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THE TAX CONSEQUENCES OF THE MARYLAND MARITAL PROPERTY ACT

Jeffrey H. Levi†

Since the adoption of the Marital Property Act by the General Assembly, the Act has been the subject of much commentary. This Article examines the federal income taxation consequences of the new divorce property settlement scheme. The author concludes that inasmuch as the Act stops short of the community property concept, it will have significant tax consequences for both spouses.

I. BACKGROUND

During its 1978 session the General Assembly of Maryland passed the Marital Property Act¹ and significantly altered the Maryland law concerning disposition of property upon divorce or annulment. Maryland thereupon shifted from a separate property jurisdiction to a quasi-separate property jurisdiction. The purpose of this article is to analyze the tax effects of the new law. This analysis contains three parts: a brief examination of the prior disposition of property law and its tax consequences; an examination of the Marital Property Act and the resulting tax consequences of a court order, award, or decree; and the tax consequences of a property settlement agreement.²

Prior to the discussion of the tax consequences of the Act, a thorough examination of state law defining property rights is required. Although state law defines the nature of the legal right to property, federal law specifies how rights created under state law will be taxed.³ An example of the deference which the United States

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1. Act of May 29, 1978, ch. 794, 1978 Md. Laws 2304 (codified as amended at MD. CTS. & JUD. PROC. CODE ANN. §§ 3-6A-01 to 3-6A-07 (Supp. 1979)) [hereinafter referred to as the Maryland Property Act]. See generally Comment, *Property Disposition upon Divorce in Maryland: An Analysis of the New Statute*, 8 U. BALT. L. REV. 377 (1979).
2. The author is aware that Maryland law provides that "[e]quality of Rights under the law shall not be abridged or denied because of sex." MD. CONST., DECL. OF RIGHTS art. 46. Thus, article 46 ensures that either spouse may be granted a monetary award as an adjustment of rights under the Marital Property Act. Merely for stylistic purposes, however, the author has designated the husband as the economically dominant spouse throughout the article.
3. *Huddleston v. Dwyer*, 322 U.S. 232 (1944); *Morgan v. Commissioner*, 309 U.S. 78 (1940); *Poe v. Seaborn*, 282 U.S. 101 (1930).

Supreme Court has shown to a highest state court's definition of property may be seen in *Collins v. Commissioner*,⁴ in which a Tenth Circuit decision was remanded in light of the adjudication of property rights by the Oklahoma Supreme Court in a case incident to divorce.⁵

II. PRIOR MARYLAND PROPERTY LAW AND ITS TAX CONSEQUENCES

Prior to the enactment of the Marital Property Act, Maryland was a separate property jurisdiction. Maryland courts in divorce proceedings had no power to transfer the husband's separate property to the wife.⁶ If a husband purchased property with his funds and titled it in his name alone, the courts were without any power to compel transfer of title to the wife. The General Assembly did provide for court determination and apportionment of property rights in connection with the ownership of personal property which was titled only in the name of one party, but the courts were limited to considering solely the actual monetary contribution of the parties to that property.⁷ In tracing the actual contribution to the acquisition of property, a court could order a partition or sale upon a finding that a partnership existed⁸ or that a constructive trust had been created,⁹ but the court was powerless to transfer property titled in the husband's name to the wife when the wife neither brought property to the marriage nor worked during the marriage.¹⁰

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4. 393 U.S. 215 (1968). The *Collins* family of cases is discussed at length later in the article. See notes 43-73 and accompanying text *infra*.
 5. *Collins v. Oklahoma Tax Comm'n*, 446 P.2d 290 (Okla. 1968).
 6. *Lopez v. Lopez*, 206 Md. 509, 518, 112 A.2d 466, 470 (1955); *Dougherty v. Dougherty*, 187 Md. 21, 32, 48 A.2d 451, 457 (1946).
 7. MD. ANN. CODE art. 16, § 29 (1973) (repealed). See *Joyce v. Joyce*, 16 Md. App. 17, 293 A.2d 839 (1972). Subsequent similar provisions were codified at MD. CTS. & JUD. PROC. CODE ANN. § 3-603 (Supp. 1978) (repealed). The current provisions for the disposition of personal property are found at MD. CTS. & JUD. PROC. CODE ANN. § 3-6A-03 (Supp. 1979).
 8. *Gosman v. Gosman*, 271 Md. 514, 318 A.2d 821 (1974).
 9. *Ensor v. Ensor*, 270 Md. 549, 312 A.2d 286 (1973).
 10. *Gebhard v. Gebhard*, 253 Md. 125, 129, 252 A.2d 171, 173 (1969). It would be remiss not to mention *Bender v. Bender*, 282 Md. 525, 534, 386 A.2d 772, 778-79 (1978), in which the court of appeals carved out an exception to the rule, cited in *Gebhard*, *Lopez*, and *Dougherty*, that the courts did not have the power to transfer property from the husband to the wife. The court of appeals declared that there is a rebuttable presumption that household goods and furnishings purchased by one spouse before or during marriage are owned by both the husband and wife jointly by the entirety. It is presumed that the husband made a gift to the marriage of the household goods and furnishings.

The tax implications of a divorce, consequently, were relatively straightforward. Because the court had no power to transfer property from the husband to the wife, no taxable event occurred. If the husband transferred property to the wife in satisfaction of alimony, the transfer was considered to be a sale of the property from the husband to the wife on which the husband had to pay income tax on a capital gain, if appropriate.¹¹ The capital gain was equal to the fair market value of the property on the date of transfer less the adjusted basis of the property. More importantly, however, the wife did not realize any capital gain on the transfer of property to her. Her basis was equal to the fair market value of the property on the date of the transfer.¹² If the husband transferred property to her that was held in tenancy by the entireties,¹³ he recognized a capital gain equal to one-half of the fair market value on the date of transfer less one-half of the adjusted basis on the date of transfer.¹⁴ The wife's basis in the property after the transfer was equal to one-half of the original cost basis in the property plus one-half of the fair market value on the date of transfer.¹⁵

In summary, under prior law, the husband's transfer of property to the wife was considered to be a sale with the resulting recognition of gain in the same manner as if the sale were made at arm's length to a third party. The wife's basis was equal to the fair market value of the property at the date of the transfer because she "purchased" the property from the husband by surrendering her inchoate marital rights. The wife recognized no gain in the surrender of these marital rights because their basis was held to be equal to the fair market value of the property which she received.

III. THE MARITAL PROPERTY ACT — THE PROBLEM

The Marital Property Act substantially altered the rights of the husband and wife in a divorce proceeding. As mentioned previously, the divorce proceeding formerly could not affect the rights in solely owned property. The law now entitles the wife to a monetary award, which reflects her contribution to the acquisition of property during the marriage.¹⁶ The property subject to this monetary award includes any property acquired during the marriage without regard to title, but excludes property acquired by either inheritance or gift from a third party, any property excluded by a valid property settlement agreement, or any other property traceable to any of the

11. *United States v. Davis*, 370 U.S. 65 (1962).

12. Rev. Rul. 67-221, 1967-2 C.B. 63.

13. MD. REAL PROP. CODE ANN. § 4-108(b)(3) (1974). Contrary to the common law, Maryland provides for the conveyance by one member of a tenancy by the entirety to the other.

14. *Stephens v. Commissioner*, 38 T.C. 345 (1962).

15. *McKinney v. Commissioner*, 64 T.C. 263 (1975).

16. MD. CTS. & JUD. PROC. CODE ANN § 3-6A-05(a) (Supp. 1979).

excluded sources.¹⁷ This award to the wife or non-titled contributing spouse is not mandatory, but is discretionary based upon the following factors: the monetary and non-monetary contributions of the parties during the marriage; the property owned by the parties without regard to title; the financial situation of the parties at the time of the award; the circumstances leading to the dissolution of the marriage; the length of the marriage; the age, physical and mental condition of the parties; the effort expended by each party in accumulating the marital property, including how and when the property was acquired; disposition of personal property or the family home; and such other factors that the court may deem necessary to

17. *Id.* § 3-6A-01(e).

The definition of marital property in and of itself presents many interesting problems. The statute as written fails to take into account the appreciation of property during the marriage which is the sole result of the husband's efforts and labor. An example is an instance when the husband owns an unincorporated business prior to the marriage. If the husband fails to incorporate the business, it is easy to identify any additional property which he acquires after the date of the marriage. All that has to be done is check his books and tax returns. However, if this same man incorporates his business before the marriage and receives shares of stock in the new corporation, he now merely owns shares of stock which, by definition, is property acquired prior to the marriage and thereby excluded from the purview of the statute. Because a stockholder owns only shares in the corporation and not the assets that are titled in the corporation's name, the husband has effectively excluded any appreciation in the value of the business as reflected in assets acquired by the corporation after the date of marriage. This is especially important in a business which is owned by one person who makes his living from this business and whose wealth is reflected in the prosperity of the business. The use of the corporate mechanism shelters the owner from accounting for much of the appreciation of his net worth for which he would ordinarily account if he remained a sole proprietor. This appears to be an effective means of sheltering the earnings of the husband, the profits, and appreciation from property which otherwise might be characterized as marital property due to the fact that it resulted from the skill and efforts of the husband during marriage.

This problem has not gone unrecognized by states that follow community property law. In *Johnson v. Johnson*, 89 Nev. 244, 510 P.2d 625 (1973), the Supreme Court of Nevada recognized that, although the stock in the husband's business may be titled in the husband's name alone because the business was incorporated prior to marriage, the increase in value in the stock resulting from the labor, skill, and industry of the husband during the marriage should be subject to division under community property law.

As previously discussed, the Marital Property Act specifically excludes property acquired before the marriage. Therefore, the author recommends that a sole proprietor incorporate his business prior to his marriage in order to avoid the inclusion of this property in the "marital property." Although the author fully appreciates that the stated purpose of this article is to analyze the tax effects of the Marital Property Act, he firmly believes that one of the best methods of tax planning is to exclude property solely owned by the husband prior to the marriage from the purview of the Act so that the property remains the husband's sole property and is thereby exempt from taxation due to the absence of any transaction.

In the same vein, consider the effect of the Marital Property Act on real property owned by the husband subject to a mortgage. Since Maryland is a "title state," it may be argued that the husband never had title to the property but merely owned the equity of redemption. On the other hand, it may be argued with equal force that the mortgagor has title against all of the world except his

arrive at an appropriate award.¹⁸ Any unpaid amount of the award may be reduced to judgment.¹⁹ The crucial factor for tax analysis of the Act is that a Maryland court never has the right to transfer ownership of either personal property²⁰ or real property.²¹ Rather, the court may partition jointly held property or order a sale in lieu of partition.²² In this respect the law is unchanged. The court may also declare the ownership interest of either spouse in the property,²³ but once it declares that one spouse is the sole owner of property no compulsory transfer may take place. This concept is extremely important because the wife never acquires any rights of ownership in the *res* itself. Her rights do not attain the status of co-ownership in the property but merely reflect what she may be awarded as compensation in terms of a monetary judgment. This monetary judgment, as in the case of any judgment, is the classic example of a burden on the property. Even when the entire legal fault for the dissolution of the marriage rests with the husband, the best that any court could do to offset the injury to the wife is to award a large judgment in her favor. The husband nonetheless retains the ownership of the property subject to the judgment awarded to the wife. The wife's rights, which may be asserted upon the filing of a divorce and which are inchoate in the same sense as was dower, never attain the dignity of co-ownership. The status of the wife's rights will be discussed following an analysis of the principal cases from other jurisdictions.

The final and perhaps most significant element of the statute is the disposition of the family home and family use personal property.

mortgagee and that he acquired the property prior to the marriage. The possibility exists that mortgaged property may be excluded from the definition of marital property. In order to assure fully that this property will be excluded from marital property, the husband should pay off the mortgage prior to the marriage and get an unsecured loan if possible. By paying off the mortgage, the husband avoids the marital property problem because the mortgage will not be paid off with marital property earnings. This prevents any argument by the wife that the husband did not have title in the property and that he only acquired title in the property by using marital property funds.

The author also recommends that the husband continue to retain in his sole name after the marriage all stocks, bonds, and bank accounts which he had in his own name prior to the marriage. This, too, will prevent these items from being included in marital property. This segregation of assets can only serve to help the husband trace his separate property at the dissolution of the marriage. Finally, when the husband transfers funds attributable to his separate property, he should use a checking account established for the sole purpose of handling separate property funds. In this manner, he can avoid the commingling of these funds with marital property.

18. MD. CTS. & JUD. PROC. CODE ANN. § 3-6A-05(b) (Supp. 1979).

19. *Id.* § 3-6A-05(c).

20. *Id.* § 3-6A-03(a).

21. *Id.* § 3-6A-04(a).

22. *Id.* §§ 3-6A-03(b)(2), 3-6A-04(b)(2).

23. *Id.* §§ 3-6A-03(b)(1), 3-6A-04(b)(1).

The family home is defined as the principal residence of the family as a unit, but does not include property acquired before the marriage, by gift or inheritance from a third party, or property excluded by a valid agreement.²⁴ Family use personal property is essentially tangible personal property acquired during the marriage and used around the home, including motor vehicles, but not including property acquired by gift or inheritance from a third party.²⁵ The Act empowers courts to award temporary use of the family home and family use personal property to the spouse who has custody of a minor child so that the child may continue to live in familiar surroundings.²⁶ As long as the custodial parent does not remarry, this spouse and the minor child may have temporary possession of the family home and family use personal property for a period not exceeding three years. At the end of three years, or a lesser period if the court so declares, the family home and family use personal property will be treated as marital property unless the family home or family use personal property was acquired prior to the marriage, or by gift or inheritance from a third party, or excluded by a valid agreement, in which case it shall be awarded to its rightful owner.²⁷ The court may also order the spouse who is not the occupant of the family home to pay for any or all of its upkeep including rent or mortgage payments, insurance, taxes, and maintenance.²⁸

In summary, the Marital Property Act allows a possible monetary judgment in favor of the wife in order more accurately to reflect her monetary and non-monetary contributions to the accumulation of property during the marriage. The Act recognizes

24. *Id.* § 3-6A-01(b).

25. *Id.* § 3-6A-01(c). Act of May 14, 1979, ch. 295, 1979 Md. Laws 957, effective July 1, 1979, amends this provision of the Marital Property Act to enlarge the exclusion. With the adoption of this statute, family use personal property may now be excluded by a valid agreement.

26. *Id.* § 3-6A-06(a).

27. *Id.* § 3-6A-06(f). There is a conflict which must be noted between the definitional and operational sections of the Marital Property Act concerning family use personal property and the family home. In the definitional section, § 3-6A-01, property acquired before the marriage, by gift or inheritance from a third party, or excluded by a valid agreement is excluded from family use personal property and the family home. One would think in reading this definitional section that property so acquired is excluded from a temporary use and possession order. Yet the operational section of the statute states that upon the termination of a use and possession order, property which was acquired before the marriage, by gift or inheritance from a third party, or excluded by valid agreement shall be returned to its actual owner. This implies that a person's sole property which was acquired under these conditions is subject to a temporary use and possession order. This conflicts directly with the definitional section which excludes the very same property from the use and possession order. This inconsistency should be resolved by the General Assembly. See Comment, *Property Disposition upon Divorce in Maryland: An Analysis of the New Statute*, 8 U. BALT. L. REV. 377, 405 (1979) (citing additional inconsistencies).

28. *Id.* § 3-6A-06(c)(2).

her contributions in and out of the home to the accumulation of wealth by the family unit. While she has custody of the children, the Act also permits her to continue to occupy the home for a period not exceeding three years. In permitting this temporary occupancy, the General Assembly has attempted to minimize the traumatic impact of the divorce upon the children. In analyzing the tax consequences of the Act, this article will first discuss the monetary award and then the use and possession order.

IV. THE CASES

The key tax case in the analysis of any property transfer resulting from a divorce is *United States v. Davis*.²⁹ In *Davis*, the husband transferred appreciated property under Delaware law pursuant to a property settlement agreement. The agreement stated that it constituted a "division in settlement of their property"³⁰ and that it was "in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy . . .)."³¹

The first issue addressed by the *Davis* Court was whether the transfer of stock constituted a taxable event. The husband contended that it was merely a non-taxable division of property pursuant to an agreement between co-owners. The Court rejected this contention by stating that under Delaware law the wife's rights in the husband's property do not attain the dignity of co-ownership.³² She had no interest in her husband's property while he was alive and could share in his estate only if she survived him. The wife's rights, therefore, were inchoate rights. Her eventual share in her husband's property was defined by the Delaware trial court's finding of reasonableness, based on such factors as the wife's financial condition, her accustomed standard of living, her age and health, the age of the children, and the husband's earning capacity.³³ The Supreme Court summarized that regardless of the labels affixed to the transaction, Delaware law merely places a burden on the husband's property analogous to alimony or support and does not make the wife a co-owner. The husband's obligation under *Davis* is personal in nature and is not a division of property between co-owners.

In examining subsequent cases and analyzing the Marital Property Act it is apparent that the principal issue, as in *Davis*, is whether the wife's rights under the Act acquire the dignity of co-

29. 370 U.S. 65 (1962).

30. *Id.* at 66 (emphasis added).

31. *Id.* at 67.

32. *Id.* at 70.

33. *Cf.* Md. Cts & Jud. Proc. Code Ann. §3-6A-05(b) (Supp. 1979) (listing the factors on which a monetary award may be based).

ownership, thereby constituting a division of property between co-owners, or whether a personal obligation is placed upon the husband by divorce which imposes a burden on his property. In post-*Davis* cases, some jurisdictions have held that the rights of co-ownership may be found, even though they arise only upon the filing of a divorce.³⁴ Others hold that a number of factors may be considered in arriving at the division of the property.³⁵ The basic question, however, remains whether a co-ownership or personal obligation exists. The answer to this question is determinative of tax status because if the wife is found to be the co-owner, there is merely a non-taxable division of property between co-owners; otherwise, the event is taxable.

In computing the gain to be taxed when the husband transferred property to the wife, the *Davis* Court held that the husband realized a gain in the amount of the difference between the fair market value of the property on the date of transfer less his adjusted basis in the property.³⁶ Because the transfer was treated as an arm's length transaction, the value of the property that was transferred by the husband was presumed to be equal to the value of the marital rights that the wife surrendered. The wife's basis in the property that she received in exchange for those marital rights was the fair market value of the property at the time of the transfer.³⁷ In addition, there was no gain in the surrender of the wife's marital rights because they had no historical basis.³⁸

A significant Eighth Circuit decision applying *Davis* was *Wallace v. United States*.³⁹ The appellant's wife filed for divorce in Iowa. The husband and wife entered into a property settlement agreement whereby the wife retained her own real and personal property and received the marital home. The wife received no alimony, and the division of the husband's stock was left to the court. The court ordered the husband to transfer to the wife stock with a fair market value of \$158,486 and a basis in the husband's hands of \$3,051.⁴⁰ The issue before the court of appeals was whether the gain of \$155,435 was taxable to the husband. In holding that the gain was taxable, the court noted that the Iowa statute on division of

34. *Imel v. United States*, 523 F.2d 853 (10th Cir. 1975) (applying Colorado law).

35. *Collins v. Oklahoma Tax Comm'n*, 446 P.2d 290 (Okla. 1968).

36. 370 U.S. at 72-74.

37. *Philadelphia Park Amusement Co. v. United States*, 126 F. Supp. 184 (Ct. Cl. 1954) (where the court held that the cost basis of property received in a taxable exchange is the fair market value of the property received in the exchange). *United States v. Davis*, 370 U.S. 65 (1962), made voluntary property settlement transfers taxable events at least to the husband. See text accompanying note 29 *supra*.

38. 370 U.S. at 73 n.7; Rev. Rul. 67-221, 1967-2 C.B. 63.

39. 439 F.2d 757 (8th Cir.), *cert. denied*, 404 U.S. 831 (1971).

40. *Id.* at 758.

property⁴¹ gave the trial court, similar to the power given the Delaware court in *Davis*, great discretion in awarding relief.

The *Wallace* court also distinguished an apparently contrary decision by the Tenth Circuit in *Collins v. Commissioner*.⁴² The Tenth Circuit had held in *Collins* that an Oklahoma divorce resulted in a non-taxable division of property because the wife "possessed a species of common ownership in his [the husband's] property 'similar in conception to community property of community property states.'"⁴³ *Collins* was distinguished from *Davis* because the wife in *Collins* was made part owner of the husband's property by operation of a state statute. The courts in Oklahoma, therefore, had a mandatory, and not a permissive duty to divide the jointly held property. The court in *Wallace* concurred with the district court's determination that *Wallace* was more similar to *Davis* than to *Collins* because the wife's property rights were inchoate.

Wallace is important for two reasons. First, the Eighth Circuit rejected the artificial distinction between a property settlement agreement and a court order that adjusts the rights between the parties. *Wallace* is also useful because the court sought to answer the fundamental question for tax purposes of whether a property transfer necessitated by a divorce made the wife a co-owner of the property, or whether the statute merely granted inchoate rights to the wife. The test set out in *Wallace* seemed to be that statutes making the division of property mandatory are indicative of co-ownership, while statutes establishing permissive division are indicative of inchoate rights.

It follows, therefore, from *Davis* and *Wallace* that if the wife is actually the co-owner of the property, then her right to the property should be absolute so as to compel a mandatory division. It is the proper function of the court to determine the extent of ownership based upon those factors that the state legislature deems important. This situation can be differentiated from the circumstance in which the wife does not have any rights in the property until the court makes a discretionary award of property to the wife. This discretionary award is tentative and recognizes that the wife has no current property rights, whereas the mandatory award recognizes the wife as co-owner and seeks to adjudicate merely the extent of her ownership.

41. IOWA CODE § 598.14 (1950): "When a divorce is decreed, the court may make such order in relation to the children, property, parties, and the maintenance of the parties as shall be right Subsequent changes may be made by it in these respects when circumstances render them expedient."

42. 412 F.2d 211 (10th Cir. 1969).

43. 439 F.2d at 760 (citing *Collins v. Oklahoma Tax Comm'n*, 446 P.2d 290, 295 (Okla. 1968)). This *Collins* case [hereinafter *Collins-Oklahoma*] was the basis of the remand order in *Collins v. Commissioner*, 393 U.S. 215 (1968).

In Maryland, the granting of a monetary award under the Marital Property Act rests with the discretion of the court. The wife does not have an absolute right to this award but merely a tentative or inchoate right based upon the court's discretion. The size of the award is not important in determining her tax status. The fact that her right is tentative is an indication, according to the *Wallace* test, that the wife is not a co-owner of the property and that she has merely inchoate rights in the property.

The most thorough exposition of the law on this subject is *Collins v. Commissioner*,⁴⁴ and related subsequent cases. The parties in *Collins* were married in 1942. The wife brought property not exceeding a value of \$10,000 to the marriage while the husband brought shares of a family-owned company. During the marriage, the husband acquired additional stock. In accordance with the property settlement agreement between the parties, the husband transferred stock to the wife, the fair market value of which at the date of transfer was greatly in excess of the husband's basis. The husband contended that the transfer was not a taxable event because his wife had acquired a vested right in the stock by virtue of the marriage. Thus, the court had only to determine the extent of her interest. The Commissioner took the opposite view, contending that the transfer was a taxable event because Oklahoma law did not vest any property rights in the wife, and that therefore her rights did not resemble co-ownership. The Commissioner buttressed his position by contending that the wife's rights were not descendible, that she could not have prevented disposition of the property, and that she had no right to a fixed percentage of the property. The Commissioner also argued that the court's determination was based upon factors other than her efforts to increase the value of the property, such as her needs, her station in life, and her costs in educating the children of the parties.⁴⁵ In holding that the transfer of property constituted a taxable event, the Tax Court based its decision upon the determination that the wife had no vested interest in her husband's property until the filing of the divorce and that the division of the jointly acquired property was subject to vast judicial discretion.⁴⁶

In affirming the Tax Court ruling, the *Collins* court based its decision on the fact that the wife did not have the traditional elements of co-ownership such as a descendible interest, right of control in and disposition of the property, and a vested interest in

44. 46 T.C. 461 (1966), *aff'd*, 388 F.2d 353 (10th Cir. 1968), *vacated and remanded*, 393 U.S. 215 (1968), *for decision consistent with*, *Collins v. Oklahoma Tax Comm'n*, 446 P.2d 290 (Okla. 1968), *rev'd*, 412 F.2d 211 (10th Cir. 1969).

45. 388 F.2d at 354.

46. 46 T.C. at 474.

the property.⁴⁷ The division of the property between the parties need not be equal. In fact, all of the property could be awarded to one spouse upon the payment to the other spouse for his or her share of the property. Although the court found that in many instances the wife has the right to share in the property, this right does not obtain the dignity of co-ownership. This finding was consistent with the rule in *Davis*.⁴⁸

In a one sentence opinion, the United States Supreme Court vacated and remanded the Tenth Circuit's decision in *Collins*⁴⁹ for reconsideration in light of an Oklahoma Supreme Court tax case involving the same petitioner. In *Collins v. Oklahoma Tax Commission*⁵⁰ (hereinafter referred to as *Collins-Oklahoma*), the Oklahoma Supreme Court held that the transfer of appreciated stock was a division between co-owners, because an Oklahoma statute⁵¹ required the division of jointly acquired property between the spouses upon demand. The wife therefore had a vested interest in the property acquired by joint efforts which could not be defeated even if she were the party principally at fault in the dissolution of the marriage, the property were titled in the husband's name alone, or the husband had brought separate property to the marriage and through joint efforts, skills, or funds it had increased in value.⁵² It is not surprising that on remand the Tenth Circuit reversed its former position and found that the transaction was a non-taxable division of property.⁵³ The court, however, continued to stress the underlying requirement for an examination of state law in order to determine whether the transfer is a non-taxable division of property between co-owners or a taxable sale of the property. The court held that the *Davis* practice of looking beyond the labels to the actual rights of the parties must be continued.⁵⁴ Because the highest court of Oklahoma concluded the division to be a non-taxable division, the Tenth Circuit was bound by this determination and could only conclude that the transfer was a non-taxable division between co-owners.

The *Collins* cases offer useful insights for analysis of the federal income tax consequences of the Marital Property Act. In *Collins-Oklahoma*, the Oklahoma Supreme Court found that the statutory division of property was mandatory and not permissive. In Maryland, the monetary award permitted under the Marital Property Act can only be interpreted as permissive because it is discretionary with the court.⁵⁵ In Oklahoma, a wife has a vested

47. 388 F.2d at 358.

48. *Id.*

49. 393 U.S. 215 (1968).

50. 446 P.2d 290 (Okla. 1968).

51. *Id.* at 295. OKLA. STAT. ANN. tit. 12, §1278 (West Supp. 1961).

52. 446 P.2d at 294-95.

53. 412 F.2d 211 (10th Cir. 1969).

54. *Id.* at 212.

55. MD. CTS. & JUD. PROC. CODE ANN. §3-6A-06(b) (Supp. 1979).

interest in jointly acquired property even though she may be the party at fault. In Maryland, however, the Marital Property Act permits the court to consider fault in granting a monetary award.⁵⁶ In Oklahoma, record title in the husband does not destroy the status of the property as jointly acquired property subject to division. In Maryland, the Act expressly prohibits the court from transferring property owned by the husband to the wife.⁵⁷ In Oklahoma, any property brought separately by the husband into the marriage that increases in value by his and his spouse's joint efforts, skills, or funds becomes jointly acquired property subject to division by a court upon divorce. In Maryland, this same property would remain separate and not subject to division.⁵⁸ In Oklahoma, the statutory division may be decreed even if the court does not dissolve the marriage. In Maryland, the court may make a monetary award only upon granting either a divorce *a vinculo matrimonii* or an annulment.⁵⁹ In Oklahoma, the wife has an absolute right to the division of the property and has absolute rights in the *res* itself. In Maryland, on the other hand, the wife has no right to the *res* itself but merely to a discretionary monetary award.

If *Collins-Oklahoma* (mandatory division rights) is accepted as the definition of ownership, then the Maryland rule appears to place a burden on the husband's property because the wife has only a discretionary right to share in his property, and the court cannot change ownership of the property. The wife's potential rights in Maryland are limited to a discretionary monetary award that may be reduced to a judgment, which represents a classic burden on his property. Thus, it appears that transfers under the Maryland rule fall within the category of a taxable transfer of property between husband and wife similar to that in *Davis*. A further analysis of other cases will provide additional support for this conclusion.

In *Wiles v. Commissioner*,⁶⁰ the appellant's wife filed for a divorce in Kansas. The husband and wife reached a settlement in which neither would claim alimony, and all property, whether held jointly or separately, would be equally divided. In order to carry out this agreement, the husband transferred stock which had a fair market value in excess of \$500,000 and which had a basis in his hands of about \$80,000. Again, the tax issue was whether the transfer constituted a division of property between co-owners and was therefore not taxable. The *Wiles* court held that, in Kansas, the wife had only inchoate rights to marital property. Her rights during the marriage were limited to the provisions for intestate succession

56. *Id.* § 3-6A-06(b)(4).

57. *Id.* §§ 3-6A-03(a), 3-6A-04(a).

58. *Id.*

59. *Id.* § 3-6A-05(a).

60. 499 F.2d 255 (10th Cir. 1974), *cert. denied*, 419 U.S. 966 (1974).

which also included an interest in one-half of all of her husband's realty which he conveyed during the marriage without obtaining her consent. Upon the filing of the divorce in Kansas, the wife gained additional rights. The Kansas statute provided for the court to divide all of the couple's property in a just and reasonable manner.⁶¹ The division of property was solely within the trial court's discretion and was dependent on such factors as the source of the property, the contributions of the husband and wife, the earning capacity, fault, needs, ages, and the length of the marriage.⁶² The court held that these factors were inconsistent with co-ownership and, therefore, failed the *Davis* test.⁶³

According to *Wiles*, rights of actual co-ownership should be based on more than a tenuous equitable share. Until determined, if at all, such a share could have no real value. Despite the fact that the Oklahoma mandatory division statute was based upon the Kansas statute under review in *Wiles*,⁶⁴ the court also distinguished its *Collins* decision and *Collins-Oklahoma*. The *Wiles* court held that it must find a non-taxable division of ownership (even though they apparently logically believed it was unfounded) because of the United States Supreme Court's remand in *Collins* and the Court's directive to follow the reasoning in *Collins-Oklahoma* that the wife had acquired a "species of common ownership by statute."⁶⁵ The *Wiles* court found this interpretation troublesome,⁶⁶ however, in light of *Sanditen v. Sanditen*,⁶⁷ another Oklahoma decision decided after the *Collins* cases. The *Wiles* court believed that *Sanditen* stood for the proposition "that a wife has no vested rights in the property subject to division. Vesting occurs by virtue of the divorce action and not the marriage relationship."⁶⁸ If that were true, then *Sanditen* appeared to limit if not overrule *Collins-Oklahoma*. In attempting to bolster its decision in *Wiles* by questioning the decision it was compelled to make in *Collins*, however, the Tenth Circuit misinterpreted *Sanditen*, which actually held that a husband could not give away jointly acquired property with the purpose of defeating a wife's marital rights at death.⁶⁹ The *Sanditen* court cited a line of cases

61. KAN. STAT. ANN. § 60-1610(c) (Supp. 1978).

62. 499 F.2d at 257-58. All of these factors are to be considered in the monetary award under the Marital Property Act.

63. *Id.* at 258.

64. *Id.*

65. *Id.*

66. *Id.* "In any event, the Oklahoma position is still troublesome."

67. 496 P.2d 365 (Okla. 1972). See text accompanying note 49 *supra*.

68. 499 F.2d at 258.

69. 496 P.2d at 367-68 (emphasis added).

which held that the wife's rights are protected to the extent that a husband cannot (1) make an incomplete gift so as to defeat a wife's intestate rights at his death, (2) give away jointly acquired property in contemplation of divorce to limit property available for settlement, (3) give away property so as to lessen his ability to support his wife during or after a marriage, and (4) dispose of the homestead.⁷⁰ When interpreted in this light, *Sanditen* is consistent with those cases holding that the wife's rights are merely protected without stating that the rights are vested. To that extent, the *Wiles* court was incorrect in holding that the rights are vested.

Wiles represents an interesting attempt by the Tenth Circuit to steer its way past its decision in *Collins* and back to its safe harbor of taxing property transfers when the wife's rights vest only upon the filing of a divorce. *Wiles* fails in this attempt, however, because of its erroneous interpretation of *Sanditen* as an equivocation of the rights clarified in *Collins-Oklahoma*. Far from retreating from the proposition that the wife's rights in the husband's property vest upon the filing of a divorce, *Sanditen* reiterates that position⁷¹ and adds that the husband may not defraud a wife of her marital rights by giving away jointly acquired property. The Tenth Circuit seems to hold that vesting of the rights of co-ownership can only mean a vesting at the time the marriage began. The more appropriate and realistic conclusion is that vesting occurs upon filing for a divorce. This vesting recognizes the inchoate rights which the wife acquired at the commencement of the marriage but had no need to assert so long as the marital relationship was a strong and stable one.⁷²

70. *Id.* at 367.

71. *Id.*

72. See, e.g., *Putnam v. Putnam*, 104 Kan. 47, 177 P. 838, 840-41 (1919). In *Putnam* the court stated:

But a wife has certain rights and interests in property acquired by the husband during the existence of the marriage relation which, with the aid of the statute, the courts upon proper occasion will recognize and protect. Without such statute these rights of the wife would be imperfect and unenforceable, but they would morally exist nevertheless, and they only need such statute to give them legal vitality. . . .

. . . In pioneer times the family usually commenced life with little or no property. Land was cheap and easily acquired. The combined efforts and economies of the husband and wife for a long stretch of years usually resulted in prosperity, in the accumulation of the familiar forms of Kansas property. During the years of mutual industry, self-denial, and domestic harmony of the married couple, it would not ordinarily be important whether each succeeding tract of land or other property acquired by their joint efforts was taken in the name of the husband or wife. If they lived together happily both would enjoy the property, and upon the death of one of them, the other's half interest would completely mature, and the statute of wills and of descents and distributions would protect it. If their marital partnership — for the joint accumulations of property by a husband and wife are slightly analogous to that of a partnership — is wrecked by marital discord and their troubles become the concern of a divorce court, the court may equitably divide the property accumulated during the marriage relation.

The vesting of rights of which the Supreme Court spoke in *Davis* is not the automatic vesting of property rights at marriage as found in community property states,⁷³ but rather when the inchoate rights of the wife become absolute *at any stage* of the marital relationship. It should make no difference whether the wife's rights vest absolutely at the marriage ceremony, as in community property states, or upon the filing of a petition for divorce, as in *Collins-Oklahoma*, because both recognize the wife's contribution to the accumulation of property by the marital unit. The important issue for tax purposes is whether these rights vest absolutely or depend on the discretion of any court for creation. It is equally important to determine whether the wife has a right to the *res* itself. The Maryland Marital Property Act gives neither of these rights to the wife.

The final series of cases that may be profitably analyzed arises from Colorado law. In *Pulliam v. Commissioner*,⁷⁴ the appellant's wife filed for a divorce and requested a division of property to which the husband agreed. The trial court granted the divorce and transferred property to the wife. The Tenth Circuit reviewed Colorado law in attempting to ascertain the extent of the wife's rights, and held that her rights did not vest during the marriage and that the nature of the husband's obligation to her was personal.⁷⁵ The wife had no right of dower and only a right to one-half of the husband's estate in intestacy. The Colorado divorce statutes permitted the courts to grant alimony and to divide the property using its discretion.⁷⁶ Hence, the court awarded each party his own separate property and ordered the husband to transfer one additional parcel of property to the wife.

The husband contended in *Pulliam* that because the property transfer resulted from a court decree, it was not a voluntary property settlement agreement. Therefore, he argued that the property transferred could not be valued at its fair market value as in an arm's length transaction, and that he could not be held responsible for the gain recognized. The court rejected this argument by applying the *Davis* holding that "where property without ascertainable value is exchanged for other property in an arm's length transaction, . . . the values of the property on each side of the

73. *Harrah v. Commissioner*, 70 T.C. 735 (1978). For a more detailed explanation of community property law, see PEPPY & DEFUNIAK, *COMMUNITY PROPERTY IN THE UNITED STATES* (1975); Vaughn, *The Policy of Community Property and Inter-Spousal Transactions*, 19 BAYLOR L. REV. 20 (1967).

74. 329 F.2d 97 (10th Cir. 1964).

75. *Id.* at 97-98.

76. *Id.* at 98.

exchange are equal,"⁷⁷ even though it was not a true voluntary transaction. The court also rejected the argument that emotional factors prevented this from being an arm's length transaction. The court concluded that because both parties requested the division of property, the best solution would be to treat the transfer for tax purposes as though it were voluntary.⁷⁸ In a final attempt to distinguish *Davis*, the husband argued that there was no release of marital rights in exchange for the property transferred. The court concluded, however, that the decree ended any marital rights to which the wife may have been entitled and thereby acted in a manner similar to a voluntary property settlement agreement including a release of marital rights.

Pulliam is important in applying Maryland law because of the court's careful analysis of state law to determine the nature of the wife's rights. The court's determination that the rights of the wife do not attain the dignity of co-ownership is based upon the conditional nature of those rights as evidenced by the discretionary power in the court to divide the property. The Tenth Circuit's analysis that the decree operates in the same manner as a release of marital rights found in a voluntary separation agreement is likewise well reasoned. Although the finding in *Pulliam* was eventually overturned by *Imel v. United States*,⁷⁹ dictating that in Colorado the wife's rights are now found to attain the dignity of co-ownership,⁸⁰ *Pulliam's* studied approach to a difficult problem is welcome.

A subsequent Tenth Circuit case, *Hayutin v. Commissioner*,⁸¹ however, is consistent with *Pulliam*, notwithstanding that court's later decision in *Imel*. The parties were married in 1945 and divorced seventeen years later. In a property settlement agreement, the wife was to receive \$198,000 which consisted of the husband's interest in the house, a \$5,000 note, the household goods, and a cash settlement of \$163,000 to be paid over the course of eighteen years. Due to the inconsistent treatment of this payment by the husband and wife on their respective tax returns,⁸² the Commissioner assessed deficiencies against both parties. The wife's claim that these payments were not alimony but were in recognition of a non-taxable division of property by co-owners was rejected.⁸³

In *Imel*, decided in the same term as *Hayutin*, the wife had obtained her divorce in Colorado in 1964 with the court retaining

77. *Id.* at 99.

78. *Id.*

79. 523 F.2d 853 (10th Cir. 1975).

80. *Id.* at 856-57.

81. 508 F.2d 462 (10th Cir. 1974).

82. I.R.C. §§ 71(a), 71(c), 215. The husband reported a larger alimony deduction than the wife reported income.

83. 508 F.2d at 469.

jurisdiction over alimony and a future division of property. In 1965, the court approved a property settlement agreement entered into by the parties, finding that the wife was an active participant in the accumulation of the family wealth, that the agreement fairly recognized this participation, and that it was a fair division of the property. In accordance with the agreement, the husband transferred corporate stock which had a fair market value in excess of \$1,100,000 and a basis in his hands of \$400,000. The Commissioner assessed a deficiency against the husband, who paid it under protest and filed a timely petition for refund with the United States District Court for the District of Colorado. The issue before the district court was whether the transfer was a non-taxable division of property between co-owners. The district court entered judgment in favor of the taxpayer.^{83a}

On appeal, the primary argument offered by the Commissioner was that "state law cannot determine what is a taxable event under the federal income tax laws."⁸⁴ The *Imel* court disagreed by noting that while it is state law which defines one's interests and rights in domestic relations, it is federal law which determines how the transfer of those interests and rights are taxed.

The Commissioner also argued that the decision of the Colorado Supreme Court was contrary to *Davis*. The Tenth Circuit noted in *Imel* that the Colorado Supreme Court found that the wife had a species of common ownership similar to that which the Oklahoma court had found in *Collins-Oklahoma*. The court also noted that it was persuaded by *Collins-Oklahoma* to find a non-taxable division of property between co-owners. *Imel* was the first post-*Collins* case to reach the Tenth Circuit, and that court held the transfer to be taxable after it considered the *Pulliam* decision and the similarity between Oklahoma and Colorado law. The court realized it was facing a dilemma when it said: "We have now gone full circle. Just as Oklahoma held that we were wrong in *Collins # 1* so has Colorado ruled that *Pulliam* does not state Colorado law. We followed the Oklahoma decision and the question is whether we should follow the Colorado decision."⁸⁵ The court solved its dilemma by holding that *Davis* "did not establish a federal standard as to the nature of the pre-transfer right in the transferred property,"⁸⁶ nor did it "define the time when the interest of the wife had to vest."⁸⁷ The court noted that in Oklahoma and Colorado, the wife's rights become vested with the filing of the divorce. The court held that there was "nothing

83a. 523 F.2d at 853-54.

84. *Id.* at 855.

85. *Id.* at 856.

86. *Id.*

87. *Id.*

in *Davis* which requires that the wife's interest vest before the bringing of the divorce action."⁸⁸

In affirming the decision of the district court that there was a non-taxable division of property between co-owners, the Tenth Circuit reviewed most of the cases which have been previously discussed in this article. *Davis* was noted because of its recognition that it would permit different tax treatment of property settlement in different states.⁸⁹ *Pulliam* was discussed to show that the court had previously ruled that in Colorado, the wife's rights did not vest so as to attain the dignity of co-ownership.⁹⁰ The *Collins* cases were reviewed to show that the United States Supreme Court required the Tenth Circuit to review its decision in light of *Collins-Oklahoma* which held that the wife acquired a species of common ownership.⁹¹ Finally, the court analyzed both its certification to the Colorado Supreme Court for the determination of the nature and extent of the wife's rights⁹² and the district court's analysis of the tax consequences thereon. The court added credence to its position by noting that the Colorado Supreme Court decision was a true adversarial proceeding in which both Colorado and federal law were reviewed.⁹³

The Tenth Circuit's attempt to distinguish both *Wiles* and *Hayutin* is interesting. It reasoned that *Wiles* was decided in accordance with *Davis* and that the wife's rights do not vest under Kansas law. According to the court, *Hayutin* was distinguishable on both the law and the facts. This conclusion is questionable when the reader considers the careful review of authorities and the outright dismissal of the *Imel* certification question by the court in *Hayutin*.⁹⁴ This pitiful attempt to distinguish *Hayutin* serves no purpose because the exact question answered in *Hayutin* is later overruled in *Imel*.

Finally, it is interesting to note the emphasis which the court placed on certification in reaching its decision.⁹⁵ It must be remembered that the Colorado Supreme Court decision in *Imel* was available to the Tenth Circuit in *Hayutin*, and it chose to ignore that *Imel* decision. Certification can be useful when it defines the nature and extent of the wife's rights. The decision of whether these rights, however, attain the dignity of co-ownership perhaps should be left to the federal courts; otherwise, the state court has in essence determined the federal tax consequences of a disposition of property.

88. *Id.*

89. *Id.* at 854.

90. *Id.*

91. *Id.*

92. *In re* Questions Submitted by the United States District Court, 184 Colo. 1, 517 P.2d 1331 (1974).

93. 523 F.2d at 855.

94. 508 F.2d at 468-69.

95. 523 F.2d at 856-57.

Federal courts, at this point, probably believe that they must automatically comply with a certification in this matter in light of the remand by the Supreme Court in *Collins*. Certainly, the legal community would have been better served if the Supreme Court delineated how the wife's rights attained the dignity of co-ownership.

V. THE EFFECT IN MARYLAND

A. *The Monetary Award*

A review of the important cases on the subject perhaps provides an answer to the fundamental question of whether a wife's rights attain the dignity of co-ownership such that a non-taxable division of property results when a monetary award is given by a court in accordance with Maryland's Marital Property Act. In light of the cases, a practitioner should conclude that the wife's rights do not attain the dignity of a co-ownership in Maryland. *Davis* states that the attorney must look beyond labels to the actual rights of the wife. In Maryland, the statute clearly delineates the wife's rights by stating that the court cannot transfer ownership of the property from one spouse to the other.⁹⁶ How then can the wife's rights attain the dignity of co-ownership if she cannot take title to the property itself? Clearly, she cannot be a co-owner as the cases have defined that term. Absent any rights to the *res* itself, it would be mere legal sophistry to argue that a division of property occurs between co-owners in Maryland.

This opinion is not based on this conclusion alone but on the other factors which have been discussed by the courts. The *Collins* cases are extremely important because they delineate the standards which must be satisfied if a division of property between co-owners is to be achieved. It should not be left to state courts arbitrarily to determine co-ownership, because it is the *absolute nature* of the wife's rights which enable her to be designated as a co-owner. Absolute rights should be created by legislatures, not courts.

The Oklahoma statute requires a division of jointly acquired property upon divorce.⁹⁷ By comparison, the rights granted to the wife under the Maryland Act pale into insignificance, because, in Maryland, the wife has no right to any share of the property itself. The monetary award is solely a matter of the court's discretion and fault is used by the court as a factor to determine the amount of the award. The husband's separate property is expressly excluded by statute from any determination in computing the monetary award. If

96. MD. CTS. & JUD. PROC. CODE ANN. §§ 3-6A-03(a), 3-6A3-04(a) (Supp. 1979).

97. OKLA. STAT. ANN. tit. 12, § 1278 (West Supp. 1978).

a comparison is made of the wife's rights in Oklahoma with the wife's rights in Maryland, the Oklahoma rights are absolute and vested rather than contingent and tentative as in Maryland. Prior to the passage of the Marital Property Act, the wife's rights were clearly inchoate. She had a right to a statutory share of her husband's property at his death and the right to alimony should she be granted a divorce, but at no time did she have a right to his property which amounted to co-ownership. The question which now must be asked is whether the Act grants new rights which are indicative of co-ownership. The author thinks not, for the wife is still not entitled to share in the property itself. Her rights remain inchoate in nature subject to discretionary invocation by the court, and the wife is not entitled to a mandatory division of the husband's property.

In reflecting upon whether the wife's rights attain the dignity of co-ownership, one must examine the concept of the wife's attaining additional rights upon the filing of a divorce. The cases examined reveal that Kansas, Iowa, Oklahoma, and Colorado recognize certain rights of the wife upon the filing of a divorce. Following enactment of the Marital Property Act, Maryland has apparently joined this circle of states that has rejected the traditional concept of co-ownership during marriage. These traditional elements of ownership of property can be defined as the possession of a descendible interest, the right to control the property, and the right to dispose of the property. The above-mentioned states, however, do not recognize this traditional definition and, instead, examine the rights of the parties upon the filing of the divorce. The traditional factors play a role in the analysis by the courts of these states secondary to the recognition of the indirect and direct efforts by each spouse in accumulating and enhancing the value of the marital property. The courts and society in general have re-examined the traditional concepts of marriage and divorce;⁹⁸ perhaps a redefinition of co-ownership in marriage is also appropriate. The filing of a divorce, which was the exception not so many years ago, is now an almost common fact of life. The law of domestic relations must reflect these changes in society. The Marital Property Act is an attempt to reflect such change by recognizing that during a marriage, property contributed initially by the husband is enhanced in value by monetary as well as non-monetary contributions of the wife. The Act attempts to recognize that the husband and the wife both contribute to the marriage and to the accumulation of property, no matter how it is titled. This law recognizes that when a marriage is dissolved, the wife should receive a share of the property that reflects her contribution to it. The law recognizes a right which the

98. *Marvin v. Marvin*, 18 Cal. 3d 660, 557 P.2d 106, 134 Cal. Rptr. 815 (1976).

wife need not assert while the marriage is sound. This change is timely and proper. The method Maryland has chosen, however, does not give to the wife the rights of co-ownership for federal tax purposes. Her rights are discretionary with the court and do not entitle her to the property itself. She is not a co-owner. The wife's monetary award, which may be reduced to judgment, can only be classified as a burden on the husband's property or an obligation of a personal nature to the husband. Consequently, it must be concluded that, in Maryland, there is not a division of property between co-owners, and that the wife's rights are inchoate in nature.

Inasmuch as it has been concluded that there is not a non-taxable division of property between co-owners in Maryland, the remaining question is the tax consequence of the wife's monetary award. It is the author's belief that the monetary award should be treated in the same manner as the voluntary property settlement agreement in *Davis*, that is as a sale.⁹⁹ The Supreme Court, in *Davis*, noted that the current administrative practice was not to consider the surrender of the wife's rights as a taxable event.¹⁰⁰ In order to be a taxable event, there should be gain. Because there is no basis in marital rights, there is no way to calculate gain. If the gain cannot be determined, there is no practical way to assess the tax. The Commissioner has subsequently ruled that the wife realizes no gain or loss on the surrender of her dower rights in exchange for an interest in real property.¹⁰¹ Because dower has been labelled by the Supreme Court as an inchoate right which has not attained the dignity of co-ownership,¹⁰² and it appears that the wife's rights in Maryland are still inchoate in nature, the wife will continue not to recognize any taxable gain upon the receipt of money in satisfaction of her monetary award. The wife, at least for tax purposes, is treated as if she participated in a non-taxable division of property in a community property state. In Delaware, under *Davis*, the wife is not taxed on the property she receives in a voluntary settlement agreement. Likewise, in Maryland, she should not be taxed on the monetary award that she receives.

The Maryland husband has not made a sale in the usual sense, but will be taxed as if he had. For the price of the award, he receives the wife's marital rights as in *Davis*. In satisfying the monetary award, the husband will create a cost basis to him in these rights, for he will take the fair market value of the property transferred by him as the basis in the inchoate rights of the wife which he receives.¹⁰³

99. *Wallace v. United States*, 439 F.2d 757, 760-61 (8th Cir.), cert. denied, 404 U.S. 831 (1971).

100. 370 U.S. at 730 n.7.

101. Rev. Rul. 67-221, 1967-2 C.B. 63.

102. 370 U.S. at 70.

103. *Id.* at 72-73. See also I.R.C. § 1011.

The question, therefore, is how to allocate this basis to his marital property. An analysis by the court of the wife's contribution to each item of marital property would seem to satisfy the *Davis* presumption that the sale between the husband and wife is an arm's length transaction¹⁰⁴ and, in the absence of this analysis, the husband should allocate the amount of the monetary award to his marital property to reflect the purchase of his wife's inchoate rights in each item of marital property.

B. The Use and Possession Order

As stated previously the wife is entitled to a use and possession order for the family home and family use personal property. Moreover, the husband may be ordered to pay the rent, mortgage, insurance, taxes, and maintenance related to the property.¹⁰⁵ Before examining the tax treatment of these items, it is important to remember that, according to the statute, if the wife remarries, her right to these payments terminates.¹⁰⁶ The condition against remarriage is important inasmuch as it enables the husband to treat these items as deductions for federal tax purposes¹⁰⁷ because of a contingency imposed by local law despite failure of the payments to extend over ten years.¹⁰⁸ As long as the payments are periodic and conditional in nature, they will meet the preliminary requirements of being includible in the wife's income¹⁰⁹ and deductible by the husband;¹¹⁰ however, a further analysis is necessary in order to characterize these payments accurately.

In *Marinello v. Commissioner*, the Tax Court held that, when pursuant to a divorce decree the husband is obligated to pay the wife's rent, this rent is includible in the wife's income and deductible by the husband.¹¹¹ This case is interesting because the husband transferred the property (in which his wife was still living) to his wholly owned corporation and then paid rent to the corporation. The Tax Court characterized the payment of rent by the husband to his corporation as periodic payments which are includible in the wife's income. Because the court also permitted the husband's payments for heat to be included in the periodic payments in *Marinello*, then arguably, payments by the husband in Maryland pursuant to a use and possession order for rent, utilities, heat, and maintenance

104. 370 U.S. at 72.

105. MD. CTS. & JUD. PROC. CODE ANN. § 3-6A-06(c)(2) (Supp. 1979).

106. *Id.* § 3-6A-06(a).

107. Treas. Reg. § 1.71-1(d)(3)(i)(a) (1963).

108. Rev. Rul. 59-190, 1959-1 C.B. 23.

109. I.R.C. § 71.

110. *Id.* § 215.

111. 54 T.C. 577 (1970).

should be includible in the wife's income and deductible by the husband.

A contrary decision was reached in *Pappenheimer v. Allen*.¹¹² In *Pappenheimer* the husband owned an unencumbered home. Pursuant to a consent decree, the wife was to occupy the home until her death, her remarriage, the marriage of all of the children, or their youngest child attained age twenty-three, whichever occurred first. The husband attempted to deduct the fair rental value of the home as a periodic payment to the wife pursuant to a decree of divorce. The Fifth Circuit disallowed this deduction because the judgment specified that the wife had a unified or single right to occupy the home; because occupancy was continuing, there were no periodic payments by the husband. A use and possession order which permits the wife to occupy the husband's home free of rent would neither give the husband a right to deduct the value of the rental nor impose an obligation on the wife to take into income the value of the rental.

Under certain conditions following a use and possession order, the husband will be permitted a partial deduction of his mortgage payment for a property held by tenancy in common. The Commissioner has ruled that one-half of the interest, principal, insurance, and taxes is deductible by the husband and includible by the wife provided the payments cover a period of more than ten years or are otherwise periodic.¹¹³ As discussed previously, the statutory condition of termination because of remarriage makes these items periodic both under the regulations and revenue rulings.¹¹⁴ The same ruling also held that one-half of the interest and property taxes are allocable to the husband and deductible by him and that one-half of the interest and property taxes are deductible by the wife under sections 163 and 164 of the Internal Revenue Code. The Commissioner also has noted that the one-half payment attributable to the husband's ownership interest is clearly not deductible to him.¹¹⁵

The Commissioner has also determined that where mortgage payments are made by the husband on property owned in tenancy by the entireties or in joint tenancy with right of survivorship with his wife, one-half of the mortgage payment and interest is includible in the wife's income and deductible by the husband, provided the payments otherwise qualify as alimony.¹¹⁶ It should be noted that under a use and possession order in Maryland, the above determination is applicable even if a divorce *a mensa et thoro* is granted; such

112. 164 F.2d 428 (5th Cir. 1947).

113. Rev. Rul. 62-39, 1962-1 C.B. 17.

114. See notes 106-110 and accompanying text *supra*.

115. Rev. Rul. 59-190, 1959-1 C.B. 23.

116. Rev. Rul. 67-420, 1967-2 C.B. 63.

a divorce does not terminate a tenancy by the entireties.¹¹⁷ When a divorce *a vinculo matrimonii* is granted, however, the tenancy by entireties is terminated and becomes a tenancy in common;¹¹⁸ the rules applicable to a tenancy in common would then apply. Insurance and real estate taxes paid by the husband are not includible in the wife's income when the property is owned in tenancy by the entireties.¹¹⁹ Real estate taxes, on the other hand, are deductible by the husband if he itemizes them. No matter how the home is owned by the parties, utilities are deductible as alimony when paid by the husband for the wife under a use and possession order because they are considered current expenses for the enjoyment of the property.¹²⁰

VI. FOOD FOR THOUGHT FOR MARYLAND TAX ADVISORS

The parties to a divorce need not wait to have their marital property rights determined by the court. They may still enter into a valid agreement that determines the nature and value of these rights.¹²¹ Having shown that in Maryland the wife's rights are inchoate in nature, a transfer of property by the husband in satisfaction of these rights would appear to be a mirror image of the tax consequences of *Davis*. Specifically, the husband would realize gain to the extent that the fair market value of the property transferred to the wife exceeds his basis in it, and the wife would not realize gain upon the surrender of her marital rights. Her basis in the property which she receives would be its fair market value.¹²² To that extent, Maryland taxpayers can anticipate a result consistent with *Davis*.

With these conclusions in mind, the husband can follow several different routes to minimize his tax consequences. Clearly the first alternative is to transfer property with a high basis in reference to its fair market value so as to minimize gain. The second alternative is for the property settlement agreement to allocate the wife's marital property rights to specific marital property and to provide for the husband to give the wife a lump sum cash settlement. The husband can then sell the designated property to provide for the cash necessary in the settlement and also realize less gain due to his purchase of the wife's inchoate rights and the accompanying increase in basis to the property to which the cost of the rights was

117. *Roberts v. Roberts*, 160 Md. 513, 154 A. 95 (1931).

118. *Keen v. Keen*, 191 Md. 31, 60 A.2d 206 (1948).

119. Rev. Rul. 62-38, 1962-1 C.B. 15.

120. Rev. Rul. 62-39, 1962-1 C.B. 17.

121. MD. CTS. & JUD. PROC. CODE ANN. §3A-6A-01(e) (Supp. 1979).

122. 370 U.S. at 72-73.

allocated. The nature of his gain will depend upon the property transferred by the husband to the wife.

A word of caution is in order, however. First, in assigning values of the wife's inchoate rights, the husband should assign those rights to marital property and not to his separate property. In *Jean C. Carrieres*,¹²³ the Tax Court held that the wife in a community property state realized gain when she received a portion of her husband's separate property instead of receiving a portion of the marital property. The gain was realized because the wife exchanged community property with a cost basis for separate property (cash). The court treated this exchange as a sale. By analogy, it appears doubtful that the Commissioner would permit the use of separate property in Maryland to satisfy a marital property rights obligation without the wife's full realization of the gain attributable to the separate property. The increase in basis due to the purchase of the inchoate marital rights cannot be transferred to the husband's separate property, only to marital property. Second, the parties should attempt a fair allocation as to what the husband is paying for alimony and what he is paying or transferring in exchange for the wife's marital rights. In *Grant R. Bishop*,¹²⁴ the Commissioner successfully recharacterized what the parties had labelled solely alimony as both a non-deductible division of community property and alimony. It is suggested that a reasonable allocation must therefore be attempted to avoid the attention that an unreasonable allocation would certainly draw, as happened in *Bishop*.

VII. CONCLUSION

In summary, the Marital Property Act does not elevate the wife's rights in Maryland to the level of co-ownership. It does provide, however, for tax planning opportunities which should be utilized. An award by a court pursuant to the new statute is not classified as income for the wife. This result is curious because the wife's rights do not attain the dignity of co-ownership. It is the unique construction of the Marital Property Act that permits this result. In addition, a property settlement agreement under the act is a classic *Davis* transfer with its accompanying tax problems for the husband.

123. 64 T.C. 959 (1975), *aff'd per curiam*, 552 F.2d 1350 (9th Cir. 1977).

124. 55 T.C. 720, 725 (1971).