Florida State University Law Review

Volume 8 | Issue 4 Article 2

Fall 1980

Federal Income Taxation of Exchanges in Partition of Commonly Owned Property: Realization vs. Realism

Jonathan D. Kaney, Jr.

FEDERAL INCOME TAXATION OF EXCHANGES IN PARTITION OF COMMONLY OWNED PROPERTY: REALIZATION VS. REALISM

JONATHAN D. KANEY JR.*

INTRODUCTION

Partition of property between common owners is a nontaxable event under a settled rule of federal income taxation.[1] Although this rule is widely known and frequently applied, the reason underlying the rule is neither well understood nor often discussed. This article analyzes authorities in this area for the purpose of discerning the latent reason underlying the rule and educing principles of general significance. The thesis of this analysis is that the cases can be explained by the fundamental statutory doctrine that gain from dealing in property is not included in gross income until it is realized. The realization doctrine explains the partition cases, and in their turn, the cases elucidate the doctrine.

The Tax Court has suggested conflicting reasons for the rule that divisions of jointly owned property are nontaxable. On the one hand, it has stated that the division of commonly owned property is not a sale or exchange.[2] On the other hand, it has stated that the division is a nonrecognition exchange.[3] Uncertainty concerning the reason for the rule creates practical difficulties for taxpayers who must predict tax consequences in analogous cases without benefit of the underlying rationale. If the reason for the rule can be clarified, the scope of the rule and the general principles which govern its application will be better understood.

The reason for the rule that divisions of jointly owned property are nontaxable is examined in Part I and implications of the rule when rationalized by the realization doctrine are explored in Part II.

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* LL.M. (taxation) 1979, University of Florida; J.D. 1969, Florida State University College of Law. Member of The Florida Bar. Mr. Kaney practices law in Daytona Beach, Florida, with the law firm of Cobb & Cole, P.A.

1. *See* Collins v. Commissioner, 393 U.S. 215 (1968); United States v. Davis, 370 U.S. 65 (1962).

2. Gerlach v. Commissioner, 55 T.C. 156, 171 (1970).

3. Carrieres v. Commissioner, 64 T.C. 959, 963 (1975), *aff'd*, 552 F.2d 1350 (9th Cir. 1977).

PART I

A. *Preliminary Consideration of the Problem*

Nontaxable divisions of property[4] among co-owners take one of two forms. A single item, or several fungible items of property, may be divided into two proportional parts or groups, one of which is set apart to each of the joint owners. This article will refer to such a division as a simple partition.[5] On the other hand, an aggregate of nonfungible items may be divided into distinct aggregates of proportional value, one of which is set apart to each joint owner. This form will be referred to as a complex partition. The simple partition cleaves a single item, but the complex partition divides an aggregate. The salient features of each partition can be illustrated by the following example.

Example

Assume that two parties, Adam and Nobel, are joint owners of two different items of property as follows:

Description	Adjusted Basis	Fair Market Value
Blackacre (1,000 acres of raw land)	$ 50,000	$100,000
1,000 shares of *X* Corp. common stock	$ 10,000	$100,000

The properties are capital assets held for investment for more than one year. To effect an equal division in kind, Adam and Nobel can use one of two divisions:

Simple Partition. The parties divide each asset proportionately, each receiving 500 shares of stock and 500 contiguous acres of Blackacre having a value of $50,000. To effect this division, Adam executes and delivers a deed to Nobel conveying all his interest in one parcel of 500 acres to Nobel. Nobel, in like manner, conveys his interest in the other parcel to Adam. Also, Adam and Nobel exchange stock assignments transferring 500 shares of *X* Corp. stock to the other whereupon the joint certificate is surrendered and separate certificates evidencing ownership of 500 shares by each are issued by *X* Corp.

4. This article deals with divisions of any form of commonly owned property which may be recognized as jointly or commonly owned under the principles of United States v. Davis, 370 U.S. 65 (1962). Neither the term joint property, nor other terms referring to co-ownership, are used in any special common law significance unless the context so indicates.

5. Partition is not used in its common law sense in this article, but is used to refer generally to the process of dividing property in kind among co-owners.

Complex Partition. The parties divide the assets disproportionately, but equally in value. Adam takes all of Blackacre, and Nobel takes all shares of *X* Corp. stock. To effect this division, Adam executes and delivers to Nobel an assignment transferring all of his interest in the 1,000 shares of *X* Corp. stock to Nobel. In return, Nobel executes and delivers to Adam a deed conveying all of Nobel's interest in Blackacre to Adam.

The question is whether or not either partition is a taxable event. The simple partition of *X* Corp. stock is a nontaxable division on the authority of Revenue Ruling 56-437.[6] With respect to the simple partition of Blackacre, although no case directly on point has been discovered, most authorities assume that the principle of Revenue Ruling 56-437 applies, so that the simple partition of Blackacre also is nontaxable.[7] In general, then, simple partitions are nontaxable divisions. On the other hand, the complex partition may be either a nontaxable division or a taxable exchange, depending on other factors.

Community property is one factor which must be taken into account. If the parties to the complex partition are a divorcing couple residing in a community property state, and if Blackacre and *X* Corp. stock are community property, then the division is nontaxable under the rule of *Walz v. Commissioner.*[8] In cases not covered by the *Walz* rule, however, plain reason indicates that the complex partition is a taxable exchange.

Revenue Ruling 79-44 is the only direct authority to have held reciprocal exchanges in partition of commonly owned property to be a taxable event.[9] There, two unrelated persons who were tenants in common in two separate parcels of land, "rearranged their interests so that each owned 100 percent of a separate parcel."[10] The ruling holds that the transfers which converted this jointly owned property into separately owned parcels amount to an exchange to which section 1001(a) of the Internal Revenue Code (the Code) applies. The holding makes clear that when common owners of two or more distinct items of property effect a complex parti-

6. 1956-2 C.B. 507 (partition of jointly owned shares of stock represented by one certificate into separately owned shares represented by two certificates).

7. *See, e.g.,* Hjorth, *Community Property Marital Settlements: The Problem and a Proposal,* 50 WASH. L. REV. 231 (1975).

8. 32 B.T.A. 718 (1935). The *Walz* rule has been extended to certain common law marital property divisions involving joint property. *See* text accompanying notes 61-102 *infra.*

9. 1979-1 C.B. 265. *See* Rev. Rul. 69-486, 1969-2 C.B. 159.

10. 1979-1 C.B. at 265.

tion, the trading of interests is a taxable event. Despite the obviousness of the principle applied by this ruling, however, the complex partition will be a nontaxable division of property between co-owners under the circumstances to which *Walz* applies.

To identify and rationalize the precise factors which serve to distinguish nontaxable partitions under *Walz* and Revenue Ruling 56-437 from their taxable counterparts exemplified by Revenue Ruling 79-44 will be the major undertaking of this article. The analysis is little advanced by *Walz* or Revenue Ruling 56-437, for neither offers cogent discussion of the reasoning upon which the result is based. The ruling states that "there was no sale or exchange and the taxpayers neither realized a taxable gain nor sustained a deductible loss."[11] *Walz* includes a similar comment: "Here there has been no sale or exchange of the property in question, but a division of property."[12]

From these statements, it appears that both authorities turn on whether the transaction was a sale or exchange.[13] Although a partition is obviously not a sale, it is quite difficult to understand why a partition, especially a complex partition such as was described above in the example, is not an exchange. In the complex partition, Adam and Nobel have traded their respective individual interests in those assets set apart to the other. Are these not reciprocal transfers of property? Of course these are exchanges; Revenue Ruling 79-44 makes this clear.

Even the simple partition, although generally regarded as nontaxable, poses the same analytical difficulty, because reciprocal transfers of property also are necessary to effect the simple division. In the simple partition of *X* Corp. stock, Adam and Nobel reciprocally transfer the undivided interest of each in those shares set apart to the other. The same reciprocal transfers are seen in the exchange of conveyances which separate Blackacre into separate parcels. Therefore, even the simple partition is an exchange, and the reason it is nontaxable is no less obscure than the reason the complex partition is nontaxable.[14]

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11. 1956-2 C.B. at 507.

12. 32 B.T.A. at 720.

13. A sale is the conversion of property into money, Ray v. Commissioner, 18 T.C. 438, 441 (1952), *aff'd*, 210 F.2d 390 (5th Cir.), *cert. denied*, 348 U.S. 829 (1954), whereas an exchange is a reciprocal transfer of property for property, Treas. Reg. § 1.1002-1(d) (1957).

14. In the example set forth in the text, the simple partitions appear to qualify for nonrecognition under I.R.C. § 1036(a), which would apply to the exchanges in partition of stock, and I.R.C. § 1031(a), which would apply to the exchanges in partition of Blackacre, provided the property is to be held for investment or use in business. In fact, however, if no gain is

Despite the fact that "exchanges easily recognized by the tax lawyer are taking place,"[15] however, in the cases examined in this study the courts have consistently applied and expanded the *Walz* rule without clarifying the reason for nontaxability. Consequently, the rule expressed in *Walz* has come to be regarded as a rule without a reason, a rootless judicial amnesty from taxation.[16] Among those who have considered the question, the *Walz* rule is almost uniformly considered erroneous, and the error is either criticized on doctrinal grounds or praised on policy grounds.[17]

The possibility that *Walz* and its progeny can be squared with the Code has not been seriously entertained, but it is believed that these cases can be explained as applications of the fundamental principle that a gain is not taxed under the Code until it is realized. A brief perspective on the realization element of gross income is essential to this inquiry.

B. *The Section 61(a)(3) Taxable Event: Disposition and Realization*

Under Code section 61(a)(3), gross income includes gains derived from dealings in property.[18] Gross income arises when two distinct elements concur, that is, when a *disposition* of property results in

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realized, neither statute can apply. The Internal Revenue Service, in Rev. Rul. 56-437, 1956-2 C.B. 507, could have applied § 1036(a) but did not. This point appears to have little practical significance with respect to immediate or deferred consequences. The example, however, can be infused with practical immediacy if it is assumed that, by prearrangement, Adam will sell his parcel of Blackacre for cash of $10,000 plus a purchase money note payable over 10 years and will report gain on the sale pursuant to I.R.C. § 453. Adam would fail to satisfy the "to be held" requirement of § 1031(a). *See* Rev. Rul. 75-292, 1975-2 C.B. 333. Whether or not the exchange in partition is a nonrealization event determines, in practical effect, whether Adam has immediate or deferred recognition of his gain. If the partition is not taxable, gain is not realized until the sale, and § 453 will be effective to defer his gain. The present analysis is concerned with realization, however, and this secondary question of recognition is not of immediate concern.

15. J. Freeland, S. Lind, & R. Stephens, Fundamentals of Federal Income Taxation 165 (2d ed. 1977) [hereinafter cited as Freeland, Lind, & Stephens].

16. *See* Carrieres v. Commissioner, 64 T.C. 959 (1975), *aff'd*, 552 F.2d 1350 (9th Cir. 1977).

17. *See, e.g.*, Freeland, Lind, & Stephens, *supra* note 15, at 165-66; Taylor & Schwartz, *Tax Aspects of Marital Property Agreements*, 7 Tax L. Rev. 19, 56 (1951).

18. Gross income arising under § 61(a)(3) is defined and measured by § 1001(a),(b). Under some views of the statute, it is possible to understand § 1001(c) as the operative statutory command to recognize gain from dealings in property. The view of the statute followed in this article is that § 61(a)(3) includes in gross income gains from dealings in property; that § 1001(a),(b) define and measure the gain; and that § 1001(c), somewhat redundantly, directs that this gain, so defined and measured, shall be recognized unless the Code provides an exception. *See* note 22 *infra*.

realization of gain.[19] A disposition is any transfer, including a sale or exchange.[20] Since a partition is effected by the exchange of property, it involves dispositions by both parties, but if it does not result in realized gain, section 61(a)(3) does not apply, and the partition is properly held nontaxable. In ordinary usage, "to realize" means to convert into money.[21] The tax significance of the term is broader but cognate. The realization doctrine holds that mere appreciation in the value of property is not gross income. From this it follows that realization involves change; it occurs upon the conversion of property into money, other property, or other economic benefit cognizable for tax purposes.

The key to the present analysis is the separation of the realization element of gross income from the disposition element. Unfortunately the cases and literature obscure the separateness of these elements. More often than not, the disposition will result in the taxable change of position, and the concurrent elements of the taxable event need not then be separated. The courts have long recognized, however, that a taxable change of position does not necessarily concur with every exchange.

The habit of speech which uses the couplet "sale or exchange" to denote the section 61(a)(3) taxable event blurs the distinct requirement of realization and obscures the fact that not every exchange is a taxable event.[22] Use of the couplet to denote the section 61(a)(3) taxable event is not conducive to precise communication in two respects. It wrongly implies that dispositions other than sales or exchanges are not taxable,[23] and it wrongly implies that all

19. Eisner v. Macomber, 252 U.S. 189 (1920); Estate of Levine, [1979] TAX COURT RPTR. (CCH) No. 68 at 3707 (Aug. 6, 1979).

20. *See, e.g.*, Estate of Herbert v. Commissioner, 139 F.2d 756 (3d Cir. 1943), *cert. denied*, 322 U.S. 752 (1944).

21. WEBSTER'S NEW WORLD DICTIONARY 1182 (1978).

22. The use of the phrase "sale or exchange" to denote the § 61(a)(3) taxable event no doubt derives from I.R.C. § 1001(c) which provides: "Except as otherwise provided in this subtitle, the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized." This subsection is preceded by two subsections which employ the broader "sale or other disposition." Whereas the broader term appears in subsections dealing with measurement of gain, the subsection using the narrower term deals with the operative matter of recognition. Because it uses the narrower term, it might have been supposed that the statute would not tax other dispositions; of course, this inference never has been drawn. *See* Helvering v. Roth, 115 F.2d 239 (2d Cir. 1940). Section 1001(c) never has been understood to narrow the tax base, but it has tended to force an awkward usage at times. *E.g.*, *Walz*, 32 B.T.A. at 720 ("no sale or exchange . . . but a division").

23. *See, e.g.*, Estate of Herbert v. Commissioner, 139 F.2d 745, 758 (3d Cir. 1943), *cert. denied*, 322 U.S. 752 (1944) ("[T]he taxpayers argue that 'other disposition' is to be limited in its meaning by the preceding word 'sale'. We do not think so."). *See also* United States v.

exchanges are taxable.[24] Dispositions are a broader category than sales or exchanges and taxable events are a narrower category than dispositions. When used to mean the section 61(a)(3) taxable event, the couplet, by force of custom, is idiomatic. Nevertheless it is an exocentric term of art identifying a concept which is larger than the sum of its parts.

An equivocation can result when "sale or exchange" is used to stand for the taxable event. From the premise, the term "sale or exchange" means "taxable event," it is false to deduce that every exchange is a taxable event. "Exchange" is used in one sense in the premise and in another sense in the conclusion. This equivocation may be responsible for much of the confusion in the partition cases.

The rule that gains are not taxable until realized was developed in cases applying the early income tax statutes.[25] Early on it was settled that mere growth in value was not income under the statute. The position of the government in *Lynch v. Turrish* was that: "Mere appreciation of capital value does not produce 'income,' . . . ."[26] The increase is taxable "at the moment of realization by sale or some act of separation."[27] A different approach, however, was taken by the government in *Eisner v. Macomber*[28] where an unsuccessful, alternative argument was that a stock dividend could be included in gross income as the measurement of income accruing by virtue of capital appreciation of the stock. The Court held that "enrichment through increase in value of capital investment is

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General Shoe Corp., 282 F.2d 9 (6th Cir. 1960), *cert. denied,* 365 U.S. 843 (1961); International Freighting Corp. v. Commissioner, 135 F.2d 310 (2d Cir. 1943). Use of the couplet also obscures the fact that not all dispositions are taxable events. Gifts generally exemplify dispositions which are not taxable events because no realization concurs with the disposition. *See* Campbell v. Prothro, 209 F.2d 331 (5th Cir. 1954); Rev. Rul. 73-183, 1973-1 C.B. 364 (passing of property to executor "does not constitute a taxable realization of income"); Rev. Rul. 55-138, 1955-1 C.B. 223 (passing of property at death is a disposition from which gain is not realized). *But see* Estate of Levine, [1979] TAX COURT RPTR. (CCH) No. 68 at 3707 (Aug. 6, 1979); Evangelista v. Commissioner, 71 T.C. 1057 (1979), *aff'd,* 80-2 U.S.T.C. ¶ 9607 (7th Cir. 1980).

24. *See* Weiss v. Stearn, 265 U.S. 242 (1924); Treas. Reg. § 1.1001-1(a) (1957).

25. *See, e.g.,* Marr v. United States, 268 U.S. 536 (1925); Weiss v. Stearn, 265 U.S. 242 (1924); Cullinan v. Walker, 262 U.S. 134 (1923); Rockefeller v. United States, 257 U.S. 176 (1921); United States v. Phellis, 257 U.S. 156 (1921); Eisner v. Macomber, 252 U.S. 189 (1920); Towne v. Eisner, 245 U.S. 418 (1918); Lynch v. Hornby, 247 U.S. 339 (1918); Lynch v. Turrish, 247 U.S. 221 (1918).

26. 247 U.S. 221, 227 (1918).

27. *Id.*

28. 252 U.S. 189 (1920).

not income in any proper meaning of the term."[29] *Macomber* based its holding on both statutory and constitutional grounds; and although its authority is suspect on the constitutional grounds,[30] there is no doubt that the statutory meaning of gross income for purposes of sections 61(a)(3) and 1001 includes only such gains as have been realized.[31]

Macomber undertook to define gross income as something *derived* from capital. This approach properly has been criticized as being conceptually too rigid to provide a workable test in the pragmatic field of income taxation.[32] The courts no longer pursue

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29. *Id.* at 214-15.

30. *See* Helvering v. Griffiths, 318 U.S. 371 (1943).

31. *See generally* R. MAGILL, TAXABLE INCOME 80 (1945) ("*[Eisner v. Macomber]* is still a landmark in its holding that income must be realized, the minority of the Court were as certain of this point as the majority."); S. SURREY & S. WARREN, FEDERAL INCOME TAXATION 521 (1955) [hereinafter cited as SURREY & WARREN] ("[S]ection 61(a) 'gain' arises only when a disposition occurs which is of such a nature that administrators, and ultimately courts, will state that the disposition constitutes a realization of income . . . ."). *See also* Estate of Levine, [1979] TAX COURT RPTR. (CCH) No. 68 at 3714 (Aug. 6, 1979) ("The question, however, is not whether a disposition occurred . . . but whether a gain was realized from such disposition.") The court in *Levine* held that a donor realizes gain on disposition by gift of property encumbered above its adjusted basis. In Marsh v. Commissioner, 73 T.C. 179, 184 (1979), the court noted that "courts have consistently held that not every economic benefit constitutes income. . . . An economic benefit is not usually considered income until it is realized." (Citations omitted.)

32. It is interesting to speculate that the realization requirement announced in *Macomber* sounded a discordant note because it was a closed concept and, as such, an anathema to the pragmatic thinking which dominates federal income taxation. Realization threatened to constrict the tax base as much because of its conceptualism as because of its constitutional status. In 1941, Stanley S. Surrey pronounced the conceptual notion dead, and redefined realization in starkly pragmatic terms:

> If we interpret it correctly, *Helvering v. Bruun* [309 U.S. 451 (1940)] marks the end of one era in our tax history. What had commenced as a highly conceptual view of the realization of income has in the intervening twenty years become no more than a recognition of an expedient procedure . . . . If increase in value of property be conceded income in the economic sense the decision not to tax that increase for one reason or another is simply a decision to base the income tax for the time being on something less than a taxpayer's total income. When an event occurs which legislators, and through them administrative officials, feel is sufficient to end the postponement, a realization of income has occurred in the legal sense.

Surrey, *The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions*, 35 ILL. L. REV. 779, 783-84 (1941) (citation omitted).

Surrey's article has had profound influence on the manner in which realization is perceived, but he overstated the case when he suggested that Helvering v. Horst, 311 U.S. 112 (1940), a case now understood as an assignment of income case, made an event of realization out of a gift. *See* Rev. Rul. 55-138, 1955-1 C.B. 223. Similarly, his depiction of realization as a formless expedient was overdrawn, as he, in effect, conceded in his textbook. SURREY & WARREN, *supra* note 31, at 521. Nevertheless, Surrey's views illustrate the vigorously pragmatic state of mind in the field, and the resulting opprobrious connotation of realization, all this derivation approach. At the core of the Court's holding in *Macomber*, however, is the relevant economic distinction between realized gain and unrealized appreciation. The distinction is found in the extent to which the distribution of a stock dividend effects a change in the appreciated property. *Macomber* found the distribution of the stock dividend was not an event of realization because, "it does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before."[33] No taxable change of position had occurred. *Macomber* is currently understood best in this light: "The Court was there endeavoring to determine whether the distribution of a corporate stock dividend constituted a realized gain to the shareholder, or changed 'only the form, not the essence,' of his capital investment."[34] Between the realized gain on the one hand, and a change of the form but not the essence of capital on the other, a line is drawn by the realization doctrine.

Macomber did not concern reciprocal transfers, but in 1924, *Weiss v. Stearn* defined the realization requirement as it applies to exchanges.[35] *Stearn* involved the application of the Revenue Act of 1916 to a corporate reorganization of an Ohio corporation. Pursuant to the reorganization, a new Ohio corporation was organized; all assets of the old corporation were transferred to the new corporation; and shareholders of the old corporation received stock of the new corporation plus cash. The opinion states: "The owner of each $100 of old stock thus received $150 cash, also $250 of new stock representing an interest in the property and business half as large as he had before."[36] The collector viewed the transaction as fully taxable, but the lower courts held, and the Supreme Court agreed, that the taxpayer "really sold half [of his stock] for cash and exchanged the remainder, without gain, for the same proportionate interest in the transferred corporate assets and business."[37]

The Court held this transaction to be a nontaxable exchange. The analysis follows *Macomber* in identifying the event sought to

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of which contribute to the desuetude of realization as a tool with which gross income questions are analyzed by bench and bar.

33. 252 U.S. at 211 (citing Town v. Eisner, 245 U.S. 418 (1918)).

34. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 430-31 (1955) (quoting Eisner v. Macomber, 252 U.S. 189, 210 (1920)).

35. 265 U.S. 242 (1924).

36. *Id.* at 252.

37. *Id.*

be taxed as one which did not create a taxable change of property. The opinion by Justice McReynolds emphasized the essential sameness of the interest of the taxpayer before and after the transaction. The Court held that it could not "conclude that mere change . . . in the technical ownership of an enterprise, under circumstances like those here disclosed, followed by issuance of new certificates, constitutes gain separated from the original capital interest [gain realized]. Something more is necessary—something which gives the stockholder a thing really different from what he theretofore had."[38]

The Court quickly narrowed the reach of *Stearn* when it decided *Marr v. United States*[39] in the following year. With Justice Brandeis writing for the majority, the Court found a taxable exchange under the Revenue Act of 1916 in a reorganization of General Motors Company which shifted the state of incorporation from New Jersey to Delaware and slightly altered the capital structure. On the facts, the Court attributed taxable significance to the alteration of rights which it inferred would result from the change of state of incorporation, and from the adjustments in capital structure which accompanied the change. Justices Van Devanter, Sutherland, Butler, and McReynolds dissented, protesting that the taxpayer received "nothing differing in substance from what he already had."[40]

Despite the confinement it experienced in the corporate reorganization area, *Stearn* establishes the test of taxability of an exchange.[41] The taxpayer must receive something really different

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38. *Id.* at 254 (citations omitted). The problem considered in *Stearn* long has been covered by explicit statutory provisions, and the case has little current significance in the reorganization area. *See* I.R.C. § 354.

39. 268 U.S. 536 (1925).

40. *Id.* at 542.

41. *See generally* 3 J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION § 20.03 (1973). In the words of Justice McReynolds, the taxpayer must receive "a thing really different from what he theretofore had." 265 U.S. at 254. This idea is expressed in various terms in other authorities. Judge Learned Hand used these words:

> [T]he question whether a profit ensues depends not so much upon whether one chattel is exchanged for another as upon what are the rights of the taxpayer before and after the transaction under consideration. If these be so far changed as to constitute substantially a new means of command over money, there may be a taxable transaction, in spite of the fact that appreciation in value in the same property never alone results in profit.

Allen v. Commissioner, 49 F.2d 716, 719 (2d Cir.), *cert. denied,* 284 U.S. 655 (1931). Judge Hand observed: "It is the change that counts . . . ." 49 F.2d at 719.

The same rule appears in the current regulations issued pursuant to § 1001 where it is provided that "the gain or loss realized from the conversion of property into cash, or from

from what he already had, different in substance and not merely in form. This test is a part of the realization doctrine, because the rule in *Stearn,* derived directly from *Macomber,* continues to be effective today.[42]

The realization requirement as applied to exchanges has limited practical significance. Under *Marr* the taxpayer readily can be shown to have received a materially different interest in property.[43] Most often this aspect of the realization doctrine is cited in cases which hold that realization occurred.[44] The important point, however, is the principle that not every exchange is a "moment of realization." This principle can be recognized only if the disposition element of the taxable event is distinguished, for purposes of analysis, from the realization element. Upon this principle and upon this distinction will rest the rationalization of the partition cases.

C. *Division of Community Property*

The partitions described in the example set forth above now can be reconsidered. Simple partition yields readily to the analysis which separates the disposition element from the realization element. The parties to a simple partition do not receive property

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the exchange of property for other property *differing materially either in kind or extent,* is treated as income or as loss sustained." Treas. Reg. § 1.1001-1(a) (1958) (emphasis added). The point was treated more elaborately in an earlier edition of the regulation which provided, in pertinent part:

> Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property . . . that is essentially different from the property disposed of. . . . In other words . . . a change in substance and not merely in form . . . is required to complete or close a transaction from which income may be realized.

Treas. Reg. 45, Art. 1563, Revenue Act of 1918 (1920 ed.). *See also* Estate of Timken v. Commissioner, 47 B.T.A. 494, 501 (1942), *aff'd,* 141 F.2d 625 (6th Cir. 1944); Rev. Rul. 72-265, 1972-1 C.B. 222, 223.

42. Treas. Reg. § 1.1001-1(a) (1958). *See, e.g.,* Rev. Rul. 68-633, 1968-2 C.B. 329, 330 ("The transaction effected a substantial change in her property interest . . . .") (citations omitted).

43. In fact, the doctrine of realization as applied to corporate distributions and reorganizations, and developed in opinions by Justice Pitney in Lynch v. Hornby, 247 U.S. 339 (1918), United States v. Phellis, 257 U.S. 156 (1921), and Rockefeller v. United States, 257 U.S. 176 (1921), had already established ample support for treating merely legal changes as events of realization. In that respect, *Stearn* stands alone among the early realization cases. However, alone among the cases theretofore decided, *Stearn* involved an exchange, and is more readily distinguished especially when it is recalled that the Court was, in 1925, still concerned with the *derivation* of income from property.

44. *See, e.g.,* Commercial Trust Co. v. Commissioner, 8 B.T.A. 1138 (1927). *See also* R. MAGILL, *supra* note 31, at 77; cases cited in SURREY & WARREN, *supra* note 31, at 520-21.

which is essentially different in kind or extent than that which they transfer. In fact, where the stock of *X* Corp. is partitioned, the property transferred is identical to the property received. *Stearn* could hardly fit the facts of an exchange more neatly. The simple partition of Revenue Ruling 56-437, therefore, can be understood as an exchange of property not resulting in realized gain. Although the disposition is clear, no gain is realized because no taxable change of property occurs.

Complex partition is the same, but the analysis is not as easily demonstrated. A closer examination of *Walz* is needed. *Walz* concerned the division of community property in the dissolution of a Texas marriage. Under a separation agreement, the husband transferred his entire interest in certain depreciated stock to the wife as a part of an equal value division of the community property in which he received other assets of the community. The husband claimed a loss on the stock, but the deficiency notice stated that " 'losses' resulting from the partition of community property or resulting from a separation agreement do not constitute allowable deductions."[45] The Board of Tax Appeals upheld the Commissioner, stating: "Can it be said that when two or more parties are the owners in common of a mixed aggregate of assets purchased for profit and decide to partition it, a gain or loss results from such partition? We think not."[46] This result was not affected by the fact that the division was disproportionate with respect to each item of property. Although the wife received all of the stock, "[o]ther property of an equivalent value was awarded to the husband."[47]

The best indication of the Board's reasoning is the statement that, "when the one-half interest of the wife in the community property was set apart to her in the separation agreement, she was only receiving that which was hers already."[48] This is tantamount to holding that the separate requirement of realization is absent. In effect, the Board says the taxpayer received nothing from the exchange that she had not owned prior to the exchange, so that no taxable change of property has occurred which would be an event of realization. An echo of *Stearn*, decided only ten years earlier, can be heard in this decision. Justice McReynolds spoke of the need to receive "a thing really different from what he theretofore

45. 32 B.T.A. at 719.
46. *Id.*
47. *Id.* at 720.
48. *Id.* at 719-20.

had,"[49] and Judge Black found that the wife merely received "that which was hers already."[50] Despite the failure of the Board in *Walz* to cite authority connecting that case to the principle on which it is decided, *Walz* is continuous with *Stearn,* and must be understood to have turned on the finding that the exchange, because it did not result in a receipt of different property, was a nonrealization event to which the statute did not apply.[51]

It is clear that *Walz* assumes that a single thing was divided, as revealed by the syntax in the critical statement: "Can it be said that when two or more parties are the owners in common of a mixed aggregate of assets . . . and decide to partition it, a gain or loss results from such partition?"[52] The object of the infinitive "to partition" is the singular pronoun "it," the antecedent of which is the singular "aggregate," and not the plural "assets." Having joined the mixed assets into a single thing, the Board, by simple logic, reasons that gain is not to be realized when the taxpayer merely separates his undivided interest in a single object of property into a several interest in a distinct part of the property.

Although several assets were involved in the partition and the transfers separating them can in no formal way be distinguished from the transfers deemed to exist in Revenue Ruling 79-44, under the *Walz* analysis, these several assets are one single thing, linked together by some unarticulated syndetic. Revenue Ruling 79-44, on the other hand, is distinguishable because the assets there involved were not parts of a single thing for purposes of the realization analysis. Whatever syndetic force bound the *Walz* assets together was not perceived in the facts of Revenue Ruling 79-44.

The syndetic is community property.[53] The Board decided its

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49. 265 U.S. at 254.

50. 32 B.T.A. at 720.

51. Simplified, *Walz* says that a partition of a single thing between its co-owners is nontaxable. *See* PART I, section *G. infra.*

52. 32 B.T.A. at 719.

53. *See* Rev. Rul. 76-83, 1976-1 C.B. 213. In Private Letter Ruling 8016050 (Jan. 23, 1980), the Internal Revenue Service stated:

> Rev. Rul. 76-83 stands for the proposition that an approximately equal division of the total value of the community property that provides for the transfer of some assets in their entirety to one spouse or the other is neither a sale nor an exchange, but is a nontaxable division of the joint interests in the property. *Rev. Rul. 76-83 is based on the principle that the interest of each spouse in the community property is an interest in the property as an entity.* A decree of partition merely severs that interest. As a consequence the adjusted basis and the holding period of the property received in the partition is the same as it was in the hands of the community. (Emphasis added.)

The italicized portion of the above quotation is the first recorded instance in which the case on this factor, not merely that the parties were married, nor merely that the parties owned several items in the same proportions, but actually that the property was community property.

In the predominating view among the Tax Court judges, the community estate has a singularity which is the root of the *Walz* analysis, although the cases also recognize that the community property interest inheres in each distinct item. The best articulated review of *Walz* is found in *C.C. Rouse v. Commissioner*, in which the Tax Court stated: "We concluded [in *Walz*] that there was no sale or exchange of property, but merely a division."[54] Distinguishing the case sub judice, in which the husband acquired the wife's community interest with a promissory note, the court stated:

> If there were simply a division of the community estate . . . the property would have been equally divided, or at least an attempt would have been made in good faith to achieve an equal division. In that event, where, in exchange for a vested undivided one-half interest in the whole, each party receives a vested interest in the whole of one-half, obviously there would be no resulting taxable gain, and no change in the basis of any of the property by reason of the settlement.[55]

The court used a collective, singular noun, "community estate," to refer to what *Walz* called a "mixed aggregate of assets," and artfully phrased the essence of the nonrealization partition, as the *exchange* of a vested undivided one-half interest in the whole for a vested interest in the whole of one-half. It is unfortunate that the court felt that this exchange was so obviously nontaxable that citation showing the link to the realization doctrine is not made, but these comments illuminate the *Walz* rule nonetheless.[56]

Service has acknowledged that partitions of community property are partitions of a single thing. Viewed in this light, the cases involve partitions which are nontaxable because no gain is *realized* when the owners "merely sever" their interests. Such an approach to the cases is consistent with the thesis of this article and inconsistent with the view that the cases constitute a judicial nonrecognition rule limited to marital dissolution cases.

54. 6 T.C. 908, 914 (1946).

55. *Id.* at 913-14.

56. A similar view is expressed in Conner v. Commissioner, 34 T.C.M. (CCH) 1043, 1045 (1975):

> [E]ach spouse is entitled to one-half of each asset comprising the community estate. Since it would be impracticable to distribute one-half of each asset to each spouse, the community property may be divided in kind with each spouse receiving assets of approximately equal total value . . . . Each spouse thus receives property equal to his one-half interest in the community. Since each spouse receives only what is already his, such an equal division of the community property

References by the tax judges to the community as a singular object seem to follow the view of community property state courts and commentators. Their view is that while the interest of a spouse in community property inheres in each asset, the interest also undeniably has a transcending character which inheres in the aggregate as well.[57] Thus, community property has a dual aspect. It is not useful for purposes of this analysis to attempt to resolve the competing explanations of community property, for none of the tax cases under consideration have chosen to attach significance to nuances among the states' community property laws. Community property is treated as a solid concept by the courts of tax jurisdiction which are concerned with the broad effect of these laws, not with their subtleties.[58]

The essential feature of community property upon which the rule of *Walz* is bottomed is that, insofar as relevent to the analysis of the tax consequences, the community estate is a single asset composed of separate units. It is polychotomous but singular.[59] It

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is not a taxable event.

The final sentence drives home the latent principle of nonrealization.

57. *Compare* Hjorth, *supra* note 7, at 240-41 *and* Schwartz, *Divorce and Taxes: New Aspects of the* Davis *Denouement*, 15 U.C.L.A. L. REV. 176, 196-97 (1967) *with* Taylor & Schwartz, *supra* note 17, at 56 *and* Hull, *The New Uniform Divorce Laws: The* Davis *Decision*, in NEW YORK UNIVERSITY THIRTY-SEVENTH ANNUAL INSTITUTE ON FEDERAL TAXATION ¶ 36.05 (1979). Support can be found both for the view that each spouse has a separate interest in each asset, and for the view that the interests of the spouses inhere in the aggregate. The latter view is the appropriate view for tax purposes. Hjorth, *supra* at 240-41. *See* Mortensen v. Knight, 305 P.2d 463 (Ariz. 1956); *In re* Chavez's Estate, 280 P. 241 (N.M. 1929) (Bickley, J., dissenting) for comparisons of the community with a partnership. *But cf.* Crosby v. Commissioner, 46 B.T.A. 323, 327 (1942), *vacated and remanded per curiam*, 43-2 U.S.T.C. ¶ 9588 (9th Cir. 1943) ("A marital community can not soundly be viewed as so completely a partnership as to require application of the Federal statutes as to income tax . . . .").

58. *See, e.g.*, Rev. Rul. 76-83, 1976-1 C.B. 213 ("In *community property states* a division of community property incident to a divorce . . . is not considered a taxable event to either spouse when there is an equal division of the fair market value of the community property with some of the assets going in their entirety to one spouse and some going in their entirety to the other.") (emphasis added) (citations omitted). For purposes of the present study, the salient aspect of community property is its aggregate characteristic. During coverture, property acquires and loses its community status because of the status of the parties. If an item is disposed of, its proceeds are nevertheless community property, as will be the item acquired therewith. There is an interest in each item, but not a severable interest. Upon dissolution of the marriage, the interest in each item is merged in the whole, for it is the general rule that complex partition is the usual form of division. *See* Hjorth, *supra* note 7, at 240-41 n.43.

59. Thomsen v. Thomsen, 159 P. 1054 (Cal. 3d Dist. Ct. App. 1916) expresses the notion upon which *Walz* and its progeny apply the nonrealization principle derived from *Stearn* to community property divisions. *Thomsen* vividly depicts the so-called "aggregate" theory of community property which holds that the spouses' rights inhere in the aggregate of the

is now well settled that complex partition of community property

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community property and not in each item of property.

> In adjusting the property rights of the parties the court may consider all the common property as one asset or fund, composed of separate units, and can often more equitably settle and adjust matters by giving all of designated and described pieces of property to one party than by awarding to each an undivided interest in all . . . . The court is no more bound to award to each spouse an undivided interest in each piece of land than it is to award to each an undivided interest in each cow or horse.

Id. at 1056.

The aggregate theory contrasts with the "item" theory which holds that the spouses have specific undivided interests in each discrete item of property. The extent to which any community property state bases the legal rights of the spouses on either theory is unclear, for cases which would develop these principles usually deal, not with a choice between theories, but with a concrete issue the resolution of which may be more or less harmonious with one theory or the other. Hjorth, *supra* note 7, at 240-41 n.43 notes:

> In an "item theory" community property state [treating a complex partition of community property as a taxable event] would be theoretically correct. Before dissolution each spouse has an undivided one-half interest in each asset owned by the community. This undivided interest in all assets is exchanged for a complete interest in some assets. Thus there is a [taxable event] . . . . It is doubtful, however, whether any community property state adheres strictly to the "item theory." In the divorce context, the item theory seems to be limited to the rule that items of property not specifically allocated to one spouse or the other will be held by them after termination of the marital community, as tenants in common . . . . The "aggregate" theory seems more appropriate in the dissolution context. Under the "aggregate" theory, a [complex] partition of the whole community . . . is just as much a partition as is a partition of each individual asset owned by the community. (Citation omitted.)

The author suggests that the context in which the issue arises will determine which theory is appropriate, and this appears to be the best view.

Much literature concerned with private rights under community property systems is not concerned with the "aggregate-item" dichotomy. For example, W. DEFUNIAK, PRINCIPLES OF COMMUNITY PROPERTY (1943) gives no consideration to the matter of the characterization of rights under either theory. Similarly, Cross, *The Community Property Law in Washington,* 49 WASH. L. REV. 729, 818 (1974), while covering the subject of spousal rights at divorce, does not discuss these alternative characterizations. Regardless of whether a particular community property jurisdiction has overtly characterized its position in terms of the "aggregate" theory, it is clear that the Tax Court has decided every case in the *Walz* line on the basis of a latent assumption that, in the dissolution context, the spouses' rights in their community property are those which are characterized by the aggregate theory.

The Tax Court is nonetheless aware of the competing characterization of spousal rights in community property. This awareness is demonstrated in a recent decision in which Washington community property law was in issue, Estate of Lee v. Commissioner, 69 T.C. 860, 873-74 (1978). In *Lee* it was necessary that the Tax Court determine whether or not the surviving spouse's community interest could be satisfied by a non-pro rata distribution out of the aggregate. Based on the construction of Washington's statute concerning testamentary disposition of community property in *In re* Estate of Patton, 494 P.2d 238 (Wash. Ct. App. 1972), the court in *Lee* held that the spouse had a vested right to an undivided one-half interest in each asset. 69 T.C. at 875. *Patton* discusses the item theory in terms, but its holding is limited to the matter of testamentary dispositions. 494 P.2d at 242-43. *See also* Private Letter Ruling 8016050, *supra* note 53.

incident to divorce is not a taxable event.[60] Moreover, the *Walz* rule has been extended to certain divisions of property incident to divorce in common law states.

D. *Division of Jointly Acquired Property*

Extension of *Walz* to common law states was precipitated by the pivotal decision of *United States v. Davis*.[61] The Court in *Davis* held that the transfer of appreciated property in satisfaction of marital rights is a disposition resulting in realized gain, the amount realized being measured by the fair market value of the transferred property.[62] In *Davis* the taxpayer contended that the transfer was comparable to a nontaxable division of property between two co-owners. The Court accepted at face value the suggestion that the transaction would be nontaxable if it involved a division of property between co-owners comparable to the division of community property between spouses incident to divorce, but the Court held that the case before it did not involve the division of property. "The taxpayer's analogy, however, stumbles on its own premise, for the inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership."[63]

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60. The rule of *Walz* and its progeny is accepted by the Commissioner of Internal Revenue. *See* Rev. Rul. 76-83, 1976-1 C.B. 213. Nontaxable partitions of community property have been found in whole or in part in Carson v. Commissioner, 37 T.C.M. (CCH) 818 (1978); Carrieres v. Commissioner, 64 T.C. 959 (1975); Wren v. Commissioner, 24 T.C.M. (CCH) 290 (1965); Davenport v. Commissioner, 12 T.C.M. (CCH) 856 (1953); Oliver v. Commissioner, 8 T.C.M. (CCH) 403 (1949); and Walz v. Commissioner, 32 B.T.A. 718 (1935). The principle has been approved but found inapplicable because of separate consideration paid for the interest of one spouse in Siewert v. Commissioner, 72 T.C. 326 (1979); Connor v. Commissioner, 34 T.C.M. (CCH) 1043 (1975); May v. Commissioner, 33 T.C.M. (CCH) 256 (1974); Showalter v. Commissioner, 33 T.C.M. (CCH) 192 (1974); Howard v. Commissioner, 32 T.C. 1284 (1959); Edwards v. Commissioner, 22 T.C. 65 (1954); Brown v. Commissioner, 12 T.C.M. (CCH) 948 (1953); and Rouse v. Commissioner, 6 T.C. 908 (1946), *aff'd*, 159 F.2d 706 (5th Cir. 1947).

61. 370 U.S. 65 (1962). In two earlier cases, the Board of Tax Appeals had been reversed for finding that a division of property under equitable division of property statutes amounted to a nontaxable division, Halliwell v. Commissioner, 44 B.T.A. 740, 748-49 (1941), *rev'd*, 131 F.2d 642 (2d Cir. 1942), *cert. denied*, 319 U.S. 741 (1943); Mesta v. Commissioner, 42 B.T.A. 933, 940-41 (1940), *rev'd*, 123 F.2d 986 (3d Cir. 1941), *cert. denied*, 316 U.S. 695 (1942), and this approach was not considered again by reported cases until *Davis*.

62. 370 U.S. at 68-75.

63. *Id.* at 70. Reviewing Delaware law, the Court noted that the wife had no rights in management and disposition of the husband's personal property, that her rights to property at divorce were not descendable, and that the state court would allow her to share in property only to the extent that it deemed reasonable, taking into account such criteria as the wife's financial condition and needs. The Court concluded that the wife's position was not

Davis implicitly sanctioned the nontaxability of a division of property among co-owners. Unfortunately, the Court did not specify the essential elements of such a nontaxable division. *Davis* actually is inapposite with the property division cases because the spouse in *Davis* had no property interest in the marital assets. The Court's remarks on the question of the division of property are therefore clouded with Delphic ambiguities, but two inferences can be drawn. It must be inferred that those divisions which the Court assumed would not be taxable necessarily were the *Walz* community property divisions, since at that time, only the *Walz* line of community property cases had so treated divisions of property. It would follow that the Court accepted the *Walz* rule at face value. Moreover, it must be inferred that the Court entertained the possibility that *Walz* is not confined to community property states, for *Davis* dealt with the wife's interest under Delaware law more extensively than would have been required if the Court viewed *Walz* as peculiar to community property cases—a point which could have been made in a sentence. Beyond these two implications, *Davis* offers little guidance.

Subsequent to *Davis*, the nontaxable division has been an issue in several common law states, and taxpayers in two states have succeeded in characterizing local equitable property division laws as creating rights having the dignity of co-ownership. In *Collins v. Commissioner*, the Tenth Circuit ultimately accepted a characterization of the interest of an Oklahoma spouse as a species of co-ownership.[64] Oklahoma law thus was found to create a form of co-ownership sufficiently similar to community property to warrant similar treatment. Based on this characterization of the Oklahoma "jointly acquired property," the Tenth Circuit conceded that a division of jointly acquired property in the nature of a complex partition was a nontaxable division of the property between its co-owners.[65]

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an interest in property. Instead it partook of a personal liability or burden on the husband's property. *Id.*

64. This matter was determined in a legal marathon involving George F. Collins. In the *Collins* cases, the taxpayer lost in the Tax Court and the Tenth Circuit, but prevailed in the Supreme Court. Collins v. Commissioner, 46 T.C. 461 (1966) *(Collins I), aff'd,* 388 F.2d 353 (10th Cir.) *(Collins II), vacated and remanded,* 393 U.S. 215 (1968) *(Collins IV).* On remand, the Tenth Circuit reversed *Collins I.* Collins v. Commissioner, 412 F.2d 211 (10th Cir. 1969) *(Collins V). See also* Collins v. Oklahoma Tax Comm'n, 446 P.2d 290 (Okla. 1968) *(Collins III)* (Oklahoma Supreme Court holds for taxpayer in parallel state action).

65. 412 F.2d 211, 212 (10th Cir. 1969). This characterization was supplied by the Oklahoma Supreme Court in the parallel state tax action:

Collins has been criticized by commentators. It is said to be poorly reasoned because it attached federal tax consequences to the label ("species of common ownership") given to the property rights in the state court proceedings.[66] Actually nothing was said by the Oklahoma Supreme Court in the parallel state proceedings that had not already been conceded in the Tax Court when it had held against the taxpayer. Moreover the "species of common ownership" label was supplied by an early Oklahoma case[67] and was not invented for the tax occasion. The reversal of position by the Tenth Circuit (which followed after the state court had ruled in its parallel state action) seems to have been influenced more by the terms of the remand of the United States Supreme Court in *Collins*[68] than by the holding of the Oklahoma Supreme Court.

The Supreme Court's remand is significant. It indicates that the lower courts had misinterpreted *Davis*. The Tax Court had conceded that the jointly acquired property doctrine under Oklahoma law created a species of co-ownership conceptually similar to community property,[69] but the Tax Court and the Tenth Circuit had regarded this as irrelevant because both courts confined *Davis* to cases involving true community property and to cases involving expressly created legal joint ownership.[70] The remand in *Collins* shows this was not the correct interpretation of *Davis*.

Following *Collins*, Colorado law also has been brought within the nontaxable division rule. A federal district court in Colorado, sub-

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> The nature of the wife's interest is similar in conception to community property of community property states, and is regarded as held by a species of common ownership. The fact record title is in the husband by reason of conveyance or contract does not destroy such joint ownership, since the plain language of the statute precludes such requirement. . . . The purpose to be accomplished by equitable division is a complete severance of common title, so the portion awarded each is free from claims or domination of the other. . . . The nature of the estate subject to division is not a matter of judicial discretion. . . . Although one spouse brings separate property to the marriage, enhanced value resulting from joint efforts, skill or funds of both working together constitutes jointly acquired property subject to division. . . . The statutory division may be decreed even though the court does not dissolve the marriage.

Collins v. Oklahoma Tax Comm'n, 446 P.2d 290, 295 (Okla. 1968) (citations omitted).

66. *E.g.*, Hull, *supra* note 57, at ¶ 36.04; Note, *Tax Consequences of Divisions of Jointly Owned and Community Property Incident to Divorce*, 27 U. FLA. L. REV. 1033, 1036 (1975). *See also* Lawson, *Tax Implications of Using Appreciated Property in a Property Settlement*, 43 J. TAX. 58, 59 (1975).

67. Thompson v. Thompson, 173 P. 1037 (Okla. 1918).

68. 393 U.S. 215 (1968).

69. 46 T.C. 461, 471 (1966).

70. *Id.*, 388 F.2d 353 (10th Cir. 1968).

sequently affirmed by the Tenth Circuit, determined that Colorado's jointly acquired property statute, like Oklahoma's, created essentially the same set of rights, analogous to community property and eligible for nontaxable treatment.[71] *Collins* has not been extended to other states,[72] and it does not presently appear that there are any other common law states whose laws are sufficiently analogous to community property laws to warrant further extension.[73]

Assuming the Oklahoma and Colorado cases rightly decided that the property there at issue had the indicia of co-ownership, they appear to be valid applications of the rule developed in the *Walz* cases. The jointly acquired property can be seen to have that polychotomous singularity which is the syndetic feature of community property for purposes of the *Walz* rule. During coverture, as the spouses acquire and dispose of property, its jointly acquired status depends on the joint industry and contribution of the spouses and their marital status and not on the election as to how title is taken. The interest of neither spouse is specific or several, and a judicially determined partition may effect a disproportionate division.[74]

E. *Division of Entireties Property*[75]

Walz has been applied in cases involving division of jointly owned property incident to divorce in common law states. Although those cases have not considered the property distinction which exists between common law joint property and community

71. Imel v. United States, 375 F. Supp. 1102 (D. Colo. 1974), *aff'd*, 523 F.2d 853 (10th Cir. 1975). *See also In re* Questions Submitted by the U.S. Dist. Ct., 517 P.2d 1331 (Colo. 1974).

72. *E.g.*, Wallace v. United States, 439 F.2d 757 (8th Cir. 1971) (Iowa); Kraut v. United States, 316 F. Supp. 740 (E.D. Wis. 1970) (Wisconsin); Dunn v. Commissioner, 36 T.C.M. (CCH) 664 (1977) (Tennessee); Wiles v. Commissioner, 60 T.C. 56 (1973), *aff'd*, 499 F.2d 255 (10th Cir.), *cert. denied*, 419 U.S. 996 (1974) (Kansas); Swaim v. Commissioner, 50 T.C. 302 (1968), *aff'd*, 417 F.2d 353 (6th Cir. 1969) (Kentucky).

73. *See, e.g.*, Hull, *supra* note 57, at ¶ 36.04. *But cf.* Bosch v. United States, 590 F.2d 165 (5th Cir. 1979), *cert. denied*, 100 S. Ct. 731 (1980) (Florida doctrine of special equities creates a species of property, but the doctrine depends on unique facts and is distinguishable from the generally applicable Oklahoma and Colorado statutes).

74. As noted in Thomsen v. Thomsen, 159 P. 1054, 1056 (Cal. 3d Dist. Ct. App. 1916), the court has the power to give the cows to one and the horses to the other.

75. The term "entireties property" is used loosely to signify jointly owned assets of a married couple, title to which is in both names. The term is not limited to its common law sense, and it excludes community property, and equitable joint property. This section is an expansion of an earlier article. Kaney & Aylward, *Nontaxable Divisions of Jointly Owned Property Incident to Divorce*, 53 FLA. B.J. 257 (1979).

property, that distinction has much significance for the tax analysis.

Legal joint ownership of property, although the interest of each spouse has the dignity of co-ownership,[76] differs markedly from community property and jointly acquired property. The joint title arises item by item and only by the act of the parties. What is joint and what is separate bears no necessary relation to property acquired during coverture. If one jointly owned asset is disposed of, the parties must elect whether to hold the proceeds jointly or severally. At divorce, this property is subject to voluntary or judicial partition, but it has no inherent syndetic unity. The right of each spouse is a right to a discrete item of property. Except where special equities are present, the court's power to partition the property is the same as the court's power to partition property among any common tenants, although its powers to award alimony and satisfy rights of a spouse such as those involved in *Davis* may permit alterations of proportionate interests.[77]

When the tax consequences of a complex partition of common law jointly owned property have been considered by the courts, the partitions have in each case been held to be nontaxable divisions of property between co-owners. Some of the cases are poorly rationalized and stretch the *Walz* rule but, if carefully confined, they do not break the rule of *Walz*. Thus far, each case can be understood to turn on facts showing joint acquisition as in *Collins*, coupled with the legal joint title as required by *Davis*. On these facts the cases present no doctrinal discontinuity, but the analyses employed in the cases generally fail to reveal a clear understanding of the rule. The cases can be reviewed in light of this doctrinal difficulty.

The earliest case is *Cofield v. Koehler*, a district court opinion

76. *See* Beth W. Corp. v. United States, 350 F. Supp. 1190 (S.D. Fla. 1972), *aff'd per curiam*, 481 F.2d 1401 (5th Cir. 1973), *cert. denied*, 415 U.S. 916 (1974).

77. *See generally* G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY § 1784 (1979) (estate by the entireties exists by virtue of *title* acquired during marriage); 41 AM. JUR. 2d *Husband and Wife* § 57 (1968) (estate arises upon a conveyance to husband and wife); *id.* § 71 (severance by decree of divorce results in partible tenancy in common). *See also* Bosch v. United States, 590 F.2d 165 (5th Cir. 1979), *cert. denied*, 100 S. Ct. 731 (1980). No singularity attaches to entireties property of the spouses merely because the property is held by that title, but cases abound where there is, nevertheless, a factual correlation between joint acquisition during coverture and joint title. A widely practiced custom of common law marriages is to hold title to jointly acquired assets as tenants by the entireties. Jointly acquired property of a long-term couple, as a matter of fact, often will be held in legal joint ownership.

involving Kansas law.[78] The court found that when the marriage began, neither spouse had any significant properties and that the marital property had been acquired through their joint activities.[79] The issue was whether the husband realized income from accrued interest on a substantial amount of Series "E" Bonds. As the court understood the issue, the interest would be realized by the husband if the transfer to the wife "resulted in a taxable incident," which it held had not occurred.[80]

> [T]he transfer of these bonds to the wife did not result in realization of income to the husband. He exchanged these bonds in which each had an undivided one-half interest, including the accrued interest, for other property of equal value, also jointly owned by them. The effect of the divorce decree did no more than set apart to each in severalty the interest they owned in their *community property.* They gained nothing and they lost nothing.[81]

This, indeed, is a case of great interest to the present discussion. It is arguably the best analyzed of the lot, dealing in a straightforward manner with the realization concept by considering whether the taxpayers changed position. "They gained nothing and they lost nothing."[82] Again, the echo of the "something really different" test of *Stearn.* The decision is technically precise in that it described what happened as an exchange from which no gain was realized, avoiding the arbitrary denial that a sale or exchange had occurred.

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78. 207 F. Supp. 73 (D. Kan. 1962).

79. The court in *Cofield* noted:

> She was equally competent with him in business matters. They continued in business as business partners both in the lumber business and in various other business enterprises. They were successful and accumulated a considerable estate consisting of personal property, including a substantial amount of Government Series "E" Bonds, as well as a large amount of real estate. The Series "E" Bonds were issued in their joint names. . . . [T]he judgment of the [state divorce] court awarded the wife permanent alimony in the sum of $5,000.00, and set aside to her as her separate property, one-half of the jointly accumulated property specifically described in the decree.
>
> Included in the property set aside to her were United States Savings Bonds in the approximate amount of $50,225.00. . . . The [state] court specifically found that these bonds were the joint accumulations of the husband and wife and were not purchased from separate funds of the wife.

Id. at 73-74.

80. *Id.* at 74.

81. *Id.* (emphasis added).

82. *Id.*

In this decision the separateness of the realization requirement is evident. The case is on sound ground when it approaches the question of realization through the equal value rule, noting that bonds were "exchanged" for "other property of equal value," the latter being a phrase from *Walz.*[83] The case is seriously deficient, however, because no reference is made to the authorities upon which the court bases its decision. Nevertheless, that the court inarguably is applying *Walz* is revealed by the reference to the equal value of the exchange and the cryptic reference to the joint assets as "community property." In effect, the court determined that the jointly owned properties were sufficiently analogous to community property to justify application of the *Walz* rule. The analogy to community property is based on the joint accumulation. Both spouses started their marriage with no property. During the marriage each participated as a partner in business ventures in which each was equally competent. The result is jointly owned property, jointly accumulated.[84]

Florida tenancy by the entireties property was involved in *Beth W. Corp. v. United States (Beth Corp.).*[85] *Beth Corp.* presents serious difficulties. Like *Cofield,* it is sparsely supported; unlike *Cofield,* it is poorly reasoned. The court does not articulate any facts of the case which could establish the critical link to community property or jointly acquired property cases. In fact, much of the court's effort was directed toward distinguishing *Davis,* an effort which, while eminently successful, did not meet the issue. The court went to great lengths to demonstrate that the interest of the Florida wife in tenancy by the entireties property rises to the "dignity of co-ownership."[86] As the court understood *Davis,* it seemed

83. *Id.*

84. *Id.* at 73. Judge Scott of the Tax Court shares this analysis of *Cofield.* In Gerlach v. Commissioner, she distinguished *Cofield,* but observed: "[I]f the jointly owned property involved in *Cofield* . . . is to be treated comparable to 'community property' . . . the conclusion in that case is in line with our holding in *[Walz]* . . . ." 55 T.C. 156, 171 (1970).

85. 350 F. Supp. 1190 (S.D. Fla. 1972), *aff'd mem.,* 481 F.2d 1401 (5th Cir. 1973), *cert. denied,* 415 U.S. 916 (1974). The parties had been married approximately 31 years, owned all relevant property as tenants by the entireties, and effected a complex partition of the property incident to divorce. The partitioning transfers were not in exchange for any rights of the wife other than her interest in the entireties property. 350 F. Supp. at 1191. The court found that the property division had been intended as an "equal division," accepting the husband's testimony to the effect that: "[T]he basis for the apportionment of property between him and his wife in the property settlement agreement was an attempt to arrive at a 50%-50% division of the jointly owned property, based upon current market values," and holding that the "transaction resembles a non-taxable division of property between coowners." *Id.* at 1192.

86. *Id.* at 1191.

to it necessary merely to reach this determination in order to distinguish *Davis* and conclude that the transaction was not taxable.

The only other authority considered on the question of the taxability of the division was dictum from *Hornback v. United States.*[87] The *Beth Corp.* court's discussion of *Hornback*, however, was relegated to distinguishing its authority. It is difficult to resist the temptation to conclude that the court in *Beth Corp.* was under the erroneous impression that once *Davis* was distinguished, the conclusion that the transfer was nontaxable necessarily followed.[88]

Beth Corp. was cited in a Tax Court memorandum decision concerning a complex division of jointly owned property, *Pokusa v. Commissioner.*[89] *Pokusa* involved the question of basis for computing gain realized by the wife upon a subsequent disposition. The government contended for a transferred basis from a nontaxable division, and the taxpayer contended for a cost basis from a taxable division.[90] The court found that the parties were co-owners of the property and emphasized that: "[T]he record indicates that the [spouses] accumulated their property through their joint efforts

87. 298 F. Supp. 977 (W.D. Mo. 1969). In *Hornback*, the joint properties were impartible so the husband gave the wife a promissory note in an amount equal to one-half of the value of the joint holdings, and she conveyed her interest in the joint holdings to the husband. 298 F. Supp. at 980. *Hornback* held this exchange to be a taxable sale, but by way of dictum, the court also discussed simple and complex partitions, suggesting that an equal value complex partition would be nontaxable. *Id.* at 981. *Hornback*, however, cited only Wren v. Commissioner, 24 T.C.M. (CCH) 290 (1965), a community property case, although the *Hornback* dictum concerns common law jointly owned property.

88. 350 F. Supp. at 1190. Some suggestions can be found if the report of *Beth Corp.* is searched for those elements which, as in *Cofield*, would link the several entireties properties into an aggregate and therefore make it "comparable to community property." The marriage had endured for more than 30 years, and the government succeeded in submitting to the jury, as an alternative argument for nontaxability of the transfers, a question as to whether the spouses had actually been partners. *Id.* at 1192. If such facts were present, then *Beth Corp.* can be explained as continuous with *Walz*, *Collins*, and *Cofield*. Since the government prevailed in *Beth Corp.*, the suspected presence of joint accumulation facts is especially meaningful, for it can be assumed that the case is understood in this way by the government.

89. 37 T.C.M. (CCH) 434, 437 (1978). The marriage in *Pokusa* had lasted 21 years, during which time the parties were domiciled in common law states. At the time of the marriage, neither party owned any "appreciable property." During their marriage, by the joint efforts and contributions of the spouses, a substantial collection of property was acquired and held by them in joint ownership. The parties were divorced by a decree in Delaware, but they did not then divide their property, and so became tenants in common of their jointly owned property. About 15 months after the divorce, pursuant to an agreement, the parties effected a complex partition of the joint properties. The agreement made no reference to release of the wife's marital rights as a condition of the division of the property. *Id.* at 435.

90. *Id.* at 436.

and contributions."[91] As the court understood the issue, the parties were co-owners of the property, and since the property division involved no release of marital rights, the "division of their property will be a nontaxable event if such division was intended to be equal."[92] On the facts, the taxpayer's effort to show inequality in the division was unpersuasive. The court held the original division nontaxable.[93]

The Internal Revenue Service has issued one ruling, Revenue Ruling 74-347, on the noncommunity property division question and has under consideration a proposed new ruling on the question.[94] The published ruling considered the tax consequences of a disproportionate division of several items of jointly owned property. The facts surrounding the acquisition of property are as follows:

> A husband and wife were married in 1953 when each had approximately $600 in assets. Neither received an inheritance or gift of any significance during the marriage. Both husband and wife were employed throughout the marriage and their earnings were commingled so that it was impossible to determine whose earnings were used to purchase any given asset.
>
> In 1973, the wife was granted a divorce. The total assets owned by the husband and wife had a net fair market value of $110,000

91. *Id.*

92. *Id.* at 436-37 (citing *Beth Corp.*).

93. 37 T.C.M. (CCH) 434 (1978). Although the court in *Pokusa* emphasized the joint accumulation of the joint property, it is possible to understand the emphasis on this point was directed to the ambiguous record as to whether the property was legally owned as tenants by the entireties. It does not appear that the court in *Pokusa* intended to suggest that joint accumulation of the property is comparable to community property. If that were the case, it can be speculated that this judge also believes the law to be that by showing that there was a property interest in the transferee spouse, so that the transfer is not in settlement of marital rights, the division is nontaxable if "intended" to be equal. On the other hand, such speculation aside, *Pokusa* can readily be connected to *Cofield, Collins* and *Walz* because it involves an equal value division of property held in tenancy by the entireties, which property was jointly accumulated, and constitutes an aggregate of property in which there are floating equities to be considered as well as separate items of ownership.

94. Rev. Rul. 74-347, 1974-2 C.B. 26. On August 30, 1979, the Service issued Private Letter Ruling 7948083 applying Rev. Rul. 74-347 to similar facts. On December 28, 1979, Private Letter Ruling 8012092 revoked the August ruling and announced that a proposed revenue ruling concerning noncommunity property states is under consideration. At the deadline for publication of this article, the new ruling had not been issued. In the face of the Service's silence it is appropriate to observe that the article at 53 FLA. B.J. 257, *supra* note 75, appears to have been the first published comment on the incomplete analysis of Rev. Rul. 74-347. Although the present article suggests an analysis upon which Rev. Rul. 74-347 can be suggested, the objective is not to predict judicial or administrative behavior but to comment on the principals which should be considered in the cases and rulings.

> at the time of the divorce. The jointly-owned property, that it, the property either purchased with the earnings of both the husband and the wife or received by means of a completed gift, consisted of several assets having a combined net fair market value of $70,000. The husband's separately owned property had a net fair market value of $40,000. The wife owned no property in her own capacity.[95]

The divorce decree awarded the wife jointly owned property having a value of $55,000. The remainder of the jointly owned property, and all of the separately owned property was awarded to the husband. Alimony and support for the children was separately provided for.[96] The ruling states:

> The married couple did not reside in a community property State at the time of the divorce. Under the applicable State law, the wife's interest in her husband's separately-owned property was not the equivalent of coownership since her only rights in her husband's separately-owned property were either inchoate or entitled her to an equitable distribution of property upon divorce.[97]

The ruling considers the question whether the unequal division of the jointly owned property constitutes a taxable transfer, but assumes that to the extent the division of the jointly owned property was equal, it was nontaxable. By implication, the ruling accepts some variation of the *Cofield, Beth Corp., Pokusa* doctrine.

Announcing the principle of the *Davis* case, the ruling adverts to the dignity of co-ownership statement therein, and continues, citing *Collins:* "Property may be coowned where (1) title to it is taken jointly under State property law, (2) the State is a community property law State, or (3) State property law is found to be similar to community property law."[98] Under the facts of the ruling, "only the jointly-owned property of the husband and wife is within the scope of the term 'coownership.' "[99] Thus, the ruling holds:

> [S]ince the wife's interest in her husband's separately-owned property was not the equivalent of coownership, the unequal division of jointly owned property awarded the wife constitutes a taxable exchange of a portion of the husband's jointly-owned prop-

95. *Id.* at 26.
96. *Id.* at 27.
97. *Id.*
98. *Id.*
99. *Id.*

> erty for the wife's marital rights in the husband's separately-owned property.[100]

By glossing this ruling, the doctrinal connection to the *Walz* rule can be made, but the Service's current reconsideration of the issue may indicate that this connection was not considered in 1974. The ruling stresses joint accumulations: this factor associates its holding with the joint accumulation criterion involved in *Collins* and also present in *Cofield*. The ruling holds that the governing state law was neither community property law nor comparable to community property law.

Because the ruling sets up three categories in which co-ownership will be recognized, it must be taken that the first category—that consisting of property title to which is "taken jointly under State property law"[101]—was involved in the case posited by the ruling. It must further be inferred that to some extent the unallocable joint accumulation of the property from commingled earnings is also a factor in rendering the division nontaxable. If these inferences are correct, then the ruling indicates the Service's position to be that a distinction exists between jointly owned property which is also jointly acquired property, on the one hand, and jointly owned property which is not jointly acquired property on the other. The position of the Service no doubt will be clarified, and perhaps changed, when the new ruling is issued

If the entireties cases are rightly understood as applying the *Walz* rule where joint ownership is coupled with joint accumulation, then these cases are in line with *Walz*. They represent arguable extensions of the notion that a polychotomous aggregate is a single unit of property for purposes of realization analysis. The unifying factor in these cases is the intertwining tangle of equities which would make it impossible to determine the precise interest of each spouse. Without such unity, the cases could not be distinguished from the Revenue Ruling 79-44[102] taxable exchange.

F. *Nonrealization vs. Nonrecognition*

The partition cases are rarely approved on doctrinal grounds.[103] They draw hostile criticism from commentators who reason that

100. *Id.*
101. *Id.*
102. 1979-1 C.B. 265.
103. Schwartz, *supra* note 57, at 186 comes closest to approval.

taxable exchanges are being overlooked,[104] and they draw faint praise from courts and commentators who regard them as wrongly decided but commendable as judicial legislation.[105] Both lines of criticism proceed from the assumption, express or implied, that every exchange is a taxable event and from the apparent assumption that simple partitions do not involve exchanges. Both criticisms should be considered.

In an early article, typical of hostile criticism, Taylor and Schwartz argue that each spouse is deemed to own "an interest in each of the specific assets . . . rather than an interest in the community itself,"[106] and that *Walz* and its progeny are wrongly decided. The authors advance this argument by constructing an example of parallel joint ownership of a farm and corporate stock, virtually identical to the model used above to illustrate simple and complex partitions. With respect to a complex partition between unrelated parties, they argue: "This transaction is not a partition (since each receives *all* of one piece of property) . . . . Therefore, gain or loss from the sale would certainly be recognized."[107] The authors argue that the result ought to be the same between a divorcing or separating married couple.[108] It is significant that Taylor and Schwartz assumed that a simple partition would be nontaxable both with respect to the fungible stock and with respect to the nonfungible lands.[109] Those who criticize the *Walz* treatment of complex partitions for the most part accept the nontaxability of simple partitions of nonfungible property.[110]

Walz is more nearly like a simple partition than might appear at first analysis. The simple partition and the complex partition are similar in these respects: (1) an exchange is present in each; (2) after the exchange, the parties own in severalty that which was formerly owned in common; and (3) that which is owned in severalty after the exchange necessarily differs from that which was previously owned in common.

Several ownership is, per se, different from common ownership.

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104. *See, e.g.*, Taylor & Schwartz, *supra* note 17, at 56; Hull, *supra* note 57, at ¶ 36.05.

105. *See, e.g.*, Carrieres v. Commissioner, 64 T.C. 959, 963 (1975), *aff'd*, 552 F.2d 1350 (9th Cir. 1977); FREELAND, LIND, & STEPHENS, *supra* note 15, at 155-66.

106. Taylor & Schwartz, *supra* note 17, at 56.

107. *Id.* (emphasis in original) (footnote omitted).

108. *Id.*

109. *Id.*

110. *See, e.g.*, FREELAND, LIND, & STEPHENS, *supra* note 15, at 165; Hull, *supra* note 57, at ¶ 35.05. *Cf.* Note, *supra* note 66, at 1038 (unsupported assumption that simple partitions are nontaxable is premise for justifying rule in complex cases).

Such a difference can provoke taxation in some cases. Revenue Ruling 68-633,[111] at the apex of a line of cases stretching back to *Allen v. Commissioner*,[112] holds that the conversion of certificates of participation in a fixed investment trust into the underlying investments of the trust, even if exchanged strictly pro rata, constitutes a taxable exchange. The ruling states:

> In this case *A* received something different from the property right surrendered. While *A* had an equitable interest in all stock owned by the trust, she did not have an exclusive beneficial interest therein. When she terminated the trust relationship, she surrendered her interest in the shares remaining in the trust. The transaction effected a substantial change in a property interest and represents an exchange within the meaning of section 1002 of the Code.[113]

Though otherwise distinguishable,[114] this ruling is of interest because it attaches a taxable significance to the difference between exclusive ownership and nonexclusive ownership of the same property. The surrender of the undivided interest in the shares which remained in the trust, in exchange for the entire interest in the shares received, was considered a taxable change in the taxpayer's position. If this analysis were applied to the simple partition, the several ownership of the same thing which formerly was owned in common could be seen as a substantially different interest in prop-

111. 1968-2 C.B. 329.

112. 49 F.2d 716 (2d Cir.), *cert. denied*, 284 U.S. 655 (1931).

113. 1968-2 C.B. at 330.

114. The cases discussed in the text can be distinguished in that: (1) they concern distributions out of trusts, not co-ownership; and (2) large numbers of people are involved. It is also instructive to compare the treatment of other transactions which are loosely analogous. In the case of partnerships, it was established by an early regulation that a partner did not realize gain or loss upon receipt of a distribution in kind in liquidation. Treas. Reg. 45, art. 1570, Act of 1918. In 1939, the Board of Tax Appeals upheld the then pertinent regulation upon the analysis that a distribution in kind, "does not confer title to the assets upon the members, but is merely an apportioning among them of what they already owned jointly." Crawford v. Commissioner, 39 B.T.A. 521, 524 (1939). This language echoes that of *Walz* and *Stearn*. *See* text accompanying notes 49 and 50 *supra*. Earlier, Judge Learned Hand suggested this regulation was of doubtful validity, a suggestion that is consistent with his opinion in Allen v. Commissioner, 49 F.2d 716 (2d Cir.), *cert. denied*, 284 U.S. 655 (1931). Of course, the rule is now codified at I.R.C. § 731. Distributions in kind by corporations were treated differently from the earliest days of the income tax law. Although the roughest sort of analogy might have been drawn, the Revenue Act of 1924, Pub. L. No. 176, ch. 234, 43 Stat. 253 (1924), instituted treatment of liquidation as a sale of stock by the stockholder. *See generally* B. BITTKER & J. EUSTIS, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 11.03 (4th ed. 1979).

erty, sufficiently different to effect a realization.

Of course, this analysis has not been applied to partitions, but the fact that it could have been serves to illustrate that even the simple partition involves not only an exchange but also the receipt of different property. Moreover, a simple partition of nonfungible property may result in the receipt of different property than the property which was surrendered in yet another respect. None of the cases actually extend to the point, but the cited authorities assume that the partition of a single tract of land into two separate tracts is a simple nontaxable partition.[115] Taylor and Schwartz held this opinion before Revenue Ruling 56-437. In the simple partition of Blackacre it necessarily follows that the actual property received by Adam differs not only in that it is owned exclusively in severalty but also because it is different property. According to common law, each acre or parcel of land is unique.

A simple partition never results in receipt of precisely the same property. The property is different in that it is several, and might be different in other respects as well. Therefore the complex partition held nontaxable under *Walz* is not readily distinguished from the simple partition when viewed in this light. The distinction can only be found in the manner in which the property is owned, in the postulate which binds the community estate and its analogs into one unit for purposes of the analysis.[116]

The *Walz* rule has fared well in spite of its unfriendly critics but it faces virtual extinction from friendly critics. Having failed to perceive the root of the rule in the realization doctrine or, perceiving it, having failed to accept its legitimacy, the courts choose to accept the rule as judicial legislation. The rule has come to be seen as a rule defining recognition. In 1975 Judge Hall of the Tax Court, in *Carrieres v. Commissioner*,[117] considered the *Walz* rule in a case which appears to mark the point where the reason underlying the rule was finally lost. Unable otherwise to explain the rule, Judge Hall remarked:

> Usually, unless otherwise expressly provided in the Code, gain from the sale or exchange of property is recognized for tax purposes. . . . However, the judge-made, well-settled law concerning the division of community property upon a divorce makes excep-

115. *See, e.g.*, FREELAND, LIND, & STEPHENS, *supra* note 15, at 165; Hull, *supra* note 57, at ¶ 35.05. *See also* Note, *supra* note 66, at 1038.

116. *See* Thomsen v. Thomsen, 159 P. 1054 (Cal. 3d Dist. Ct. App. 1916).

117. 64 T.C. 959 (1975), *aff'd*, 552 F.2d 1350 (9th Cir. 1977).

> tions to that general rule. In effect, a nonstatutory nonrecognition rule has been created.[118]

Judge Hall seemed uncomfortable with this nonstatutory rule of nonrecognition, linking the realistic notion of judicial lawmaking with the traditional rule of stare decisis ("judge-made, well-settled law").[119]

Other commentators have accepted the *Carrieres* characterization of the rule enthusiastically. Freeland, Lind, and Stephens meet the issue with self-acknowledged realism, agreeing that the statute should apply: "Even though all the property involved is community property, exchanges easily recognized by the tax lawyer are taking place; and there is no statutory exception to the recognition of gain or loss seemingly required by § 1001(c)."[120] With respect to Judge Hall's description of the rule as a nonstatutory rule of nonrecognition, these authors suggest: "Probably anyone not seriously allergic to judicial legislation applauds this result."[121]

It is not necessarily correct that the *Walz* cases override the statutory command to recognize gain. The cases can be understood to have developed a reasonable and justifiable rule of nonrealization founded solidly upon fundamental, statutory principle. To say the rule exempts a taxable gain merely because exchanges can be seen to occur overlooks the key point of this analysis: the requirement of realization is distinct from the requirement of disposition. Moreover, while it is possible to quarrel with the *Walz* notion that a single, polychotomous unit can be the subject of a nonrealization division, the courts are within the reasonable bounds of judicial discretion in developing this doctrine out of the practical notion of realization. Upon what logic can this functional concept be rejected as contrary to the statute in favor of an outright, dysfunctional disregard of the statute?

The *Walz* cases cannot rightly be explained as judicial legislation for two reasons. First, as judicial legislation, the *Walz* rule would be beyond the proper scope of the lawmaking discretion of

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118. 64 T.C. at 963 (citation omitted). Judge Hall's notion of the rule as a nonrecognition rule was repeated in the most recent of the cases, Carson v. Commissioner, 37 T.C.M. (CCH) 818, 820 (1978): "Despite this effective exchange of interests in the property, the arrangement is treated as a nontaxable partition. The origin of this *exception* is in the early case of *[Walz]*." (Emphasis added.)

119. 64 T.C. at 959. "What is wrong with reading the statute?" Focht v. Commissioner, 68 T.C. 223, 244 (1977) (Hall, J., dissenting).

120. FREELAND, LIND, & STEPHENS, *supra* note 15, at 165.

121. *Id.* at 166.

the courts. Second, if viewed as legislation, the rule would create an arbitrary and capricious distinction. These aspects of the legislative explanation of the rule should be considered.

Modern legal realistic thought recognizes that the American judicial process cannot be understood unless it is acknowledged that courts make laws even when engaged in the process of interpreting and applying statutes.[122] This is especially true in federal income taxation, because the meaning of statutory gross income and, therefore, to a large extent, the scope of the statute itself has been delegated to the courts.[123] Nevertheless, a clear understanding of the fact that law is made by judges ought not to obscure the proper bounds within which this lawmaking function must occur.

It was Justice Frankfurter's sound view that interpretation of statutes required of courts only so much lawmaking as is necessary to carry out formulated policy, but not to initiate policy.[124] In some cases these lines may be blurred, but where the court clearly perceives the statutory policy, it is the court's duty to observe it.[125] On the other hand, of course, courts commit acts of lawmaking beyond proper limits where statutory intent is clear to the court but simply ignored as a matter of policy. "This is law-making of the usurpatory variety, and though as bald as the bald eagle, is perhaps also as rare."[126]

If understood as a judge-made rule of nonrecognition, the *Walz* line of cases would be judicial lawmaking of the usurpatorial variety. The legislative command to tax these gains always has been clear and unambiguous, yet, on this view, the courts have ignored the command. Based on such unjustifiable grounds, a nonstatutory

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122. *E.g.*, Cohen, *Judicial "Legisputation" and the Dimensions of Legislative Meaning*, 36 IND. L.J. 414 (1961).

123. Surrey & Warren, *The Income Tax Project of the American Law Institute: Gross Income, Deductions, Accounting, Gains and Losses, Cancellation of Indebtedness*, 66 HARV. L. REV. 761, 770-71 (1953).

124. Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 534 (1947). Justice Frankfurter expressed the limits in his article as follows:

> [T]o say that . . . courts make law just as do legislatures is to deny essential features in the history of our democracy. It denies that legislation and adjudication have had different lines of growth, served vitally different purposes, function under different conditions, and bear different responsibilities. . . . In short, judges are not unfettered glossators.

Id. at 534. *See also* Commissioner v. Beck's Estate, 129 F.2d 243, 246 (2d Cir. 1942).

125. *See* Cohen, *supra* note 122, at 415.

126. *Id. See also* Chazo, *Determinacy and Deliberation: An Inquiry Concerning Forensic Epistemology*, 7 FLA. ST. U.L. REV. 237, 238 (1979) ("There is no profit to be gained in idle lamentations over the loss of enlightened innocence, or the corrupting sophistication of modernism.").

rule of nonrecognition is flatly beyond proper bounds of judicial power. The doctrine of realization is a chief instrument in judicial determination of the definition of gross income, but Congress has reserved to itself the policy determination as to the precise circumstances under which realized income should not be recognized.[127] The line is clear, and any nonstatutory rule of nonrecognition would cross it.[128]

The *Walz* line of cases, if viewed as judicial legislation, is not merely vulnerable to the charge of usurpatorial judicial legislation, but also open to challenge as arbitrary and capricious legislation. In *Davis,* the Court held a disposition of property taxable *even though* the dispositions were incident to divorce. If *Walz* is a nonrecognition rule, then the *Walz* cases hold dispositions of property nontaxable, *merely because* the dispositions are incident to divorce. If, as in *Walz,* the statute is to be ignored when property is exchanged for property, why cannot the same statute be ignored when, as in *Davis,* property is transferred in discharge of a burden thereon? From a legislative policy standpoint, both cases should be treated the same. In both cases a transfer of property is required solely because a marriage existed between two parties. The community property cases compel the transfer by means of community property laws while the common law states compel the transfer through equitable apportionment laws or permanent alimony laws. Distinctions between the two legal systems have considerable significance to the courts, but should not to the legislature. Federal tax policy factors at divorce are identical for community property and common law states. In fact, Congress has evidenced a strong, consistent policy of equating, for tax purposes, the transfer of property via community property law with transfers via common law.[129] The distinction which *Davis* based on the "facts of life"[130] recognized this uniform policy. Yet based on the existing legislative standards, the Court found that a judicial distinction had to be drawn between the cases. Any view of the *Walz* rule as a nonrecognition rule is inconsistent with both *Davis* and *Collins.*

G. The Rationale of Nontaxability

The first purpose of this article is to explain the nontaxability of

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127. *See generally* Cohen, note 122 *supra.*
128. I.R.C. §§ 61(a)(3); 1001(c).
129. *E.g.,* I.R.C. §§ 1(a), 2056, 2523.
130. 370 U.S. at 71.

divisions of property between its co-owners. A sound justification for otherwise puzzling case law is found in the realization doctrine. The cases are difficult to analyze, because the early cases fail to connect themselves to the governing line of authority, and the later cases fail to perceive the conceptual connection and to reason accordingly. Throughout these cases, the phrase "nontaxable division of property between co-owners" is repeated uncritically, as if this litany were a reason instead of an anodyne for the pains of reasoning. Because of the resort to labeling instead of reasoning in the cases, it is appropriate to briefly reiterate the logic of a defensible nonrealization doctrine.

The statutory taxable event occurs when a disposition of property results in the realization of gain or loss. Disposition and realization are concurrent elements of the taxable event. A partition in kind, no matter how simple, always takes the form of an exchange. The exchange is a disposition, but no gain or loss necessarily is *realized* from this disposition. Only those exchanges which effect a taxable change in property will give rise to realization of gain or loss. The courts have not treated the conversion into several ownership of that which was held in common ownership as a sufficient change of property to require realization of gain or loss.[131]

This analysis is most readily accepted when a single item of property is divided, but the *Walz* line of cases extends the analysis to disproportionate divisions of certain aggregates of disparate items. The courts chose to regard the community estate (and its analogs) as a single, partible unit, the division of which is nontaxable for the same reason that a simple partition is nontaxable.

Critics of the complex partition cases, including those who regard them as judicial nonrecognition exchanges, have not fully articulated the analysis upon which the criticism is based. It is usually suggested that complex partitions are taxable because they involve exchanges,[132] but this is not a completely articulated argument. At the root of these critical analyses, it is believed that one of two arguments can be found.

One argument involves the premise that all exchanges are taxable. It would run as follows:

> All partitions are exchanges. All exchanges are taxable dispositions. Therefore, all partitions are taxable dispositions.

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131. *See* Weiss v. Stearn, 265 U.S. 242 (1924); Collins v. Commissioner, 412 F.2d 211 (10th Cir. 1969); Walz v. Commissioner, 32 B.T.A. 718 (1935).

132. *See* Hull, *supra* note 57, at ¶ 36.05; Taylor & Schwartz, *supra* note 17, at 56.

Although this syllogism could have been derived from a literal reading of the statute, it was not. The minor premise never has been accepted in the law. It is contradicted by *Stearn* and by Treasury Regulations § 1.1001-1(a).[133]

A variation of the argument that complex partitions are taxable because all exchanges are taxable seeks to distinguish the special treatment of simple partitions on the ground that the simple partition is not, in fact, an exchange. This argument uses words such as "division" or "severance" to describe the simple partition. It is not possible to understand partitions in these terms, however, because an act of exchange between the co-owners is necessary to sever or divide even a single item. It appears that the attempt to characterize simple partitions as non-exchanges is a forced line of reasoning made necessary by the need to distinguish the nontaxability of simple partitions from the taxability of transactions such as that in Revenue Ruling 79-44. Since the line of reasoning proceeds from the assumption that all exchanges are taxable, the argument must explain the conceded nontaxability of the simple partitions in other terms.

A second argument would begin with a premise which accepts the nontaxability of certain exchanges. It proceeds:

> Granting that every exchange is not taxable, those partition exchanges which do not result in a taxable change of property are only those exchanges which divide a single item of property; all other partitions are taxable. The community estate (and its analogs) consist of several, disparate items of property and not a single item. Therefore, the complex, disproportionate partition of such items involves taxable exchanges.

This argument draws on the obvious factual distinction between simple and complex partitions. It assumes too much, however, when it assumes there is a clear line of distinction between single items and polychotomous items. Further, this analysis is legally precluded by *Davis* and *Collins,* because the polychotomous aggregate is the partible unit to which each case referred. The major premise of this argument is, therefore, contradicted by the necessary implications of *Davis* and *Collins.* If these implications are accepted, the premise of this argument cannot be accepted.

The partition cases are themselves responsible for these questionable modes of reasoning, because the cases do not rationalize

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133. (1980).

themselves. Despite this, however, the cases are rational; they respond to realization analysis. Viewed in this light, the cases constitute a fairly coherent body of judicial rules concerning partitions and realization. Viewed as a judicial rule of nonrecognition, on the other hand, the cases present quite a different perspective.

The question whether or not the *Walz* rule is a judicial rule of nonrecognition has immediate practical concern. As a nonrecognition rule for marital dissolutions, the rule can be extended far beyond the limits within which the realization doctrine would confine it. In marital divisions the rule can be held to grant amnesty from taxability, even under those statutes which require recognition of gain or loss without regard to realization. Moreover it will be held to grant amnesty from taxability in cases where jointly owned property is divided without regard to whether it was jointly accumulated. On the other hand, as it evolves into a rule peculiar to the marital division cases, its broader significance as a doctrine of general application to partitions will be lost. Therefore, how the rule is understood at the level of fundamental principle has much practical significance to taxpayers who seek to predict the consequences of transactions in these areas.

PART II

A. *Synthesis of Nonrealization Rules*

The second purpose of this article is to educe from the cases principles governing the tax consequences of all partitions in kind. If the decided cases are understood in terms of the realization doctrine, the partition cases have broader significance than their origins in a dissolution of marriage context might suggest. It must be recalled, however, that the Tax Court has explained the marital cases as judicial nonrecognition cases, a view which, if sustained, limits these cases strictly to the divorce context.

The first principle educed from the partition cases is the limiting effect of the realization rule. Nonrealization follows only from the exchange of a vested undivided interest in the whole of some singular item of property for a separate, vested interest in the whole of an aliquot portion. Two corollaries of this principle hold that the severed interest must be carved out of a single unit of property and that receipt of property from outside the common unit is not covered by the rule.[134]

134. *See generally* cases cited note 60 *supra*.

Determining what constitutes a single, partible unit of property involves questions of relativity. Fungible units such as shares of stock possess the requisite singularity.[135] The aggregate of community property,[136] jointly acquired property in Oklahoma[137] and Colorado,[138] and jointly acquired property held in legal joint ownership in other common law jurisdictions,[139] have been held to possess the requisite singularity. The cases so holding have found that a polychotomous aggregate was a single item of property. They are peculiar to their own facts in most respects. Nevertheless, the cases suggest a test for singularity, and they certainly could be applied in the marital context outside of divorce and separation.

The cases dealing with partitions of polychotomous aggregates find the syndetic factor in the way property is owned. The cases seem to support the idea that if in legal effect a single unit of property composed of divisible units has a legal unity and constitutes the object of a single set of ownership rights, it probably has the needed singularity. An example of how this principle might be extended is found in the division in kind of a tract of land. Where one tract is divided, title to which is held in undivided shares, the realization test should turn on the unity of title and not on the similarity of the divided parcels, so that a tract composed of cultivated land and timber lands might be divided to give the timber lands to one owner and the cultivated lands to the other. *Walz* and its progeny, in fact, are the only support for the nontaxability of this partition. This test will not go far toward lending certainty to transactions; such is the rough nature of the judicial doctrine of realization.

As between married persons, the realization doctrine implies that no determinative effect attaches to the fact of divorce. Separation of jointly owned properties for estate planning purposes, for example, might take the form of a nontaxable complex partition. Obviously, no presumption of arm's length dealing and a resulting equality of values would be available.[140]

By analogy to *Cofield* and *Pokusa,* it may be possible to repli-

135. Rev. Rul. 56-437, 1956-2 C.B. 507.

136. *See* cases cited note 60 *supra.*

137. *See* cases cited note 64 *supra.*

138. Imel v. United States, 375 F. Supp. 1102 (D. Colo. 1974), *aff'd,* 523 F.2d 853 (10th Cir. 1975).

139. *See* text accompanying notes 75-102 *supra.*

140. *See, e.g.,* Wren v. Commissioner, 24 T.C.M. (CCH) 290, 293 (1965).

cate the polychotomous unit among unmarried persons.[141] Cohabitation cases offer a close analogy, but it is conceivable that other relationships or associations could produce a pattern of behavior similar to that of the *Cofield* spouses. The distinguishing elements appear to be that joint industry and contributions have resulted in the accumulation of an aggregate of jointly owned properties so closely tied by a net of interlacing equities that it is impossible to separate each party's interest in each asset. Such a case might arise between parent and child or in other familial relations based on mutual dealing in confidence and trust.

Apart from questions concerning partible singularity of property, the realization doctrine requires that partitions in which boot, owelty, or other extrinsic considerations are mixed into the exchanges will give rise to realized gain or loss to that extent.[142] This rule was developed in the *Walz* line of cases, and has been the subject of some confusion.

In the beginning, *Walz* made nontaxability appear to depend upon equality of value, and appeared to condone the presence of extrinsic consideration in the division because in *Walz* a substantial promissory note was given by the husband to the wife. The appearance was deceptive; since the issue in *Walz* concerned realization of loss by the husband, the note given by him to the wife did not affect the outcome. For a time it was uncertain why the partition had to be equal and why inequality resulted in gain to the transferor of the greater value. In *Davenport v. Commissioner*,[143] for example, the Tax Court seemed to apply a subjective test. Its decision turned on whether the parties intended to make a division and not a sale.

In marital cases it is now clear, however, that gain results not from inequality per se, but from receipt of extrinsic consideration based on a presumption of sorts, arising from the husband's transfer of the greater value, that satisfaction results in gain under *Davis*.[144] In the marital cases, a rule of convenience permits some outside consideration, but the extent to which a disproportionate division may be equalized by separate consideration without tax

141. *See, e.g.*, Marvin v. Marvin, 557 P.2d 106 (Cal. 1976); Bost & Kimball, *Divorces in Community Property States: Selected Tax Problems*, in NEW YORK UNIVERSITY THIRTY-SEVENTH ANNUAL INSTITUTE ON FEDERAL TAXATION ¶ 35.03 (1979).

142. *E.g.*, Carrieres v. Commissioner, 64 T.C. 959 (1975).

143. 12 T.C.M. (CCH) 856 (1953).

144. *See* Rev. Rul. 74-347, 1974-2 C.B. 26. *Cf.* Bost & Kimball, *supra* note 141, ¶ 35.02[2] at 35-6 (no obligation under California law with respect to separate property).

effect is not clear. In Revenue Ruling 76-83, an equalizing note for $258 out of a total community of $300,000 was disregarded as "not of sufficient magnitude to prevent the division from being approximately equal."[145] In *Carson v. Commissioner*,[146] 53.8% of the community property worth $185,275 was set apart to the wife. The court held that the taxpayer had not overcome the administrative determination that this was not substantially disproportionate, hence there was no realization of a claimed capital loss by the taxpayer.[147]

If cash is community property, the cases have recognized that it may be allocated disproportionately in a complex partition without realization.[148] The question has not surfaced in an entireties case, but the rule ought to be the same in a properly decided case involving jointly accumulated entireties property. Revenue Ruling 74-347 hints at trouble in this respect when it defines the jointly owned property as that received by way of completed gift.[149] Ordinarily, a joint bank account gives each owner a unilateral right of withdrawal so that deposits of separate funds to such accounts are not completed gifts to the codepositor until a disproportionate withdrawal occurs.[150] When jointly acquired property is partitioned the presence of cash in the hotchpot may trigger realization unless its jointly acquired status can be shown.

Assumption of debt is similar to the giving of cash.[151] In community property cases, the rule appears to be that the assumption of community debt is treated as the giving and receiving of community cash. A community debt is not extrinsic consideration, but it enters the balance of values.[152] The analogy should govern when a complex partition of jointly acquired property is involved, but where cotenants other than married persons are partitioning property, there may be no sufficient analogy to community debt.

B. *Special Statutory Taxable Events*

As defined by section 61(a)(3), gross income is limited by the

145. 1976-1 C.B. 213, 214.

146. 37 T.C.M. (CCH) 818 (1978).

147. *Id.* at 821.

148. *E.g.*, Carrieres v. Commissioner, 64 T.C. 959 (1975); Davenport v. Commissioner, 12 T.C.M. (CCH) 856 (1953).

149. 1974-2 C.B. 26. The ruling also defines jointly owned property as property purchased with the earnings of both the husband and wife.

150. *Id.*

151. Crane v. Commissioner, 331 U.S. 1 (1947).

152. *See generally* Hjorth, *supra* note 7, at 246.

requirement of realization, but elsewhere the Code provides that dispositions give rise to recognized gain or loss without regard to whether a realization occurs.[153] These statutes, which can be called special statutory taxable events to distinguish them from the section 61(a)(3) taxable event, are based on underlying policies not influenced by realization. In general, the special statutory taxable events require that a realized gain previously unrecognized,[154] or a tax benefit previously enjoyed,[155] be recouped when the property with respect to which the deferred gain or benefit was enjoyed later changes hands.

The question of how the nontaxable partition is affected by special statutory taxable events has not been squarely decided.[156] If exchanges in partition are nontaxable if and only if the requirement of realization has not been satisfied, then such exchanges, notwithstanding the partition cases, may constitute taxable events in cases where realization is not a requirement. On the other hand, if partitions incident to divorce are covered by a nonstatutory rule of nonrecognition, then such partitions would be nontaxable without regard to the requirement of realization. When the question arises in a divorce context, the *Carrieres* approach to the rule of nontaxability would permit the court to brush these statutes aside, because the legislative policy of such a judicial rule of nonrecognition would dictate that the exception to taxability be complete. Outside the context of divorce, however, or if the *Carrieres* approach is rejected, the taxonomy of realization requires a new distinction. Since the underpinning of the rule of nontaxability in the "anamolous" dissolution cases is nonrealization, there is no basis in the rule itself to avoid the special statutory taxable event, although some arguments to the contrary can be considered.

Where the statute uses the term "disposition," it could be argued that the word does not have the same meaning as it has in section 1001. Certainly it is possible that Congress could have used the same term in different senses in different places in the Code, but it is not likely that Congress ever has used the word disposition in any sense other than its broadest generic sense. The stat-

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153. *E.g.*, I.R.C. §§ 47(a)(1), 425(c), 453B(a), 454(b), 691(a)(2), 1245(a)(1), 1250(a)(1)(A), 1251(b)(5), 1252(a)(1), 1254(a)(1), 1255(a)(1).

154. *E.g.*, I.R.C. § 453B(a) (disposition of installment obligations).

155. *E.g.*, I.R.C. § 1245(a)(1) (disposition of "1245" depreciable property).

156. *See* Hjorth, *supra* note 7, at 263. *But cf.* Oliver v. Commissioner, 8 T.C.M. (CCH) 403, 429 (1949) (installment obligation was present but this issue apparently not considered).

utes in question reveal an intention to use the term in its broadest sense, because specific exceptions are created for gifts or transfers by inheritance and devise.[157]

A second argument might assert that the "division" which occurs in a partition is not a "disposition." In the language of the cases, beginning with *Walz*, and including the first of the *Collins* cases,[158] there is verbal support for this position, but the support is illusory. The division argument is but another variation on the nonrecognition argument.

Although these arguments seem to offer no exception to taxability where a special statutory taxable event occurs, it is possible that the special statutory taxable event will admit of some particular exception that would cover a partition. The principal statutes in question can be reviewed for the purpose of testing that hypothesis.

Perhaps the most pervasive special statutory taxable event concerns section 453 installment obligations. Section 453B(a)(2) provides:

> If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and . . . the fair market value of the obligation at the time of distribution, transmission, or disposition . . . otherwise than by sale or exchange.[159]

Under the explicit terms of the statute, gain or loss results without realization. Gifts, distributions from trusts and estates, and other nonrealization events will trigger section 453B(a)(2).[160] Exceptions are provided by the statute for transmission of the obligation at death, in which case section 691(a) applies,[161] and for corporate liquidations and liquidating distributions,[162] but no statutory exception touches the partition transaction.

The regulations provide a general exception: "Where the Code

157. *E.g.*, I.R.C. § 1245(b)(1), (2) (exceptions and limitations to § 1245(a)).

158. Collins v. Commissioner, 46 T.C. 461, 472 (1966) ("a division of property between coowners would not be a disposition by either").

159. I.R.C. § 453B(a)(2). This discussion reflects the provisions of the Installment Sales Revision Act of 1980, Pub. L. No. 96-471, signed by the President on Oct. 14, 1980.

160. *See* Legg v. Commissioner, 57 T.C. 164, 168-71 (1971), *aff'd per curiam*, 496 F.2d 1179 (9th Cir. 1974). *See generally* Emory, *Disposition of Installment Obligations: Income Deferral, "Thou Art Lost and Gone Forever,"* 54 IOWA L. REV. 945 (1969).

161. I.R.C. § 453B(c).

162. I.R.C. § 453B(d).

provides for exceptions to the recognition of gain or loss in the case of certain dispositions, no gain or loss shall result under section 453 . . . ."[163] This exception cannot literally protect the partition if partitions are viewed as nonrealization events and not as nonrecognition events. Because this regulation appears to create a gratuitous exception not supported by section 453B(a), it might appear, however, to invite similar administrative treatment for partitions. Nevertheless, nonrecognition of gain by force of statute reflects the judgment of Congress that reckoning of an item of gross income should be deferred pursuant to specific rules concerning basis, character, and timing. The regulation's general exception can be supported, therefore, as an interpretation of the several nonrecognition statutes, even if it cannot be supported as an interpretation of section 453B(a). On that analysis, similar treatment of partitions is no more merited than the nonstatutory rule of nonrecognition itself.

Partition of an installment obligation could take one of two forms. If a single obligation is subjected to a simple partition, it is not practically likely that a disposition will occur. Ordinarily, a jointly owned installment obligation is an indivisible unit, a promissory note payable to the order of two persons. If such a note payable to husband and wife is simply converted from tenancy by the entireties to tenancy in common,[164] and placed for collection with an agent (or left with one spouse as agent) who divides the proceeds, a disposition should not be found to have occurred.[165] On the other hand, in a complex partition where one spouse endorses his interest in a jointly payable note to the other spouse, there is no question that a disposition occurs. When this case comes to judicial attention in the marital context, a strong likelihood exists that a further exception will be created, but in other cases, section 453B(a)(2) most likely will be applied.

In the case of an item of income in respect of a decedent, a special statutory taxable event is created by section 691(a)(2) which provides that if a right to receive income in respect of a decedent is "transferred" by the person to whom it passes at death, "there shall be included in gross income the value of the amount of in-

163. Treas. Reg. § 1.453-9(c)(2) (1980). The regulations do not reflect the Installment Sales Revision Act of 1980.

164. *See* Rev. Rul. 56-437, 1956-2 C.B. 507 (also holding that conversion from joint tenancy with right of survivorship to tenancy in common is not a taxable event).

165. *See* Rev. Rul. 79-44, 1979-1 C.B. 265.

come in respect of the decedent."[166] "Transfer" includes a sale, exchange, or other disposition or satisfaction at other than face value.[167] The statute excludes transmission at death to the estate of the decedent or transfer to a person, other than the obligor, pursuant to the right of the person to receive the amount by reason of death.[168] The right to receive an item of income in respect of the decedent includes, by virtue of section 691(a)(4), the deferred gain in a section 453 installment obligation. The regulations interpret section 691(a)(2) to create a taxable event in the case of a gift,[169] and realization is not an element of the taxable event. The statute does not provide an exception which touches the partitions.

Recapture of depreciation is covered by sections 1245 and 1250, which create a special statutory taxable event in the case of the disposition of a certain class of property defined in those statutes as "Section 1245 property" and as "Section 1250 property" respectively. Each statute provides for recognition of gain whenever the property is "disposed of." A disposition in this case is a transfer.[170]

Both recapture statutes clearly apply to nonrealization dispositions. Neither statute includes any exception which would cover the nonrealization exchange incident to partition. Both statutes make exception for: gifts; transfer at death except as provided in section 691; transactions involving a substituted basis under sections 332, 351, 361, 371(a), 374(a), 721, or 731; exchanges under section 1031 and 1033; and transactions between a partner and a partnership.[171] How the recapture provisions would apply to the division of property is an entirely open question. The strict analysis based on the realization doctrine is that the partition would be a taxable disposition, but the propensity of the courts would be to hold that the statutes do not apply.[172]

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166. I.R.C. § 691(a)(2).

167. *Id. See generally* C. FERGUSON, J. FREELAND, & R. STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 157-62 (1970).

168. I.R.C. § 691(a)(2),(5).

169. Treas. Reg. § 1.691(a)-4(a) (1957).

170. Treas. Reg. §§ 1.1245-1(a) (1965); 1.1250-1(a) (1971). *See generally* C. FERGUSON, J. FREELAND, & R. STEPHENS, *supra* note 167, at 786-800.

171. I.R.C. §§ 1245(b)(3), 1250(d)(3).

172. *But see* Note, *supra* note 66, at 1041: "Under the equal value rule no sale or exchange is deemed to occur. It is only a short jump to the conclusion that there is no disposition for purposes of the recapture rules." This analysis offers an instructive example of the confusion created when "sale or exchange" is used to denote the § 61(a)(3) taxable event. When the taxable event does not occur, despite a disposition, it is due to the absence of realization. In that case, to say that no sale or exchange occurs, as courts often do, actually is to overlook the exocentricity of the couplet. It is not correct to reason from the artificial

Premature disposition of property with respect to which investment credit and other credits have been claimed by the taxpayer is a special statutory taxable event under section 47(a)(1), which requires the taxpayer to recoup his investment credit in part: "If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit . . . ."[173] A case might arise where section 38 property enters into a complex partition in such manner that the clear effect of the transaction is that the property ceases to be section 38 property. This might occur, for example, if an automobile, title to which is held in joint names, formerly used by the husband in business, is transferred to the wife before the close of its useful life and is used by her for personal transportation. There is no avoiding the fact that the car ceases to be used in business, hence ceases to be depreciable,[174] hence ceases to be section 38 property. Such a special statutory event will not easily be overcome, even by the judicial rule of nonrecognition.

Dispositions will be taxable events under the following statutes all of which involve the operative word "disposition": sections 425(c), 454(b), 617(d), 1251, 1252, 1254, 1255.[175] All of these special statutory taxable events potentially affect a partition if it is viewed strictly as a nonrealization transaction. None provide an exception which would cover the partition. On the other hand, the partition is protected from ostensible taxability under certain statutes which purport to operate on dispositions but nevertheless apply only to the realized gain. These are special characterization statutes and include sections 955(c), 1232(c), and 1235(a).

In addition to the income taxable events created by special statutory provisions, sections 6166A(h)(1)(A)(ii) and 6166(g)(1) use the term "disposed of" to define contingencies upon the happening of which the deferral of estate tax under that section is terminated. A similar consequence of a disposition is created in section 2032A(c)(1) with respect to special valuation property used for farming purposes or in a trade or business. Partitions conceivably would trigger these statutes upon the analysis that they constitute dispositions.

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meaning of the term to its ordinary meaning.

173. I.R.C. § 47(a)(1).

174. I.R.C. § 167(a)(1).

175. *See generally*, C. FERGUSON, J. FREELAND, & R. STEPHENS, *supra* note 167, at 801-07.

C. *Deferred Consequences of Partitions Wholly Without Realization*

When a partition is wholly within the rule of nontaxability, the tax consequences are deferred. The partition resembles common nontaxable exchanges in this respect but only in a general way, for the precise rules differ significantly.[176]

To illustrate the rules governing deferred tax consequences of a simple partition, the example set forth above can be supplemented by further assumptions. First, Adam acquires all of Blackacre for the cash sum of $25,000. Subsequently, Adam, allocating his basis ratably, sells an undivided one-half interest to Noble for $15,000. More than one year later, Adam and Noble effect a partition of Blackacre. Immediately prior to partition, Noble's adjusted basis in his undivided interest is $15,000, and Adam's adjusted basis in his undivided interest is $12,500.[177] After partition, Noble's basis in his separated 500-acre parcel will be $15,000; Adam's basis, $12,500.[178] As to holding period, a question arises concerning whether section 1223(1) or 1223(2) applies.[179] Are the taxpayers substituting the basis of the transferred property, or are they carrying forward with a transferred basis? This issue determines which holding period rule applies, and upon that question will depend the holding period of noncapital assets. Literally, section 1223(1) is the governing provision. In no respect should basis be deemed to have been determined by reference to the basis of the "other person."

In a wholly nontaxable complex partition, different nuances arise. To illustrate, assume that Adam and Noble in the initial example are spouses, and their joint property is community property. Incident to dissolution, Adam receives Blackacre. His basis will be the basis of Blackacre to the community.[180] In this case, there is nothing resembling a substituted basis, and the holding periods would be tacked under section 1223(2), since the basis of Adam is determined in part by reference to the basis of Noble.

Many cases will satisfy the nonrealization rule. If gain were real-

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176. With respect to specific tax consequences of exchanges in partition, we now enter a well covered area. *See generally* Bost & Kimball, *supra* note 141, at ¶ 35.02; Hjorth, note 7 *supra*; Schwartz, note 57 *supra;* Note, note 66 *supra.*

177. I.R.C. § 1012(a).

178. This result is not supported by any authority discovered. The question has not been considered.

179. *See* Private Letter Ruling 8016050 (Jan. 23, 1980).

180. *E.g., Beth Corp.*, 350 F. Supp. at 1191.

ized in the partition, many also would satisfy a nonrecognition rule. Substantial differences in tax treatment could follow. Assume that the example is varied so that the properties involved are Blackacre and Whiteacre, separate tracts each of which is held for investment. The shared basis in Blackacre is $50,000, but the shared basis of Whiteacre is $25,000, allocable equally to each owner. A complex partition gives Whiteacre to Adam and Blackacre to Noble. If Adam and Noble are unmarried, gain is realized, but section 1031(a) (assuming the parties satisfy the holding test)[181] would apply, providing amnesty from recognition of the gain. The net effect would be a basis to Adam of $37,500 in Whiteacre computed as follows:

(1) Section 1012(a). As to the one-half interest of Whiteacre with which Adam began, his basis is the cost	$12,500
(2) Section 1031(b). As to the one-half interest in Whiteacre acquired in exchange for Blackacre, Adam substitutes his former basis in the property so exchanged	$25,000
Total	$37,500

If, however, the nonrealization rule applies because the parties are divorcing spouses in a community property state, the basis to Adam will be $25,000 as he takes the transferred basis from the marital unit. In general, basis stays with the taxpayer in a nonrecognition exchange by virtue of explicit statutory provisions which permit it to be substituted to the new property.[182] In nonrealization transfers, however, by virtue of statutory provisions,[183] and by virtue of judicially developed gloss,[184] basis follows the property. The differing treatment roughly reflects the difference between deferring a tax consequence and ignoring it.

Certain statutory provisions attach special characteristics to property which will continue through a disposition. Among these provisions, sections 306(a) and 1244(a) are noteworthy. Their application to the *X* Corp. stock in a simple or complex partition as supposed in the initial example can be taken for a paradigm.

If *X* Corp. stock is "section 306 stock," the wholly nontaxable

181. *See* I.R.C. § 1031(a).
182. *E.g.*, I.R.C. §§ 358(a)(1); 1031(b).
183. *E.g.*, I.R.C. § 1015.
184. *E.g.*, *Beth Corp.*, 350 F. Supp. at 1190.

partition, whether simple or complex, would not precipitate section 306(a). Although this section purports to operate by virtue of a sale or *other disposition,* the effect of section 306(a) is only to characterize the amount realized.[185] If no amount is realized, section 306(a) does not apply. The *X* Corp. stock would continue to be section 306 stock in the hands of its transferee by application of section 306(c)(1)(C), which provides that stock is section 306 stock if it is: "[S]tock the basis of which (in the hands of the shareholder selling or otherwise disposing of such stock) is determined by reference to the basis (in the hands of such shareholder or any other person) of section 306 stock."[186] This statute would apply whether basis is considered to be substituted or carried over.

If the *X* Corp. stock is section 1244 stock, it appears that the transferee pursuant to a complex partition would lose the benefit of section 1244 to the extent of the transferred portion. Section 1244(a) applies its special ordinary loss characterization "in the case of an individual" with respect to "section 1244 stock issued to such individual." The regulations issued pursuant to this section take a narrow view of the meaning of the phrase "section 1244 stock issued to such individual," providing:

> In order to claim a deduction under section 1244 the individual, or the partnership, sustaining the loss, must have continuously held the stock from the date of issuance. . . . An individual who acquires stock from a shareholder by purchase, gift, devise, or in any other manner is not entitled to an ordinary loss under section 1244 with respect to such stock.[187]

According to these regulations the partner of a partnership to whom section 1244 stock is issued is not entitled to the section 1244 benefit if the stock is distributed by the partnership to the partner. The reasonable view of this regulation as applied to the complex partition should be that, at least to the extent of the undivided one-half interest originally inhering to the transferee, the section 1244 status continues, but as to that undivided one-half interest received from the other co-owner, section 1244 status is lost. On the other hand, where a simple partition of stock which is section 1244 stock prior to the partition occurs, the status of the stock as section 1244 stock ought to continue with respect to each

185. Treas. Reg. § 1.306-1(b)(1) (1955).
186. I.R.C. § 306(c)(1)(C).
187. Treas. Reg. § 1.1244(a)-1(b) (1960).

of the co-owners after the partition. They continue to be, with respect to their divided shares of the stock, the individuals to whom the section 1244 stock was issued.

D. *Immediate Consequences of Partial Realization of Gain Incident to Partition*

A partition may be taxable in part because extrinsic consideration is given and received. In these cases it is necessary to determine the amount of gain realized and whether it will be recognized.[188] Measurement of gain involves questions unique to partitions.

The partially taxable partition requires that section 1001 be applied. In simple partitions where the parties have a single or uniform basis, the procedure is uncomplicated. For example, if Adam and Noble partition a 100-acre tract so that Adam receives 40 acres in kind plus boot of $10, the amount realized by Adam is $10. The gain realized will be the excess of $10 over Adam's basis in the proportion of the land exchanged for cash. In the simple case, that basis would be determined simply by prorating so that 20% of Adam's basis would offset the amount realized. In a complex partition, however, problems arise in identifying which basis measures the gain. Two approaches are available.

Revenue Ruling 74-347 uses a blended basis approach.[189] Under the facts of this ruling there was no evidence that particular assets were treated distinctly, so it was not possible to determine whether some assets were exchanged and others were sold. The ruling announces a general approach to computing the gain. The basis of the husband in the excess jointly owned property received by the wife was determined by the application of a formula which had the effect of allocating the basis between the exchanged property and the sold property in the proportion that the value of the excess jointly owned property bore to the net fair market value of all jointly owned property.[190] The fraction is as follows:[191]

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188. *See* Bost & Kimball, *supra* note 141, at ¶ 35.02; Hjorth, note 7 *supra;* Schwartz, note 57 *supra;* Note, note 66 *supra.*

189. 1974-2 C.B. 26.

190. *See* Hjorth, *supra* note 7, at 255.

191. 1974-2 C.B. at 27.

$$\text{Adjusted basis of excess jointly-owned property received by the wife} = \frac{\text{Net fair market value of excess jointly-owned property received by the wife}}{\text{Net fair market value of all jointly-owned property received by the wife}} \times \text{Adjusted basis of all jointly-owned property received by the wife}$$

The adjusted basis of all the jointly owned property received by the wife included personal property with a basis of $4,000 and a net fair market value of $2,000. The basis of this property in the hands of the wife was reduced to $2,000. The ruling states that the adjusted basis of the jointly owned property received by the wife does not include the portion of the adjusted basis of any jointly owned asset which exceeds the net fair market value.[192] The basis of the wife in the jointly owned property transferred to her would, under *Davis*, be the fair market value of the taxable portion and the transferred basis of the nontaxable portion.

The blended basis approach of Revenue Ruling 74-347 is not always applicable. It is required only when it is not possible to determine that particular assets were sold. In other cases, *Carrieres* holds that where the taxpayer can show that a particular asset was the subject of the taxable sale and purchase, gain will be realized accordingly.[193] Under *Carrieres*, taxpayers are allowed latitude for tax planning, because assets with relatively less appreciation may be allocated to the taxable portion of the transaction by agreement between the parties.[194]

Since a partition always takes the form of an exchange, the potential application of a nonrecognition provision to the realized part of gain in a partially taxable partition must be considered. If a polychotomous unit of property is divided unequally and if the recipient of the greater portion of the joint property transfers separate property to equalize the division, the separate property may be eligible for nonrecognition treatment under section 1031 or sec-

192. *Id.*
193. 64 T.C. at 965-66.
194. *Id.*

tion 1036. Applying the *Carrieres* selective basis approach, the taxpayers may order the transaction so that the gain realized is not recognized by virtue of a specific nonrecognition provision.

CONCLUSION

The partition cases present a jurisprudential anomaly. Over many years, this body of cases has defined a class of exchanges which are not subject to taxation. From the beginning, these cases developed the rule with scant attention to its rationale under the Code. Although that rationale may have been self-evident to the Board of Tax Appeals when *Walz* was decided, courts and commentators in more recent years have been unable to rationalize the cases in statutory terms. Consequently, the rule of these cases lately has been regarded as a judicially created exception to a clear, statutory requirement of taxability justified solely by force of precedent. When so understood, the cases claim no legitimacy, create an arbitrary tax policy, and cause endless problems for taxpayers who, without guidance of the reason for the rule, must seek to predict tax consequences under circumstances analogous to those decided by the cases.

On closer examination, however, it is clear that the division of property between co-owners is a nontaxable event, regardless of whether it is incident to a marital dissolution. The rationale for this rule is found in the realization requirement which is part of the judicial gloss on the statutory definition of gross income. It is also apparent that the Board of Tax Appeals which decided *Walz* viewed this realization doctrine as the self-evident rationale for its result. Therefore, the marital partition cases should be understood as having developed a branch of the realization doctrine. So understood, these cases can be reconciled with the statute, and given restored legitimacy. Moreover, by reference to their nonrealization rationale, the marital partition nonrealization cases can afford reasonably predictable results in many areas which become opened to straightforward reasoning by legal analogy to the decided cases. Thus, the "marital anomaly" cases elucidate a useful area of the realization doctrine not otherwise developed in the law, because they delve farther into the tax analysis of the partition exchanges than any other body of authority has done.

Most writers who consider this area recommend a congressional solution to the marital property division problem because of the inappropriateness of the *Davis* tax as a matter of policy and because of the inequity which exists under the cases.[195] It is believed that a statutory rule of nonrecognition in marital cases is needed for these reasons and for the further reason that the courts, following the suggestion in *Carrieres*, are certain to continue the effort to develop judicial solutions in default of a congressional solution. Such solutions are rough and arbitrary, because the courts are ill-equipped to legislate.

On the other hand, it is not apparent that the subject of partitions, as opposed to marital property divisions, ought to be covered by statute. The existing provisions for nonrecognition of gain in certain exchanges cover most partitions. The realization doctrine should prove sufficient to develop solutions to marginal problems presented by the most varied circumstances out of which partitions might arise.

195. *E.g.*, Hjorth, *supra* note 7, at 264-74 (suggesting partnership analogy by legislation); Hull, *supra* note 57, at ¶ 36.10-11 (endorsing American Bar Association Family Law Section proposal patterned after § 2516); Schwartz, *supra* note 57, at 199.