JOINT OWNERSHIP BEFORE AND AFTER THE TAX REFORM ACT

William W. Stuart*

Until the Tax Reform Act of 1976, joint tenancies had been treated almost exclusively under the originally enacted provisions of the Federal Estate and Gift Tax portion of the Revenue Code.[1] Aside from the development of special provisions dealing with joint tenancies in community property states during the period 1942 to 1948[2] there was only one significant change of the code in this area[3] from 1916 to 1976. In the Tax Reform Act of 1976[4] and in the Revenue Act of 1978,[5] however, there was significant revisions in the taxation of joint ownership. These changes, while affecting only joint tenancies between husband and wife, have had great impact because of the widespread use of joint tenancies by spouses.

The majority of residences are owned by married couples who hold their property either as joint tenants or as tenants by the entirety.[6] It is generally thought that for spouses' these are forms of ownership

* Visiting Associate Professor, University of Illinois School of Law 1978-1979; Associate Professor of Law, DePaul University; A.B., 1965, Stanford University; LL.B., 1969, Washington and Lee University.

1. *See* Revenue Act of 1916, ch. 463, § 202(c), 39 Stat. 756, 778 (1916) (currently codified in scattered sections of 26 U.S.C.).

2. Revenue Act of 1942, ch. 619, § 402, 56 Stat. 798, 941-42 (repealed 1948).

3. *See* I.R.C. § 25.2.

4. Pub. L. No. 94-455, 90 Stat. 1520 (1976) (codified in scattered sections of 26 U.S.C.).

5. Pub. L. No. 95-600, 92 Stat. 2763 (1978) (to be codified in scattered sections of 26 U.S.C.).

6. *See* Hines, *Real Property Joint Tenancies, Law Fact and Fancy*, 51 IOWA L. REV. 582, 617 (1966); Powell, *Joint Ownership in Estate Planning*, 22 OHIO ST.L.J. 292, 295 (1961).

Joint tenancy and tenancy by the entirety are technical concepts of property law. One may summarize these concepts as follows:

[(1)] Joint Tenancy with Right of Survivorship

The distinctive characteristic of joint tenancy is the right of survivorship, the property passing to the surviving joint tenants, generally free of the claims of the heirs and creditors of the deceased cotenant.

[(2)] Tenancy by the Entirety

The essential distinction between a tenancy by the entirety and joint tenancy is that the former applies only to husband and wives and that each spouse owns the whole estate. Its essential similarity with joint tenancy is that each spouse has the right of

desirable and normal because of the spouses' close relationship and because of their mutual economic and service contributions to the property jointed owned. Further, joint tenancy provides security for a spouse upon the death of the other and avoids the cost and burden of probate. Joint tenancy, however, can provide obstacles to estate planning, since it restricts the disposition of property in an individual's will and can result in high estate taxes.

This Article will first consider the history of the treatment of joint tenancy under tax laws of the United States and the problems which developed over the period prior to the enactment of the Tax Reform Act of 1976. Attention then will be given to changes in treatment of joint tenancies made by the Tax Reform Act as well as problems which have been created by this enactment. Specifically, consideration will be given to problems of double taxation, proof, special elections, fractional interests, successive additions to value, and severance. Next, the modification made by the Revenue Act of 1978 will be taken up including elimination of actuarial computation, treatment of qualified joint interests, and joint interests in family enterprises. Finally, attention will be directed to the consequences of disclaimers of joint tenancy.

I. INITIAL TREATMENT OF JOINT TENANCIES

Estate Tax

Section 202(c) of the Revenue Act of 1916[7] was the initial authority for federal estate taxation of joint tenancies. Except for property nominally held jointly but, in fact, originally belonging to someone other than the decedent, this section provided for valuation in a decedent's property, at the time of death, including any property held in joint ownership.[8] This provision, currently codified in section 2040(a) of the Internal Revenue Code of 1954, has remained basically unchanged except for the recent changes in the law affecting joint tenancies between husband and wife.[9]

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survivorship. Neither spouse may terminate the tenancy so as to affect the right of survivorship in the other spouse, but together they may end it by sale or conveyance. [1977] FED. TAXES (P-H) ¶ 13,002.

7. Revenue Act of 1916, ch. 463, § 202(c), 39 Stat. 756, 778 (current version at I.R.C. § 2040(a)) provided:

> That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated:
>
> (c) To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or institutions in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have belonged to the decedent.

8. *Id.*

9. I.R.C. § 2040(a), *as amended by* Tax Reform Act of 1976, Pub. L. No. 94-455, § 2000(c)(1), 90 Stat. 1520.

Except for any individually retained right in the property, this provision treated the creation of a joint tenancy in real property by a husband and wife, as a gift by the donor spouse. In practice, the husband usually furnished all the consideration for a home held in joint tenancy with his wife, but the required gift tax return was often not filed. It was argued that the tax law should be modified to reflect the fact that most couples using joint ownership acted to insure the right of survivorship in the surviving spouse, without intending to make a gift.[10] In 1954, Congress amended prospectively the gift tax statute to provide that the creation of a joint tenancy in real property between husband and wife would not be a taxable event for gift tax purposes, unless an election were made to treat the transfer as a gift within the time provided for the filing of a gift tax return.[11]

Upon the death of the donor spouse under the original provision, the donor's gross estate included the entire value of the property held jointly by the decedent and his spouse, unless it could be established that consideration for the acquisition of the property was furnished by the surviving spouse, or that the property was acquired by the joint owners by gifts or inheritance.[12] If a claim was to be made that the entire value of the jointly-held property was not to be included in the estate, the executor was required to conduct a tracing procedure to identify the contributors to jointly-held property and determine their individual contributions. Obviously, as to long-term holdings or where property improvements were made over an extended period, the executor's job was not easy, and he could not have confidence in the results unless meticulous records had been kept either by the decedent or the joint tenants.[13] Consequently, estate taxes were frequently overpaid for lack of proof as to the surviving cotenant's contribution to the property.

The standard necessary to determine the contribution of the decedent and cotenant for estate tax purposes upon the death of a joint tenant, has long been recognized. The conclusiveness of this test was established by the United States Supreme Court in *United States v. Jacobs*.[14] The issue in that case was whether the entire value or only one-half of the value of real property purchased by a decedent with his own funds and held at his death by him and his wife in a joint tenancy set up prior to 1916 should be included in the decedent's gross estate under

10. *See generally* Dean, *Federal Tax Consequences of Ownership*, 53 GEO. WASH. L.J. 863 (1965).

11. I.R.C. § 2515(a). The gift tax treatment of property subjected to joint ownership will be addressed later. See text & notes 31-48 *infra*.

12. Int. Rev. Code of 1954, ch. 11, § 2040, 68A Stat. 385 (superceded).

13. *See generally* Cheifetz, *Joint Tenancy: New Law Simplifies Estates Tax Consequences of this Type of Ownership*, 18 TAX. FOR ACCOUNTANTS 270 *passim* (1977).

14. 306 U.S. 363 (1939).

the 1924 Revenue Act.[15]

In *Jacobs*, real estate was conveyed to a husband and wife, "as joint tenants." The joint tenancy continued until the husband's death but the wife never contributed any part of, or consideration for, the jointly-held property. When the husband died, the wife became the sole owner of the property.[16] The Commissioner, pursuant to the 1924 Act,[17] included the full value of the property in the decedent's gross estate for taxation.[18] In earlier opinions, however, the Supreme Court had ruled that the 1916 Revenue Act did not purport to impose an estate tax measured by the value of property held in joint tenancies created prior to the 1916 Act.[19] On the basis of the 1924 enactment, the Court held that if the property was acquired with the decedent's funds, or set up in part by his contribution and in part by the contribution from the spouse of property which the decedent had previously given the spouse, a gross estate should include the full value of real or personal property that was owned by the decedent and his spouse as joint tenants at the time of his death.[20] Therefore, if the tenant who died first contributed none of the consideration and his or her executor substantiated this fact, no part of the jointly-held property could be included in his or her gross estate.[21]

Prior to the Tax Reform Act of 1976, therefore, property held jointly by spouses was included in the gross estate of the first spouse to die, except to the extent that the surviving spouse could show that he or she had furnished consideration for the purchase of such property. The result was often litigation, double taxation, and a variety of other undesirable consequences from various viewpoints.[22] It was held, for example, that even though the full value of jointly-held property would otherwise be included in the decedent's gross estate, if, together with his

15. *Id.* at 364.

16. *Id.*

17. Act of 1924, ch. 234, § 301(a), 43 Stat. 253, 303 (1924) (currently codified in scattered sections of 26 U.S.C.) imposed a tax "upon the transfer of a tax net estate of every decedent dying after" the Act's enactment. The Act included in each gross estate the value of "the interest . . . [in property] held as joint tenants by the decedent, any other person, or as tenants by the entirety by the decedent and spouse, . . . except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than a fair consideration in money or money's worth: *Provided*, that where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such person from the decedent for less than a fair consideration in money or money's worth, there shall be excepted only such part of the value of such property as in proportionate to the consideration furnished by such other person. . . ." *Id.* § 302(e), 43 Stat. at 304-05.

18. 306 U.S. at 370-71.

19. *See* Knox v. McElligott, 258 U.S. 546, 549 (1922); Shwab v. Doyle, 258 U.S. 529, 535 (1922).

20. 306 U.S. at 371.

21. *See generally* Tuck v. United States, 282 F.2d 405 (9th Cir. 1960); Estate of Fleming, 43 T.C.M. (P-H) ¶ 74,307 (1974); Treas. Reg. § 20.2040-1(c) (1959).

22. *See* Worthy, *Problems of Jointly Owned Property*, 22 TAX LAW. 601, 615-17 (1969).

spouse, the decedent made a deathbed gift of the property to a third party, then by operation of section 2035 only one-half of the value of the property would be deemed to be in the decedent's gross estate.[23]

Furthermore, the "consideration furnished" test employed under the earlier provisions required a tracing of funds which was usually difficult and sometimes impossible. As a result, jointly-owned property could be subjected to an estate tax even though more complete records would have permitted at least a partial exclusion. Because of this sometimes harsh result, estate planners recommended against the joint ownership of property by spouses.[24]

Problems of proof relating to claimed contribution by the survivor gave rise to considerable litigation. Both the regulations and the case law placed the burden of proof on the executor.[25] Where funds had been commingled and there was no evidence as to the proportion of the contribution that was attributable to the surviving spouse, the Tax Court ruled that all the property was includible in the decedent's estate.[26] The Ninth Circuit affirmed the requirement that the survivor must establish contribution in order to exclude property from an estate for purposes of avoiding estate taxation.[27]

Although regulations under section 2040 appeared to be relatively straightforward, these regulations were subject to limitation upon judicial review. For instance, regulation 20.2040-1(c)(4) provided that if the decedent had given a joint owner the money that was used to acquire the jointly-owned property, the entire property was to be included in the decedent's estate.[28] On at least three occasions, courts have refused to apply this regulation strictly. In *Harvey v. United States*,[29] the Seventh Circuit held that income from gift property or gain from its realized appreciation in value is not deemed to be prop-

23. *See* Sullivan's Estate v. Commissioner, 175 F.2d 657, 659-60 (9th Cir. 1949).

24. *See, e.g.*, Worthy, *supra* note 22, at 626.

25. *See* Tuck v. United States, 282 F.2d 405, 409 (9th Cir. 1960); Treas. Reg. § 20.2040-1(a) (1959).

26. Estate of Heidt, 8 T.C. 969, 976-77 (1947), *aff'd*, 170 F.2d 1021 (9th Cir. 1948). The Ninth Circuit in Tuck v. United States, 282 F.2d 405 (9th Cir. 1960), held that the entire value of stock was includible in the estate of the decedent where the decedent had transferred stock in a controlled corporation to his spouse shortly before a stock dividend had been declared and the spouse, in turn, transferred all shares into joint tenancy. *Id.* at 410. The court ruled that the surviving spouse failed to meet the burden of proving that the capitalized profits had been earned after the transfer. *Id.* at 410.

27. Estate of Heidt, 170 F.2d 1021, 1022 (9th Cir. 1948) (per curiam).

28. If the decedent, before the acquisition of the property by himself and the other joint owner, gave the latter a sum of money or other property which thereafter became the other joint owner's entire contribution to the purchase price, then the value of the entire property is so included, notwithstanding the fact that the other property may have appreciated in value due to market conditions between the time of the gift and the time of the acquisition of the jointly held property.

Treas. Reg. § 20.2040-1(c)(4) (1958).

29. 185 F.2d 463 (7th Cir. 1950).

erty acquired from the donor and any contribution of the income to joint tenancy property is that of the donee.[30] Two federal district courts, finding that the entire proceeds from the sale of donated property were contributed to the joint tenancies, held the gain realized to be the contribution of the donee.[31] Both courts also noted that if the original transaction transferring property from the donor to the donee had been for "less than one adequate or full consideration in money or money's worth," rather than being entirely a gift, regulation 20.2040-1(c)(5) would hold that income was the contribution of the donee and that there was basis for different treatment under subsection (4) of that regulation.[32]

One approach taken by surviving joint tenants has been to claim that the property they own should not be treated as jointly owned for tax purposes. While it is difficult, it is not impossible to establish that what is a joint tenancy in form, is not a joint tenancy for tax purposes.

In *Estate of Chrysler v. Commissioner*,[33] the Second Circuit held that putting property in joint tenancy between the decedent and his minor children was merely a device to avoid guardianship and a formal trust.[34] In upholding the estate, the court found that the joint tenancies were merely devices for making completed gifts to the children without satisfying the cumbersome requirements of the state custodianship statute.[35] In its opinion the court concluded:

> We find convincing evidence of decedent's intention to relinquish all beneficial interest in the property transferred, including the right of survivorship, in favor of his minor children; . . . in the reporting of each transfer as a completed gift; in the reporting of income from the property transferred as income of the children; and in the fact that decedent never used any of the funds transferred for his own benefit. With such extrinsic proofs, it seems likely that if the children had died first, the property would have been part of their estates.[36]

Nevertheless, there is every indication that the Commissioner will resist such claims. In *Estate of Hicks v. Commissioner*,[37] for example, a similar argument was summarily dismissed by the Tax Court,[38] although it

30. *Id.* at 468.
31. First Nat'l Bank v. United States, 223 F. Supp. 963, 967 (W.D. Mo. 1963); Schwartz v. United States, 182 F. Supp. 540, 542 (D. Mass. 1960).
32. First Nat'l Bank v. United States, 223 F. Supp. 963, 967 (W.D. Mo. 1963); Schwartz v. United States, 182 F. Supp. 540, 542 (D. Mass. 1960). Another issue raised under § 2040 is the claim of contribution for participation by the surviving tenant in a joint business enterprise, which is dealt with later in relation to change made by the Revenue Act of 1978. See text & notes 49-57 *infra*.
33. 361 F.2d 508 (2d Cir. 1966).
34. *Id.* at 510.
35. *Id.*
36. *Id.*
37. 36 T.C.M. (CCH) 905 (1977).
38. *Id.* at 907.

should be noted that the decedent in *Hicks* did not have the carefully prepared ledgers that were presented into evidence in *Chrysler*.[39]

Treatment of property held in joint tenancy under the estate tax provisions of the Revenue Code has required that the entire value of the property be included in a decedent's estate unless the individual conditions of the joint tenancy could be established either in terms of an initial paid for contribution or a consideration furnished contribution. Problems of proof were necessarily faced by any executor making any claim of exclusion from the estate of the decedent holding jointly owned property.

Gift Tax

Until 1954, the gift tax treatment of joint tenancies was left almost entirely to judicial decision, which, in turn, looked to state law. *Lily v. Smith*[40] was one of the earliest opinions considering the tax consequences of joint tenancies. In that case, the taxpayer and his wife acquired a residence as tenants by the entirety, with funds provided by the taxpayer.[41] Rejecting the taxpayer's argument that the "gift tax" law and the "estate tax" law must be construed *in pari materia*, the court held that there was no fatal inconsistency between the gift tax and the estate tax and that the gift tax could be applied to the transaction.[42]

On determining the value of a gift consisting of joint ownership, reference to state law governing joint ownership has been required. If the tenancy is severable by either party, valuation is simple: The value of each party's interest is one-half of the total value and the value of the gift is the donee's interest less any contribution provided by the donee.[43] If the tenancy is not severable (as in some tenancies by the entirety), accurate tables must be consulted.[44] There are exceptions. The creation of joint tenancies in bank accounts or savings bonds is not considered a gift until the funds are actually withdrawn by the donee joint tenant.[45] Similarly, brokerage accounts in joint tenancy are not considered gifts until actual transfer of stock certificates;[46] actual stock certificates, however, can be held in joint tenancy and considered a gift

39. *Id. See* Internal Revenue Manual § 1277-8 (indicating that includibility will be sought under § 2038 of a transfer by a decedent to himself as custodian under the Uniform Gift to Minors Act).
40. 96 F.2d 341 (7th Cir.), *cert. denied*, 305 U.S. 604 (1938).
41. *Id.* at 342.
42. *Id.* at 343-44.
43. Treas. Reg. §§ 25.2511-1(h)(5), .2512-2(b)(1) (1954).
44. *Id.* § 25.2515-2(b)(2) (1954). *See also* Lilly v. Smith, 96 F.2d 341, 342 n.2 (7th Cir.), *cert. denied*, 305 U.S. 604 (1938).
45. Treas. Reg. § 25.2511-1(h)(4) (1954).
46. Rev. Rul. 69-148, 1969-1 C.B. 226.

at the time the donee's name is registered.[47]

Prior to the enactment of the Internal Revenue Code of 1954, the treatment of joint tenancies under the gift tax law was not without its problems. As has been noted, many spouses acquired homes in joint tenancy with consideration supplied by one spouse but without a gift tax being paid. This presented a problem of inadvertent tax law violation. The 1954 Report of the House Ways and Means Committee noted this problem and suggested legislation to remedy it:

> Under present law the creation of a tenancy by the entirety may result in a gift from one spouse to the other at the time the tenancy is created. Moreover, the termination of the tenancy may also constitute a gift unless the proceeds are divided between the husband and wife. Frequently, real property is held in a tenancy by the entirety to insure the right of survivorship in the surviving spouse. Many couples who elect this method of buying a home have no intention of making a gift at the time of the creation of the tenancy by the entirety or any knowledge that they are considered as having done so.[48]

In 1954, Congress amended the gift tax statute prospectively to provide that the creation of a joint tenancy in real property between husband and wife after December 31, 1954 would not be a taxable event for gift tax purposes, unless within the time provided for filing of a gift tax return, an election was made to treat the transfer as a gift.[49] The election can be made by filing a gift tax return reporting the transfer for the calendar quarter in which the transfer is made.[50] Likewise, each mortgage payment on or each addition to the joint property is an additional gift to the donee for tax purposes only if a similar election is filed.[51] This gift tax return must be filed[52] regardless of whether a gift tax is payable under the provision providing for a $3,000 annual gift exclusion.[53]

If no gift had been reported at the creation of such a joint tenancy, there would be a gift if the proceeds upon a subsequent sale were not divided in accordance with the original contributions. If the proceeds received by one spouse were greater than his or her pro-rata share based upon consideration furnished, a gift tax would be imposed on the

47. Guzy v. Commissioner, 8 T.C.M. (CCH) 681, 683 (1949); Treas. Reg. § 25.2511-1(h)(5) (1954).

48. H.R. REP. No. 1337, 83d Cong., 2d Sess. 94 (1954), *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4120-21.

49. I.R.C. § 2515(a). The 1954 enactment left untouched other joint tenancies, such as those among parents and children or among siblings and omitted any treatment of joint tenancies in personal property by these provisions.

50. *Id.* § 2515(c)(1).

51. *Id.* § 2515(c)(2).

52. *Id.* § 2515(a)(1).

53. *Id.* § 2503(b).

additional amount received.[54]

One advantage of filing the election at the time of the formation of the joint tenancy was that any subsequent appreciation could accrue to the donee spouse without incurring any additional gift tax.[55] Thus, the effect of the 1954 enactments was to provide possible immunization of appreciation in value from the gift tax if there is a severance or sale followed by distribution of the proceeds. With investment real estate, this immunization can be a true advantage if the purpose is to augment the donee spouse's estate. With a residence, however, such an election might have very undesirable tax consequences. For instance, if the gift tax on one-half of the property eligible for the gift tax marital deduction[56] is compared with the estate tax on the whole, less any credit for gift taxes paid,[57] the estate tax could be equal to or less than the gift tax paid. It will also be necessary to consider the time value of money lost by paying the tax at the time of the gift. No litigation has evolved from the election to treat such a creation as a gift. Moreover, at least one authority has commented that he has never known anyone to make the election.[58] The only controversies are found in revenue rulings: Whether a co-operative apartment in New York constitutes real property;[59] what constitutes a termination when no election has been made.[60]

Generally, where no gift tax was paid originally, a gift tax must be paid on the exchange of jointly-owned property for other property, unless either the value of the interest each tenant acquires in the new property is proportionate to his original contribution toward the acquisition of the originally jointly-held property, or the new property is real estate and title to it is taken in the same manner as the original property was held.[61] Thus if the original creation of the joint tenancy was not treated as a gift, there would be two ways to avoid a gift tax on the later sale. First, one could divide the sale proceeds between co-owners

54. *Id.* § 2515(b).

55. Treas. Reg. § 25.2515-4(b) (1958). If the tenancy is not severable by either spouse acting alone, one must use actuarial computations to determine the spouse's relative values at termination. Distribution of proceeds other than in accordance with the relative values will be a taxable gift.

56. *See* I.R.C. § 2523, *as amended by* Tax Reform Act of 1976, Pub. L. No. 94-455, § 2002(b), 90 Stat. 1520.

57. I.R.C. § 2012 (inapplicable to gifts made after December 31, 1976). *See id.* § 2012(e).

58. *See* Schlesinger, *TRA-Marital Joint Interests and Trust Transfers of Appreciated Property*, 11 U. MIAMI INST. ON EST. PLAN. 10-1, 10-24 (1977).

59. It does not. Rev. Rul. 66-40, 1966-1 C.B. 227.

60. A transfer of the joint property to a trust constitutes a termination. Rev. Rul. 76-157, 1976-1 C.B. 306. A sale of property for a note and mortgage is a termination, even though the note and mortgage are held jointly. Rev. Rul. 75-507, 1975-2 C.B. 378. A transfer of the joint property to a trust constitutes a termination. A sale of property for a note and mortgage constitutes a termination even though the note and mortgage are held jointly.

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

in exactly the same proportion as the original contributions made to enable acquisition of the property. Second, where the proceeds were not divided as in the first way, a gift tax could still be avoided if the sale proceeds were invested in other real estate and if title were taken in the same way as title was taken to the originally held property. To take advantage of this exception, however, the contract for purchase of the new property must be signed by the due date for filing a gift tax return for the quarter in which the old property was sold.[62] Title to the new property must also be taken within a reasonable time after the date of the sale contract on the original property.[63]

In summary, prior to 1976 the value of property held in joint tenancy was included in the estate of a decedent unless independent contributions to the joint tenants could be established. In cases where joint tenancies were deemed to have been created by gift or where there was subsequent appreciation of jointly held property not originally acquired by equal contributions, gift tax liability could be imposed. In the case of spouses, the tax treatment of jointly-held property often appeared burdensome and unfair.

II. CHANGES IN THE TAX REFORM ACT OF 1976

Problem of Double Taxation

The application of the tax law prior to the Tax Reform Act of 1976 was characterized by the possibility of double taxation, under both gift and estate tax laws, of jointly owned property. This double taxation, although mitigated by the allowance of a credit for gift taxes paid,[64] occurred because the gift tax consequences of joint ownership flowed from legal interests created under local law, while the estate tax consequences were determined by the decedent's contribution to purchase price.[65] Under the pre-1976 law, joint interests were subject to treatment under section 2040 if real property were held in joint tenancy or tenancy by the entirety.[66] Section 2040, however, applied neither to property held by the decedent and others as tenants in common, nor to community property interests.[67] Obviously, technical requirements of local property law, if not properly complied with, presented danger of unexpected tax liability. As to the estate tax law itself, it was often difficult, as between spouses, to determine the degree to which each

62. *Id.* § 25.2515-1(d)(2)(ii)(b) (1958).
63. *Id.* § 25.2515-1(d)(2)(ii)(c) (1958).
64. I.R.C. § 2012.
65. *See* Worthy, *supra* note 22, at 615.
66. Int. Rev. Code of 1954, ch. 11 § 2040, 68A Stat. 385 (superceded) (it also applied to money or securities payable to the decedent or a named survivor).
67. *Id.*

spouse was responsible for the acquisition and improvement of the jointly owned property.[68]

To eliminate some of this confusion, the Tax Reform Act of 1976 provides that if the joint tenancy is established by a completed gift and, in the case of real property, an election were made to treat the establishment of the tenancy as a gift, then only one-half of the value of the property is to be included in the decedent's gross estate.[69] Where no election is made, the new provision is inapplicable and the decedent's estate must use the old "consideration furnished test."[70] To the extent that the original gift represented a taxable gift, the value would be used in the computation of decedent's estate tax;[71] to the extent that a gift tax marital deduction has been taken in excess of fifty per cent of the gift, the decedent's estate tax marital deduction would be reduced.[72] Thus, in effect, the decedent's gross estate under the new provisions includes an amount equal to one-half of the value of the jointly held property as of the date of gift and one-half of the value of such property as of the date of death.

The real effect of the new provisions is to keep the appreciation of the nondonor spouse's one-half interest in the property out of the donor spouse's estate.[73] If this savings is thought to be significant in a given situation, existing joint interests could be destroyed and recreated to qualify for such treatment. Consideration should be given, however, to the gift tax consequences and to the fact that one-half of the value of the property will be taxable in the donee spouse's estate if he or she dies first.[74] Under the new act, which eliminates the provision governing gifts in contemplation of death, all transfers made within three years of death, less the $3,000 annual exclusion, are includable in the gross estate regardless of the decedent's motives.[75] This rule only applies to estates of decedents who die and transfers made after December 31, 1976.[76] Presumably, even under the old code provisions, if a gift tax had been paid on the original transfer, there would be little question as to which spouse furnished the consideration. Thus, the real problem

68. H.R. REP. No. 455, 94th Cong., 2d Sess. 21 (1976).

69. I.R.C. § 2040(b)(1). The reason for this change was a desire for simplification of these complex litigation questions. H.R. REP. No. 1380, 94th Cong., 2d Sess. 21 (1976). Note that if, for any reasons, the value of the total joint property were not included in the decedent's gross estate, the value of the gift would be excluded in the computation of taxable gifts. I.R.C. § 2001(b) (defining "adjusted taxable gifts").

70. See text & notes 98-101 *infra*.

71. I.R.C. § 2001(b).

72. *Id.* § 2056(c)(1)(B).

73. *See* Cowley & Jones, *The New Estate and Gift Tax Provisions Concerning Unified Rates and Credits, Marital Deductions and Joint Interests*, 29 S. CAL. L. CENTER TAX INST. 223, 238-39 (1977).

74. I.R.C. § 2040(b)(1).

75. *Id.* § 2035(b).

76. *See id.* § 2035.

arose when no gift tax had been assessed or paid. Under the new code provisions, if no gift tax were paid on the original transfer, not only would the need arise to determine who furnished the consideration (*e.g.*, to decide whose marital deduction to decrease or whose amount of taxable gifts to increase) but the even more complex question of the gift's value as of the date of gift would also have to be resolved.[77]

Problems of Proof

The problem of proof of contribution at death was addressed in the Tax Reform Act of 1976. The legislation introduced the concept of "qualified joint interest" in order to reduce the difficulty of determining the degree to which each spouse is responsible for the acquisition and improvement of jointly owned property.[78] Section 2002(c) of the Tax Reform Act added new subsections to both sections 2040 and 2515 of the then existing law.[79] As a result of these additions, section 2040(b)(1) now provides that only one-half of a qualified joint interest is includible in the gross estate of the first spouse to die.[80] Section 2040(b)(2) provides a definition of qualified joint interest that includes joint tenancy or tenancy by the entirety. The tenancy must be created by spouses. In the case of personal property, the tenancy must constitute a gift or, in the case of real property, be subject to the election provided in section 2515.[81] The amendments to section 2515 are modest. If a section 2515 election is made, it automatically applies to all additions in value[82] and the retained interest of each spouse is a one-half interest.[83] The new sections were made effective for joint interests created after December 31, 1976.[84]

The changes are not necessarily as useful as Congress anticipated. Since one-half of the qualified joint interest is now included in the

77. *Id.* § 2512(a).
78. H.R. REP. No. 1380, 94th Cong., 2d Sess. 752-53 (1976).
79. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2002(c)(1), (2), 90 Stat. 1520, 1855 (1976).
80. I.R.C. § 2040(b)(1).
81. I.R.C. § 2040(b)(2) provides in part that
the term "qualified joint interest" means any interest in property held by the decedent and the decendent's spouse as joint tenants or tenants by the entirety, but only if
(A) such joint interest was created by the decedent, the decedent's spouse, or both,
(B)(i) in the case of personal property, the creation of such joint interest constituted in whole or in part a gift for purposes of chapter 12, or
(ii) in the case of real property, an election under § 2515 applies with respect to the creation of such joint interest, and
(C) in the case of a joint tenancy, only the decedent and the decedent's spouse are joint tenants.
82. I.R.C. § 2515(c)(2).
83. *Id.* § 2515(c)(3). This means actuarial computations are no longer required.
84. The Tax Reform Act of 1976, Pub. L. No. 94-455, § 2002(d)(1)(A), 90 Stat. 1520, 1856 (1976).

gross estate of the first spouse to die, a section 2515 election now has estate tax ramifications.

A qualified joint interest includes the creation by gift of a joint tenancy in personal property.[85] In contrast to real property, however, the treatment of personal property is not elective.[86]

The new additions have two objectives, elimination of the complexity of determining contribution between spouses and elimination of double taxation, yet only the first is achieved. Except for those joint tenancies whose creation does not constitute a gift—bank accounts, savings bonds, and brokerage accounts—proof of contribution is no longer required. Also, double taxation has been eliminated, *but only if the contributing spouse* (or the spouse with the greater contribution if each contributes) *dies first*. If the noncontributing spouse dies first, the half given to that spouse is taxed at the creation of the tenancy and again on the death of the noncontributing spouse, with no apparent credit for prior gift taxes.[87] Any double taxation resulting from the death of the surviving joint tenant is still a problem, with only a prior tax credit as potential relief.[88]

Special Election Provided in Tax Reform Act

The Tax Reform Act of 1976 creates a new incentive for spouses to elect to treat the creation of a joint tenancy or tenancy by the entirety in real property as a taxable gift. If such an election is made for a joint interest created after December 31, 1976 by either spouse or both, then, upon the death of the first spouse, only one-half of the value of the property at date of death or alternative valuation date will be included in his or her estate. The Reform Act provides further that if the election is made, it also applies to all subsequent additions in value, such as improvements to the property and mortgage payments.[89] Additional gift tax returns are required with respect to such additions in value for any taxable period in which gift to the donee spouse exceeds the $3,000 annual exclusion.[90]

The Reform Act creates an exception to the general rule that on

85. I.R.C. § 2040(b)(2)(B)(i).

86. *Compare id.* § 2040(b)(2)(B)(i) *with id.* § 2040(b)(2)(B)(ii). Although the statute seems unambiguous, the House Report is not clear on this point. At times, the committee report refers to making an election in general, and at other times the report makes clear that the election applies only to real property. H.R. REP. No. 1380, *supra* note 78, at 754 n.58.

87. The credit for gift taxes paid on gifts made after December 31, 1976 is now governed by I.R.C. §§ 2001(b)(2) and 2001(d), neither of which would appear to govern this situation. I.R.C. § 2013 applies only to cases where the transferor either has predeceased the transferee by less than 10 years or survives the transferee by less than two years.

88. I.R.C. § 2013.

89. *Id.* §§ 2040, 2515(c).

90. *Id.* § 2515(c).

the death of a joint tenant, the entire value of the property owned in joint tenancy is included in the decedent's gross estate, except for the value of such portion of the property which is attributable to consideration furnished by the surviving joint tenant.[91] The exception provides that only one-half of the value of property, at the date of death, held by husband and wife as joint tenants or tenants by the entirety, is includable in the estate of the first spouse to die, regardless of which spouse furnished the consideration, provided that the interest in the property is a "qualified joint interest."[92] A "qualified joint interest" is any interest that satisfies the following requirements: (1) The joint interest is created by the decedent or his spouse or both, and is created after December 31, 1976;[93] (2) in the case of personal property, the creation of the joint interest is a completed gift for gift tax purposes;[94] (3) in the case of real property, the donor elects to treat the creation of the joint tenancy as a taxable gift, which requires a gift tax return under section 2515 if the transfer is a gift;[95] (4) the decedent and the decedent's spouse are the only joint tenants and they possess a 100 percent interest.[96] If the gift election is made at the time of the creation of a "qualified" joint tenancy, such election automatically applies to subsequent additions to the value of the property. This includes both improvements and debt reduction.

Example: Assume that a husband purchases a residence that costs $80,000, paying $20,000 as a down payment. Title is taken as joint tenants or tenants by the entirety. At his death, the husband has paid off $10,000 of the mortgage and the property is worth $100,000.[97]

Under the prior law, the value of the property, $100,000, less the outstanding mortgage, $50,000, would be includable in his estate.

Example: Assume the same facts, as above except that the wife furnished $10,000 of the down payment and had furnished $3,000 toward the reduction of the mortgage.[98]

The wife's total contribution, assuming that it could be proven, would be $13,000 of the total $30,000 furnished. Therefore, 13/30 of $50,000 or $22,667 could be excluded from the husband's estate, leaving only $27,333 subject to tax in his estate.

Under the amended provisions, assuming that the husband has furnished all the consideration, as in the first example, he could treat

91. *Id.* § 2040(b). See text & note 12 *supra.*
92. I.R.C. § 2040(b)(1).
93. *Id.* § 2040(b)(2)(A).
94. *Id.* § 2040(b)(2)(B)(i).
95. *Id.* § 2040(b)(2)(B)(ii).
96. *Id.* § 2040(b)(2)(C).
97. Cheifetz, *supra* note 13, at 271.
98. *Id.*

half of the original down payment as a gift under section 2515. The same treatment would apply for payments to amortize the mortgage. Therefore, at his death, only half of the net value of the residence, or $25,000, would be includible in his estate for tax purposes.[99] The entire property would still go to the wife and escape probate and probate costs. Except for the initial down payment, no tracing need be undertaken. In a community property state, the property acquired during marriage (except for gifts and devises by third parties) is presumed to be acquired and owned one-half by each spouse as a matter of law. No gift is involved since the earnings of one spouse are presumed to be the earnings of the community and thus accrue equally to each one of them. Therefore, only one-half of the property of the community is included in the decedent spouse's estate where the community property is held in joint tenancy.

Since joint tenancy property passes automatically to the survivor, care should be taken with regard to the effect such transfer will have on the funding of the marital deduction in the taxable estate.[100] Many estate plans are built around the concept of a taxable estate, with part of the estate placed in a trust with income to the spouse for life, a remainder interest to the children, and a nontaxable portion subject to the spouse's power of appointment, even though it is placed in a trust vehicle. The nontaxable portion, the marital deduction trust, is subject to federal estate tax at the time of the spouse's death. Care should be taken in utilizing the nontaxable marital deduction to avoid placing too much value in the surviving spouse's estate, so that an excessive tax burden is avoided.[101] Since it passes from the decedent to the surviving spouse by operation of law, jointly-owned property is often overlooked as being available for the marital deduction trust. If ignored, the disposition of this property could result in "over-funding" of the marital deduction (assets in excess of the values which may be deducted) and an unnecessarily larger tax on the second estate. The provision of the Tax Reform Act that provides for an election to treat the establishment of a joint tenancy as a transfer by gift from a contributing spouse is an important means for limiting the tax consequences of joint tenancy. This election can result in only one-half of the jointly-held property being included in the decedent's estate. Moreover, the marital deduction can also be used to further decrease the tax burden upon an estate consisting in part of jointly-held property.

99. *Id.*
100. *See* I.R.C. § 2056.
101. *See generally* S. KESS & B. WESTLIN, CCH ESTATE PLANNING GUIDE ¶ 220 (1977 ed.).

Fractional Interests Rule for Joint Ownership of Real Property by Spouses

The Tax Reform Act of 1976 creates a limited exception to the general rule that jointly-owned property is to be included in the gross estate of the decedent to the extent that the decedent originally owned or supplied the consideration for the purchase of the property.[102] This fractional interest exception provides that only one-half the value of the jointly-owned property is included in the gross estate of the first cotenant to die, if the four following conditions are met:

(1) Only the decedent and the decedent's spouse were cotenants;[103]
(2) the jointly-owned property must have been created by the decedent, the decedent's spouse or both;[104]
(3) the creation of the jointly-owned property must have constituted, in whole or in part, a completed gift for tax purposes;[105] and
(4) the joint-ownership interest must have been created after 1976.[106]

Previously, the Code provided that if real property had been purchased with the funds of one spouse and title had been placed in both names as tenants by entirety or joint tenancy, there was no gift unless the donor elected to treat it as a gift by filing a timely gift tax return for the original purchase and for each subsequent payment for a subsequent improvement to the property.[107] The Tax Reform Act modified this position: Now a single election will apply to each addition made to the value of the tenancy, so an election is no longer necessary for every addition in value.[108] According to the new law, if an election is made, additional gift tax returns must be filed with respect to additions that result in a gift of more than $3,000 to the other spouse.[109] Nevertheless, the result of this enactment is that the value of each spouse's interest may not exceed fifty percent of the total value of the property.

By enacting this prospective exception to the general estate taxa-

102. I.R.C. § 2040(b). *See generally* Gamble, *Joint Property Interest of Husband and Wife Under the Tax Reform Act of 1976*, 55 MICH. ST. B.J. 930 (1976).
103. I.R.C. § 2040(b)(2)(C).
104. *Id.* § 2040(b)(2)(A). Joint property created by inheritance or by a gift to a husband and wife is already subject to a 50% rule. *Id.* § 2040(c).
105. *Id.* § 2040(b)(2)(B).
106. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2002(d)(3), 90 Stat. 1520, 1856 (1976).
107. Int. Rev. Code of 1954, ch. 12, § 2515, 68A Stat. 409 (1954) (superceded).
108. I.R.C. § 2515(c)(2).
109. *Id.* § 2503(b). Mortgage payments will be treated as additions to value. H.R. REP. No. 1380, 94th Cong., 2d Sess. 21 (1976). It should be noted that mortgage payments will be treated as additions to value.

tion rules provided in section 2040, Congress intended to give recognition to the "services furnished by a spouse toward the accumulation of the jointly owned property even though a monetary value of the services cannot be accurately determined."[110] A commentator has noted that joint ownership of property can provide both financial and psychological security for a spouse who earns no income; nevertheless, under the old estate tax law in many cases, a wife who was a wage earner and had no separate source of funds had difficulty proving a contribution that would enable her to avoid additional tax liability.[111] While it is true that, in the past, courts have recognized a wife's work in a family business as a contribution to the jointly-owned property purchased from the profits of the business, a burden was always imposed to prove contribution toward the acquisition of jointly-held property.[112] With passage of the 1976 Act, Congress finally gave recognition to a far more common contribution—the domestic work done by a homemaker.

Thus, under the old law, where one spouse was the sole wage earner and the other a homemaker, the wage earner may have had the only identifiable source of income. Property acquired was attributable only to the spouse who supplied funds for acquisition of the jointly-owned property. By placing property in joint tenancy, a transfer was made to the homemaker spouse. If, upon the wage earner's death, the estate had hoped to prove that the homemaker's domestic services constituted adequate consideration for the transfer of the property, it had to establish that the homemaker's domestic services constituted adequate consideration for the transfer of property. The estate had to prove that the domestic services were consideration, economically beneficial to the decedent equal in value to the portion of the property sought to be excluded.[113] Congress has eliminated the need to establish the existence and value of domestic services by establishing a rule that is grounded on the assumption that each spouse contributed half the value of the jointly-owned property.[114]

The 1976 Tax Reform Act reflects an awareness by Congress of the difficulty between spouses in determining the degree to which each is responsible for the acquisition and improvement of the jointly-owned property.[115] It has been argued, however, that this reform did not go far enough because it failed both to abolish the distinction between

110. H.R. REP. NO. 1380, *supra* note 78, at 20.
111. Note, *Homemaker's Contribution to Jointly Owned Property*, 29 TAX LAW. 623, 623-24 (1976).
112. H. HARRIS, HANDLING FEDERAL ESTATE AND GIFT TAXES 128 (2d ed. 1972).
113. Note, *supra* note 111, at 635.
114. *Id.* at 636. *See Hearings on Economic Problems of Women Before the Joint Economic Committee*, 93d Cong., 1st Sess. 265-66 (1973) (statement of Babette B. Barten).
115. H.R. REP. NO. 1380, supra note 78, at 10-72.

spouse and nonspouse joint tenants and to eliminate the distinction between real and personal property in its treatment of joint tenancies.[116]

In sum, this reform was enacted to lessen the problem of determining the degree to which each spouse is responsible for the acquisition and improvement of the jointly-owned property. The House Ways and Means Committee clearly intended to lessen the need to trace consideration and to recognize the services rendered by nonworking spouses where the value of the services cannot be easily and accurately determined.[117] Additionally, Congress hoped to eliminate the double taxation effect created by the interplay of the gift and estate tax laws applicable to jointly-owned property.

Problems of Successive Additions of Value to and Severance of Jointly-Owned Property

As part of the Tax Reform Act of 1976, Congress enacted coordinating amendments to section 2515(c).[118] Under the prior law, contributions to the purchase of real property, held jointly by a husband and wife, did not constitute a gift for purposes of the gift tax unless the contributor so elected.[119] An election to treat the creation of such interest and each addition to the value of the property could be treated as a gift so long as an election was made in each calendar quarter in which the creation or addition to value was made. Under the Reform Act, however, the election to treat a contribution as a gift must be made at the time of the creation of the joint-ownership interest.[120] That election, however, will be applied to all subsequent additions to value; no further election is required.[121]

Making the election under section 2515 requires that the property be created in joint tenancy after December 31, 1976. The House Report suggests that an existing tenancy can be severed after 1976 and re-

116. Pedrick, *Estate Planning and Future Shock*, 55 TAXES 226, 232 (1977).

> Just why this difference is perpetuated is not clear. The House Report laudably expresses concern about achieving an equitable treatment of the surviving spouse by recognizing the services performed by that spouse . . . The fruits of these services are just as apt to be invested in personal property as real property, but this is an insight for which Congress is not yet prepared. Moreover, the requirement for treating the original acquisition of the property as a gift fails to recognize any services performed by the wife that contributed to the accumulation of the funds used to acquire the property. In truth what the Act really accomplishes is to eliminate the double taxation that resulted under the old rules. Those rules required not only a gift tax upon the creation of the tenancy, but also full inclusion of the joint property in the estate of the spouse who provided the funds for its acquisition. This should be applauded as a good step in the right direction, but the joint property rules remain a maze of bewildering complexity.

Gamble, *supra* note 102, at 932 n.6.

117. H.R. REP. No. 1380, *supra* note 78, at 19, 20.

118. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2002(c)(2), 90 Stat. 1520, 1856 (1976).

119. Int. Rev. Code of 1954, ch. 12, § 2515(a), 68A Stat. 409 (superceded).

120. I.R.C. § 2515(c); Treas. Reg. § 25.2512-2 (1958).

121. I.R.C. § 2515(c)(1), (2).

created to qualify for the new estate tax treatment.[122] If the report were taken literally, local recorders of deeds would be swamped with paper work from those spouses wishing to sever and reconvey. Apparently no special Internal Revenue Service method has been created that would alleviate that problem.

It is recognized that the House Report on section 2515 reveals an intention of Congress that the section should apply to real property tenancies created after 1954 for which no election was made under old section 2515 whether they be joint tenancies or tenancies by the entirety; this is significant since old section 2515 on its face only applies to tenancies by the entirety.[123]

The House Report suggests that a conveyance of title after 1976 to the husband alone, followed by a reconveyance to himself and his spouse, followed, in turn, by an election under section 2515 to treat the value of the wife's interest in the new tenancy as a gift, would create a "qualified joint interest."[124] Of course, considering appreciation and inflation, the amount of the gift in the reconveyance would be quite large if the transferor has owned the property for any length of time.

Real property tenancies created before 1955, if severed and recreated, would have to meet the requirement that a section 2515 election be made. Since these tenancies gave rise to a gift when they were originally created, their severance now would have to be on an actuarial basis to avoid a gift as a result of the severance. On the other hand, if the new fifty percent rule applies for valuation purposes upon the recreation of the tenancy, care should be taken to ensure that the severance produces a tenancy in common that is something other than a fifty-fifty relationship, so as to cause a partial shifting of an interest as to constitute a gift when the election is made under section 2515.

It remains uncertain whether the House Committee intended to extend the severance-re-creation rule to personal property tenancies. The necessity to have the re-creation of the tenancy constitute a gift, in whole or in part, requires attention both to valuation and to consideration of a possible need to file gift tax returns to establish, for the record, that the re-creation did constitute a gift.

In order to comply with gift tax requirements, section 2515, in its original form, required constant review of the respective contributions of spouses for additions in value to the real property jointly owned. By its terms, section 2040 provides that "in the case of real property an election under section 2515 applies with respect to the creation of such

122. H.R. REP. NO. 1380, *supra* note 78, at 20.
123. *Id.*
124. *Id.* at 21.

joint interest."[125] This provision is not artfully drawn, since it could be interpreted to mean that the fractional interest exception is available whenever section 2515 is available, regardless of whether the section 2515 election is actually made. The House Report of the Committee on Ways and Means, however, indicates that the donor must elect section 2515 in order to obtain the benefit of the fractional interest rule.[126] Regulations can be expected to require such an election.[127] In one sense, the availability of the election under section 2515 is more restrictive under the Reform Act than it was previously: It is available only at the time of the creation of jointly owned interests.[128] If the election is made with respect to the creation of jointly owned interests, it is effective for all future additions to value.[129]

Some difficulty is presented by the valuation of gifts involved in the creation of joint interests prior to 1977. As to a joint interest created prior to January 1, 1977, if, under local law, either tenant, without the consent of the other, can sever the tenancy, the value of the donor's retained interest is one-half the value of the property.[130] The value of the gift is the difference between the value of the donor's retained interest and the total value of the property—one-half the value of the property.[131] If, under local law, each spouse is entitled to share the income and enjoyment of the property, but neither can sever the tenancy without the consent of the other, the value of the donor's retained interest is determined by actuarial factors, based on the spouses respective attained ages at the time of the gift.[132]

To reduce the complications involved in determining the value of successive contributions and increases in value of property held in joint tenancies created after January 1, 1977, Congress provided that in computing the value of the gift, one should ignore actuarial comparisons of respective life expectancies of the tenants in those situations where the jointly owned property cannot be severed by one tenant alone.[133] While the legislative history does not explicitly modify prior law, Congress probably determined that one election for gift tax treatment, with respect to a down payment, should be enough to qualify spouses for the special fractional interest exception, since typically most real property held by spouses involves relatively small down payment and mortgage

125. I.R.C. § 2040(b)(2)(B)(ii).
126. H.R. REP. No. 1380, *supra* note 78, at 20.
127. M. FELLOWS, FEDERAL TAXATION OF ESTATES, GIFT AND TRUST 62 (Supp. 1977).
128. I.R.C. § 2515(c)(1).
129. *Id.* § 2515(c)(2). Additions to value do not include appreciation but do include improvements and mortgage payments. H.R. REP. No. 1380, *supra* note 78, at 21.
130. Treas. Reg. § 25.2515-1(c)(2) (1954).
131. I.R.C. § 2512(b); Treas. Reg. § 25.2512-1(1954).
132. Treas. Reg. § 25.2515-5(c) (1958).
133. I.R.C. § 2515(c)(3).

payments. In order for individuals to obtain the benefits of the new tax law provisions dealing with joint tenancies, their marital status is significant.

Under section 2040, questions similar to those present in the marital deduction context might arise concerning the marital status of individuals.[134] Questions regarding the marital status of joint tenants might arise at two critical points: At the time the joint ownership interests are created, and at the time the first joint tenant dies. The two cotenants must be married on these two critical dates.[135] The requirement that only the decedent and decedent's spouse can be cotenants usually is easily satisfied: Jointly owned property appears to be a popular form of ownership for married persons, and it is atypical that other persons would have interests in the property.[136] The requirement that the joint ownership interest must have been created by the decedent, the decedent's spouse, or both might result in unnecessary disqualification of jointly-owned property, unless regulations broadly interpret this subsection.[137]

Jointly-owned property has not been a preferred property arrangement for estate planning purposes because it is inflexible and leads to overqualification of the marital deduction.[138] A further discouragement of this type of ownership existed under section 2040: A gift tax was imposed upon the creation of the joint interests or at the time values were added to the property, but without concomitant advantage of removing future appreciation from the gross estate of the donor.[139] Although this latter factor is removed by section 2040(b) in some, but not all, situations, previous planning preferences should not be affected, since, if a couple owns much of its property jointly, they will suffer higher estate taxes due to the overqualification of the marital deductions, regardless of qualification under section 2040(b).[140] Furthermore, even if holding some jointly owned property appears advisable, qualification under section 2040(b) should be avoided, if possible, because the application of section 2040(b) will not decrease and might, in certain situations, increase the total transfer taxes.[141]

134. *Id.* § 2040(b). *See* Estate of Spalding v. Comm'r, 537 F.2d 666, 669 (2d Cir. 1976); Estate of Wesley A. Steffke, 64 T.C. 530, 538 (1975), *aff'd*, 538 F.2d 730 (7th Cir.), *cert. denied*, 429 U.S. 1022 (1976).

135. I.R.C. § 2040(b)(2)(A), (c).

136. *Id.* § 2040(b)(2)(C).

137. *Id.* § 2040(b)(1)(A). A similar requirement as that provided in this section is found in section 2515(a), dealing with the gift tax election for real property jointly owned by a husband and wife.

138. *See* Campfield, *Estate Planning for Joint Tenancies*, 1974 DUKE L.J. 669, 671-75.

139. I.R.C. § 2040. *See* Campfield, *supra* note 138, at 722.

140. M. FELLOWS, *supra* note 127, at 56.

141. *Id.* at 70.

The fractional interest rule has been criticized for not resulting in any true tax savings to a couple holding property in joint tenancy.[142] The fact that the Tax Reform Act eliminates the need to determine respective contributions of the spouses at the death of the first spouse is hardly sufficient reason to laud the provision. Lifetime contributions must still be determined for gift tax purposes, so there is no necessary resultant administrative savings. One critic has aptly described the overall impact of section 2040(b):

> With due respect, then, to the Committee and to others who have accepted its explanation, § 2040(b) does not recognize anyone's services in any peculiar way, nor does it peculiarly dispense in any way with requiring a valuation of consideration in monetary terms. Rather, precisely like all other gift and estate tax provisions (other than § 2040(a)) both before and after the Tax Reform Act of 1976, it permits property to be removed from the owner's gross estate upon, and only upon, subjection of the transfer to gift taxation based on the dollar value of the gift.[143]

Thus, while Congress meant to provide an opportunity to effectuate the intent of spouses in establishing joint ownership reflecting both market and nonmarket terms, the effect of the statute is not one that makes it any easier to establish special nonmarket valued contributions of spouses. Furthermore, the reform measures do not necessarily provide any true tax savings to spouses holding property in joint ownership.

III. THE REVENUE ACT OF 1978

The Revenue Act of 1978 incorporates three major new provisions applying to joint tenancies: The elimination of the necessity of actuarial computations in the creation of joint tenancies in personal property,[144] an election to treat pre-1977 joint tenancies as qualified joint interests,[145] and a new method for computing contribution of spouses in a jointly held farm or other business where there is material participation by both spouses.[146]

Elimination of Actuarial Computations for Jointly Held Personal Property

Section 2515A has been added to the Code to eliminate the necessity of actuarial computations upon the creation of joint tenancies in personal property, except in those cases where the fair market value of

142. *Id.* at 80.
143. Horn, *Much Ado About Nothing: New Section 2040(b)*, EST., GIFTS & TRUSTS J., May-June 1978, at 15.
144. I.R.C. § 2515(a).
145. *Id.* § 2040(d).
146. *Id.* § 2040(c).

the interest, determined as if each spouse had the right to sever, can only be reasonably ascertained by reference to the life expectancy of one or both spouses.[147]

Generally, creation of a joint tenancy in personal property with rights of survivorship is treated under the present law as constituting a gift to the extent that the contribution made by a tenant exceeds the tenant's retained interest in the property.[148] Where the joint tenancy involves real property with rights of survivorship between spouses, no gift tax is imposed unless the donor spouse elects to treat the creation of the joint tenancy as a gift.[149] Prior to enactment of the Revenue Act of 1976, the Code provided that upon the making of an election to have the joint tenancy treated as a gift to the spouse, the amount of the donor spouse's retained interest in reality was determined by the use of actuarial factors in those cases where local law prevented either joint tenant from unilaterally severing the joint tenancy.[150]

The Revenue Act of 1978 eliminated the need to use actuarial calculations where a joint tenancy in real property was created between a husband and wife.[151] Under the new provisions, the retained interest of each spouse is determined to be one-half of the value of the property subject to the joint tenancy whether or not either tenant can unilaterally sever the joint tenancy.[152]

It should be noted that the new provision eliminating the need for actuarial calculations applies to the creation of a joint tenancy in personal property between spouses.[153] Nevertheless, the provision does require the use of actuarial calculators where the fair market value of the personal property subject to the joint tenancy cannot be reasonably determined without reference to the life expectancy of one or both spouses.[154]

Election to Treat Pre-1977 Joint Interests as Qualified Joint Interests

Section 2040(d), added to the Code by the Revenue Act of 1978, provides for an election to treat joint interests created prior to January, 1977, as qualified joint interests.[155] Assuming that a gift tax return was

147. *Id.* § 2515A.
148. *Id.* § 2501.
149. *Id.* § 2515(a).
150. For gifts made between 1951 and 1971 see I.R.S. PUB. NO. 11 "Actuarial Values for Estate and Gift Tax." For valuation of gifts made after 1971 see Treas. Regs. § 25.2512-9 and I.R.S. PUB. NO. 723A, "Actuarial Values II: Factors at 6 Percent Involving One and Two Lives." PUB. NO. 723 *reprinted in* 2 FED. EST. & GIFT TAX REP. (CCH) ¶ 6441.
151. I.R.C. § 2515A.
152. *Id.* §§ 2515(c)(3), 2515A(a).
153. *Id.* § 2515(A)(a)(1).
154. *Id.* § 2515(A)(b).
155. *Id.* § 2040(d).

filed at the time of the creation of the joint tenancy, a new gift tax return must be filed for one-half of the increase in value attributable to the difference in contribution at creation.[156]

A taxpayer making the election provided for in this new subsection is to be treated as having made a gift at the close of the calendar quarter for which the return is filed. Generally, the amount of the gift will be equal to the appreciation attributable to the gift portion of the consideration furnished by the donor spouse at the time of the creation of the joint interest.

The legislative history of this provision includes comments, in the report of the Senate Finance Committee, indicating that the enactment is an attempt to further ease complications in use of the joint tenancy by spouses. No longer is it required that spouses who desire to have pre-1977 joint tenancies qualify as joint tenancies sever an existing interest and then re-create a joint tenancy as was required under the Tax Reform Act of 1976.[157] In defining the amount of a gift, the new Code section provides that where the joint tenancy was not originally treated as a gift, the value of the property on the date of the creation of the joint interest shall be treated as zero.[158]

Unlike section 2515, however, section 2040(d) does not address the fact that most married couples create joint tenancies with complete disregard to the Internal Revenue Code.[159] With regard to personal property, section 2040(d)(5)(B), describing a situation which is often nonexistent, states that where no return is filed, there is no limitation on assessment.[160] If a gift tax return had been filed because of a gift of some unrelated property, the gift is treated as being made at the time a section 2040(d) election is made.[161] If no gift tax return had been filed, the taxpayer must file the overdue return, pay penalties and interest, and then make a new section 2040(d) election.[162]

156. *Id.* The return could be filed in any calendar quarter in 1977, 1978, or 1979.

157. S. REP. No. 745, 95th Cong., 2d Sess. 93-94 (1977). Section 2040(e), also enacted in Revenue Act of 1978, further requires that those who have already gone through the process of severing and recreating a joint tenancy make the same election as required by § 2040(d).

158. Section 2040(d)(5) provides:

> For purposes of paragraph (4)(A) . . .
>
> (A) in the case of real property, if the creation was not treated as a gift at the time of creation, or
>
> (B) in the case of personal property, if the gift was required to be included, and the period of limitations on assessment under § 6501 has expired with respect to the tax (if any) on such gift,
>
> then the value of the property on the date of the creation of the joint interest shall be treated as zero.

I.R.C. § 2040(d)(5).

159. Schlesinger, *supra* note 58, at 10-25.

160. *See* I.R.C. § 6501(c)(3).

161. *Id.* § 2040(d).

162. *Id.*

Most estate planners find this election neither helpful nor providing of a saving; they recommend avoiding an election of gift treatment for joint tenancies.[163] Other commentators, however, complain that donors often do not file gift tax returns covering property placed in joint ownership, with the result that this area of tax law remains a trap for the unwary.[164] The suggestion has been made that, rather than making the election, the preferable route is often to simply undo the transaction with the donor taking title in his or her own name, thereby, avoiding gift tax consequences.[165] Nevertheless, it should be noted that the regulations stress the objective facts and circumstances of the putative gift, rather than the subjective motives of the donor.[166]

Joint Tenancy and the Family Business

The Revenue Act of 1978 also added section 2040(c), which provides for the allocation of contribution in the case of joint participation in a family business operation.[167] The problem Congress faces is perhaps best understood by considering the case before the tax court in *Estate of Otte v. Commissioner*.[168] In that case, the decedent purchased a farm in his own name shortly before his marriage in 1932. He did not convey it into joint tenancy until 1958.[169] The court had little difficulty in finding that the surviving spouse had made a fifty percent contribu-

163. Schlesinger, *supra* note 58, at 10-25.

164. *See generally* Casner, *Estate Planning Statesmanship*, 8 U. MIAMI INST. ON EST. PLAN. ¶ 74.1202 (1974). Casner describes the difficulties which arise in this area in the following terms:

> A not uncommon situation that is encountered is the client who has placed the ownership of stock he had acquired in the name of himself and wife as joint tenants with the right of survivorship. In form, this arrangement involves a gift of an undivided one-half interest in the stock from the donor spouse to the donee spouse. The gift, if one has been made, qualifies for the annual gift tax exclusion of $3,000 as it is a gift of a present interest and also qualifies for the gift tax marital deduction. The issue, however, is whether the donor spouse intended the gift result that the form of the arrangement implies. In discussing with the client why he adopted this form of ownership when he acquired the stock, it may be the case that he thought he would be in full control as to the disposition of the stock while he lived, that the full ownership of the stock would pass to his wife if she survived him without the necessity of probate, and that he would be entitled to two $100 exclusions with respect to stock dividends on his income tax returns . . . . If it can be established with respect to the ownership of stock which in form is in joint tenancy that the predominant intention of the donor spouse was the retention of full control, it should be reasonable to take the position that no gift tax purposes was made at the time of the establishment of the arrangement. Form should give way to substance, with the result that there would be no default as to gift tax returns with respect to the establishment of the joint ownership arrangement.

Id. ¶ 74.02.

165. *Id.*

166. Treas. Reg. § 25.2511-1(g)(1) (1958) provides:

> Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.

167. I.R.C. § 2040(c).

168. 31 T.C.M. (CCH) 301 (1972).

169. *Id.*

tion to the real property held in joint tenancy.[170] Moreover, the court extended its analysis to cover all of the decedent's jointly owned property.[171]

The Tax Court's approach seems to be all or nothing. Congress, instead, developed a far more complex approach which it incorporated into section 2040(c). Regarding the anticipated operation of this complex provision, the Conference Committee suggested that:

> The amount excludable would be determined by applying a percentage rate of 2 percent for each year the surviving spouse materially participated in the business (not to exceed 50 percent) to the excess of the value of the joint interest over the amount attributable to the original consideration furnished. For this purpose, the amount attributable to the original consideration would consist of the amount of that consideration plus assumed appreciation at the rate of 6 percent simple interest for the period of investment of the consideration.[172]

As a result of the Senate amendment, the amount by which the value of a joint interest includible in the gross estate may be reduced is limited to $500,000.[173] Although section 2040(c)(9) states that this section is elective,[174] it is unclear whether it is exclusive or whether a taxpayer may still seek the benefit of the *Otte* opinion.

IV. DISCLAIMERS AND JOINT TENANCY

Although there is very little litigation or literature on the subject of disclaiming a joint interest, the disclaimer of partial or entire interests has long been a useful estate planning device. In the two reported cases applying state law, it was held that disclaimers by a surviving joint tenant were not mere refusals to accept ownership of a bequest or inheri-

170. *Id.* at 307. The court in *Otte* observed:

> We are persuaded that the continuing contribution of [the wife's] services, industry, and skills during the 35 years of marriage helped substantially to preserve and increase the values of the homeplace property. Her varied activities in the overall operation of the farming enterprise at the homeplace, as reflected in our findings, represent "money's worth" in the production of the joint income used to acquire equipment and other assets used on this property, and contributed significantly to the enhanced value of the homeplace. Although the homeplace was held by decedent in his own name until 1958, we believe the enhanced value of the homeplace resulting from decedent's and Laura's efforts working together as a "team" constitutes jointly acquired property subject to equal division for estate tax purposes.

Id.

171. *Id.* at 308.

172. 2 FED. EST. & GIFT TAX REP. (CCH) ¶ 6900.03 (quoting the Conference Committee Report). The Technical Corrections Bill of 1979, H.R. 2797, would amend this to provide that the reduction of the amount in the estate of the decedent for the survivor's contribution cannot reduce that value below the decedent's adjusted consideration. H.R. 2797, 96th Cong., 1st Sess. (1978).

173. H.R. 2797, *supra* note 172.

174. I.R.C. § 2040(c)(9).

tance, but a gift of property absolutely owned.[175] Under local law in each case, the transfer occurred when the joint tenancy was created, not at the time of the first joint tenant's death.

Prior to the Tax Reform Act of 1976, the only mention of disclaimer was contained in Treasury Regulation section 25.2511-1(c) which provided that, in cases of gifts by bequest or devise, a refusal could be made if it was unequivocable and effective under local law, so long as no earlier acceptance had been made.[176] There was, however, no direct mention of property subject to joint ownership.

The law on disclaimers was relatively settled until *Keinath v. Commissioner*,[177] in which the Eighth Circuit upheld a remainderman's disclaimer of his interest, shortly after the death of the life tenant.[178] The life tenant died eighteen years after the creation of the trust. Finding the disclaimer of the remainderman valid under state law and finding all other requirements met including the "reasonable time" requirement, the court held that the disclaimer did not constitute a taxable gift.[179]

The Tax Reform Act of 1976 added section 2518, which had the effect of reversing the result in *Keinath*.[180] As originally enacted, section 2518(b) set out the following requirements for a qualified disclaimer: (1) It must be irrevocable and unqualified; (2) it must be in writing; (3) it must be received by the transferor or his legal representative not later than nine months after the effective date of the transfer or after the transferee attains the age of twenty-one; (4) the transferee must not accept any benefits from the transfer; and (5) the recipient upon refusal must not be designated by the transferee.[181] A passage in the Conference Committee Report states that it was the purpose of Congress to provide "a single set of definitive rules for disclaimers for

175. Krakoff v. United States, 439 F.2d 1023, 1026-27 (5th Cir. 1971); Bishop v. United States, 338 F. Supp. 1336, 1348 (N.D. Miss. 1970), *aff'd*, 468 F.2d 950 (5th Cir. 1972).

176. Treas. Reg. § 25.2511-1(c) (1954).

> Where the law governing the administration of the decedent's estate gives a beneficiary, heir or next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent. . ., a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable and effective under the local law. There can be no refusal of ownership of property after its acceptance.

Id.

177. 480 F.2d 57 (8th Cir. 1973).

178. *Id.* at 65.

179. *Id.* at 65-66.

180. I.R.C. § 2518. *See generally* McCue, *Disclaimers: A Survey of I.R.C. § 2518 and the Illinois Disclaimer Statute*, 1978 ILL. L.F. 395.

181. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009(b), 90 Stat. 1520, 2518 (1976). The Revenue Act of 1978 amended § 2518(b)(4) to provide that the interest can pass either "(A) to the spouse of the decedent, or (B) to a person other than the person making the disclaimer." I.R.C. § 2518(b)(4).

purposes of estate, gift, and generation skipping transfer taxes."[182] Since they are considered for purposes of estate and gift tax law, one might easily conclude that these rules were meant to apply to joint tenancy. This conclusion, however, has been put in doubt by subsequent opinion letters of the Commissioner of Internal Revenue.[183]

While there is no reference to state law in section 2518, it would seem impossible to satisfy all requirements of the tax code if the disclaimer is not valid under state law.[184] For example, an invalid disclaimer might leave the property subject to the claims of creditors, thereby ensuing to the benefit of the disclaimant and thus violating the requirement of the tax code provision that the transferee must not benefit from the transfer.[185]

Difficulty is also posed by the formation of joint tenancies where there is no election of the gift tax provision, and the first taxable event is the death of the transferor. Revenue rulings have stated that, following earlier acceptance of the property, a surviving joint tenant may not disclaim an interest in a joint tenancy in real or personal property upon the death of the other joint tenant.[186] The disclaimer is treated as a complete transfer of property owned absolutely and constitutes a gift for federal gift tax purposes.[187]

In recently enacted state statutes, such as that adopted in Illinois, the position is taken that "a surviving joint tenant may disclaim in whole or in part any property or interest therein held in joint tenancy with right of survivorship with a deceased joint tenant."[188] The Illinois statute permits disclaimer of interest in joint tenancy for the purpose of avoiding federal tax liability in compliance with section 2518.[189] As has been suggested above, the Commissioner seems to take a contrary view in not permitting disclaimer after death of a joint tenant.[190] While Congress has indicated a desire to implement a simple uniform set of rules for disclaimer, presumably independent of state law, the effort apparently has not been successful. Estate planners have been concerned with devices for terminating joint tenancies with minimum tax consequences.[191] Nevertheless, it remains to be determined in litigation

182. H.R. REP. No. 1515, 94th Cong., 2d Sess. 623 (1976).
183. *See* text & note 186 *infra*.
184. McCue, *supra* note 180, at 95-96.
185. *See* I.R.C. § 2518(b)(3).
186. *See* I.R.S. LETTER RULING REP. (CCH) 1071 LTR 7911005 (November 29, 1978); 73 LTR 7829008 (April 14, 1978). *But see* I.R.C. § 6110(j)(3).
187. See citations at note 186 *supra*.
188. ILL. ANN. STAT. ch. 30, § 211-213 (Supp. 1979); *id.* ch. 110-½, § 2.7 (1978).
189. *See id.* ch. 30, § 212 (Supp. 1979).
190. See text & note 186 *supra*.
191. *See* Banks, *Unraveling Undesirable Joint Tenancies with Minimum Gift Tax Burden*, 34 J. TAX. 36-40 (1971); Knecht, *Unwinding Joint Ownerships to Achieve Minimum Tax Liability*, 25 J. TAX. 344-47 (1966).

whether a surviving joint tenant can ever disclaim under section 2518, even if permitted by state law.

V. CONCLUSION

Joint tenancy and tenancy by the entirety are the most widespread forms of joint ownership between spouses. Such forms of joint ownership reflect the respective contribution of spouses and provides economic security. The original tax treatment of these forms of common ownership viewed them as involving a gift by the donor spouse, except to the extent that any ownership right was retained in the property. Originally, problems of double taxation, in the form of both estate and gift tax, were almost inevitable. Early efforts, however, were made to provide an election to apply the gift tax or estate tax exculsively. Under the estate tax, however, difficulties arose from the need to determine the respective contribution of husband and wife to the jointly-held property.

The Tax Reform Act of 1976 was directed at simplifying the election process, providing a procedure to avoid double taxation, while recognizing the contribution of home working spouses. Under the Tax Reform Act, if an election is made to treat the formation of a joint tenancy or tenancy by the entirety as a gift by the donor spouse, then only one-half of the jointly-owned property is attributable to the estate of a decedent spouse. To a great extent, the 1976 Act eliminates the problems of proof of contribution which plagued the application of the earlier provisions governing joint ownership. Under the Act, a single election applies to any addition to value in the tenancy. The result is that this fractional interest rule precludes the need for successive filings required under the previous provisions.

The Revenue Act of 1978 is directed at further simplifying the process of complying with the tax law provisions governing jointly-held property. An opportunity has been provided to have pre-1977 joint interests qualify for treatment under the Tax Reform Act of 1976. Further, treatment has been extended to jointly-held personal property in that there is no longer a need to employ actuarial compensation in jointly-held personal property. Finally, provision is made for recognizing the contribution of each spouse to the family business treated as jointly owned.

One major issue that remains largely unresolved in the tax law of joint tenancies is that of disclaimer. In the Tax Reform Act of 1976, Congress made an effort to provide a uniform and simple procedure to cover disclaimer. Nevertheless, recent letter rulings of the Commissioner suggest that there remains a great deal of uncertainty as to the

applicability of the disclaimer procedures to property obtained from joint tenancy or tenancy by the entirety.