2036 issue, its rationale tended to strengthen the principle that section 2040 is not to be read with any of the other "estate inclusion" sections of the 1954 Code. Both sections 2035 and 2036 were confirmed in their priority over section 2040 and its rule of inclusion of jointly-held property.⁸⁵

Nevertheless, the Government persisted in its effort to contest this judicial weakening of section 2040. In *United States v. Allen*⁸⁶ Mrs. Allen created an irrevocable trust, but reserved three fifths of the income therefrom for the remainder of her life. The balance of the income was apportioned between two of her children. Eighteen years later she sold her life estate to a third child for its approximate actuarial value; that price, of course, was far less than the value of the three fifths of the principal required to generate the income. Although Mrs. Allen died within the three-year period following the sale of her life estate, the district court determined that the "sale" of

In 1962-2 CUM. BULL. 6, the Commissioner withdrew his acquiescences to the above-cited decisions. See text accompanying note 89 *infra*.

84. 306 F.2d 57 (7th Cir. 1962), *affirming in part and reversing in part* 196 F. Supp. 47 (N.D. Ind. 1961).

85. The writer is indebted to the excellent article by Marshall Zissman, *Problem Areas in the Estate Tax*, 41 TAXES 875-80 (1963), from which this development of the strength of § 2040 is drawn. On the general subject of gifts of joint tenancy property in contemplation of death, see Wright, *Transfers of Joint Property in Contemplation of Death*, 55 MICH. L. REV. 1 (1956).

86. 293 F.2d 916 (10th Cir.), *cert. denied*, 368 U.S. 944 (1961).

her income interest barred any inclusion of it in her estate under a section 2035 contemplation-of-death theory.⁸⁷ The Court of Appeals for the Tenth Circuit rejected this apparent reliance on the *Sullivan* case and held that an amount equal to three fifths of the principal of the trust, less the proceeds received from the sale of the income interest, should be included in the decedent's estate under section 2036. A comparison of the two opinions in the case indicates that there was substantial disagreement as to the extent of Mrs. Allen's taxable "interest" in the retained income. Since all three Code sections in issue—sections 2035, 2036, and 2040—are worded in terms of the decedent's "interest" in property, this difference in viewpoint was basic and must be explained more fully.

Indeed, the problem of determining the meaning of this concept of "interest" allows a synthesis of the various lines of reasoning that have been discussed above. The word "interest" is not defined in the Code. The Commissioner, as well as the Tenth Circuit in the *Allen* decision, interprets "interest" to mean the amount by which the gross estate of a decedent has been reduced as a result of a transfer. Under this rationale, it can readily be seen that either a section 2035 gift of jointly owned property in contemplation of death or a section 2036 transfer of such property with retained interest must result in taxation of the entire principal in the decedent's estate, because this is precisely the amount of the reduction in value either transfer will effect in his estate. The taxpayer, on the other hand, will attempt to rebut the foregoing assertion by contending that the word "interest" refers only to the decedent's "right" (under local property law) which was the subject of the transfer; this "right" is usually a mere half of the principal. More simply, the question is whether the "interest" in income retained for life by the decedent is to be measured by the amount of the ultimate diminution of his taxable estate as a result of the inter vivos transfer, or by the value of the property right actually transferred. The latter view is in accord with both the *Sullivan* and *Glaser* decisions; the former view is not. Practitioners should note that this controversy can still be considered very much alive.⁸⁸

Having outlined the theoretical problems associated with gifts of survivorship property in contemplation of death, we must now con-

87. 60-2 U.S. Tax Cas. ¶ 11965 (D. Colo. 1960).

88. The ambivalent meaning of the word "interest" has been studied in depth in Hartwig, *Estate Tax Consequences of Various Kinds of Property Holding by Husband and Wife: Joint and Reciprocal Wills; and Intestacy*, N.Y.U. 23d INST. ON FED. TAX 1093 (1965). The confusion engendered by this term was most recently illustrated in *Heasty v. United States*, 239 F. Supp. 345 (D. Kan. 1965).

sider both the practical aspects of this subject and the current status of the law. After achieving success in the *Allen* case, the Commissioner withdrew his acquiescences in the Tax Court decisions which had followed *Sullivan*,⁸⁹ but he did not appeal the adverse decision in *Glaser*.

Thus, there would seem to be nothing to lose by assuming that clients can pursue their estate planning on the basis of the validity of both *Sullivan* and *Glaser*.⁹⁰ Of course, if the transferor of jointly held property survives the three-year contemplation-of-death period, section 2035 will pose no problem. If the transferor dies within the period, and the *Sullivan* rationale is not followed in his circuit, his estate still is no worse off by including only half of the value of the survivorship property than if a transfer within the period had been made. In addition, section 2036 of the Code should apply only to the fractional interest *transferred* by the decedent. Based upon what he knows of the state property law and the applicable federal cases in his jurisdiction, the attorney must weigh the desired result against the attendant risks.

D. Mortgages on Jointly Held Property

Does the existence of a mortgage or other secured indebtedness on jointly held property constitute a "valuable consideration" as between the joint owners, so that the surviving tenant may establish an exclusion from the decedent's estate? Is this a simple expedient for eliminating the harsh section 2040 inclusion rule? If so, does it make a difference whether the joint tenants took the property "subject to" an existing mortgage, or created or assumed the mortgage?

A New York case shows the importance of particular state law on this subject. In *Bremer v. Luff*⁹¹ the decedent and his wife had bought real property as entireties tenants and created a purchase money mortgage on the property. Decedent himself had furnished the cash down payment and the mortgage note. The court held that state law fixed the purchase money mortgage as a joint obligation, and thus half of its original balance was deemed to be a contribution of the surviving wife, which was excludable from the husband's estate. Although it seems somewhat inconsistent, the court also allowed the husband's estate a deduction for the entire existing mortgage debt. Which spouse actually made payments on the mortgage was considered immaterial. The latter aspect of the case has been jus-

89. 1962-2 CUM. BULL. 6.

90. This suggestion is discussed in Zissman, *supra* note 85, at 880.

91. 7 F. Supp. 148 (N.D.N.Y. 1933).

tifiably criticized,⁹² but the former part of the holding was substantially followed in *Drummond's Estate v. Paschal*,⁹³ a case originating in Arkansas and involving entireties property subject to a joint purchase money mortgage on which both spouses were personally liable.

Despite the approach taken by the court in the *Bremer* case, the writer feels that consistency demands that only *half* the unpaid balance of the mortgage indebtedness at the time of the death of one of two joint tenants be excluded from the estate. Moreover, the mortgage should be one which was created or assumed by the parties and on which state law provides for personal individual liability. Given these qualifications, the creation of such a mortgage furnishes promising relief against the burdens which otherwise would attach to the joint property under section 2040. On the other hand, if the joint tenants take their property subject to an existing mortgage on which there is no personal liability, it would seem that the consideration (or contribution) should be attributable only to that tenant making the down payment and the mortgage payments. The mortgage itself would not be considered a "contribution," and the value of the property, less the mortgage balance, would be included in the paying tenant's estate.⁹⁴

Should a mortgage which is created or assumed by joint tenants be a full or partial deduction from the first decedent tenant's estate? In this regard it should be noted that section 2053(a)(4) of the Code allows a deduction "for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate." The decision in *Bremer* allowed the husband's estate to deduct the entire joint mortgage liability because there was personal liability upon both joint tenants. The court arrived at this result even though the wife's portion of the joint mortgage caused exclusion of a corresponding portion of the value of the property from the husband's gross estate. A sounder view would seem to require the inclusion of half of the unpaid joint mortgage as an asset in the decedent's estate in those jurisdictions where there is a right of contribution enforceable against the surviving tenant.

92. See 2 MERTENS, *FEDERAL GIFT AND ESTATE TAXATION* § 15.05, at 278 n.43 (1959). See also the excellent review of the *Bremen* case in Giljum, *Estate Tax Problems Inherent in the Creation and Liquidation of Mortgages on Jointly-Held Property*, ST. LOUIS B.J. 3, 5 (1964).

93. 75 F. Supp. 46 (E.D. Ark. 1947).

94. See LOWNDES & KRAMER, *FEDERAL ESTATE AND GIFT TAXES* § 11.7, at 237 (2d ed. 1962); Giljum, *supra* note 92, at 7.

E. Disclaimers by Joint Tenants

An additional, albeit limited, device for avoiding the consequences of section 2040 involves the use of a disclaimer by the surviving tenant. As previously noted,⁹⁵ the existence in the estate of a large amount of survivorship property often results in an uneconomical use of the marital deduction privilege. Therefore, in order to prevent a wasting of the marital deduction where the decedent spouse had devised at least half of his adjusted gross estate to the survivor, the surviving spouse might attempt to disclaim survivorship rights. While there is a paucity of case authority on the effectiveness of such an act, it would seem that the survivor would be held to have acquiesced originally to the survivorship condition at the time of the creation of the tenancy. Upon the death of the first joint tenant, this argument, which is similar to an estoppel theory, should effectively counter any attempted disclaimer.⁹⁶ However, the disclaimer device may be available to the holders of a joint bank account. In an Ohio case, *In the Matter of the Estate of Krakoff*,⁹⁷ the court held that the contractual arrangement between joint depositors under state law was so similar to a testamentary disposition that it was possible for the surviving depositor to disclaim the contract benefits. Such a disclaimer results in the joint account falling into the decedent's estate in probate, and thus the account would be subject to any testamentary formula clause for maximizing the marital deduction.

F. Separate Ownership and Extraneous Gifts Into Joint Ownership

In some of the preceding sections consideration has been given to some fairly elaborate routes around the sweeping provisions of section 2040. However, one should not overlook the simplest route of all: a mere division of property into the separate names of the joint owners. If this course is adopted, only the previously discussed problems relating to severability and the gift tax⁹⁸ need to be considered. Moreover, it should also be emphasized that married persons may arrange to receive a legacy from a parent of one spouse in joint tenancy, and can then legitimately claim an equal division for tax purposes of the property so inherited. In a "severable" jurisdiction, only half of the value of such a survivorship tenancy will be taxed in the estate of the spouse who dies first.⁹⁹ Whether a parent

95. See text accompanying note 25 *supra*.

96. See CASNER, ESTATE PLANNING SUPPLEMENT 142 (1963).

97. 179 N.E.2d 566 (Franklin County, Ohio P. Ct. 1961).

98. See text accompanying notes 57-64 *supra*.

99. See Estate of Nathalie Koussevitsky, 5 T.C. 650 (1945), *acq.*, 1945 CUM. BULL. 4; Treas. Reg. § 20.2040-1(c)(7) (1958).

will consider that his son-in-law or daughter-in-law should share in a testamentary disposition of this type is conjectural, for here again one encounters the emotional and sociological overtones of the whole survivorship tenancy concept.

V. CONCLUSION

The writer has tried to do three things in this survey article. First, an attempt has been made to explain to the estate practitioner, particularly the attorney with something less than day-to-day contact with the problem, why people still favor joint tenancy as a means of holding property. In this regard, the inducements Congress has wittingly or unwittingly given to survivorship ownership have been listed. Second, the major estate and gift tax disadvantages of joint tenancies have been enumerated. Third, alternatives outside joint ownership, and at least partially viable expedients within it, have been suggested. It is hoped that emphasis by the practitioner on the first and third aspects of this problem will result in a more constructive approach to the tax disadvantages of joint tenancy.

Anyone called upon to advise married couples on the desirability of holding property jointly must approach his task very tactfully to avoid the psychological and even sentimental barriers to abandoning this form of ownership. A certain mental and psychological "fix" endows, and will continue to endow, "joint tenancy with right of survivorship" with a degree of permanency. The writer's experience gained from private practice suggests that the attorney must skillfully set forth the monetary advantages of other forms of ownership and the control made possible by well drawn will and trust instruments. Moreover, our entire profession can aid the desired conversion in thinking by emphasizing and bringing into fruition speedy, efficient, and trustworthy probate practices not tainted with delay and high cost. Trust instruments, where called for as an alternative to joint ownership, can be made less cumbersome and more meaningful. Finally, clients can be introduced to the experience and efficiency of commercial bank trust departments. The legal profession is in a sense called upon to prove its educative worth in this exercise of training clients in the astute and business-like preservation and conservation of their assets.