University of Miami Law Review

Volume 19 | Number 2 Article 2

11-1-1964

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GIFT TAX CONSEQUENCES OF JOINT OWNERSHIP AND THE TAXABLE DIVORCE

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I. INTRODUCTION

Perhaps no other single facet of estate planning has been so plagued by misunderstanding and ignorance as that part concerned with the concurrent ownership of property. Whether attributable to the desire to avoid probate and the claims of creditors, or to the erroneous belief that jointly held property will pass on the death of one of the tenants to the survivor outside the grasp of the federal government, the device of joint ownership is considerably more widespread than sound planning dictates. Although it is true that owning property jointly will enable the first co-owner who dies to avoid the inclusion of the property in his *probate* estate and though it may in certain cases provide insulation against the claims of one's personal creditors, the estate and gift tax consequences of this form of ownership are often so adverse that in the absence of extremely compelling non-tax reasons an alternative form of ownership should be given serious consideration.

Concurrent ownership in real or personal property may assume one of three forms. Title may be held in joint tenancy, whereby each joint tenant is deemed to own an undivided interest in the whole property with a right of survivorship. In order to create the traditional joint tenancy, each tenant must hold the property pursuant to the four so-called "unities" of time, title, interest and possession.[1] The destruction of any one

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1. See generally MOYNIHAN, REAL PROPERTY 129 (1940); 4 POWELL, REAL PROPERTY § 615 (1954); 4 THOMPSON, REAL PROPERTY §§ 1775, 1777 (1961); 2 TIFFANY, REAL PROPERTY § 418 (1939).

of the unities results in the termination of a joint tenancy. This will take place when the joint tenants join in a conveyance of the property to a third person; when the tenants, acting jointly, sever the tenancy in favor of a tenancy in common; or when either tenant, acting alone, alienates his interest to a third person.[2] Although at the common law the right of survivorship was inalienable either by an inter vivos transfer or by will,[3] the unilateral conveyance by one joint tenant of his undivided in-

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It is not necessary that the words "joint tenancy" or "as joint tenants" be used in order to create such an estate; any expression clearly disclosing an intent to create a joint tenancy is sufficient. Thus, the use of words of survivorship alone, without reference to the existence of a joint ownership relationship, will suffice to create a joint tenancy. See, *e.g.*, Peters v. Alsup, 95 F. Supp. 684 (D. Hawaii 1951) (survivor of the settlors of a trust to have a life estate and power to appoint the remainder held to be a joint tenancy); Finch v. Haynes, 144 Mich. 352, 107 N.W. 910 (1906) (to A and B or the survivor of them); Schwab v. Schwab, 280 App. Div. 139, 122 N.Y.S.2d. 354 (1952) ("the parties of the second part, their heirs and assigns forever" in granting and habendum clauses indicated a concept of survivorship not repugnant to an introductory designation as "joint tenants").

At the common law, joint tenancies were favored over tenancies in common because the feudal system was opposed to the division of tenures. Consequently, a conveyance to two or more persons, without more, was presumed to be a joint tenancy. In order to create a tenancy in common it was necessary that there be something to show the intent that the grantees or devisees were to hold by several and distinct titles, or that instead of survivorship in one, there should be a right of inheritance from the tenants individually. See 4 THOMPSON, *op. cit. supra* at § 1775. Today, the common law presumption has been reversed, and by statute in many states a conveyance of property simply "to A and B" is presumptively a tenancy in common. For an example of a statute of this sort, see FLA. STAT. § 689.15 (1963).

Under the common law doctrine of the "unities," a person could not create a joint tenancy between himself and another in property he already owned without first conveying it through a "straw." This was necessary because in a direct conveyance from A to A and B the unity of time would be absent, since A would have acquired his interest in the property earlier than B. Where the common law rule is still honored, the parties will be deemed to hold the property as tenants in common without the right of survivorship. Dolley v. Powers, 404 Ill. 510, 89 N.E.2d 412 (1950); Price v. National Union Fire Ins. Co., 294 Mich. 289, 293 N.W. 652 (1940); Anson v. Murphy, 149 Neb. 716, 32 N.W.2d 271 (1948) (created a tenancy in common with a "supplementary" right of survivorship). Other jurisdictions no longer require strict compliance with the "unities" requirement, finding it to be an anachronism of the common law. See Switzer v. Pratt, 237 Iowa 788, 23 N.W.2d 837 (1946); Therrien v. Therrien, 94 N.H. 66, 46 A.2d 538 (1946). See also 4 POWELL, *op. cit. supra* at § 616.

In most states, however, including Florida, the four "unities" are required both for the creation and continuance of a joint tenancy. Weed v. Knox, 157 Fla. 876, 27 So.2d 419 (1946). For a definition of each of the "unities" and what is required thereunder, see 2 TIFFANY, *op. cit. supra* at § 418.

Joint tenancies may be created in community property states between husband and wife. However, the interests of the spouses are not community property in that they are separate property not subject to distribution by the courts upon divorce. Collier v. Collier, 73 Ariz. 405, 242 P.2d 537 (1952); Barba v. Barba, 103 Cal. App. 2d 395, 229 P.2d 465 (1951). Further, a joint tenancy may be created by a husband a wife out of their community property. Chavez v. Chavez, 56 N.M. 393, 244 P.2d 781 (1952).

2. See generally MOYNIHAN, *op. cit. supra* note 1, at 131; 4 THOMPSON, *op. cit. supra* note 1, at § 1780; 2 TIFFANY, *op. cit. supra* note 1, at § 425.

3. 4 THOMPSON, *op. cit. supra* note 1, at §§ 1779, 1781. Nor can there be dower or curtesy in an estate held in joint tenancy, because the right of survivorship takes precedence over a marital interest in the estate. Mayburry v. Brien, 40 U.S. (15 Pet.) 21 (1841); Babbitt v. Day, 41 N.J. Eq. 392, 5 Atl. 275 (1886); Turner v. Turner, 185 Va. 505, 39 S.E.2d 299 (1946).

terest to a third person resulted in the destruction of the right of survivorship in the non-transferring joint tenant.

A joint tenancy is to be distinguished from a tenancy by the entirety, which at the common law was essentially a joint tenancy modified by the fiction that husband and wife were but one person. Thus, the unity of marriage was added to the original four unities in order to give rise to a tenancy by the entirety.[4] In theory, each spouse was seised of the whole interest and not of a share, as opposed to joint tenants, who were said to be seised of a share and of the whole.[5] As a result of that conceptual distinction, the rule developed that the right of survivorship of one tenant by the entirety could not be defeated by unilateral action on the part of either tenant. Although the common law tenancy by the entirety has been abolished in a number of American jurisdictions and modified in many respects where it still exists, nevertheless the majority of states which do recognize it prohibit the destruction of the right of survivorship by either spouse acting alone.[6]

The doctrine of survivorship appears to have resulted from the theory that joint tenants together own a single estate. See the discussion in note 5 *infra*. If this theory were carried out and rigidly applied, it would recognize no distinct interest in a person which would pass on his death to his heirs or devisees. 2 TIFFANY, *op. cit. supra* note 1, at § 419.

4. As Bracton noted, "Vir et exor sunt quasi unica persona quia caro una et sanguis unus" —"the husband and wife are, as it were, one person, because only one flesh and blood." BLACK, LAW DICTIONARY (4th ed. 1951). Blackstone also recognized that "to the four unities of a joint tenancy therefore is added the unity of husband and wife as a person in the law." 2 BLACKSTONE, COMMENTARIES *182. See also, generally, 4 POWELL, *op. cit. supra* note 1, at § 620; 4 THOMPSON, *op. cit. supra* note 1, at § 1784.

In Florida, the legislature has authorized a direct conveyance between husband and wife for the purpose of creating a tenancy by the entirety. FLA. STAT. § 689.11 (1963). See also BOYER, FLORIDA REAL ESTATE TRANSACTIONS 440-44 (1964).

5. Blackstone explained that the joint tenancy differed from the tenancy by the entirety in that according to the latter, the parties held *per tout et non per my*—that is, each held all but neither held a share. Consequently, neither could dispose of his part without the other's consent. 2 BLACKSTONE, COMMENTARIES *182.

Under this theory, neither spouse in the tenancy by the entirety situation has any individual portion which can be alienated or separated, or reached by the creditors of either spouse. 4 THOMPSON, *op. cit. supra* note 1, at § 1784. The survivor takes no new title by virtue of survivorship, but rather, he holds under the deed by virtue of which he was originally seised of the whole. 2 TIFFANY, *op. cit. supra* note 1, at § 419.

It is said that the surviving joint tenant takes the whole of the estate by survivorship, rather than by descent. According to one theory, nothing passes to the surviving tenant on the death of one joint tenant, but rather, since ownership and possession was *per tout* the survivor *continues* as owner of the whole. It is easy to see that a literal application of that concept would turn the Internal Revenue Code upside down, since there would be no "transfer" subject to the estate tax under § 2040 upon the death of one joint tenant, nor would an interest "pass" to the surviving spouse for purposes of the marital deduction under § 2056.

For a thorough review of the tenancy by the entirety, see the case of King v. Greene, 30 N.J. 395, 153 A.2d 49 (1959).

6. *E.g.*, Bailey v. Smith, 89 Fla. 303, 103 So. 833 (1925); Marble v. Jackson, 245 Mass. 504, 139 N.E. 422 (1923); Lopez v. McQuade, 151 Misc. 390, 273 N.Y. Supp. 34 (Sup. Ct. 1934). See also 2 AMERICAN LAW OF PROPERTY § 6.6 (Casner ed. 1952).

However, the prohibition applies only to unilateral destructions of the right of survivorship. Thus, the tenancy by the entirety may be terminated by the husband and wife joining together in a conveyance of the property to a third person. Maxwell v. Sullivan,

The final species of concurrent ownership is the tenancy in common, which resembles in many ways a joint tenancy without the right of survivorship. This form of ownership permits either co-tenant to freely alienate his one-half interest during his lifetime, much the same as a joint tenant. However, upon the death of one tenant in common his property will not pass to his co-tenant; rather, it will pass as his own property to his heirs at law or as he has provided under his will. In addition to its being created pursuant to the intentions of the parties, a tenancy in common may also arise by operation of law upon the severance of a joint tenancy.[7]

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123 Fla. 263, 166 So. 575 (1936). Moreover, whenever the unity of marriage is destroyed, as by the death of a spouse or by divorce, the tenancy is terminated. In Florida, it is recognized that divorce of the spouses will result in a termination of the tenancy. Valentine v. Valentine, 45 So.2d 885 (Fla. 1950); Andrews v. Andrews, 155 Fla. 654, 21 So.2d 205 (1945). In such cases, the former husband and wife will continue to own the property as tenants in common.

The divorce court will not award the property to one of the spouses without a finding that some special equity existed. Holmes v. Holmes, 95 So.2d 593 (Fla. 1957); Jones v. Jones, 121 So.2d. 811 (Fla. 3d Dist. 1960); Latta v. Latta, 121 So.2d 42 (Fla. 3d Dist. 1960). But, the court may award the husband's interest to the wife as lump sum alimony. Kilian v. Kilian, 97 So.2d 201 (Fla. 3d Dist. 1957). This is not the case, however, when the wife is an adulteress. Benson v. Benson, 102 So.2d 748 (Fla. 3d Dist. 1958).

An interesting problem is posed when both spouses die in a common disaster, making it impossible to determine which spouse survived the other. Some courts have held that the property descends to the heirs of each as if it had been held by the spouses as tenants in common. McGhee v. Henry, 144 Tenn. 548, 234 S.W. 509 (1921). However, if it can be shown that one of the spouses, usually the husband, furnished the entire consideration for the purchase of the property, it will descend to his heirs alone. *In re* Strong's Will, 171 Misc. 445, 12 N.Y.S.2d 544 (Sur. Ct. 1939). The Uniform Simultaneous Death Act provides in effect that when there is no evidence of which joint tenant or tenant by the entirety survived the other, then the property will descend *as if* it had been held by them as tenants in common. UNIFORM SIMULTANEOUS DEATH ACT § 3, adopted in Florida in FLA. STAT. § 736.05 (1963). This problem is the subject of a brief annotation in 18 A.L.R. 105 (1922).

For a comprehensive and illuminating analysis of the traditional and modern joint tenancy and tenancy by the entirety in the United States, see Comment, 61 MICH. L. REV. 1335 (1963).

7. Although in many respects a tenancy in common seems to be first cousin to the joint tenancy absent the survivorship feature, they are in theory quite distinct. A tenancy in common, technically, is not an estate, but rather, it is a relationship between persons. The only "unity" which exists is the unity of *possession*; hence, remaindermen cannot be said to hold as tenants in common until they have a right to present possession. See 4 THOMPSON, *op. cit. supra* note 1, at § 1793.

Since each tenant in common holds his title independent of the other, his interest may be alienated freely, or devised and encumbered without the need for the consent of his co-tenant. Moreover, each tenant in common has an equal right to the use and occupation of the property, provided he does not use it in such a way as to exclude the other tenants from enjoying their equal privileges. *Ibid.*

When there are three joint tenants and one of them conveys his undivided one-third interest, the two remaining joint tenants hold their undivided two-thirds in joint tenancy with one another; together, they are tenants in common with the transferee of the transferring joint tenant, in the ratio of two-thirds to one-third, respectively. When one of the non-transferring joint tenants dies, the survivor succeeds to a two-thirds interest as tenant in common with the transferee. Jackson v. O'Connell, 23 Ill. 2d 52, 177 N.E.2d 194 (1961).

For a discussion of the characteristics of a tenancy in common and the attendant rights of the co-owners, see also MOYNIHAN, *op. cit. supra* note 1, at 131; 2 TIFFANY, *op. cit. supra* note 1, at § 425.

As will be seen shortly, the gift tax consequences of holding property in joint ownership will differ according to the form of concurrent ownership used. Consequently, the planner is wise to ascertain the law of property which prevails in the local jurisdiction before proceeding to recommend a specific form of co-ownership.

II. FEDERAL ESTATE TAX—A BRIEF WARNING

In order to place the gift taxation of jointly-held property in its proper setting, a few words should be said about the estate tax consequences associated with this form of ownership. The basic estate tax rule is furnished by section 2040 of the 1954 Code, which provides that the gross estate of a decedent shall include for the purposes of the federal estate tax the value of all property in which the decedent owned an interest at his death as a joint tenant or tenant by the entirety. This amount is diminished by the amount of consideration shown to have been furnished by the surviving spouse or other joint tenant for the creation of, or additions in value to, such tenancy.

The burden of proving consideration, however, rests on the shoulders of the decedent's estate, and as a practical matter has proven to be virtually insurmountable.[8] One can but speculate at the surprise experienced by a husband who, thinking he has found the estate planner's panacea in the joint ownership device, discovers that not only is the value of the property includible in the gross estate of his deceased wife, but also that he is unable to prove that he had, in actuality, furnished the entire consideration for the purchase of the property. Nothwithstanding the normal realities of such a situation, presumptions have not been entertained in favor of the husband's contribution. Even when the husband is the first of the spouses to die, the inclusion of all jointly owned property in his gross estate is often a consequence totally unintended. Although some relief is granted by the availability of the estate tax marital deduction,[9] usually it is not sufficient in itself to render the joint form of ownership desirable, since an outright devise or bequest to the surviving spouse would be entitled to the same treatment.

If section 2040 lurks as a trap for the unsuspecting taxpayer, the gift tax consequences associated with joint ownership emerge to add painful insult to the injury. The remainder of this article will be devoted to the exploration of those consequences.

III. PRE-1955 LAW—THE UNKNOWN SNARE

The Internal Revenue Code of 1939 made no specific reference to gift taxation of jointly-held property. Nevertheless, by case law the federal

8. For a discussion of the problems involved in tracing payments of consideration, see Laikin, *Joint Ownership and Tax Planning*, 42 MARQ. L. REV. 176 (1959).

9. INT. REV. CODE OF 1954, § 2056.

gift tax was applied to transfers of separate property into joint tenancy with another.[10] Since no provisions in the Code could be singled out to justify the imposition of a gift tax, the courts relied upon the property law concepts, which had controlled the estate tax, in holding that a taxable gift was made to the extent that one of the tenants made a gratuitous transfer of an interest in the property to the other.[11]

The amount of the gift was determined to be the difference between the consideration furnished for the creation of the tenancy and the value of the rights the donor had retained in the property.[12] In this respect, the differences under the governing local law between a joint tenancy and tenancy by the entirety became crucial. In the case of a joint tenancy, the donor's retained interest in the property was always equal to one-half its value, on the basis that each tenant acting alone could sever the tenancy inter vivos, entitling himself to one-half the property. Consequently, the value of the gift to the donee joint tenant was also equal to one-half the value of the property. On the other hand, in the case of a tenancy by the entirety, the value of the donor's retained interest varied according to the relative ages of the spouses. Because neither tenant, acting alone, could sever the tenancy, the value of a tenant by the entirety's retained interest depended on the probability that he would outlive his co-owner and survive to the entire property. For this reason, it was necessary to resort to actuarial tables[13] relating the life expectancies of the spouses.

Not only did a gift arise on the creation of a joint tenancy or tenancy by the entirety, but any additions to the value of the tenancy or reductions in indebtedness thereon would result in a second gift to the extent that

10 Lilly v. Smith, 96 F.2d 341 (7th Cir. 1938), *cert. denied*, 305 U.S. 604, *rehearing denied*, 307 U.S. 651 (1939); Gutman, 41 B.T.A. 816 (1940). The imposition of gift tax liability on the creation of a tenancy by the entirety was upheld under the law prior to 1954 despite the fact that the entire property was subject to an estate tax on the donor's death. Commissioner v. Hart, 106 F.2d 269 (3d Cir. 1939). Nor was the value of the gift reduced by the value of the widow's dower interest in the property. Hopkins v. Magruder, 34 F. Supp. 381, *aff'd*, 122 F.2d 693 (4th Cir. 1941); Correlia M. Thompson, 37 B.T.A. 793 (1938).

See also LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES 658-59 (2d ed. 1962); 4 RABKIN & JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 51.07 (1964); Bernstein, *Tax Dangers in Estates by the Entirety*, 1 MIAMI L.Q. 86, 93-94 (1947).

11. See Kimbrough, *State and Federal Taxation*, 93 TRUSTS & ESTATES 904 (1954). The taxable event occurred at the moment that control was transferred from the donor to the donee. Thus, when a husband paid the full purchase price for a conveyance of property to himself and his wife as tenants by the entirety or as joint tenants, his power over part of the whole title was considered definitely to have been destroyed by the conveyance. It was this shift in control which marked the appropriate event for the imposition of the gift tax. See 2 PAUL, FEDERAL ESTATE AND GIFT TAXATION 1100 (1942); Knecht, *Correcting Joint Property Evils*, 93 TRUSTS & ESTATES 8 (1954).

12. Treas. Reg. 108, § 86.19(h). For a comprehensive treatment of the pre-1955 law, see Kimbrough, *State and Federal Taxation*, 93 TRUSTS & ESTATES 904 (1954); Knecht, *Correcting Joint Property Evils*, 93 TRUSTS & ESTATES 8 (1954). See also MONTGOMERY, FEDERAL TAXES 21.77 (38th ed. 1961).

13. Prior to 1952, these tables could be found in Treas. Reg. 108, § 86.2(a)(6) and 86.19(f)-(h).

the consideration furnished by one of the spouses exceeded his retained interest in the property.[14]

Finally, under the pre-1955 law, a third gift was likely to arise on the termination of a tenancy whenever the proceeds of termination were received in a manner disproportionate to the interests of the tenants in the property. Thus, if joint tenants were to sell the property and distribute the proceeds, a gift would arise to the extent that one tenant received more than one-half the proceeds. A similar result would obtain on the termination of a tenancy by the entirety; in this case, however, the amount of the gift would be determined by use of the actuarially-computed retained interests of the spouses.

The gift tax rules prior to 1955 were applicable regardless of whether the property was real or personal. In two areas, however, special treatment was accorded. First, the creation of a joint bank account did not in itself give rise to a gift from the person furnishing the consideration for the account. In the case of a joint bank account (or a similar type of ownership wherein the person furnishing the consideration might regain the entire property without his co-owner's consent), the Regulations[15] provided that a gift would arise only at such time as the donee drew upon the account for his own benefit. In that event, a gift would result to the extent of the amount withdrawn.[16]

The second exception to the general gift tax rules was accorded to a person who purchased United States savings bonds with his separate property and took title thereto in joint names. In such cases, no gift arose until the donor, during his lifetime, permitted the donee to redeem the bonds and retain the proceeds of his or her separate property. In that event, a gift of the then redemption value of the bonds would be made.[17]

14 The earlier gift tax regulations did not deal specifically with the valuation of a transfer of property held in joint tenancy or by the entirety to sole ownership of one of the tenants. However, Treas. Reg. 108, § 86.2(a)(6) prescribed the method of valuing the interest which passed to the wife when her husband used separate property for a purchase in both names as tenants by the entirety. Hence, it would seem that when the property is transferred to the wife's sole ownership, the gift would be measured by the computed value of the husband's retained rights at the time of the transfer, since that is what he has given up at that time. The value of his retained rights would depend on the attained ages of the husband and wife at the time of the transfer. See Ekman, *Tax Consequences of Tenancies by the Entirety and Joint Tenancies*, N.Y.U. 13TH INST. ON FED. TAX 291 (1955); Knecht, *supra* note 12.

15. Treas. Reg. 108, § 86.2(4). The same result is provided for under the present law. Treas. Reg. § 25.2511-1(h)(4) (1958). This rule is consistent with the "transfer of control" standard which governs other forms of gifts. It is also consistent with the rules governing other transfers of jointly-held property, rather than being an exception to those rules.

16. However, in the case of withdrawal by the donee in order to purchase necessities which the donor is obligated to furnish—such as money withdrawn to pay for household expenses—no gift arises. See LOWNDES & KRAMER, *op. cit. supra* note 10, at 666. If local law treats the joint deposit as an irrevocable transfer to the donee, to the extent of one-half, a gift arises at the creation of the account and not at the time of withdrawal. *Ibid.*

17. If the bonds were not redeemed during the lifetime of the donor, they would be

IV. SECTION 2515—A PARTIAL REPRIEVE

Despite the relative simplicity of the gift tax law concerning joint ownership prior to 1955, one basic truth was painfully apparent: almost without exception the taxpayer was oblivious to the law. Ignorant of the fact that a gift tax might be payable following the creation of, addition to or termination of a joint tenancy or tenancy by the entirety, taxpayers with almost perfect unanimity neglected to file gift tax returns.[18] In the face of wholesale noncompliance, the Congress was impelled to take action.

The legislative history of what later became section 2515 of the Internal Revenue Code of 1954 is scanty, and the reasons for its enactment must be left, for the most part, to speculation. Probably the most powerful motivating force for its enactment was the fact that many couples had elected—and probably would continue to elect—to purchase their homes in joint ownership without the intention of making a gift at the time of purchase.[19] Moreover, since transferee liability for the gift tax might arise in the case of a transfer subsequent to the creation of a joint tenancy or tenancy by the entirety, serious problems were presented for the title searcher. Finally, as Joseph Trachtman remarked, it may have been the intent of Congress to educate the public and thereby make "honest men out of such unwitting tax violators."[20] As it will be pointed out, however, it is questionable whether the new provision has made the taxpayer any more aware of his gift tax obligations, or whether it has merely postponed his violation to a future date.

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includible in his gross estate at their full redemption value. Mimeo No. 5202, 1941-2 CUM. BULL. 241. The same result obtains under the present law. Treas. Reg. § 25.2511-1(h)(4) (1958).

If, however, a person purchases a United States savings bond and has it made payable to himself or to a named beneficiary on his death, there is no taxable gift, since during his lifetime the purchaser has not parted with the bond. Although there will be a transfer at his death, it is dealt with by the estate tax. LOWNDES & KRAMER, *op. cit. supra* note 10, at 667-68. Thus, once again the tax consequences are dictated by property law considerations of "control."

18. See Ekman, *supra* note 14.

19. House Report, U.S. CODE CONG. & AD. NEWS 4120-21 (1954):

> Under present law the creation of a tenancy by the entirety may result in a gift from one spouse to other [*sic*] at the time the tenancy is created. Moreover, the termination of the tenancy may also constitute a gift unless the proceeds are divided between the husband and wife. Frequently, real property is held in a tenancy by the entirety to insure the right of survivorship in the surviving spouse. 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 by the entirety or any knowledge that they are considered as having done so. (Emphasis added.)

It is particularly noteworthy that all of the cases in which the imposition of the gift tax was upheld prior to 1954 involved the creation of either a joint tenancy or tenancy by the entirety in the *family residence*. See cases cited at note 10 *supra*.

20 TRACHTMAN, ESTATE PLANNING 176 (P.L.I. ed. 1964). *But see* Lawler, *Joint Tenancy and the Federal Estate Tax Law*, 101 TRUSTS & ESTATES 1038, 1039 (1962): "In net effect, Section 2515 merely replaced a gift tax 'sleeper' with a later and deeper 'sleeper.'"

In substance, section 2515 of the Internal Revenue Code of 1954 provides the following:

> (1) The creation of a tenancy by the entirety after December 31, 1954, in real property and between husband and wife, or the additions in value thereto or reductions in indebtedness thereon, will not be deemed a transfer subject to a gift tax regardless of the proportion of consideration furnished by the spouses unless the donor spouse *elects* to treat the transfer as a gift for federal gift tax purposes.[21]
>
> (2) However, when there is a termination of the tenancy *other than by reason of the death of either spouse,* and the donor spouse did not elect to treat the creation of the tenancy as a gift, then there will be a gift to the extent that the proceeds of termination received by the spouses are not in exact proportion to the consideration furnished by them during the existence of the tenancy.[22]
>
> (3) The election at the time of creation, or at the time of additions to value or reductions in indebtedness, to the extent that such transfers will be treated as gifts, is made by filing a gift tax return in the calendar year in which the creation of or additions to the tenancy arose, regardless of whether the gift exceeds the annual exclusion of section 2503(b).[23]
>
> (4) For purposes of section 2515, the term tenancy by the entirety includes a joint tenancy with right of survivorship between husband and wife.[24]

Before embarking on an exploration of the minute corners of section 2515, it is necessary to define its broad contours. By its terms, the statute is rendered operative only in the case of a tenancy by the entirety or joint tenancy between husband and wife. Second, it applies only to such tenancies created in real property. Finally, section 2515 is not applicable unless the tenancy in realty between spouses has been created after December 31, 1954. Thus, tenancies in personalty regardless of the co-owners, tenancies in realty between non-spouses, tenancies in

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21. INT. REV. CODE OF 1954, § 2515(a).

22. INT. REV. CODE OF 1954, § 2515(b). Termination of the tenancy by reason of the death of one of the tenants is not treated as a termination, because any transfer at that time would be testamentary in nature and taxed under the applicable estate tax provision of section 2040. See LOWNDES & KRAMER, *op. cit. supra* note 10, at 663.

23. INT. REV. CODE OF 1954, § 2515(c).

24. INT. REV. CODE OF 1954, § 2515(d). The original House version of the bill did not include this provision. It was added by Senate Amendment No. 280, because:

> Many states do not recognize a tenancy by the entirety but do allow husband and wife to hold property as joint tenants with right of survivorship. In order to make the benefits of this section applicable to all taxpayers, your committee has expanded the House provisions to include joint tenancies in real property between husband and wife with right of survivorship. U.S. CODE CONG. & AD. NEWS 4762 (1954).

See also S. REP. No. 1622, 83d Cong., 2d Sess. 481 (1954), where the amendment to the House bill is reported by the Senate.

realty between husband and wife created prior to 1955 and tenancies in common—regardless of co-ownership, type of property or time of creation—will be subject to the prior law.[25]

Inasmuch as the Code provides that a donor spouse may elect gift tax consequences to be incurred upon the creation of a joint tenancy or tenancy by the entirety, the over-all picture of multiple taxable events still exists, at least as a possibility, and it thereby becomes necessary to consider gift taxation at both the creation and termination of the tenancy.

A. *The Election Exercised—Gift on Creation of the Tenancy*

As pointed out previously, prior to 1955 a gift arose on the creation of a joint tenancy or tenancy by the entirety to the extent the consideration furnished by either spouse exceeded the value of the rights retained by that spouse. The most striking change wrought by the 1954 Code lies in this area, for by virtue of section 2515(a) the creation of such tenancies in reality gives rise to a taxable gift only in the event that the donor elects to have it so treated. As the only significant difficulties in this area concern the determination of the amount of consideration furnished, the value of the donor's retained interest and the manner by which the election is exercised, these will be discussed separately.

1. CONSIDERATION

In general, the consideration furnished by a person is the amount contributed by him in connection with the creation of or additions in value to a joint tenancy or tenancy by the entirety. Either spouse may furnish the contribution, or it may be furnished by a third party; it may be supplied in the form of money, other property or an interest in property.[26] When the consideration is furnished in the form of other property or an interest in property, the amount of the contribution is equal to the fair market value of the property at the time of the contribution, rather than the transferor's cost or basis.[27] The same principle applies whether the contributed property was the property transferred to husband and wife jointly or was exchanged for the property held by husband and wife.

One area in which a problem is likely to arise—characterization of consideration derived from third party sources—is clarified by the Regu-

25. An attempt was made to have the provisions of § 2515 apply to personal property as well as to realty, but it was unsuccessful—apparently because a number of states do not recognize a tenancy by the entirety in personal property. ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK, COMMITTEE ON TAXATION, FIRST REPORT ON H.R. 8300, at 73 (1954).

26. Treas. Reg. § 25.2515-1(c)(1)(i) (1958). For a discussion of the allocation of consideration under the Regulations, see Tomlinson, *Gift Tax Aspects of Entireties*, 98 TRUSTS & ESTATES 895 (1959); see also LOWNDES & KRAMER, *op. cit. supra* note 10, at 661-62.

27 Treas. Reg. § 25.2515-1(c)(1)(i) (1958).

lations. Whether consideration so derived is deemed to have been furnished by the third person or by the spouses is made to depend on the terms under which the transfer is made. Thus, if a decedent devises real property to the spouses as tenants by the entirety, it is the decedent and not the spouses who has furnished the consideration for the creation of the tenancy. The same result obtains when the decedent by his will directs his executor to discharge an indebtedness on the tenancy owned by the spouses; in such event it is the decedent who has furnished the consideration for the addition in value. However, if the decedent has bequeathed a general legacy to the spouses, which they in turn apply to discharge an indebtedness, the spouses and not the decedent will be treated as the persons who have furnished the consideration for the additions in value to the tenancy.[28] The above principles are applicable equally in the case of inter vivos transfers made by third persons.

Problems involving the attribution of consideration may also arise when a tenancy is terminated in part. This occurs when a portion of the tenancy property is sold to a third party, or when the original property is disposed of and in its place there is substituted other property of lesser value acquired through reinvestment.[29] In the event of a partial termination, the proportionate contribution of each co-owner to the remaining tenancy will be generally the same as his proportionate contribution to the original tenancy. Once these proportions are ascertained, they are applied to the cost of the remaining or substituted property. Thus, if property originally purchased for $100,000 by contributions from husband and wife of $60,000 and $40,000 respectively, is sold for $100,000, and $50,000 is reinvested in an identical tenancy, the consideration for the new tenancy will be allocated $30,000 to the husband and $20,000 to the wife. The Regulations[30] provide an exception, however, when it can be shown that a disproportionate part of the consideration originally furnished was attributable to the fraction of the property sold. In such cases it is necessary to allocate the contribution between the portion sold and the portion remaining in co-ownership to reflect properly the consideration attributable to the unsold portion.

The Regulations adopt a rather novel approach to the question of appreciation in value resulting from changes in market value between two successive contribution dates.[31] This type of fluctuation is termed "gen-

28. Treas Reg. § 25.2515-1(c)(1)(ii) (1958).

29. Treas. Reg. § 25.2515-1(c)(1)(iii) (1958). As to what constitutes a reinvestment, see Treas. Reg. § 25.2515-1(d)(2)(ii) (1958) and the text accompanying notes 51 through 53 *infra*.

30. Treas. Reg. § 25.2515-1(c)(1)(iii) (1958).

31. The Regulations define "successive contribution dates" as the two consecutive dates on which any contributions to the tenancy are made, although not necessarily by the same party. Any appreciation allocable to a specific contribution date will fall into the same class of consideration as the prior consideration to which it relates. Treas Reg. § 25.2515-1(c)(2) (1958).

eral appreciation." If the general appreciation can be measured readily, and can be allocated with reasonable certainty to a particular contribution previously furnished, it will be treated as if it were additional consideration furnished by the person furnishing the prior consideration. General depreciation is treated in the same manner.[32] Two simple illustrations will serve to demonstrate the application of these principles:

> *Example 1.* In 1950 *H* purchases real property for $20,000 and has title transferred to himself and *W*, his wife, as tenants by the entirety. In 1957 the property has appreciated in value to $50,000, at which time *W* makes improvements to the property in the amount of $10,000. In 1958 the property is sold for $60,000. The $30,000 general appreciation is attributable to the original $20,000 consideration furnished by *H*.
>
> *Example 2.* In 1955 *H* and *W* purchase property conveyed to them as tenants by the entirety. Of the $25,000 purchase price, *H* and *W* furnish $15,000 and $10,000 respectively. In 1960, when the fair market value of the property is $30,000, *W* makes improvements worth $10,000. In 1962, the property is sold for $40,000. The general appreciation in value of $5,000 results in an additional contribution by H of $3,000 (15,000/25,000 × 5,000) and by *W* of $2,000 (10,000/25,000 × 5,000). *H*'s total contribution, therefore, is $18,000 (15,000 + 3,000). *W*'s total contribution is $22,000 (10,000 + 2,000 + 10,000).

However, when the appreciation is very gradual and the contributions are so numerous that the amount allocable to a particular contribution cannnot be ascertained with reasonable certainty, the appreciation in value will be disregarded in determining the respective amounts of consideration furnished. Such a situation is most likely to exist when, for example, a mortgage on the property is discharged in monthly installments over a period of many years, while at the same time the value of the property is slowly appreciating.[33]

2. VALUE OF THE DONOR'S RETAINED INTEREST

In the event that the donor spouse decides to exercise his election to treat the creation of the tenancy as a gift, the amount of the gift at that time is equal to the amount of his contribution to the tenancy less the value of his retained interest.[34]

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32. Treas Reg. § 25.2515-1(c)(2) (1958).

33. Treas Reg. § 25.2515-1(c)(2) (1958). Tomlinson suggests, however, that an extension of the "general appreciation" concept to more complicated cases may, in many instances, bring about a shift of consideration between the parties which will have an effect on gift valuations. Tomlinson, *supra* note 26.

34. Treas. Reg. 25.2515-2(b) (1958). Note that this result is identical with the law prior to 1955. The computations will not be the same in the case of tenancies by the entirety, however, since previous to 1952 different actuarial tables were used. See Ringel, *Federal Estate and Gift Tax Treatment of Tenancies by the Entirety in Florida*, 38 FLA. B.J. 122 (1964).

In this connection, the tax treatment of a gift at creation will differ according to the differences in local law between a joint tenancy and tenancy by the entirety. Thus, if under local law either party acting alone is able to bring about a termination of his or her interest in the property and destroy the right of survivorship in the other—in short, the case of a traditional joint tenancy—then the value of the donor's retained interest is always equal to one-half the value of the property.[35] If, on the other hand, local law permits each spouse to share in the income and enjoyment of the property but prohibits either spouse from acting alone to defeat the right of survivorship in the other—the usual case of a tenancy by the entirety[36]—then the amount of the donor's retained interest must be computed by use of actuarial factors[37] which reflect the attained ages of the spouses at the time the transaction is effected.[38]

The reason for such divergent treatment should be obvious. If the tenancy is severable at any time by one of the spouses acting unilaterally, he or she will always retain—in actuality as well as in theory—a one-half interest in the property, regardless of the respective ages of the spouses. To demonstrate by hyperbole, assume the case of the octogenarian and his twenty-one year old bride. If they own property as joint tenants and not as tenants by the entirety, despite the fact that the husband's chances of outliving his wife are minuscule, he nevertheless may sever the tenancy tomorrow and destroy his wife's right to survive to the entire property upon his death. If, on the other hand, the spouses hold title as tenants by the entirety, the husband may not sever the tenancy and his interest in the property is only the value of his chances to outlive his wife. Here then, each spouse has merely a contingent right to the entire property, the present value of which must be computed on the basis of life expectancies.

In order to determine the value of the donor's retained interest, the actuarial factor representing the relative ages of the spouses must be

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

36. In Florida, neither spouse acting alone can sever a tenancy by the entirety. Andrews v. Andrews, 155 Fla. 654, 21 So.2d 205 (1945); Bailey v. Smith, 89 Fla. 303, 103 So. 833 (1925). Income from property held by the entirety is also deemed to be the property of the husband and wife equally. See Dodson v. National Title Ins. Co., 159 Fla. 371, 31 So.2d 402 (1947); Ohio Butterine Co. v. Hargrave, 79 Fla. 458, 84 So. 376 (1920). Neither spouse acting alone can defeat the other spouse's right of survivorship in the whole property. Bailey v. Smith, *supra*.

For an excellent analysis of § 2515 and its application under Florida property law concepts, see Ringel, *Federal Estate and Gift Tax Treatment of Tenancies by the Entirety in Florida*, 38 FLA. B.J. 122 (1964). See also BOYER, *op. cit. supra* note 4, at 439-47.

37. These appear in Table IX of the Internal Revenue Service booklet entitled "Actuarial Tables for Estate and Gift Taxes," IR-Mimeo. No. 54-188, reproduced in 2 CCH FED. EST. & GIFT TAX REP. 7055-57. However, Table IX applies only when each spouse is entitled to one-half the rents and profits from the property. Where local law holds that the husband is entitled to all the use and income from the property under a tenancy by the entirety, Table XI cannot be used. In such cases, Chapter VI of the booklet explains the method and proper tables to employ.

38. Treas. Reg. § 25.2515-2(b)(2) (1958).

multiplied by the value of the entire property. By way of illustration, suppose that with his own funds *H* purchases property for $100,000 and has title conveyed to himself and his wife, *W*, as tenants by the entirety. At this time *H* is 46 and *W* is 40 years of age, and *H* elects to treat the transfer as a gift pursuant to section 2515(a). The appropriate actuarial factor for the attained ages of the spouses is .43908, and the value of *H*'s retained interest is therefore $43,908 (.43908 × $100,000). *H* has made a gift to *W* of $56,092 ($100,000 — $43,908) disregarding the annual exclusion,[39] lifetime specific exemption[40] and the gift tax marital deduction.[41] Note, however, that had the transfer been to husband and wife as joint tenants and not as tenants by the entirety, the value of *H*'s retained interest in the example above would have been equal to one-half the value of the property, or $50,000, and a gift in the same amount would have resulted.

3. MANNER OF ELECTION

Ever since the Revenue Act of 1932, gift tax returns have been required for any year in which there were gifts of present interests in property to any one person during any one calendar year of a value more than the annual exclusion,[42] and for gifts of a future interest in property regardless of the value of the interest.

Section 2515(c) provides that the election to treat the creation of or addition in value to a joint tenancy or tenancy by the entirety in real property is exercised by including the value of such gifts in the donor's gift tax return for the calendar year in which the tenancy was created or the additions in value to the property were made.[43] In order to exercise the election, a gift tax return must be filed, *regardless* of the fact that the amount of the gift does not exceed the annual exclusion under section 2503(b).[44] The importance of filing the gift tax return cannot be overemphasized, since by failing to do so the donor is prevented later from exercising the election. As will be seen later,[45] there are specific instances when substantial tax savings may be effected by exercising the election under section 2515(a).

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39. INT. REV. CODE OF 1954, § 2503(b).

40. INT. REV. CODE OF 1954, § 2521.

41. INT. REV. CODE OF 1954, § 2523(d). See also Treas. Reg. § 25.2515-2(d) (1958); Tomlinson, *Gift Tax Aspects of Entireties*, 98 TRUSTS & ESTATES 895 (1959). For an explanation of the gift tax marital deduction as it relates to joint ownership, see 4 RABKIN & JOHNSON, *op. cit. supra* note 10; LOWNDES & KRAMER, *op. cit. supra* note 10, at 666.

42. Since 1943 the annual exclusion has been $3,000; from 1939 to 1942 it was $4,000; prior to 1939 it was $5,000.

43. See also Treas. Reg. § 25.2515-2(a) (1958).

44. INT. REV. CODE OF 1954, § 2515(c); Treas. Reg. § 25.2515-2(a) (1958). The need for gift tax returns is discussed in Ringel, *supra* note 34. It is important to note that the ordinary procedure for filing back returns is not available for gifts of real property after 1954, since by failing to file a timely return the taxpayer is precluded from doing so under the elective procedure. See Ringel, *supra*.

45. See Section V of this article's text *infra*.

B. *Gift on Termination of the Tenancy*

Section 2515(b) provides that on the termination of a joint tenancy or tenancy by the entirety other than by the death of one of the spouses, there will be a gift to the extent that the proportion of the total consideration furnished by a spouse multiplied by the proceeds of termination exceeds the value of such proceeds of termination received by such spouse. It should be noted at the very outset that a gift on termination may result notwithstanding the fact that the contribution of either spouse was elected for gift treatment under section 2515(a).[46]

1. HAS THERE BEEN A TERMINATION?

Since section 2515(b) has shifted the impact of the gift tax to the termination of the tenancy, it is important to ascertain at what moment the tenancy has been terminated. In general, a termination takes place when the entire tenancy or a portion thereof is disposed of or changed in any manner prior to the death of either of the spouses. A "disposition" for these purposes includes a sale, exchange or other disposition, a conveyance by the spouses to themselves as tenants in common, or any other alteration in the nature of their respective interests in the property formerly held by them as joint tenants or tenants by the entirety.[47]

Similarly, an increase in the indebtedness on property held in tenancy by the entireties will be deemed a termination to the extent of the increase in indebtedness, and to the extent the increase is not offset by additions to the tenancy within a reasonable time after the increase.[48] In other words, if the property is mortgaged to finance additions or improvements to the property, a termination will not occur so as to require the imposition of a gift tax at that time. However, to avoid the possibility of accounting for the same contribution more than once, the additions to the property, to the extent of the increase in indebtedness, may not be treated as additional contribution by the spouses.[49]

As hinted at previously, an exchange will be treated as a disposition effecting a termination of the tenancy. The Regulations, however, provide an exception when the property subject to the tenancy is exchanged for other real property, the title to which is held by the spouses in an *identical* tenancy.[50] A tenancy is considered "identical" if the proportionate values of the respective rights of the spouses are identical to those in the property exchanged.

A further exception to the general rule that a sale or other disposition constitutes a termination exists when the sale, exchange or other disposi-

46. Treas. Reg. § 25.2515-1(d)(1) (1958).
47. Treas. Reg. § 25.2515-1(d)(2)(i) (1958).
48. Treas. Reg. § 25.2515-1(d)(2)(i) (1958).
49. Treas. Reg. § 25.2515-1(d)(2)(i) (1958).
50. Treas. Reg. § 25.2515-1(d)(2)(ii) (1958).

tion is followed by a *reinvestment* in other property by the entirety. But in order to preclude a finding that a termination has occurred the following three conditions—all of which must be met—are imposed on the reinvestment:

(1) There must be no division of the proceeds of the sale or other disposition;[51]

(2) On or before the date for filing a gift tax return for the year in which the property is sold the spouses must have entered into a binding contract for the purchase of other property;[52] and

(3) After the sale or other disposition, and within a reasonable time after the contract referred to in (2) has been entered into, such other real property must actually be acquired and held by the spouses in an identical tenancy.[53]

2. PROCEEDS OF TERMINATION

The proceeds of termination may be in the form of money, property or an interest in property. When the proceeds constitute property or an interest in property, the value will be measured by the fair market value on the date of termination of the property or property interest in question.[54] If a tenancy by the entirety is terminated in favor of a tenancy in common between the spouses, the proceeds of termination received by each spouse will be the value of one-half the property at the date of termination.

There is an area likely to cause unintended tax consequences to the unwary, namely, the termination of a tenancy and a gift of the proceeds to a third person. The Regulations provide that if, under local law, a tenancy may be severed without the consent of the other (the joint tenancy situation), and if one of the tenants does so and makes a gift of his or her interest to a third person, two gifts may result—a gift to the spouse upon termination of the tenancy, and a second gift of the proceeds of termination to the third person.[55] However, when both spouses join in making to a third person a gift of property held by them as tenants by the entirety, the value of the proceeds considered to be received by each will be determined by the amount each spouse reports on his or her gift tax return.[56] The reason for this unusual treatment may be found in section

51. Treas. Reg. § 25.2515-1(d)(2)(ii)(a) (1958). However, the fact that as a matter of convenience the proceeds of sale are deposited in the name of one or both tenants separately or jointly does not violate this provision.

52. Treas. Reg. § 25.2515-1(d)(2)(ii)(b) (1958).

53. Treas. Reg. § 25.2515-1(d)(2)(ii)(c) (1958). For purposes of this subdivision, the Regulations provide that a "reasonable time" is an amount of time which, according to the facts involved in a particular case, may be needed for those matters incident to the acquisition of another property, such as the time required for the perfecting of title, arrangement for financing, and construction.

54. Treas. Reg. § 25.2515-1(d)(3)(i) (1958).

55. Treas. Reg. § 25.2515-1(d)(3)(i) (1958).

56. Treas. Reg. § 25.2515-1(d)(3)(i) (1958).

2515(b), which contemplates that the spouses may, on termination, divide the proceeds in a manner unrelated to their respective legal interests in the property. However, any gift tax savings effected by apportioning between the spouses the amount of the gift to a third person would appear to be nullified by a gift *between spouses* which would arise from a termination disproportionate to the original ratio of consideration furnished by the spouses.

3. COMPUTATION OF THE GIFT

Any time after December 31, 1954, when the election under section 2515(a) is not exercised by the donor spouse, there may be a gift upon termination of the tenancy whenever the proceeds of termination are divided in a ratio different from the ratio of consideration furnished by the spouses at the creation of the tenancy. Thus, is each spouse had furnished one-half the consideration, any unequal distribution of the proceeds of termination will result in a gift from the spouse receiving less than half the proceeds to the spouse receiving the larger share. Or, if one spouse had furnished the entire consideration for the creation of the tenancy, there will be a taxable gift at termination to the extent that the non-contributing spouse receives any portion of the proceeds of termination. Although these rules apply both to joint tenancies and tenancies by the entirety regardless of the ages of the spouses, they do not apply unless the entire consideration for the creation of or addition to the tenancy was furnished *solely by the spouses*.[57]

In order to compute the value of the gift at termination, it is necessary first to determine the share of the proceeds of each spouse attributable to the consideration he or she furnished. This if found by multiplying the total proceeds of termination by the percentage of consideration contributed by the spouse. The resulting figure defines and delimits the amount of the proceeds of termination which that spouse may receive without a gift arising. Any proceeds received in excess of that amount will result in a gift to the extent of the excess. For example, assume that in 1957 realty is purchased by *H* and *W* for $100,000, and that *H* and *W* contributed $70,000 and $30,000, respectively. In 1960 the property is sold for $200,000 and the proceeds are divided equally. *H* has made a gift to *W* in the amount of $40,000, computed as follows:

$$\frac{\$\ 70{,}000 \text{ (consideration furnished by } H \text{ alone)}}{\$100{,}000 \text{ (total consideration furnished)}} \times \$200{,}000$$

$$= \$140{,}000 \text{ (share to which } H \text{ is entitled)}$$

$$\$140{,}000 - \$100{,}000 \text{ (proceeds received by } H)$$

$$= \$\ 40{,}000 \text{ (amount of gift from } H \text{ to } W).[58]$$

57. Treas. Reg. § 25.2515-3(a)(2) (1958).

58. See also Treas. Reg. § 25.2515-3(c) *Example* (*1*) (1958). A similar example was suggested by the Senate Committee. S. REP. No. 1622, 83d Cong., 2d Sess. 481 (1954).

Note that in the above example, had *H* received a portion of the proceeds of termination in an amount greater than $140,000, he would have received a gift from *W* to the extent of the excess.

The same principles are applicable when a tenancy is terminated in part only. The only difference is that the percentage of contribution by the donor spouse will be multiplied by the proceeds of the partial termination, and the amount of gift will be determined by subtracting from that amount the value of the proceeds received by the donor spouse.[59] As to the portion of the property remaining in joint tenancy or tenancy by the entirety, the ratio established by the original contributions of each spouse will govern the portion of the tenancy not terminated in order to determine the amount of consideration furnished for the remaining tenancy.

4. GIFT ON TERMINATION WHEN CREATION WAS TREATED AS A GIFT OR WHEN CONSIDERATION WAS FURNISHED BY A THIRD PERSON

As mentioned previously, the fact that the donor has exercised his election under section 2515(a) to treat the creation of the tenancy as a gift will not, in itself, preclude a later finding of a second gift as the result of the termination of the tenancy. However, the rules which govern the computation of the amount of gift when there has been no previous election or when the consideration has been furnished solely by the spouses do not apply when there has been an election to treat the creation of the tenancy as a gift or when all or part of the consideration for the creation of the tenancy has been furnished by a third person.

If the entire consideration for the creation of the tenancy was treated as a gift under section 2515(a), or if it was contributed by a third person, a gift will arise to one of the spouses to the extent that his or her retained interest in the property is exceeded by the proceeds of termination received by such spouse.[60] In the case of a joint tenancy, the retained interest of each spouse is equal to one-half the value of the property. In the case of a tenancy by the entirety, actuarial factors similar to those used to compute a spouse's retained interest for the purpose of determining the existence of a gift upon the creation of a tenancy will be used to determine the value of the gift on termination, except that the attained ages of the spouses on termination will be used. The application of these principles may be illustrated by the following example:

> *H* furnishes the entire consideration of $100,000 for the creation of a tenancy by the entirety in the names of *H* and *W*. The creation of the tenancy is treated as a gift (either because the donor elected to do so after December 31, 1954 or because the tenancy was created prior to that time). In 1964, when *H* is 55 and *W* is

59. For an example of the operation of this principle, see Treas. Reg. § 25.2515-3(c) *Example* (2) (1958).

60. Treas. Reg. § 25.2515-4(b) (1958).

48 years of age, the property is sold for $200,000 and the proceeds distributed equally. The appropriate actuarial factor is .41285. Therefore, the value of *H*'s retained interest is $82,570 (200,000 × .41285). In this case, *W* has made a gift to *H* in the amount of $17,430, or $100,000 (amount received by *H* at termination) — $82,570 (value of *H*'s retained interest).

The problem of computation becomes increasingly complex as the type of consideration furnished becomes mixed. In order to compute the amount of the gift which arises upon the termination of a tenancy for which two types of consideration have been furnished, it is necessary first to separate the total consideration furnished into two distinct types: (1) that furnished solely by the spouses and not treated as a gift, and (2) that furnished by a third person or furnished by the spouses and treated as a gift. The value of the gift then may be computed according to the following steps:[61]

(a) By finding the ratio of Type (1) consideration to the total consideration furnished and multiplying this fraction by the proceeds of termination. This amount represents the portion of the proceeds of termination attributable to the consideration furnished solely by the spouses and not treated as a gift in the year of creation;

(b) By multiplying the amount arrived at in (a) above by the proportion of Type (1) consideration furnished by one of the spouses. This represents the portion of the proceeds of termination attributable to Type (1) consideration furnished by one of the spouses;

(c) By subtracting from the total proceeds of termination the portion of the proceeds attributable to Type (1) consideration, *i.e.*, (a) above. This represents the proceeds attributable to Type (2) consideration;

(d) By multiplying (c) above by the appropriate actuarial factor representing the spouse's retained interest and by adding the product to the result of the calculation under step (b) above. This figure represents the interest of that spouse in the proceeds of termination attributable to both types of consideration furnished.

(e) From the sum produced by step (d) above is subtracted the amount of the proceeds of termination received by the spouse. This figure represents the value of the gift from one spouse to the other.

The application of the above principles may be illustrated as follows:

61. The various levels of computation are set forth in more or less obscure detail in Treas. Reg. §§ 25.2515-4(c)to-(d) (1958). The explanation given by this writer in the text is an attempt to clarify and simplify the treatment under the Regulations.

Assume that in 1950 *D* died, devising realty worth $100,000 to *H* and *W* as tenants by the entirety. In 1955, when the market value of the property was still $100,000, improvements in the amount of $50,000 were made, for which *H* and *W* furnished $40,000 and $10,000 consideration, respectively. The addition was not treated as a gift by *H*. In 1964 the property is sold for $300,000 and the proceeds divided equally between *H* and *W*. At this time *H* and *W* are 46 and 40 years of age respectively. The value of the gift made by *H* to *W* is $17,816, computed as follows:

(a) $ 50,000 (Type (1) consideration)
$150,000 (Total consideration) = $100,000 × $300,000 (proceeds of termination)

(b) $ 40,000 (Type (1) consideration furnished by *H*)
$ 50,000 (Total Type (1) consideration) = $ 80,000 × 100,000

(c) $300,000 (Total proceeds of termination)
—100,000 (Proceeds attributable to Type (1) consideration)
$200,000 (Proceeds attributable to Type (2) consideration)

(d) $200,000 × .43908 = $ 87,816 (*H*'s retained interest in the proceeds)
$ 87,816 (*H*'s retained interest)
80,000 (*H*'s portion of proceeds attributable to Type (1) consideration)
$167,816 (Proceeds to which *H* is entitled)

(e) $167,816
—150,000 (proceeds actually received by *H*)
$ 17,816 (amount of gift from *H* to *W*)[62]

The same sequence of computations would be used in the case of a joint tenancy, except that a factor of one-half would be substituted in the above example in place of the actuarial factor.

C. *Caveat: The Taxable Divorce*

Although neither the Code nor the Regulations make specific reference to it, probably the most frequently occurring taxable "termination" is brought about when a tenancy by the entirety is "converted" to a tenancy in common as the result of a *divorce*. Since the tenancy by the entirety owes its existence to the presence of the fifth unity of marriage, whenever that unity ceases to exist the tenancy by the entirety is automatically terminated. Under general principles of property law, the

62. This example appears, with slight modifications, in the Regulations. Treas. Reg. § 25.2515-4(d) (1958).

former spouses will hold the property as tenants in common following a divorce.[63] The Regulations promulgated under section 2515 provide expressly that when a tenancy by the entirety is terminated so that thereafter each spouse owns an undivided one-half interest as tenant in common, each spouse will be deemed to have received an amount equal to one-half the value of the property at the time the tenancy is terminated.[64] Thus, when the creation of the tenancy was not treated as a gift under section 2515(a) and the consideration for the property's acquisition was not furnished equally by the spouses, a gift will result upon the "conversion" into a tenancy in common upon divorce.[65]

If, on the other hand, the election under section 2515(a) had been exercised at the time the property was acquired or when additions in value or reductions in indebtedness were made with respect to the property, no further gift tax liability will be incurred at the time the spouses are divorced, except to the extent their ages differ. This result is consistent with the prior law.[66] Indeed, perhaps the apparent nonchalance of many attorneys to the possibility of gift tax liability upon divorce stems from the fact that the prior law was so clearly to the effect that no gift was made between spouses when a tenancy by the entirety was severed in favor of a tenancy in common. The reason for this treatment under the prior law may be found in the fact that prior to 1955 it was the creation of the tenancy which met with a gift tax; consequently, upon the termination of the tenancy by the entirety a gift would result only when the ages of the spouses were not the same. With the advent of the elective procedure under the 1954 Code, however, the tax burden was shifted from the creation to the termination of the tenancy, negating the reason for the previous rule.

Further, in view of the clear language of the Regulations, there

63. The Florida statute is fairly representative of this basic rule. FLA. STAT. § 689.15 (1963). See also Quick v. Leatherman, 96 So.2d 136 (Fla. 1957); Reid v. Reid, 68 So.2d 821 (Fla. 1953); Valentine v. Valentine, 45 So.2d 885 (Fla. 1950); Andrews v. Andrews, 155 Fla. 654, 21 So.2d 205 (1945).

64. Treas. Reg. § 25.2515-1(d)(3)(i) (1958). There is also general language to the effect that a termination of the tenancy is effected when the spouses, through *any form of conveyance or agreement,* become tenants in common of the property. Treas. Reg § 25.2515-1(d)(2)(i) (1958).

65. The computation of the gift is treated in section IV(B)(3) of this article's text *supra.*

66. Special Ruling, October 1, 1948, 1 CCH FED. EST. & GIFT TAX REP. ¶ 3200.915 provides:

> The conversion of a tenancy by the entirety into a tenancy in common is not a taxable gift, if the spouses are the same age. If their ages differ, the transfer is taxable as a gift from the younger to the older to the extent of the value of the rights of the younger under the tenancy by the entirety less one-half the value of the property. The valuations are based on the Actuaries' or Combined Experience Table of Mortality.

The same conclusion was suggested in cases involving the estate taxation of gifts in contemplation of death, where it was necessary again to determine whether a "gift" was made upon the "conversion" into a tenancy in common. Rickenberg v. Commissioner, 177 F.2d 114 (9th Cir.), *cert. denied,* 338 U.S. 949 (1949); Sullivan's Estate v. Commissioner, 175 F.2d 657 (9th Cir. 1949).

would appear to be no reason to suspect that a conversion into a tenancy in common via the divorce route should receive, or was intended by the Service to receive, a treatment any different from that which is involved in an amicable conversion into a tenancy in common—a termination which clearly involves a transfer for gift tax purposes.

It should be noted that what is involved is more than simply the gift tax liability of the donor spouse. To the extent that transferee liability[67] may attach to the donee and subsequent purchasers, the problem becomes less parochial and the title examiner's job waxes more complicated. Therefore, whenever a post-1954 purchase of property by the entirety and a divorce appear in the chain of title, the possibility of a federal gift tax lien should be considered.

On the other hand, it seems equally clear that a second taxable gift does not occur when the husband's half of the newly-created tenancy in common is transferred to his former wife as lump sum alimony, either pursuant to an agreement or decree of the divorce court. Section 2516 exempts from the domain of the gift tax a transfer of property or of an interest in property made under the terms of a written agreement between the spouses in settlement of their marital rights or to provide a reasonable support allowance for the issue of their marriage, provided that a divorce in fact occurs within two years after the agreement is executed. However, it is not necessary that such an agreement be incorporated into the divorce decree or that the transfers exempted under the statute be made within any time limit,[68] as long as the divorce itself occurs within two years after the execution of the agreement.

Even in the absence of a previous agreement, when the husband transfers his half of the new tenancy in common to the wife as lump sum alimony pursuant only to the decree of divorce, the transfer is held to be *involuntary* and hence is outside the limits of the gift tax.[69] Even when there is an agreement between the spouses which is contingent upon the entry of a decree of divorce, the transfer will be treated as involuntary and not subject to the gift tax as long as the court is vested with power to decree a settlement differing from the previous agreement.[70]

67. The donee is personally liable to the extent of the value of the gift, for the amount of gift tax unpaid by the donor for the calendar year in which the gift was made. The tax is a lien upon the gift for ten years from the time the gift was made. INT. REV. CODE OF 1954, § 6324(b). See also Ekman, *Tax Consequences of Tenancies by the Entirety and Joint Tenancies*, N.Y.U. 13TH INST. ON FED. TAX 291, 299-300 (1955).

68. LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES 658, 692 (2d ed. 1962).

69. Harris v. Commissioner, 340 U.S. 106 (1950). E.T. 19, 1946-2 CUM. BULL. 166 provides that property transfers incident to divorce or legal separation, to the extent made in satisfaction of rights of support, are made for adequate consideration and hence are not subject to the imposition of gift tax liability. For an extensive treatment of this question, see Taylor, *Effect of Property Settlements Incident to Divorce*, N.Y.U. 13TH INST. ON FED. TAX 305 (1955).

70. Commissioner v. Watson, 216 F.2d 941 (2d Cir. 1954); McMurty v. Commissioner, 203 F.2d. 659 (1st Cir. 1953), *reversing* 16 T.C. 168 (1951); Florida Nat'l Bank & Trust

Although property held by husband and wife in *joint tenancy* rather than by the entirety is not subject to the automatic "conversion" into a tenancy in common upon the divorce of the spouses, as a practical matter it is usually undesirable to continue the survivorship feature once the marriage has been dissolved. However, if by choice, the spouses decide to terminate the joint tenancy in favor of a tenancy in common, a gift will result to the same extent as in the case of a conversion of a tenancy by the entirety by operation of law. Moreover, in either case the gift tax marital deduction would be unavailable. In such situations, proper planning can insure the avoidance of gift tax consequences through a disposition of the property and division of the proceeds in exact proportion to the original contributions furnished by the spouses. Any subsequent property settlement, involving either the proceeds of termination of the joint tenancy or some other property, could then be made without incurring a gift tax on the transfer, whether pursuant to a divorce decree or an agreement satisfying the requirements of section 2516.

The same remedial steps also may be taken with respect to property held as a tenancy by the entirety. In this situation, however, gift tax consequences will be avoided only if the tenancy is destroyed *prior* to a divorce and the proceeds are divided according to the original contribution ratios, since at the moment of divorce the division automatically is made on an *equal* basis by virtue of the conversion into a tenancy in common.

It is submitted that a divorce is an event unpleasant enough in itself to need no further complication in the form of a gift tax. Therefore, it would seem incumbent upon the attorney, when he sits down with the parties to discuss the various means of effectuating a fair property settlement, to give serious consideration to the severance of any tenancies by the entirety before a divorce decree is entered.

V. SHOULD THE ELECTION BE EXERCISED?

At first glance, it would appear that section 2515(a) offers to the taxpayer an election which only a fool would choose to exercise. However, a closer examination reveals that in a few specific instances a valuable tax advantage is available in the form of the elective procedure.

Co. v. United States, 182 F. Supp. 76 (S.D. Fla. 1960); Rev. Rul. 60-160, 1960-1 CUM. BULL. 374; Rev. Rul. 54-29, 1954-1 CUM. BULL. 186. See also LOWNDES & KRAMER, *op. cit. supra* note 68, at 691. Under this view, when the court has the power to decree a different settlement from that which the spouses have provided for by their agreement, the court's adoption of the agreement is considered as an expression by it of the appropriate division of the property, rather than as the mere enforcement of the agreement. This reasoning renders the subsequent transfer an involuntary transfer pursuant to order of court, rather than a voluntary transfer pursuant to agreement. However, if the court lacks this modifying power, a division in conformity with the agreement is simply the enforcement of the agreement and not an involuntary transfer; hence, it will be taxable as a gift. See LOWNDES & KRAMER, *supra*, at 691.

In the years immediately following the enactment of section 2515, it was felt by some writers that the gift tax election was a useless provision doomed to extinction from the very beginning, and that consequently it would be ignored by the taxpayer. At least one writer[71] based his prognostication on the fact that the exercise or non-exercise of the election would have no bearing on the inclusion of the entire property in the gross estate of the donor should he die first; consequently, it was reasoned, payment of a gift tax would be a waste. This reasoning, perhaps more naive than considered, at least points out the cardinal rule governing the exercise of the election under section 2515(a): the election should *never* be exercised if husband and wife plan to continue the tenancy until one of them dies. In such a situation, it is truly a waste to choose to pay a gift tax when there is no corresponding estate tax reduction. If no election is made and later one of the spouses dies, no gift tax will be payable at any time, although an estate tax—which was inevitable even if the election had been exercised—will be forthcoming.

Further, the option to defer the taxable event would preserve some excellent tax-avoiding opportunities. If, for example, income-producing property which under local law entitles the wife to one-half of the income is transferred by the husband to himself and his wife jointly, non-exercise of the election enables the same income-splitting without gift tax consequences. Moreover, the income drained off to the wife will be hers absolutely and hence not includible in her husband's gross estate upon his death, even though the value of the income-producing property will be includible.[72]

On the other hand, there are instances when it is a distinct tax advantage to elect to treat the creation of the tenancy as a gift. One such situation occurs when the spouses contemplate a termination of the tenancy *during their lives* and a division of the proceeds at a time when the property is expected to have appreciated substantially in value. In such event, it would be desirable to exercise the election at the creation of the tenancy, whether the property is owned in joint tenancy or by the entirety. Consider the following examples:

> *Example 1.* In 1955 *H* furnishes the entire consideration of $100,000 for the purchase of Blackacre, taking title in the names of *H* and *W* as joint tenants. *H* does not elect to treat the creation as a gift. In 1964, the tenancy is terminated by a sale of the property for $300,000, and the proceeds are divided equally between *H* and *W*. *H* has made a gift to *W* of $150,000, the extent of the proceeds received by *W*, since *H* furnished the entire consideration.

71. Ekman, *supra* note 67, at 297.

72. BOWE, ESTATE PLANNING 182 (1957). See also Alexander, *Joint and Survivorship Property*, 20 OHIO ST. L.J. 75 (1959).

Example 2. Assume the same facts as in Example 1 above, except that *H* elected to treat the creation of the tenancy as a gift. At that time *H*'s retained interest was equal to one-half the value of the property, or $50,000. Therefore, at creation *H* is deemed to have made a $50,000 gift to *W* ($100,000 — $50,000). At the termination of the tenancy in 1964, *H* has received $150,000, or exactly the value of his retained interest in the property. Consequently, no further gift has been made at termination. The total gift is $50,000, as opposed to a gift of $150,000 in Example 1.

Example 3. Assume the same facts as in Example 1 except that in 1955 *H* furnishes the entire consideration and takes title in the names *H* and *W* as tenants by the entirety, with no right of severance in either spouse. In 1955, *H* is 50 years of age and *W* is 45. The consideration for the purchase was furnished solely by the spouses (in this case, by *H* alone). If no election is exercised at that time, the amount of the gift from *H* to *W* at termination equals $150,000, as in Example 1.

Example 4. Assume the same facts as in Example 3, except that instead *H* elects to treat the creation of the tenancy as a gift. The value of *H*'s retained interest in 1955 is $44,284 ($100,000 × .44284) and in that year he has made a gift to *W* of $55,716 (100,000 — 44,284). Later, when the tenancy is terminated in 1964 and each spouse receives one-half the proceeds, there will be a second gift—this time from *W* to *H*. *H*'s retained interest in 1964 is equal to $129,015 (300,000 × .43005) and the amount of the gift from *W* to *H* is $20,985 (150,000 — 129,015). The total gift between spouses at creation and termination is equal to $65,269—considerably less than the $150,000 gift when the election was not exercised.

In one other situation it will be desirable for the owner to exercise the gift tax election upon the creation of the tenancy and upon any additions in value thereto. This situation involves the purchase of property by making a small cash payment and giving back a mortgage that may be discharged in such a way as to nullify the possible gift tax liability through the use of the gift tax marital deduction and annual exclusion. This principle may be illustrated by the following example:[73]

In 1955 *H* purchases Blackacre in joint tenancy with his wife *W*, paying $12,000 cash and incurring an indebtedness of $48,000 payable at the rate of $12,000 a year. *H* furnishes the entire consideration for the original $12,000 payment and each subsequent reduction in indebtedness, and elects to treat them all as gifts to his wife of one-half, or $6,000. Five years later when the property is free and clear, it is sold to a third person for $100,000. No gift tax whatsoever would have been incurred at any time

73. BOWE, *op. cit. supra* note 72, at 182-83.

prior to termination, despite that fact that *H* exercised his election each time, since each $6,000 gift from *H* to *W* was consumed exactly by the gift tax marital deduction of $3,000 and by the $3,000 annual exclusion. On termination, there is a gift from *H* to *W* only to the extent *W* receives more than half the proceeds.

A similar, though not identical, result would obtain if the property were purchased by *H* and placed in a tenancy by the entirety, except that a slight gift would result in excess of the marital deduction and annual exclusion to the extent the ages of the spouses differed. Note, however, that in either case, if no election had been made either at the creation of the tenancy or at the subsequent reductions in indebtedness, a gift would have resulted to the extent that *W* received any portion of the proceeds of termination.

In the case of property with a higher purchase price, it may be possible to extend the indebtedness over a longer period so that each anuual reduction is no greater than $12,000. Although a larger cash payment may be required in many cases, the gift tax marital deduction will increase proportionately, minimizing to some extent the balance which is not consumed by the annual exclusion. In any event, the gift tax consequences are far less severe than they might be when the section 2515(a) election is not exercised and the gift is postponed until the termination of the tenancy.

As pointed out previously, the election is lost unless it is exercised in accordance with the procedures prescribed by section 2515(c) and the Regulations[74] thereunder. It is therefore crucial that a husband and wife be advised at the time they create the tenancy of the possible advantages of exercising the election at that time. This is especially pertinent information if the property is being purchased as a speculative venture in contemplation of a substantial appreciation in value in the future. It is the duty of the attorney, therefore, to determine at the outset the nature of the property to be purchased, the purpose of the undertaking and the future plans which the spouses entertain with respect to the property. Finally, the spouses should be made aware of the gift tax savings which may be accomplished through a farsighted plan of financing which makes the maximum use of the gift tax marital deduction and annual exclusion.

VI. Conclusion

At this point it should be apparent that if there are advantages incident to the concurrent form of ownership, they are not to be located within the confines of the Internal Revenue Code. Although the man whose entire estate is owned with his wife jointly may be able to avoid estate taxes entirely should he be "fortunate" enough not to be wealthy,

74. Treas. Reg. § 25.2515-2(a) (1958).

he may not be so fortunate when it comes time to side-step the gift taxes incurred as the result of joint ownership. And in the case of the man with an estate large enough to be subject to an estate tax, joint ownership is almost always a needless means of maximizing, rather than minimizing, the bite of estate taxes. Moreover, the estate tax burden weighs most heavily on the estate of the surviving spouse, who is left without the mitigating effect of the marital deduction. Perhaps the most fitting testimonial to the joint ownership device is the fact that in order to avoid the estate tax consequences by way of a termination of the tenancy, the reprieve is accomplished often only at the expense of a gift tax. Ironically, even when this method is chosen, purgation may be less than complete if the termination takes place within three years of the death of one of the tenants.[75]

If any generalizations may be justified, it seems safe to assert that joint ownership should be avoided unless the non-tax considerations are so weightly as to render the tax consquences trivial in comparison. Certainly, the desire to avoid probate is not alone a sufficient justification for owning property jointly, since the same result may be accomplished by other more tax-favorable devices, such as the inter vivos trust, life insurance or the family annuity. Moreover, the person who chooses joint ownership in contemplation of serious difficulties with his creditors should consider the extent to which he will compromise his loved ones after death in order to evade his enemies during his lifetime.

Clearly, the most satisfactory solution to the joint ownership problem is to avoid the problem before it arises, by choosing to own and dispose of property in some other manner. However, once the harm has been done, the most innocuous remedy from the tax point of view may be effected by transferring the property to the spouses individually in proportion to the ratio of consideration each has furnished for the acquisition of the property. This may be achieved either by a partition of the property, a sale and division of the proceeds or by conversion into a tenancy in common when each spouse has furnished the consideration equally (and in the case of tenancy by the entirety whose creation was treated as a gift, when both spouses are the same age). In the great majority of cases, this procedure will involve a transfer of the entire property or proceeds back to the husband. From this point, he may begin his estate plan anew, with an emphasis on more desirable planning vehicles.

75. This problem is beyond the present scope of this article. For an excellent appraisal of the conceptual "fork in the road" the courts appear to have reached—property law versus tax interest concepts—see Comment, 61 MICH. L. REV. 1335 (1963). See also Polasky, *Current Tax Developments, Including Joint and Widow's Election*, 103 TRUSTS & ESTATES 253 (1964); Stacy, *Joint Tenancy in Estate Planning Can Have Serious Tax Disadvantages*, 20 J. TAXATION 98 (1964); Note, 37 NOTRE DAME LAW. 430 (1962).

For a graphic demonstration of the disadvantages of joint ownership, see the cases of "Mr. and Mrs. B" and "Mr. and Mrs. C" in Doherty, *Joint Tenancy—Objectives v. Results*, 37 TRUST BULL. 9 (1958).

VII. EPILOGUE

A few potential problems still remain as the aftermath of the remedial transfers described above. First, the creation of the tenancy may have been treated as a gift and a gift tax paid—either because section 2515(a) did not apply or because the election under that section was exercised. If such is the case, the transfer of the entire property or proceeds of a sale to the husband who furnished the entire consideration results in *two* needless gifts—from husband to wife of a one-half interest and from wife to husband of the same interest—without a change of ownership in the end.

Second, if the donee wife should die within three years of the transfer back to the donor husband, there is the possibility of a transfer in contemplation of death, causing at least one-half of the value of the property —and possibly all of it[76]—to be includible in the wife's estate for federal estate tax purposes, a danger which might have been avoided by the husband's outright ownership of the property in the first instance. Although the estate tax marital deduction and credit for gift taxes paid may provide some measure of partial relief, it is clear that an unnecessary estate tax may nevertheless be incurred.

76. Because the courts have not yet decided whether the property law concept or the tax interest concept is to govern the contemplation of death problem, the amount to be includible in the wife's estate, at least when the property is held by the entirety, is open to speculation at this time. See note 75 *supra*.