Joint Tenancies and the Tax Reform Act of 1976
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Abstract

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KEYWORDS: tax reform, act
Tenancy by the entirety ownership of real and personal property is so widely accepted by married couples that to suggest holding the property in the name of one spouse alone may cause nuptial unrest. Married persons "know" that a good marriage means sharing the ownership of family assets. For many generations they have been counseled by bank and real estate personnel to perpetuate the traditional concept of sharing by taking title to such assets in joint names. Lawyers have given the same advice when it is clear that a client will never experience any estate tax problems. But the better rule may be expressed in these terms: "The holding of property as joint tenants with the rights of survivorship should be the deliberate exception rather than the general rule..."2

It is the purpose of this article to re-examine the old estate planning considerations and discuss the new ones made necessary by the Tax Reform Act of 1976.3

The essay will outline the alternatives available in planning for jointly held property4 by first discussing the non-tax reasons for holding such property. Saving a dollar may not always be in the client's best interest, as the tax counselor must never forget that his client has human wants and needs. However, only a clear understanding of how many dollars are involved will give the client a proper basis for deciding whether to hold property jointly with his spouse. To facilitate, but in no way exhaust, the limits of this understanding, the discussion will be tailored to emphasize the 1976 changes5 in the estate and gift taxation of such property. It will be apparent that the reformers solved some old problems, created new ones and presented planners with several unex-

1. See T. Shaffer, The Planning and Drafting of Wills and Trusts at 62 (1972). Quaere: Is it ever clear that a client will never have such problems?
4. When the terms “joint tenancy,” “jointly held property,” or “joint tenancy with right of survivorship” are used in this article, the reference will pertain to such holdings between spouses and as such constitute a tenancy by the entirety.
5. I.R.C. §2040(b), §2515(c).
pected and probably unintended tax benefits. It should be clear, however, that the "old advice" discouraging couples from holding joint property, except in very circumscribed instances, is still good advice.

1. NON-TAX CONSIDERATIONS

The most compelling reason for the creation of a tenancy by the entirety is that many spouses regard marriage as a partnership in which each should enjoy the fruits of success and the consequences of failure. Holding title in both names reinforces family security and harmony. These values often induce a couple to hold the majority of their assets in this manner. In Florida, it is possible for spouses to own literally all of their assets jointly, including purchase money mortages, stocks, bonds and notes, and bank accounts. It is also possible to own joint property in fee, for life, for a term of years or as a chattel real (such as a five-year lease of realty).

Each spouse's security is well-founded because each knows to whom the property will pass at the death of either — the entire estate will vest, by operation of law, in the survivor. Moreover, this operation cannot be defeated by the decedent's attempt to encumber it or subject it to the payment of his obligations. Nor may one of the parties alienate his share of the property without the consent of the other or act in any way to defeat the other's rights either during his life or by will. As a result of the property passing by operation of law, the necessity of probate is eliminated, along with its attendant disadvantages. The most frequently cited evils are delay, expense and publicity.

The delay in the distribution of the probate estate can be substantial. These assets are kept in a suspended state until a personal representative has been appointed to collect and manage them. When a personal representative is appointed he must bear in mind that, until the claims of creditors have been satisfied and death tax obligations met, he may be subject to personal liability should he fail to retain sufficient

7. FLA. STAT. §689.15 (1975); Powel v. Metz, 55 So. 2d 915 (Fla. 1952).
8. Colclazier v. Colclazier, 89 So. 2d 261 (Fla. 1956).
11. See notes 6 and 10 supra.
12. Id.
funds to meet such claims and obligations. Naturally, this potential liability delays distribution until the extent of the decedent’s obligations can be ascertained. Avoiding this delay is especially desirable with respect to funds needed by a surviving spouse for purposes of support and payment of death-related expenses. While the simple probate-avoiding device of a joint bank account can be used to provide the funds for such expenses, avoiding probate altogether serves to retain the estate’s wealth. Probate expenses include executor and attorney’s fees. These claims are the first to be paid and are computed as a percentage of the total probate estate. Thus, the percentage is reduced when certain gross-estate items come to rest in their post-death arrangement by a non-probate route. Subjecting an estate to probate has another disadvantage the client may wish to avoid. The value and destination of probate assets are a matter of public record. However, one can assure privacy concerning the disposition and value of personalty, at least, by taking advantage of the survivorship feature of joint ownership.

There is, of course, some appeal to a joint tenancy, but a revocable trust will accomplish the same result, as the property subject to its administration escapes the purview of probate without incurring the disadvantage of the inflexibility inherent in jointly held property. This lack of flexibility does not allow one to freely deal with unforeseen changes in his family situation. Should the surviving spouse become

15. 31 U.S.C. §192 (1970) provides:
Every executor, administrator or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Treas. Reg. §20.2002-1 (1958) points out that the possible personal liability of the executor under the above-quoted statute is present if he makes distributions to beneficiaries of the estate.

16. Florida ameliorates the harshness of delay by providing the spouse and lineal heirs with an allowance of up to $6,000 for their maintenance during administration. § 732.403 Fla. Stat. (1977).


18. Registration of an oral trust required identification of “terms of the trust, including subject matter, beneficiaries and time of performance” with a resulting loss in secrecy. § 737.102 Fla. Stat. (1977), repealed by 2, ch. 77-344, 1977 Fla. Sess. Law Serv., effective October 1, 1977. Note that, even before the repeal, there was no absolute duty to register the trust unless the grantor or a beneficiary specifically requested it. §737.101 Fla. Stat. (1977).
unreasonable, the property may not be available to satisfy the specific needs of minors, invalids, incompetents or other loved ones who may require extraordinary treatment and support. Automatic survivorship does not provide a method for dealing with a spendthrift and offers no general assurance that the property will be managed responsibly.

Another disadvantage of the survivorship feature is that it has led many couples to believe that a will is unnecessary when property is jointly held. In such a case, the property can pass to the "wrong" hands if common disaster strikes. For example, when spouses perish together, the Uniform Simultaneous Death Act provides that the property shall be distributed "one-half as if one had survived and one-half as if the other had survived" unless otherwise provided in the will.19 In failing to provide for such a contingency, a person loses the ability to choose the ultimate disposition of his property.

In sum, the advantages and assurances of owning joint property may be outweighed by the inflexibility of such a tenancy, especially where the majority of a deceased's estate is comprised of such holdings. If, after careful review of these non-tax considerations, a client remains uncertain as to how his property should be held, a discussion concerning the taxation of jointly held property may induce him to choose other methods.

2. FEDERAL TAXATION

The creation and termination of jointly held property have differing estate and gift tax consequences, depending on the type of joint ownership, the nature of the property held, the relative amount of consideration paid by the co-owners and the ownership rights in the property provided under local law.20 The tax laws have undergone several changes in response to this confusion, but there remains a need for further legislation.

A. The Gift Taxation of Personal Property

The creation of a joint tenancy is generally a taxable gift.21 How-

20. Cuzy v. Commissioner, 8 Tax Ct. Mem. (CCH) 681 (1949), where the taxpayers' joint purchase of securities (the creation) was deemed to be a taxable gift.
ever, the creation may not always result in a "completed" transfer, which is a prerequisite to the imposition of the gift tax. A gift is considered complete when the donor has so parted with dominion and control as to leave him without the power to alter its disposition, whether for his or another's benefit. For example, a transfer of securities to a trust in which X is a beneficiary is not complete if the settlor has reserved the power to change the beneficiary. It should be obvious, however, that any distribution made to X will be a completed transfer, as the funds distributed will then be beyond the reach of the settlor. This same principle applies to joint bank accounts because the donor can regain the entire fund up until the time the donee actually makes a withdrawal.

The taxable value of a transfer will depend upon both the consideration supplied by each party and the type of tenancy created, as governed by local law. In an ordinary common law joint tenancy with right of survivorship, where either party can freely dispose of his or her interest in the property, the donee is deemed to have received a gift equal to the fair market value of the property divided by the number of tenants, less any consideration supplied by him. If, for example, the transferee spouse contributed twenty percent of the purchase price, the transferor has made a gift equal to thirty percent of the value of the property. ((Fair Market Value - 2) less twenty percent = value of the

\[ \text{value of the} \]

To note that donative intent is not an essential element of a transfer under the Code. Treas. Reg. §25.2511-1(g)(1), T.D. 6334, amended T.D. 6542; T.D. 7150; T.D. 7238; T.D. 7296. (Hereinafter this section shall be cited without its history.) But a donor in Florida always retains the power to negate a transfer by proving a lack of such intent. Pollack v. Pollack, 282 So. 2d 30 (Fla. 3rd DCA 1973). In such a case, the Floridian donor may pay a federal gift tax on property he never intended to give away and, in fact, retained. This anomalous result can be avoided, however, if the transfer is also surrounded by objective facts and circumstances that suggest a transfer was not to occur. In Bouchard v. Commissioner, 285 F. 2d 556 (1st Cir. 1961), the decedent caused securities to be issued jointly to insure a transfer to his wife at his death. His wife was not informed of the transfer and never saw the certificates until after his death because, while the decedent was alive, he kept the stock in a company safe to which she had no access. The appellate court found that no transfer had occurred.


gift.) While this process is simple enough, initially ascertaining the amount of consideration flowing from one spouse to another has, at a pace equal to the push for recognition of women’s rights, become increasingly vexatious.

Often a spouse wished to perform certain domestic services or release various marital rights as her contribution to the joint acquisition. The Supreme Court has held the release of "property" rights in a divorce situation to be valuable consideration but, while the Internal Revenue Service recognizes the release of "support" rights, it holds the release of dower and curtesy rights is not valid consideration. It distinguishes "support" rights from inheritance rights because the husband has a duty to support his wife during their joint lives or until she remarries and the satisfaction of this obligation does not have the effect of diminishing the husband’s estate any more than his other legal obligations. Domestic services are not recognized unless it can be proven that they do not arise out of love and affection.

In the case of a tenancy by the entirety in Florida, where neither spouse can dispose of his or her interest without the consent of the other, the life expectancy of both donor and donee must also be considered. Thus, if the husband is younger and therefore more likely to survive his wife, he will be deemed to have received or retained an interest more valuable than hers. Factors representing their respective interests are determined through the use of actuarial tables prescribed by the Commissioner. For example, assume that, in 1965, X conveyed property worth $100,000 to himself and Y as joint tenants. X is 62 years old and

26. I.R.C. §2043. See also Merrill v. Fahs, 324 U.S. 308 (1945), where the court held that §2043 was to be read in pari materia with the estate tax sections of the Internal Revenue Code.
27. Id. at note 25 supra.
29. See Estate of Trafton v. Commissioner, 27 T.C. 610 (1956), where the surviving spouse actively participated in the couple’s financial affairs and could trace her contributions from sources other than her husband.
30. Note 13 supra is used in conjunction with Treas. Reg. §25.2515-2 (b)(2) and (c). See note 22 for its history. See the discussion concerning the Technical Corrections Act of 1978, H.R. 6715 infra.
32. Worthy, supra note 2, at 610.
Y is 55 years old at the time of the gift. Under the Commissioner's tables, Y is deemed to have received a sixty percent interest in the property and X is deemed to have retained a forty percent interest. The amount of the gift to Y is deemed to be $60,000.33

Even where a gift has been made and its value determined, the transaction may not be a taxable event. The first $3,000 of gifts made to any one donee during a calendar year, except gifts of future interests,34 are excluded in determining the donor's tax liability.35 In addition, the donor may take a marital deduction that ranges from 100% of the value of the gift, if the aggregate value of one's lifetime intramarital transfers does not exceed $100,000, to fifty percent of the lifetime gifts to a spouse totaling more than $200,000.36 These provisions apply to both real and personal property and are quite useful in helping the couple of moderate means avoid gift taxation.

B. The Gift Taxation of Real Property Prior to the 1976 Tax Reform Act

Prior to 1954, the principles used to determine whether a gift had been made were uniformly applied to both personalty and realty.37 After 1954, the Code was amended so that, when one spouse created a joint interest in realty, the gift tax consequences would, unless the donor elected otherwise, be deferred until termination of the tenancy.38 The election procedure was implemented because so many couples neglected
to pay the gift tax due on the joint purchase of their residence.\textsuperscript{39} \textit{Quaere:} If this was Congress' concern, why is the election only available for a married couple's "real" jointly held property?\textsuperscript{40}

To illustrate the harshness of perpetuating this distinction, consider the divergent tax treatment of cooperatives and condominiums. The corporate form of co-op (the most common type) is based on a plan whereby a corporation is organized to hold title to the land and lease apartments to the tenant stockholders.\textsuperscript{41} Therefore, this type of ownership falls within the property law classification of personalty and, as such, constitutes a trap for the unwary, for it would be an automatic gift.

On the other hand, a condominium is organized on the basis of separate ownership of individual apartments, thus qualifying as real property. Although they may look the same, one's relationship with the Internal Revenue Service hinges on the difference.\textsuperscript{42}

While academicians may spend an inordinate amount of time and energy explaining or criticizing the above inquiry, the average taxpayer sees a deferral in any form as a blessing. "Whether because of ignorance of lack of tax planning at the time of purchase, or because of the understandable reluctance to elect deliberately to pay a tax now for an uncertain future gamble, such elections were rarely made."\textsuperscript{43}

When the taxable event is deferred by not making the election, there is, aside from the deferral itself, the additional advantage that no gift tax need ever be paid if termination occurs by reason of a spouse's death.\textsuperscript{44} Even if the property is sold or exchanged during their joint lives,

\textsuperscript{39} I.R.C. §§2515(a) and (d).

\textsuperscript{40} R. E. Boyer, 3 \textit{Florida Real Estate Transactions} §39.06 at 1516 (1977); Rev. Rul. 66-40, 1966-1 C.B. 227.

\textsuperscript{41} Rev. Rul. 77-423, 1977-2 C.B. 352. Note that the income tax sections of the Code do not recognize this "difference without distinction" at all. Under Treas. Reg. §1.1034-1(c)(3), T.D. 6500; amended, T.D. 6856; T.D. 6916; T.D. 7404 (hereinafter cited without its history); the term residence, for capital gains purposes treats a co-op interest as any other real property.

\textsuperscript{42} J. S. Bush, \textit{Planning to Meet Problems of Non-business Residential Property; Co-ops; Condominiums; Non-exotic Realty; Exotic Types of Real Property. Time-shared Property; Domicile and Conflict of Laws}, 3\textsuperscript{5TH ANNUAL NYU INST. ON FED. TAX}, 1403, 1407 (1977). Bush claims never to have found a client willing to make this election during the entire period from 1954 to 1976.

\textsuperscript{43} I.R.C. §§2515(a) and (b). In this event, the transfer is taxed under §2040. See text accompanying notes 64 through 96 infra.

\textsuperscript{44} I.R.C. §2515(b). Its Regulation provides that where the proceeds are not actually divided between the spouses but are held in the name of one spouse who holds
there will be no gift if the proceeds are either divided in proportion to the couple's respective contributions or reinvested in an identical tenancy.

Deferral often makes it difficult to trace the couple's proportionate contributions where there exists a series of improvements or mortgage payments. If the property appreciates in value between contributions it is necessary to allocate such increase in relation to the contributions previously made. An example given in the Regulations illustrates this rule:

In 1955 real property was purchased by H and W and conveyed to them as tenants by the entirety. The purchase price of the property was $15,000 of which H contributed $10,000 and W, $5,000. In 1960 when the fair market value of the property is $21,000, W makes improvements thereto of $5,000. The property then is sold for $26,000. The appreciation in value of $6,000 results in an additional contribution of $4,000 (10,000/15,000 X $6,000) by H, and an additional contribution by W of $2,000 (5,000/15,000 X $6,000). H's total contribution to the tenancy is $14,000 ($10,000 + $4,000) and W's total contributions is $12,500 ($5,000 + $2,000 + $5,000).

Another advantage to making the election to immediately tax the property subject to appreciation is that it fixes the value of the gift. Consider the situation in which one spouse contributes the entire purchase price of $100,000 for such property and immediately conveys a one-half interest to the other. If the couple is lucky, the property will appreciate to $250,000, at which time they will sell. When the proceeds are evenly divided, the donee spouse will have received a gift of $125,000 for the benefit of both, each spouse is presumed to have received proceeds equal in value to the value of his or her interest. Florida law also provides that the spouse taking possession of such proceeds holds for the benefit of both. Dodson v. National Title Ins. Co., 59 Fla. 371, 31 So. 2d 402 (1947).

45. Treas. Reg. §25.2515-2(d)(2) and (3), added T.D. 6334, amended T.D. 6542; T.D. 7150; T.D. 7238; T.D. 7296 (hereinafter cited without its history). The savings made possible as a result of the deferral should, however, be compared with the estate tax consequences stemming from the demise of a co-tenant either during the terms of the initial estate or while owning the property for which it was exchanged.

46. Treas. Reg. §25.2515-1(c)(2). See history Id.
47. Id. at (c)(2)(i).
48. The estate taxation of these elected gifts may also provide the motivation to elect. See text accompanying notes 65 through 96 infra.
as a result of deferring the tax until termination. Had they made the election to treat the creation as the taxable event, the donor would have paid a gift tax on $50,000. While this result occurs only in those jurisdictions giving a spouse the unilateral right to sever the tenancy,50 the result in Florida before the 1976 Tax Reform Act required couples to consider their respective actuarial interests in calculating the gift tax.

3. POST-1976 CHANGES

The Tax Reform Act was an attempt by Congress to solve some of the administrative problems stemming from the ownership of joint property. However, it appears that they have solved one problem by replacing it with another.

Before the Tax Reform Act of 1976, a donor was required to make an election by filing a gift tax return both at the creation of the tenancy and after every subsequent investment.51 These tax returns were to be filed quarterly,52 which created a tremendous amount of paper work for the donor spouse. This burden has now been alleviated to some extent. While the present law still requires an election to be made at the creation of a joint tenancy, even when the value of the taxable property is less than $3,000, the original election will automatically apply to all subsequent additions so that no additional returns are required unless the subsequent addition is greater than $3,000.53

The reformers also eliminated the divergent valuation principles which, in some jurisdictions, required the use of actuarial tables to determine a couple's respective interests.54 These tables are no longer needed as the individual interests are deemed to be equal in value. In acquiring joint property, a gift results only to the extent that one spouse's contribution exceeds one-half of the value of the property.

These solutions have created both anomalous situations and interesting questions. One apparent conflict stems from the fact that section 2515(c)(1) requires filing the election-making gift tax return in the quarter in which the tenancy is created, while section 6075 does not require gift tax returns to be filed until the last quarter of the year for cumulative gifts under $25,000.

50. See note 36 supra.
51. I.R.C. §2503(b).
53. I.R.C. §2515(c)(2).
54. I.R.C. §2515(c)(1).
Another problem results from Congress' efforts to alleviate the burden of filing a return every quarter in which an addition is made. A review of the Act shows that Congress simply assumed that any such additions will be made by the original donor. Quaere: When the original donee makes the addition, will the first election apply or must the donee make another election? If the original donee must make an election, there is a possibility that it will not be deemed a "creation" and thus fail to become a "qualified joint interest." 55

In rejecting the need for actuarial computations, a problem has arisen for spouses who make the election with the intent to create a qualified joint interest. If the tenancy is unilaterally severable, the couple must not contribute equally. If, in an effort to be fair to each other, they do make equal contributions, there will be no gift on the creation and there will be a failure to qualify. 56 In states like Florida, however, "the matter is less clear." 57 Section 2515(c) provides that an election can be made to the extent that the transfer was a "gift determined without regard to section 2515." If each spouse happened to make contributions equaling his or her respective actuarial interests, then the ordinary gift principles would indicate that no gift was made. "Presumably, however, section 2515(c)(3) was intended to eliminate resort to actuarial values in all respects." 58 This same section clearly states that the actuarial consideration need not be made on the creation of the estate. The question arises as to which method of valuation should be used when the tenancy is terminated by circumstances other than death. The presumption quoted above would seem to answer the question, but some regulations should be drafted to clear up any further confusion. Those who wish to qualify under section 2040(b) have a problem if they created their joint tenancy before 1977. However, the House Ways and Means Committee had purportedly solved this dilemma. It explains the consequences of severing and recreating tenancies as follows:

[If a severance or partition of an existing joint tenancy is made after December 31, 1976, and the joint tenancy between the spouses in that property is then recreated, the creation of the new joint tenancy would be eligible for the election so long as the other requirements are satisfied

55. See text accompanying notes 64 through 96 infra.
56. I.R.C. §2040(b).
58. Id.
and the creation of the new joint tenancy is valid under local law. The tax consequences, if any, of the severance or partition of the existing joint interest would be determined in accordance with the provisions of present law, e.g., no property interests or proceeds are distributed or reinvested in proportion to the consideration furnished by each. The amount of gift resulting from the recreation of the joint tenancy would also be determined under the principles of present law. The election provided under the bill would then be available with respect to the amount of the gift determined. 9

Although there are various ways to sever and recreate a joint tenancy, 60 the taxpayer must be careful to avoid certain pitfalls. He must make the termination properly and then make a gift on the recreation. For example, if no election had been made, then simply executing a new deed would not be sufficient to qualify, because it would merely result in a reinvestment. 61 The taxpayer can terminate his previous estate in proportion to his contribution, but he must recreate his tenancy in different proportions. In addition, the House Report states that the gift will be determined under "present law", which would seem to dictate that the 50-50 interest rule contained in the amended section would not apply. This is an additional complication for persons owning joint tenancies before 1977.

Fortunately, the Technical Corrections Act of 1978 was proposed in order to smooth out several of these problems. The Act would allow a taxpayer to avoid possible adverse tax consequences involved in a severance and recreation by providing that one's estate can become qualified merely by filing a gift tax return making the election. 82 The amount of the gift would depend on whether the creation of the pre-1977 joint tenancy was treated as a gift. If it was, the applicable tax would be computed on the basis of the appreciation accruing between the time of creation and the time of the post-1976 election. If the election was not made at the creation, the gift would then equal one-half of the fair market value of the property, less the donee's contributions.

The House Bill would also modify section 2515 to eliminate the need for actuarial computations in valuing gifts of personalty, except

60. D. Holdsworth, How to Undo a Joint Tenancy, Thus Escape Numerous Tax and Non-tax Complications, 2 ESTATE PLANNING 142 (1975). (Hereinafter cited as Holdsworth.)
62. Qualified for §2040(b).
when the fair market value of the interest or of the property (determined as if each spouse had a right to sever) cannot reasonably be ascertained except by reference to the life expectancy of one or both spouses.3

Whether it is advisable for a taxpayer to make the election will depend upon the frequency and extent to which he makes life-time gifts in relation to the various deductions and credits available in both the gift and estate tax sections of the Code. A better understanding of the interrelationship between the two sections will manifest itself upon the reaching of a complementary understanding of the estate taxation of real and personal property.

4. ESTATE TAX

A. §2040(a) Joint Interests

The use of a §2515 election prior to 1977 was restricted to occasions where the spouses contemplated the sale of jointly held appreciable realty during the existence of the tenancy. The election would fix the value of the gift at the time of the transfer, thereby eliminating a gift tax on any appreciation once the property was sold and the proceeds divided. Unfortunately, if the donor spouse died prior to sale and division of proceeds, §2040 would cause the total market value of the property to be included in his taxable estate. Renumbered as §2040(a) by the Tax Reform Act of 1976,4 this remains the general rule of §2040.

Under §2040(a) the decedent’s gross estate includes the value of all property jointly owned at the time of death, except that portion which was acquired with the survivor’s contributions, but only to the extent that it was obtained from the decedent for adequate consideration. In the case of gifts to both spouses from third parties, only half of the value of the property is included in the decedent’s gross estate.

This contribution exception is best explained by Treasury Regulation §20.2040(1)(C) which gives the following rules of application:

1. The amount to be included in the decedent’s gross estate is that part of the purchase price furnished by him over the total purchase price multiplied by the fair market value of the property at his death.5


65. The alternate valuation date may be substituted if chosen. See I.R.C. §2032.
2. Any money or property given by decedent to his spouse which in turn was used to pay for the joint property would be treated as if the decedent had made that contribution.

3. If the above property or money generated income in the hands of the surviving spouse and that income was contributed toward the joint property, then such income would be deemed her contribution.

4. If the survivor realized capital gains from the sale of property previously given by the decedent and contributed those gains, such gains would be treated as a contribution by the survivor. Yet, this probably would not be true if the appreciated property had been contributed without prior realization of gain.

5. If the decedent and survivor acquired the property from a third party by gift, bequest, devise or inheritance in tenancy by the entirety, then only one-half will be in the decedent's gross estate.

Since the burden is on the surviving spouse to prove contribution to the purchase price of the property, it is often easier to allege contribution than to prove it. Generally, it is the widow who must prove her contribution. In meeting this burden of proof, she faces the difficulty

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66. This rule is contra to the Regulations, example (4), but is supported by Harvey v. United States, 185 F. 2d 463 (7th Cir. 1950). In Harvey, the donee spouse contributed gains from the sale of gift property from her husband toward the purchase of the joint property. The court treated these gains as belonging to the donee spouse and therefore part of her contributions. However, if the appreciated property merely changed character without a corresponding change in ownership, then it will not fall within the contribution exception of §2040(a) (i.e., sale of joint appreciated property to joint proceeds to purchase of new joint property). See Endicott Trust Co. v. United States, 305 F. Supp. 943 (N.D. N.Y. 1969).


68. Tuck v. United States, 282 F. 2d 405 (9th Cir. 1960).

69. Generally the Internal Revenue Service recognized contributions of the widow from:

1. Outside sources prior to marriage. I.R.C. §2040(a).
2. Income earned from work outside of marriage after marriage. I.R.C. §2040(a).
5. Realized gains from property previously given by her husband. Harvey v. United States. 185 F.2d 463 (7th Cir. 1950).
of convincing the Internal Revenue Service to recognize not only her contribution of income, but also the contribution of her services to the acquisition of the joint property.\textsuperscript{70} The repeated refusal of the Internal Revenue Service and the courts to recognize these services as consideration was the impetus behind Congress' enactment of §2040(b).\textsuperscript{71} The problem of tracing contributions was also a factor in this 1976 "reform."\textsuperscript{72}

\textsuperscript{70} If the husband and wife purchase the jointly held property with funds acquired from a business enterprise carried on together, the court will recognize the wife's services as adequate consideration. See Berkowitz v. Comm., 108 F. 2d 319 (3d Cir. 1939) and Singer v. Shaugnessy, 198 F. 2d 178 (2nd Cir. 1952). This appears to be the rule even if the business is purchased in the name of one spouse for a low down-payment and, through the joint effort of the other spouse, the mortgage is paid off before the property is transformed to a tenancy by the entirety. See Estate of Otte v. Comm., 31 Tax Ct. Mem. (CCH) 301 (1972). However, if a court feels these business services were rendered out of love and affection, it will refuse to recognize them as consideration. See Bushman v. United States, 8 F. Supp. 694 (Ct. Cl. 1934). Generally, all domestic services fall in this category and are not recognized by the court. See Estate of Lyons v. Comm., 35 Tax Ct. Mem. (CCH) 605 (1976). In Lyons, the entire value of the jointly owned property was included in the decedent's gross estate even though his wife contributed her savings from the household allowance he gave her. The scope of domestic services has been expanded by the courts to include the nursing of one's spouse. In Estate of Loveland v. Comm., 13 T.C. 5 (1949), the court ignored a written contract between the spouses regarding the dollar payment of such services and stated that, since the wife was under a legal duty to render them, they were not adequate consideration. For a more expanded discussion of the widow's problems, see Kruse, \textit{Estate Tax Section 2040: Homemaker's Contributions to Jointly Owned Property}, 29 Tax Law 623 (1976).

\textsuperscript{71} Cong. Rep. on T.R.A. 1976, \textit{supra} note 19, at 19 and 20. The report explains that "it is often difficult, as between spouses, to determine the degree to which each spouse is responsible for the acquisition and improvement of the jointly owned property." In justifying the new act, the committee claims that "the effect of including only one-half the value of the property in the gross estate in these situations is to implicitly recognize 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."

\textsuperscript{72} \textit{Id.} Most often joint property owners do not keep adequate records of respective contributions. In such cases the courts will step in and make an arbitrary determination. See Estate of Ehret v. Comm., 35 Tax Ct. Mem. (CCH) 1432 (1976). An astute estate planner should foresee this and prepare a financial history of the property. For a more in depth analysis, see Cantwell, \textit{House and Home—Some Estate Planning Architecture for the Family Dwelling and Its Contents}, 1972 U. of M. Inst. on Est. Plan. 72.1703.
B. §2040(b) Certain Joint Interests of Husband and Wife

Section 2040(b) was to be the panacea for the evils of §2040. If a taxpayer could qualify under this section he could avoid the "unnecessarily complex" provisions of §2040(a) which often resulted in double taxation and difficulty in determining each spouse's respective contribution. Admittedly, §2040(b) appears to be an easier solution. Utilizing a fractional formula, as opposed to §2040(a)'s contribution test, it includes fifty percent of the value of jointly held property in the decedent's gross estate if the statute's requirements can be met.

To qualify, the joint tenancy must:
1. Be created by either the husband, wife, or both;
2. Be created by a gift,
   A. and, in the case of real property, one must elect to treat the creation of the joint tenancy as a gift at that time;
3. Have as its sole tenants the decedent and the decedant's spouse; and

Despite the appearance of simplicity, this new amendment has actually created more complications than it was designed to avoid. One of the main goals of the House Ways and Means Committee in creating this section was to avoid subjecting the same piece of property to a gift tax on the creation of the joint tenancy and to an estate tax upon the death of the donor. However, the double taxation problem was not as harsh as it appeared. Since one had a choice as to whether to pay a gift tax upon the creation of a joint tenancy in realty or to pay the tax after the subsequent sale of the property, most individuals opted to defer the tax until the time of the sale. Moreover, even if a gift tax was paid upon the creation of the joint tenancy, the property was never actually subjected to a double tax. The old law, which remains the general rule of §2040, merely exposed the property to the highest transfer tax. This is

74. Id.
75. Technical Corrections Act of 1978, supra note 63, proposes to do away with actuarial computations in valuing joint interests in gifts of personalty.
76. One must make an election under §2515.
78. I.R.C. §2515.
true because §2012 allowed as a credit against the decedent's estate tax the amount of the gift tax previously paid on that property. Since the gift tax rate prior to 1976 was only three-quarters that of the estate tax rate, there would always be an additional tax to the estate even if the fair market value of the property remained constant from the time of the creation of the joint tenancy. However, if the property had appreciated in value before the donor's death, an estate tax would also be levied against the appreciation. Thus, the payment of the gift tax was merely a partial prepayment of the higher estate tax on the property. The solution under §2040(b) is not as beneficial as the Committee claims. An election under this section eliminates payment of an estate tax on one-half of the appreciation of jointly held property, but also requires the immediate payment of a gift tax when the election is made. This tax would be determined under the new single unified rate schedule for estate and gift taxes.

Therefore, §2040(b) does no more than eliminate estate taxation on half of the appreciation of the property. Moreover, to qualify, the taxpayer is required to make a §2515 election in the case of real property and in the case of personal property which falls under the proposed Technical Corrections Bill of 1978. The effects of making such an

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81. A prerequisite for qualification under §2040(b) is that the creation of the joint tenancy constitutes a gift. I.R.C. §2040(b)(2)(B).
83. Congress attempted to make the §2040(b)(1) exclusion of 50% conform to the amended §2515(c) gift of 50%. However, as SURREY, supra note 57, at 493 points out, this apparent internal consistency is not always achieved.

For example, assume A makes a cash gift of $100 to her spouse B in 1977. Subsequently A and B purchase stock for $200 to chase price the $100 he was previously given by A. A predeceases B when the stock is worth $300. The creation of the joint tenancy in these circumstances, assuming A and B have a 50 percent interest in the jointly held property, is not in whole or part a gift. Thus, on A's death section 2040(a) would apply and, due to the fact that no part of the consideration for the purchase of the property belonged originally to B or was acquired by him from A for full and adequate consideration, the entire $300 value of the property will be included in A's gross estate. If, however, A had not given the $100 outright to B but rather had invested the same $200 in securities to which title was taken in joint names, the acquisition of the securities would be a complete gift of $100 from A to B and at A's death only $150 would be included in her estate.

84. Technical Corrections Act of 1978, supra note 63, would allow a taxpayer to make an election as to whether to treat the creation of a joint tenancy in personal
election to prepay the tax can be determined under a fairly complex mathematical formula.\textsuperscript{85} This formula requires the user to make an assumption as to the growth rate of the property, the present value of the dollar and the time of disposition of the property.\textsuperscript{86}

The House Ways and Means Committee Report also claimed that §2040(b) implicitly recognizes the services of a spouse, even though the monetary value of those services cannot be determined.\textsuperscript{87} The legislative intent behind §2040(b) was to arbitrarily set the value of such services as a fifty percent contribution to the value of the joint property for purposes of applying the estate tax contribution test.\textsuperscript{88} However, this legislative purpose has not been accomplished. The Internal Revenue Service in no way recognizes the value of such services because, to qualify for §2040(b), the joint tenancy must be treated as a gift. If, in determining the amount of that gift, the donee spouse wished to consider her services as contribution, these services would be susceptible to the

property as a gift for §2040(b) purposes if he failed to file a gift tax return in the past.\textsuperscript{85} Banks and Due, \textit{Joint Realty and the Gift Tax Election}, 54 \textit{TAXES} 250 (1976) presents a formula approach to the problem of whether to make a gift election. The authors use a number of assumptions; for instance, applying a reasonable growth rate to the property enables one to predict the market value at termination. They admit that it may not apply to all situations, but state that, at the very least, it is more systematic than a purely subjective approach. Basically, there are five steps in calculating the formula. One must:

1. Determine the present value of the dollar;
2. Apply a reasonable growth rate to estimate the fair market value of the property at termination;
3. Compute the gift tax on the donor's transfer;
4. Calculate the estimated tax on the property at termination of the joint tenancy if no gift tax had been paid at creation and reduce to present value; and
5. Compare tax on creation to tax on termination after reduced to present value.

To use the formula, let:

\begin{align*}
P &= \text{cost of realty at creation of tenancy;} \\
M &= \text{marital deduction;} \\
E &= \text{annual exclusion;} \\
T &= \text{applicable gift tax rate;} \\
V &= \text{appreciated fair market value of property at time of termination;} \\
T' &= \text{effective rate on taxable gift due to the cumulative nature of gift tax computation;} \\
\text{RA} &= \text{relative disadvantage/advantage; and} \\
\text{PV} &= \text{present value.}
\end{align*}

\[
\frac{P}{2} + \frac{V}{2} (M - E)T' (PV) - (V - M - E)T (PV) = RA
\]

85. Banks and Due, \textit{Joint Realty and the Gift Tax Election}, 54 \textit{TAXES} 250 (1976)

86. \textit{Id.}


88. \textit{Id.}
same tests of valuation used under pre-1977 §2040. These tests would also apply in a post-1977 severance-recreation situation. For instance, if no election is made to treat the formation of the joint tenancy as a taxable event, its severance will result in a taxable gift to the extent that either spouse received proceeds in excess of his or her proportional contribution to the total purchase price of the property.

The Report makes a helpful suggestion for those tenants with pre-1977 joint tenancies. If they wish to qualify under the amended rules of §2040(b), all that is required is a severance and recreation of the existing joint interest. Yet, this provision has created new complications for the taxpayer. Aside from the previously discussed problems of severance and recreation, there also remain unanswered questions as to what will occur where a third party is involved in this process. For example, in some jurisdictions a person cannot transfer property which he owns individually, to himself and his spouse in joint tenancy, without the use of a "straw man." Technically, then, since the "straw man" recreated the joint tenancy, it would not meet the requirements of §2040(b)(2)(A) and therefore would not qualify under §2040(b). This also raises the question as to what would occur if the joint property was acquired from the third party in a part-sale, part-gift transaction. Quaere: Does the third party's gift exclude the complete transaction from §2040(b) or is the property treated as if a portion qualified under §2040(b) with the remaining portion governed by §2040(a)?

Section 2035 adds another twist to the severance-recreation problem. A probable situation would be where the taxpayer, in contemplation of death, wishes to exclude from his taxable estate one-half of the value of joint property he purchased without contribution from his spouse. He could terminate the joint interest, collect all the proceeds, then recreate the joint tenancy and make a §2515 election. However, if he died within three years of making the election, his plans would be foiled. While it is true that only one-half of the joint interest would be brought into his gross estate under §2040(b), §2035 would bring the

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89. See note 71 supra; See also I.R.C. §§2511, 2512 and 2043.
90. Id.
92. See text accompanying notes 59 through 62 supra.
93. SURREY, supra note 57, at 492, discusses this problem in more detail.
94. §2040(b)(2)(A), which is one of the requirements for qualifying under §2040(b), states that "such joint interest was created by the decedent, the decedent's spouse, or both."
95. Note 94 supra.
remaining one-half in as a gift made within three years of death. Ultimately, a tax would be paid on the entire value of the jointly held property.

The preceding discussion illustrates why the new amendment does not meet the Committee's expectations. Section 2040(b) does not specifically recognize a spouse's services as contribution to a joint tenancy and, while it has eliminated the burdensome treatment of appreciation on half of the property, it does no more than that which would be effectuated by a lifetime gift. That is, it removes certain property from a decedent's gross estate after a gift tax has been exacted. Yet, in doing so, it has originated many complexities.

5. THE COMPLEXITIES OF §2040(b) AND ESTATE PLANNING CONSIDERATIONS

Since qualification under §2040(b) has the same effect as a gift of one-half of the joint property to the spouse, it is important for the estate planner to know if and when he should use this qualified joint interest as opposed to another format. The traditional estate planning advice, as discussed in the introduction to this article, was to avoid the use of joint ownership as an estate planning device.97 The following analysis should make it clear that the advent of §2040(b) has not affected the wisdom of that recommendation.98 To understand the soundness of this counsel, one must re-examine joint interests in light of the changes made by the Tax Reform Act of 1976.98

Proper use of the estate tax marital deduction99 is the key to good estate planning. This deduction allows one spouse to pass the greater of $250,000 or one-half of the decedent's adjusted gross estate to the surviving spouse without tax consequences,100 with an adjustment for

96. This, of course, disregards any non-tax reasons for holding joint property.
97. Since an election under §2515 is necessary to qualify under §2040(b) for real property and perhaps personal property under H. R. 6715, the above analysis is equally applicable to §2515.
98. Prior to 1976 the gift tax rate was three-fourths that of the estate tax rate. This difference in schedules played a significant role in estate planning, since it is obvious that one would gain a tax advantage by transferring his property during his life as opposed to disposing of that same property at death. However, the Tax Reform Act of 1976 has brought the gift tax rate under a single unified tax schedule. See I.R.C. §§2001 and 2502. This unified tax rate has caused estate planners to take a second look at their advice to use lifetime gifts.
100. Id.
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et al.: Joint Tenancies and the Tax Reform Act of 1976

inter vivos gifts between the spouses. The property thus passed must be of a type that will be included in the taxable gross estate of the surviving spouse, unless otherwise consumed. Thus, the effect of the marital deduction is to permit one-half of the wealthier spouse's property to escape immediate transfer taxation by simply deferring the tax until the death of the surviving spouse. In addition to this deferral benefit, the deduction also allows the wealthier spouse to effectively divide his property in such a manner so that each spouse will hold, for tax purposes, one-half of the total property. Since the sum of two taxes, one on each half of the assets, is less than one tax on the total possessions under the graduated tax system, this division should reduce the total transfer tax for the spouses.

The unified tax credit adds one more factor for the estate planner's consideration. After December 31, 1980, this credit will be $47,000 and will allow one to transfer up to $175,625 without payment of a tax. If the spouses are considered as a unit, then $351,250 of their property can escape transfer taxation.

Estate planners have derived marital deduction formulas to calculate exactly how much property should pass to the surviving spouse at the death of the testator. These formulas take into consideration lifetime gifts between spouses, the unified credit and the maximum marital deduction allowance. If one does not take the maximum unified credit but instead passes the property to his spouse under the marital deduction, the property will be included in the surviving spouse's taxable estate. Therefore, it is essential to take full advantage of the unified credit. The surviving spouse can be afforded lifetime use of property not qualifying under the marital deduction through the use of a non-marital trust. In the past, joint interests have created a problem in calculating the marital formula since such interests automatically pass to the survivor's estate. If the joint interest is large enough, it will cause the marital formula to be overfunded and consequently subject the property to needless tax in the survivor's estate. Unfortunately, §2040(b) has not changed this. A qualified joint interest operates in the same manner as

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101. I.R.C. §2056(b).
103. I.R.C. §§2010 and 2505.
a non-qualified joint interest, with the exception that only half of the property is included in the decedent’s gross estate.

The unification of transfer tax rates\(^\text{106}\) and the introduction of a unified tax credit\(^\text{107}\) make it necessary in estate planning to consider all lifetime, as well as testamentary, transfers. Prior to 1976, the main advantage of a lifetime gift between spouses was that the property transferred was subjected to a lower tax rate\(^\text{108}\) and a separate gift tax exemption.\(^\text{109}\) Although those benefits have been eliminated by the new unified federal tax system, there are now other reasons why inter vivos gifts between spouses might be advantageous. Before deciding whether a qualified joint interest should be implemented, the tax planner must understand these reasons. An examination of the marital deduction will reveal two such reasons. The gift tax marital deduction is 100% of the value of the first $100,000 of gift property, without a deduction for the next $100,000.\(^\text{110}\) For gifts in excess of $200,000, the deduction is limited to fifty percent of the value of the transferred property.\(^\text{111}\) Section 2056(a) permits a deduction of up to the greater of $250,000 or one-half of the decedent’s adjusted gross estate less the difference between the amount allowed for post-1976 transfers and fifty percent of the value of such transfers. This adjustment gives rise to the first advantage of lifetime gifts: by using such gifts, one can increase the total marital deductions allowed.\(^\text{112}\)

The second advantage of lifetime gifts is clear from an analysis of the purpose of using the marital deduction. Its principal effect is that the total tax on the spouse’s assets is reduced by the division of such assets into two estates. However, the savings that result from splitting the spouse’s assets into two estates may not be achieved if the estate tax marital deduction is used alone since, to realize these tax savings, the wealthier spouse must predecease the other. However, spouses can insure against the tax consequences arising from an “unfavorable” order

\(^\text{107}.\) I.R.C. §§2010 and 2505.
\(^\text{110}.\) I.R.C. §2523(a).
\(^\text{111}.\) Id.
\(^\text{112}.\) The following table is reprinted from Surrey, supra note 57, at 812. An analysis of this table will show the advantage of lifetime gifts between spouses with a total gross estate of $485,000. The table could be modified to fit any estate planning situation. A simple substitution of the gross estate in question would allow the estate planner to opt for the maximum tax saving plan.
of death by making lifetime interspousal gifts, thereby equalizing their respective gross estates. The remainder of the estate not qualifying for the marital deduction must bypass the spouse's gross estate, since failure to do so will subject the property to an additional tax. Likewise, the donee spouse's assets must bypass the other's gross estate.

The unified credit presents another reason for lifetime gifts. To obtain the maximum benefit from this credit, two conditions must be

I. A predeceases B

A's Estate.

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
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</thead>
<tbody>
<tr>
<td>Adjusted gross estate</td>
<td>$475,000</td>
<td>$475,000</td>
<td>$475,000</td>
<td>$475,000</td>
</tr>
<tr>
<td>less: gift to spouse</td>
<td>0</td>
<td>0</td>
<td>100,000</td>
<td>165,625</td>
</tr>
<tr>
<td>Resultant adjusted gross estate</td>
<td>475,000</td>
<td>475,000</td>
<td>375,000</td>
<td>309,375</td>
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<tr>
<td>Marital deduction</td>
<td>250,000</td>
<td>250,000</td>
<td>199,375</td>
<td>196,375</td>
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<tr>
<td>Taxable estate</td>
<td>225,000</td>
<td>225,000</td>
<td>175,625</td>
<td>113,000</td>
</tr>
<tr>
<td>plus: adjusted taxable gifts to spouse</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>62,625</td>
</tr>
<tr>
<td>Total transfers subject to tax</td>
<td>225,000</td>
<td>225,000</td>
<td>175,625</td>
<td>175,625</td>
</tr>
<tr>
<td>Tentative tax</td>
<td>62,800</td>
<td>62,800</td>
<td>47,000</td>
<td>47,000</td>
</tr>
<tr>
<td>less: unified credit</td>
<td>47,000</td>
<td>47,000</td>
<td>47,000</td>
<td>47,000</td>
</tr>
<tr>
<td>Tax payable</td>
<td>15,800</td>
<td>15,800</td>
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<td>0</td>
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B's Estate.

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<th>(3)</th>
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<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted gross estate</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$110,000</td>
<td>$175,625</td>
</tr>
<tr>
<td>plus: assets from A's estate</td>
<td>459,200</td>
<td>250,000</td>
<td>199,375</td>
<td>196,375</td>
</tr>
<tr>
<td>Taxable estate</td>
<td>469,200</td>
<td>260,000</td>
<td>309,375</td>
<td>372,000</td>
</tr>
<tr>
<td>Tentative tax</td>
<td>145,328</td>
<td>74,200</td>
<td>90,988</td>
<td>112,280</td>
</tr>
<tr>
<td>less: unified credit</td>
<td>47,000</td>
<td>47,000</td>
<td>47,000</td>
<td>47,000</td>
</tr>
<tr>
<td>Tax payable</td>
<td>98,328</td>
<td>27,200</td>
<td>43,988</td>
<td>65,280</td>
</tr>
<tr>
<td>Total transfer tax</td>
<td>$114,128</td>
<td>$43,000</td>
<td>$43,988</td>
<td>$65,280</td>
</tr>
</tbody>
</table>

II. B predeceases A

B's Estate.

<table>
<thead>
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<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable estate</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$110,000</td>
<td>$175,625</td>
</tr>
<tr>
<td>Tentative tax</td>
<td>1,800</td>
<td>1,800</td>
<td>26,800</td>
<td>47,000</td>
</tr>
<tr>
<td>less: unified credit</td>
<td>47,000</td>
<td>47,000</td>
<td>47,000</td>
<td>47,000</td>
</tr>
<tr>
<td>Tax payable</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Published by NSUWorks, 1979
met. First, each spouse must have in his or her respective estate enough property to take full advantage of the credit. Second, the amount of property covered by the credit must bypass the surviving spouse’s gross estate. Lifetime gifts from the wealthier spouse to the donee spouse can accomplish the first objective and protect against the consequences of an unexpected order of death.\footnote{113}

Lifetime gifts between spouses, therefore, are used to increase the marital deduction and to shelter each spouse’s unified credit and marital deductions. Since election under §2515 and subsequent qualification under §2040(b) creates a lifetime gift, it is important to determine whether this form will accomplish the above purposes. While a § 2040(b) joint interest qualifies for the marital deduction for both gift and estate tax purposes\footnote{114} and will thus accomplish the objective of increasing the marital deduction, it will not achieve the remaining two objectives.

The underlying requirement for effective use of lifetime gifts is that the property be permanently removed from the donor’s gross estate. Consequently, the fact that the joint property automatically passes to the estate of the survivor makes this format of gift undesirable, for, if the donee dies first, the return of the property to the donor will place it back into his tax base a second time. This return will destroy the estate-splitting effect of the marital deduction that the lifetime gifts were used to preserve. This return will also squander that portion of the donee spouse’s unified credit that would have been used had the joint property passed to a younger generation.

A qualified joint interest is distinguished from a nonqualified joint

\begin{tabular}{|l|c|c|c|c|c|}
\hline
A’s Estate. & \$485,000 & \$475,000 & \$375,000 & \$309,375 & \$237,500 \\
\hline
\hline
Adjusted gross estate & & & & & \\
plus: taxable transfers to spouse & 0 & 0 & 0 & 62,625 & 115,750 \\
\hline
Total transfers subject to tax & 485,000 & 475,000 & 375,000 & 372,000 & 353,250 \\
\hline
Tentative tax & 150,700 & 147,300 & 113,300 & 112,280 & 105,905 \\
less: unified credit & 47,000 & 47,000 & 47,000 & 47,000 & 47,000 \\
Tax payable & 103,700 & 100,300 & 66,300 & 65,280 & 58,905 \\
\hline
Total transfer tax & \$103,700 & \$100,300 & \$66,300 & \$65,280 & \$81,905 \\
\hline
\end{tabular}

\footnote{113. The donor must live for three years after making the gift; otherwise §2035 will include it in his gross estate.}
\footnote{114. I.R.C. §§2523(d) and 2056.}
Joint Tenancies: Tax Reform

interest in that it removes half of the property from the donor’s spouse’s estate. However, since gifts are added back for the purpose of determining the ultimate estate transfer tax, §2040(b)’s effect is to remove one-half of the appreciation of the joint property from the donor’s estate. Lifetime gifts will also achieve this result, but without as many complications.

On the other hand, if the donee spouse should die first, holding §2040(b) property, half of it will be included in her gross estate. However, if that property qualified under §2040(a), it would escape taxation in her estate. This treatment under §2040(b) might in some instances produce an unexpected tax benefit.

Prior to 1976, many surviving joint owners who had purchased joint property sought to include the total property in the predeceasing spouse’s gross estate. This was accomplished by withholding any evidence of contribution, with the intent to achieve a stepped-up basis in the property. However, in Madden v. Commissioner, the court rejected this scheme. It held that §1014, which allows a stepped-up basis for property passing from a decedent, contains a qualification that such property must be included in the deceased spouse’s estate. The court stated that inclusion was not required here, since available, though unproduced, evidence of the survivor’s contribution was in existence.

Since fifty percent of a joint interest under §2040(b) is required to be included in the donee spouse’s gross estate, §1014 should be satisfied. However, this half of the property should only receive a fresh-start basis as of its December 31, 1976 value under the new §1023, since carryover basis property is defined in §1023(b)(1) as property passing from the decedent within the meaning of §1014. It should be noted that one could obtain a fresh-start basis on all of the property by simply transferring it outright to the poorer spouse.

Since the creation of a joint tenancy does not remove property from a donor’s gross estate and since any possible tax advantage of this format can be matched by lifetime gifts, it should be avoided as a tax planning tool. The tax planner may avoid the adverse tax consequences

116. 52 T.C. 845, aff’d. 440 F. 2d 784 (7th Cir. 1971).
117. Id. at 849.
118. Id.
119. I.R.C. §1023(h).
of joint interests by simply severing the tenancy.\textsuperscript{120} Thus, only through a clear understanding of the negative implications involved in joint tenancies can the estate planner bring the most benefit to his client.

\textit{David C. Miller}

\textit{Robert C. Rogers, Jr.}

\textsuperscript{120} There are nine methods of severing a joint tenancy:
1. Returning title to the donor;
2. Exchanging joint interests;
3. Converting to tenancy in common;
4. Vesting sole ownership in the donor;
5. Severance of interests;
6. Sale to a third party;
7. Gift to a third party;
8. Sale of one tenant's interest to another; and
9. Increase in mortgage indebtedness.

Each method has a different effect on estate, gift and income taxes, so care must be taken when selecting a method. For a more complete discussion of these considerations, see Worthy, \textit{supra} note 2, and Holdsworth, \textit{supra} note 60. Although these articles were written prior to 1976, the basic tax considerations have not changed. However, one should now consider I.R.C. §2035, gifts within three years of death, and §2513(a), gift splitting, when making a gift to a third party. Another factor to consider is the §2515(c) elimination of actuarial tables with regard to certain joint interests.