TAX MANAGEMENT PORTFOLIOS™

ESTATES, GIFTS, AND TRUSTS

Taxation of Jointly Owned Property

by

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This Portfolio revises and supersedes 823-3rd T.M., *Taxation of Jointly Owned Property*. Portfolio 823-3rd T.M. should be discarded.

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Taxation of Jointly Owned Property

PORTFOLIO DESCRIPTION

Tax Management Portfolio, *Taxation of Jointly Owned Property*, No. 823-4th, presents a detailed study of the federal estate, gift, and income taxation of concurrent ownership interests in property with respect to which there is a right of survivorship, and highlights certain non-tax issues in connection with transfers of interests in jointly owned property. The Portfolio addresses both joint tenancies in which the co-tenants are not married and joint tenancies (and tenancies by the entirety) in which the co-tenants are married. Also, it discusses the special rules governing spousal joint tenancies when one spouse is not a U.S. citizen.

Among the issues discussed in the Portfolio are: (1) the gift tax consequences of the creation or termination of a joint tenancy; (2) the estate tax consequences at the death of a joint tenant; (3) the income tax basis rules that apply to gifts of joint tenancy interests and to a surviving joint tenant's interest following another joint tenant's death; and (4) the rules governing allocations of income, deductions, losses, and credits among joint tenants.

The Portfolio also discusses the significant developments in the rules governing spousal joint tenancies that have occurred since 1976. Repealed §2515 and §2515A, which at one time governed the gift taxation of the creation and termination of spousal joint tenancies, have been reinstated for purposes of the gift taxation of joint tenancies involving a non-citizen spouse. To assist the reader in following the evolution of these rules and in applying the previously expired rules to non-citizen spouses, the Worksheets set forth the full text of the predecessor versions of §2040 (which governs the estate taxation of joint interests), all versions of repealed §2515 and §2515A, and the regulations issued under repealed §2515.

This Portfolio may be cited as Danforth, 823-4th T.M., *Taxation of Jointly Owned Property*.

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A. Scope of Portfolio

This Portfolio considers the federal gift, estate, and income taxation of concurrent property interests in which there is a right of survivorship, which includes joint tenancies, tenancies by the entirety, and contractual arrangements having similar characteristics, such as joint bank accounts. The Portfolio also considers certain state law issues pertaining to these property interests, with an emphasis on those elements of state law that are relevant in determining the federal tax consequences.[1]

B. Types of Jointly Owned Property

1. In General

The defining characteristic of each property interest addressed in this Portfolio is the right of survivorship. When there is a right of survivorship, the death of one concurrent owner extinguishes his or her interest in favor of the surviving concurrent owner(s). The interest held by the deceased co-owner does not "pass" to the survivor, as would occur with testate or intestate succession, because each co-owner is considered to own the whole, subject to the equal ownership rights of the others.[2] As a result, when the first concurrent owner dies, the interests held by the survivors are freed by operation of law from the deceased owner's rights in the property.[3] The survivorship element of jointly held property offers a simplified means of avoiding estate administration and is thus one of the principal reasons for its popularity.

2. Joint Tenancy

A joint tenancy is a form of concurrent property ownership under which: (1) each joint tenant is deemed the owner of the whole of the estate,[4] and (2) the last surviving joint tenant becomes the sole owner. Joint tenancies can be created among two or more persons, who may be, but need not be, related by blood or marriage.[5] For purposes of this discussion, the terms "joint tenancy" and "non-spousal joint tenancy" are used to describe any form of concurrent ownership having a right of survivorship among persons who are not married. Under certain circumstances, the term "joint tenancy" is also used generically to describe any form of concurrent ownership with a right of survivorship, whether the joint tenants are married to each other or not. The terms "tenancy by the entirety" and "spousal joint tenancy" are used to describe the ownership of property by a married couple as tenants by the entireties or as the only joint tenants with right of survivorship. Tenancies by the entirety are discussed at I.B.3., below.

At common law, any conveyance to two or more persons who were not spouses was presumed to create a joint tenancy with right of survivorship. The same presumption applied to devises, but did not apply to property passing by inheritance.[6] The essence of the common law joint tenancy was that the co-owners held the property as a unit. From this essential concept the common law developed the doctrine of the four "unities" of: (1) time, (2) title, (3) interest, and (4) possession, as the test for the existence of a joint tenancy. Under this doctrine, in order for there to be a joint tenancy, all of the co-owners must have acquired their interests at the same time and by the same instrument, the interests of the co-owners must be identical as to the quality of the interest,[7] and each co-owner must have the same rights of possession.[8]

The common law presumption in favor of joint tenancies has been abolished in nearly every American jurisdiction.[9] Nearly every jurisdiction, however, also permits the creation of a joint tenancy by the use of express survivorship language in the instrument of conveyance.[10] The case reporters hold many

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[1] The federal tax consequences of transactions involving jointly held property interests vary depending on how the property interests are treated under local law. This Portfolio does not provide an exhaustive discussion of the non-tax attributes of jointly owned property under the law of any jurisdiction. Readers should consult local law before reaching any conclusions about the tax attributes of a particular joint property transaction.

[2] Whitman et al., The Law of Property, §5.3 (4th ed. 2019).

[3] Whitman et al., The Law of Property, §5.3 (4th ed. 2019); 2 William Blackstone, Commentaries, *180, *182.

[4] Whitman et al., The Law of Property, §5.3 (4th ed. 2019) (footnotes omitted):

> For purposes of tenure and survivorship, [at common law] each joint tenant was seized of the entire estate in which the joint tenancy existed, whether it was an estate in fee simple, in fee tail, or only for lives. But for purposes of alienation, each joint tenant had only a fractional interest in the entire estate.

[5] *See Schaaf v. Forbes*, 979 N.W.2d 358 (Mich. Ct. App. 2021) (trust may not hold real property as joint tenant with right of survivorship because trust "not being a natural person, has no actual residential needs, cannot occupy real property, and does not die"); *Wood v. Pavlin*, 467 S.W.3d 323 (Mo. Ct. App. 2015) (joint tenant's transfer of undivided interest to revocable trust severed joint tenancy); *Smolen v. Smolen*, 956 P.2d 128 (Nev. 1998) ("[Smolen] severed the joint tenancy when he conveyed his interest in the Las Vegas residence to the new trust. This transfer not only severed the joint tenancy but also created a tenancy in common between [the former joint tenant] and the new Martin Smolen trust."). *See also Grout v. Sickels*, 985 N.W.2d 144 (Iowa 2023) (where decedent provided all funds for purchase of property, listed individual as joint tenant with right of survivorship, and transferred interest in property to her trust, court concluded that conveyance by decedent to revocable trust terminated joint tenancy between decedent and individual). *But see* Va. Code §55.1-136(C). (providing that a transfer of tenancy by the entirety property to separate revocable trusts created by *spouses* does not cause the entireties property to lose certain key attributes).

[6] Whitman et al., The Law of Property, §5.3 (4th ed. 2019).

[7] In other words, the co-owners must have equal undivided shares, and each must be an owner of the same "estate" — life estate, fee simple, etc. Sheldon F. Kurtz, Introduction to the Law of Real Property, 290 (7th ed. 2020); 2 William Blackstone, Commentaries, *180.

[8] Whitman et al., The Law of Property, §5.3 (4th ed. 2019); Sheldon F. Kurtz, Introduction to the Law of Real Property, 290 (7th ed. 2020); 2 William Blackstone, Commentaries, *180.

[9] Whitman et al., The Law of Property, §5.3 (4th ed. 2019); Cribbet & Johnson, Principles of the Law of Property, 107 (3d ed. 1989). *See generally* Sheldon F. Kurtz, Introduction to the Law of Real Property, 291 (7th ed. 2020). For an example of a statute abolishing the survivorship presumption of joint tenancies, see Va. Code §55.1-134.

[10] *See* Sheldon F. Kurtz, Introduction to the Law of Real Property, 291 (7th ed. 2020); *see, e.g.,* Va. Code §55.1-134 (providing that statute abolishing sur-

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examples of conveyances in which an intended right of survivorship was not clearly stated.[11] For the sake of avoiding controversy, one should employ the clearest language possible — for example, "to J and B as joint tenants with right of survivorship and not as tenants in common" — and avoid the use of language that is inherently ambiguous — such as "to J and B as joint tenants"[12] or "to J and her spouse B."

Although at common law joint tenants were considered to own the property as a unit, for purposes of alienation each joint tenant was considered to have a fractional interest in the whole.[13] Thus, an essential feature of the joint tenancy was, and continues to be, that any joint tenant, acting alone, can convey his or her interest to another. The conveyance of the joint tenant's interest destroys the joint tenancy, and thus the survivorship feature, as to that joint tenant.[14] For example, if X and Y are joint tenants, Y is free to convey his or her interest to Z. As a result of the transfer, the joint tenancy is severed, and X and Z own the property as tenants in common. The result is slightly different if there are more than two joint tenants. Thus, if X, Y, and Z are joint tenants and Z conveys his or her interest to D, X and Y continue as joint tenants with respect to an undivided two-thirds of the estate, and D has an undivided one-third interest as a tenant in common with X and Y. The severance of the joint tenancy must occur during the tenant's lifetime; an attempted disposition by the will of a joint tenant does not affect the survivorship rights of the remaining joint tenants.

A joint tenancy can also be terminated by partition.[15] A voluntary partition is accomplished by an exchange of deeds among the co-owners, with all owners signing each deed, and each deed conveying a specific portion of the property to one of the original co-owners. If the owners cannot agree to a voluntary partition, any co-owner can compel a partition by bringing an appropriate action in court.[16] The partition action usually results in the physical division of the property among the former co-owners. If a physical division is impossible, the court may order continued ownership of the property as tenants in common or may order that the property be sold and the proceeds divided among the owners.

3. *Tenancy by the Entirety (Spousal Joint Tenancy)*

A tenancy by the entirety is a special form of joint ownership, existing only between a married couple,[17] in which both tenants have indefeasible survivorship rights. At common law, a tenancy by the entirety had the same four "unities" associated with joint tenancies,[18] along with a fifth unity, the unity of marriage.[19] At common law, any conveyance to a husband and wife resulted in a tenancy by the entirety, because husbands and wives were deemed to constitute a single person or entity.[20] The principal conceptual distinction between tenants by the entirety and joint tenants is that the former own the whole as a single entity (the marital unit) but not any individual share of the whole, and the latter own both the whole and a fractional share. The practical consequence of this distinction is that, as a general rule, a tenancy by the entirety cannot be severed except by the voluntary act of both co-owners. A tenant by the entirety has no right to convey his or her interest to a third party without the concurrence of the co-owner. This same conceptual distinction is the basis on which tenancies by the entirety are sheltered from the claims of one spouse's creditors. See the discussion of this issue at I.C.3.b., below.

The tenancy by the entirety has been abolished in a majority of U.S. jurisdictions.[21] In most jurisdictions that have abolished the tenancy by the entirety, a conveyance to a married couple results in a joint tenancy if the intent to create a right of survivorship is clearly stated; otherwise, the spouses take as tenants in common. In most jurisdictions that have not abolished the tenancy by the entirety, the tenancy can be used to own both real property and personal property interests.[22] It may be impossible, however, to create a tenancy by the entirety in a bank or brokerage account, because the account contractual

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vivorship presumption does not apply "when it manifestly appears from the tenor of the instrument transferring such property or memorializing the existence of a chose in action that it was intended the part of the one dying should then belong to the others").

[11] In *Estate of Tennant v. Commissioner*, 8 T.C.M. 143 (1949), for example, securities were held as "joint tenants and not as tenants in common." Applying an Indiana statute which provided that the "survivor of persons holding personal property in joint tenancy shall have the same rights only as the survivor of tenants in common, unless otherwise expressed in the instrument," the Tax Court held that this was a case of "otherwise expressed in the instrument," notwithstanding that the survivorship condition was not expressly stated.

[12] Suppose property is transferred "to J and B and the survivor of them." The prevailing rule is that this language creates a joint tenancy, although some cases have held that it creates a tenancy in common between J and B with respect to a life estate (measured by the life of the first of J and B to die), with an indestructible contingent remainder in fee simple to the survivor. *See* Whitman et al., The Law of Property, §5.3 (4th ed. 2019). The principal practical distinction between the two constructions of this language is that, with the former, the right of survivorship could be defeated by a conveyance by any joint tenant, while with the latter, it could not. *See* 2 Casner, American Law of Property, §6.3 (1952). No cases or rulings consider the question whether an interest arising in a jurisdiction that follows the latter construction would be treated as a joint tenancy for tax purposes.

[13] Whitman et al., The Law of Property, §5.3 (4th ed. 2019).

[14] Whitman et al., The Law of Property, §5.4 (4th ed. 2019); Roger H. Bernhardt & Ann M. Burkhart, Real Property in a Nutshell, 126 (7th ed. 2016); Sheldon F. Kurtz, Introduction to the Law of Real Property, 294 (7th ed. 2020). *See also, e.g., Fogal v. Fogal*, 671 S.W.3d 753 (Tex. Ct. App. 2023) (where mother conveyed 50% interest in property to son as joint tenant and later conveyed remaining 50% interest to other son, the first son's right of survivorship upon his mother's death ceased upon conveyance of mother's remaining interest to other son). Note, however, that an attempted disposition by will of an interest in jointly held property is ineffective and thus does not destroy the right of survivorship. 2 Casner & Pennell, Estate Planning, §10.2 (7th ed. 2011). *But see Canterbury v. Kovacich*, 74 P.3d 457 (Colo. Ct. App. 2003) (unilateral execution of quit claim deed conveying joint tenant's interest to himself as tenants in common was not sufficient to terminate joint tenancy), rev'd, *Taylor v. Canterbury*, 92 P.3d 961 (Colo. 2004) (en banc) (holding that unilateral conveyance of joint tenant's interest to himself as tenant in common does sever joint tenancy, without use of strawman).

[15] *See generally* Whitman et al., The Law of Property, §5.11 (4th ed. 2019).

[16] Whitman et al., The Law of Property, §5.11 (4th ed. 2019).

[17] Since *Obergefell v. Hodges*, 576 U.S. 644 (2015), same sex marriage has become legal across the entirety of the United States. Practitioners are advised to consult relevant state law regarding the creation of a tenancy by the entirety by a same sex couple. Moreover, practitioners are advised to take caution regarding same sex couples married before *Obergefell* and the potential impact that may have on property acquired by those couples prior to June 2015.

[18] *See* I.B.2., above; Hobert Hovenkamp et al., Principles of Property Law, §8.2(a)(5) (7th ed. 2016).

[19] *See* Whitman et al., The Law of Property, §5.5 (4th ed. 2019); Hobert Hovenkamp et al., Principles of Property Law, §8.2(b)(5) (7th ed. 2016).

[20] Whitman et al., The Law of Property, §5.5 (4th ed. 2019); Sheldon F. Kurtz, Introduction to the Law of Real Property, 303 (7th ed. 2020).

[21] Cribbet & Johnson, Principles of the Law of Property, 103 (3d ed. 1989); Whitman et al., The Law of Property, §5.5 (4th ed. 2019).

[22] Whitman et al., The Law of Property, §5.5 (4th ed. 2019).

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arrangement gives each spouse the unilateral right to terminate the co-ownership arrangement, which is inconsistent with the principles of a tenancy by the entirety.

At common law, the husband had full control of the property during his lifetime and was entitled to all of its income. In most jurisdictions that still recognize the tenancy by the entirety, this rule has been abrogated by either statute or court decision.[23]

A tenancy by the entirety in general cannot be severed by the unilateral action of either co-tenant. Either joint tenant may, however, convey his or her interest to the other, and both spouses can join in a deed of the entire property interest to a third party. Divorce generally converts a tenancy by the entirety into a tenancy in common, of which either co-owner can force a partition. The tenancy may also be severed by execution of a joint judgment against both spouses (but not a separate judgment against either spouse).

4. *Contractual Ownership Arrangements*

Certain types of contractual arrangements, such as jointly held bank and brokerage accounts, share the survivorship characteristic of joint tenancies and are treated in a similar manner for tax purposes. For many years, courts struggled to find a legal theory on which to sustain the survivorship element of such arrangements. Today, joint with survivorship accounts are universally recognized as valid and, in many jurisdictions, are expressly permitted by statute.

A joint account is created by a deposit agreement, signed by both parties, in which their ownership interests are described as "joint tenants with right of survivorship and not as tenants in common" (or by the use of other, comparable language). The bank or other financial institution is usually protected by a statute that permits it to pay any portion of the account upon the demand of either joint account owner without the concurrence of the other owner; the financial institution is therefore sheltered from any inquiries or claims concerning the relative ownership interests of the joint tenants. As between the joint tenants themselves, their relative ownership interests (during their joint lifetimes) are usually determined by statute and by their relative contributions to the account.

The Virginia statute is typical in providing that:

> A joint account belongs, during the lifetimes of all parties, to the parties in proportion to the net contributions by each to the sums on deposit, except that a joint account between persons married to each other shall belong to them equally, and unless, in either case, there is clear and convincing evidence of a different intent.[24]

In general, if one of the co-owners of the account was the sole contributor to the account, he or she has an absolute right to sever the survivorship interest of the other co-owner, which is usually accomplished by withdrawing all of the account funds or by directing the financial institution to change the manner in which the account is titled.[25]

Understanding the relevant state laws regarding titling of property and the manner in which remaining assets will be distributed upon the death of a joint owner is critical to ensuring fulfillment of the parties' intent. For example, an Alabama case involved a decedent who had an account used for maintenance and upkeep and jointly titled the account in the name of himself, his spouse, and his daughter from a previous marriage.[26] The decedent's will provided that the residue of his estate would be divided equally among his four children from his prior marriage. The Supreme Court of Alabama found that Alabama law favors the decedent's spouse when a joint account is held by the decedent, the decedent's spouse, and another party by entitling the surviving spouse to the assets held in such joint account, rather than being divided equally among all survivors. Thus, the surviving spouse was entitled to the joint account assets.

5. *Comparison to Other Concurrent Ownership Arrangements*

This section of the Portfolio briefly summarizes three other types of concurrent property interests for which there is no right of survivorship — tenancies in common, community property, and interests in partnerships. The taxation of these concurrent ownership arrangements, while beyond the scope of this Portfolio, is discussed in 802 T.M., *Community Property: General Considerations*, and 710 T.M., *Partnerships — Conceptual Overview* (U.S. Income Series).

A tenancy in common is characterized by undivided ownership interests in property with no survivorship rights. Of the four unities associated with joint tenancies, the tenancy in common has only the unity of possession — each co-owner has an equal right of possession and enjoyment with respect to the whole.[27] A tenancy in common interest is freely alienable by each co-owner without the consent of the others. Because survivorship is not an incident of a tenancy in common, the interest may pass by testate or intestate succession.

Community property is a form of concurrent spousal ownership found in at least nine states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.[28] The essential characteristic of this form of ownership is that, in general, property acquired during marriage is community property, which is owned by the spouses in equal undivided shares. Property owned by either spouse before marriage and property received by gift or inheritance either before or during the marriage is the recipient-spouse's separate property. Separate property may lose its character by transmutation or commingling. Transmutation is a voluntary change of the character of property; commingling results if the separate ele-

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[23] Sheldon F. Kurtz, Introduction to the Law of Real Property, 306 (7th ed. 2020).

[24] Va. Code §6.2-606(A).

[25] *See generally Burkholder v. Burkholder*, 48 S.W.3d 596 (Mo. 2001) (filing of partition suit by sole contributor was sufficient under circumstances to terminate jointly held certificate of deposit).

[26] *Fletcher v. Eddins*, 392 So.3d 17 (Ala. 2023) (court cited Alabama's enactment of the Uniform Multiple-Person Accounts Act (UMPAA)).

[27] Whitman et al., The Law of Property, §5.5 (4th ed. 2019); 2 Casner, American Law of Property, §6.5 (1952).

[28] *See generally* Jo Carrillo, Community Property in a Nutshell, 3 (4th ed. 2018). Wisconsin refers to its system as "marital property" rather than community property, but it is in essence a community property state. Additionally, Alaska and Tennessee have adopted an elective community property system. Jo Carillo, Community Property in a Nutshell, 6 (4th ed. 2018).

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ment of ownership cannot be identified by tracing.[29] In general, community property retains its identity as such even when the property itself, or the proceeds from its sale, are brought into a common law property state; many common law jurisdictions have enacted statutes implementing this general rule.[30] Community property interests generally carry no survivorship rights, and are therefore subject to testate or intestate disposition.

A partnership interest is created when two persons agree, orally or in writing, to act as partners in the conduct of a specified business or venture.[31] The property acquired by the partnership is owned by the partnership,[32] and not individually by any partner. The ownership of property by a partnership is a form of concurrent ownership, but the transfer of property to, or the ownership of property by, a partnership does not create a joint tenancy. Because the concept of survivorship does not exist in a partnership, in the absence of an agreement to the contrary, the interest of each partner in the partnership does not automatically pass to the surviving partners in the event of the partner's death. Two persons may agree, however, that their ownership interest as partners in the partnership is held as joint tenants, or if a married couple, as tenants by the entirety. Under those circumstances, the right of survivorship would exist as to the interest in the partnership.

6. Nominal Joint Interests

Under certain circumstances, property is titled in the names of two or more persons as joint tenants with the understanding that the property is really owned by only one of the tenants, usually the original owner of the property. These so-called nominal joint tenancies are sometimes created by persons who do not wish to give up ownership of the property during their lifetimes, but who wish to provide the co-tenants with ready access to the property after death or wish to have another person manage the property on their behalf during lifetime. Nominal joint tenancies are sometimes established inadvertently. For example, an elderly person may establish a joint bank account with an adult child, for the purpose of allowing the child easy access to the funds in the event that the parent is not able to care for himself or herself. The parent may never have intended that the funds remaining at death pass to that child to the exclusion of other intended beneficiaries.[33] Authorities generally refer to these arrangements as being "for the convenience" of the parent.

Nominal joint tenancies raise two distinct property law issues: (1) whether the nominal co-tenant has a right to consume or transfer any portion of the property during the lifetime of the original owner, and (2) whether the nominal co-tenant is entitled to all of the property at the original owner's death. In many jurisdictions, the first issue is determined by statutes which create presumptions about what the parties intended. Regarding the second issue, in most jurisdictions the survivorship feature of the arrangement is enforced, based on the assumption that the original owner of the property intended that result by selecting a joint ownership arrangement.[34]

Courts have occasionally held that joint tenancy title registration is not to be treated as such for federal tax purposes if the owners' intent was otherwise. For example, in the gift tax setting, the creation of a joint interest with a relative for convenience only (e.g., to avoid probate, or to make securities more accessible in the event of the illness of the real owner) has been held not to constitute a completed gift. *See* II.B.4., below. For estate tax purposes, the appreciation in a joint interest retained by a donor has been held not to be includible in the donor's gross estate where the donor had intended a completed gift of the entire interest and joint ownership had been used merely to avoid the cumbersome mechanism of using a trust or a guardianship. See the discussion of this issue at III.C.2.b.(3), below.

C. State Law Issues

1. Relevance of State Law Generally

Many questions relevant to the taxation of jointly held property can be determined only by reference to state property law.[35] For example, state law determines whether a joint tenant has a right to sever his or her interest, which is relevant in determining whether a gift occurred when the joint tenancy was created, and which is also relevant in determining the availability of the gift tax annual exclusion. Other state law issues that may be relevant to the taxation of jointly held property include:

- whether there is a right of survivorship;[36]
- the relative shares of each tenant in the income or gains from the property;[37]

[29] Whitman et al., The Law of Property, §5.14 (4th ed. 2019).

[30] *See generally* 803 T.M., *Estate Planning for the Mobile Client.*

[31] Reuschlein & Gregory, The Law of Agency and Partnership, 265 (3d ed. 2001) (citing a comment to Section 6(1) of the Revised Uniform Partnership Act).

[32] Reuschlein & Gregory, The Law of Agency and Partnership, 346 (3d ed. 2001) ("The term is perhaps best defined in Section 8(1) of the Uniform Partnership Act, which provides that 'all property originally brought into the partnership stock or subsequently acquired by purchase or otherwise, on account of the partnership, is partnership property.'").

[33] These arrangements are frequently a consequence of ignorance of other, more appropriate, arrangements, such as a bank account of which the parent is the sole owner and over which a child is given signature authority during the parent's lifetime. The assets in such an account would pass at death, not directly to the child, but under the terms of the parent's will.

[34] The Virginia statute addressing this issue is typical, providing that "[s]ums remaining on deposit at the death of a party to a joint account belong to the surviving party as against the estate of the decedent unless there is clear and convincing evidence of a different intention at the time the account is created." Va. Code §6.2-608(A). A court may disregard the survivorship feature of a joint tenancy, however, if the surviving joint tenant's interest was acquired by fraud. *See, e.g., Nugen v. Simmons*, 489 S.E.2d 7 (W. Va. 1997) (no constructive fraud resulted from surviving joint tenant's confidential or fiduciary relationship with deceased joint tenant). *See also Robinson v. Delfino*, 710 A.2d 154 (R.I. 1998) (opening joint account is conclusive evidence of intention to transfer survivorship interest in account balance at death, absent evidence of fraud, undue influence, duress, or lack of capacity).

[35] *See, e.g., Estate of Goldberg*, T.C. Memo. 2010-26 (applying New York law to find that decedent's ownership interest was tenancy by the entirety, not tenancy in common).

[36] The resolution of this issue determines whether estate taxation of the interest is governed by §2040. If there is no right of survivorship, the estate tax consequences are governed by some other provision of the Code, such as §2033, which is the catch-all provision taxing the value of all property to the extent of the decedent's interest therein at the time of his or her death.

[37] The income or gains are generally taxed to the co-owners in proportion to their relative rights to income and gains. For further discussion of this issue, see IV.A., below.

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• whether a joint tenancy can be revoked by the person who created it;[38]

• the proper disposition of the property in the case of simultaneous death;[39]

• the marital status of the tenants;[40] and

• whether a joint arrangement is for "convenience" and thus treatable as solely owned property.[41]

In resolving federal tax controversies, federal courts are thus required to consider state law principles. The deference that a federal court must give to a state court determination of state property law is governed by *Commissioner v. Estate of Bosch*,[42] in which the Supreme Court held that federal courts are not bound by a determination of property interests by a state trial court, but are bound only by a decision of the state's highest court.[43] In determining federal estate tax liability, if there is no decision of the highest state court, then the federal decision maker must apply what it finds to be the state law after giving "proper regard" to relevant rulings of other courts of the state. In this respect, the federal court is, in effect, sitting as a state court.[44]

2. *Collecting Facts Relevant to Taxation*

a. *In General*

To establish the gift, estate, or income tax consequences of a transaction involving a joint tenancy, it is important to have available all relevant information and factual data about the joint tenancy, particularly information concerning when and under what circumstances the tenancy was created or terminated, and to what extent the joint tenants contributed toward the acquisition costs. The categories of factual information that are of particular importance are summarized in this portion of the Portfolio.

b. *When and in What Manner the Tenancy Was Created*

The date of, and circumstances surrounding, the creation of a joint tenancy are important in determining:

• whether a taxable gift occurred when the tenancy was created;[45]

• how properly to divide the property (or proceeds from its sale) upon a subsequent termination of the tenancy, if the tenants desire to avoid making a taxable transfer from one tenant to the other;[46]

• whether the property is partially or totally includible in the estate of a deceased tenant;[47] and

• the income tax basis of a surviving tenant.[48]

The date of the creation of an interest in jointly owned property may also be relevant in determining the timeliness for tax purposes of a joint tenant's disclaimer.[49]

c. *When and in What Manner the Tenancy Was Terminated*

The date of, and circumstances surrounding, the termination of a joint tenancy is relevant in determining whether the termination resulted in a taxable gift.[50] The same information may also be relevant in determining whether the property is includible in the estate of a later deceased tenant and in determining the income tax basis used by the deceased tenant's successors.

d. *Joint Tenants' Relative Contributions to Property*

As discussed in greater detail at II.B.2.a., below, the relative contributions of each co-tenant to the costs of acquiring joint property is relevant in determining the amount of the gift, if any, that occurs when the joint tenancy is created. The consideration furnished by each tenant (with respect to both acquisition costs and costs of improvements) is also relevant in properly dividing the proceeds on termination, if the tenants wish to avoid making a gift from one to the other. The consideration furnished by each tenant also determines the estate tax consequences of nonspousal joint tenancies and spousal tenancies with respect to which the survivor is a non-citizen.[51] In those

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[38] As a general rule, a revocable transfer is not a taxable gift. *See* II.B.3., below. The power of revocation over the joint tenancy may also trigger estate tax inclusion under §2038. For a discussion of the interplay between §2038 and §2040, see III.F.3., below.

[39] In the event of simultaneous death, state law generally provides that each joint tenant is deemed the survivor with respect to a portion of the jointly held property and is deemed to have died first with respect to the balance of the property. This property law characterization affects the manner in which each portion is taxed for estate tax purposes. For a more complete discussion of this issue, see III.H., below.

[40] Only joint tenants who are spouses are deemed to hold "qualified joint interest[s]" for purposes of the special estate tax rules under §2040(b). *See* III.E., below. Whether a joint tenant is the "spouse" of another joint tenant is determined by reference to state matrimonial law.

[41] If the tenancy is not a true joint tenancy, its estate taxation is not controlled by §2040.

[42] 387 U.S. 456 (1967).

[43] *Estate of Bosch*, 387 U.S. 456.

[44] *Estate of Bosch*, 387 U.S. 456.

[45] As discussed at II.B.2.b., below, the rules regarding the gift tax consequences of creating spousal joint tenancies have varied considerably from time to time. Thus, the date on which the tenancy was created may determine whether its creation was a taxable gift.

[46] As a general rule, in order to avoid a taxable gift, the proceeds of termination must be divided in proportion to the co-owners' relative contributions to the property. *See* II.C.1., below. Exceptions to this general rule apply with respect to terminations of certain spousal joint tenancies. *See* II.B.2.b., below.

[47] Under the consideration-furnished test of §2040(a), as a general rule all of the joint property is includible in the estate of the first joint tenant to die, except to the extent that the personal representative can establish that the survivor or survivors contributed to the acquisition of the property. *See* III.C.2., below.

[48] A special rule may apply in determining the surviving joint tenant's income tax basis in the property if the joint tenancy was created within one year of the co-tenant's death. *See* §1014(e). *See also* IV.C.2.d., below.

[49] *See* II.E., below.

[50] As discussed at II.B.2.b.(2) and II.B.2.b.(3), below, the creation and termination of spousal tenancies before a certain date was a non-event for gift tax purposes. Moreover, the date of the termination is relevant for purposes of determining the gift tax consequences if one of the owners of a spousal joint tenancy is a non-U.S. citizen. *See* II.C.3.c., below.

[51] The consideration furnished by each co-tenant is also relevant to the estate tax consequences of all spousal joint tenancies for estates of decedents dying before 1977, and for most spousal joint tenancies for estates of decedents dying before 1982. For the estates of decedents dying after 1976 and before 1982, the consideration-furnished test of §2040(a) applies to spousal joint tenancies the creation of which were treated as taxable gifts under former §2515 and §2515A, which were repealed by the Economic Recovery Tax Act of 1981 (1981 ERTA), Pub. L. No. 97-34, §403(c)(3)(B). The full texts of former §2515 and §2515A, as they existed immediately before their repeal by the 1981 ER-

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circumstances in which the consideration furnished by each joint tenant is relevant, §2040(a) adopts a tracing rule that requires one to determine whether a contribution to the purchase price by the surviving tenant was from the surviving tenant's own funds (as opposed to funds received gratuitously from the decedent).[52]

In general, the burden of proof of showing original ownership, the relative contributions of the tenants to the costs of acquisition and improvements, and the legal status of the ownership arrangement under state law falls upon either the donor (for gift tax purposes) or the estate (for estate tax purposes). For example, under §2040(a), the entire value of jointly held property is included in the estate of the first joint tenant to die except to the extent that the decedent's personal representative can establish that the surviving tenant or tenants contributed to the acquisition of the property.[53] Thus, in order to avoid paying disproportionately high estate taxes for the decedent's joint property interest, the decedent's estate may be required to produce all records, canceled checks, deposit slips, deeds, agreements, prior income and gift tax returns, and other documentary evidence to establish the tenants' relative contributions to the property.

For a more complete discussion of these issues, see III.C., below.

e. Marital Status and Citizenship of Joint Tenants

The marital status of the joint tenants at the time of the creation of the joint interest, a marriage subsequent to that time, or a divorce during the joint tenancy[54] may be relevant in determining the gift, estate, or income tax consequences of the arrangement. An individual is considered married for federal tax purposes if he or she is married under relevant state law.[55]

Practice Tip: Because special gift and estate tax rules apply if the donee or surviving spouse is not a U.S. citizen, it is essential to determine the citizenship of spousal joint tenants.

f. Life Expectancies

The life expectancies of the joint tenants may be relevant in determining the gift tax consequences of the creation or termination of a joint tenancy. For example, if a joint tenancy is not unilaterally severable, the measure of the taxable gift upon creation of the tenancy depends on the joint tenants' relative life expectancies (the youngest joint tenant is the one most likely to outlive the others; thus, his or her interest is the most valuable). Similarly, the life expectancies of the joint tenants may be relevant in determining their relative shares of the proceeds of termination, if one wishes to terminate a joint tenancy without incurring a gift tax. In most cases, life expectancies are determined on an actuarial basis.[56] Under limited circumstances, in order to determine the gift tax consequences of a transaction, it is necessary to determine a joint tenant's actual (as opposed to actuarial) life expectancy.[57] The use of actuarial calculations to determine the gift tax consequences of a transaction involving a joint tenancy is discussed in greater detail at II.B.1., below.

3. Rights of Creditors

a. Introduction

Whether a creditor of a joint tenant can satisfy its claim from jointly held property is primarily a question of state law. The following discussion of the rights of a creditor to attach, obtain judgment liens against, or levy upon jointly held property sets forth broad, general rules, and does not attempt to explain in detail the law of any particular jurisdiction. Accordingly, when considering the rights of a creditor to jointly held property, the reader is admonished to review carefully applicable state law.

b. Tenancy by the Entirety

In a majority of the jurisdictions that still recognize the tenancy by the entirety, the interests of one spouse in a tenancy by the entirety is not subject to the claims of his or her individual creditors during the spouses' joint lives.[58] Accordingly,

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TA, are set forth in the Worksheets at the end of the Portfolio. The consideration-furnished principles remain applicable to spousal tenancies if the donee or surviving spouse is not a U.S. citizen. §2523(i)(3); Reg. §25.2523(i)-1 through §25.2523(i)-3, §20.2056A-8(a).

[52] For further discussion of the tracing rule, see II.C.3.a., below.

[53] Reg. §20.2040-1(a) (flush language).

[54] Certain transfers of property incident to a divorce, including transfers that involve the termination of joint tenancies, are exempt from the gift tax. *See* II.C.3.d., below.

[55] Reg. §301.7701-18(b), T.D. 9785, 81 Fed. Reg. 60,609 (Sept. 2, 2016); *United States v. Windsor*, 570 U.S. 744 (2013); Rev. Rul. 58-66, *amplified and clarified by* Rev. Rul. 2013-17, *obsoleted by* T.D. 9785 (containing final regulations that reflect the holdings of *Obergefell v. Hodges*, 576 U.S. 644 (2015), *United States v. Windsor*, 570 U.S. 744 (2013), and Rev. Rul. 2013-17, and that define terms in the Internal Revenue Code describing the marital status of taxpayers for federal tax purposes). Individuals who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state are not considered "married" for federal tax purposes. Reg. §301.7701-18(c).

[56] *See* Reg. §25.2512-5(d), *amended by* T.D. 9974, 88 Fed. Reg. 37,424 (June 7, 2023) (applicable to transfers on or after June 1, 2023), §25.2512-5A(g) (transfers after April 30, 2009, and before June 1, 2023), §25.2512-5A(f) (transfers after April 30, 1999, and before May 1, 2009), §25.2512-5A(e) (transfers after April 30, 1989, and before May 1, 1999).

[57] *See* Reg. §25.7520-3(b)(3) (describing circumstances in which diminished life expectancy mandates departure from use of actuarial tables).

[58] Tenants by the entirety may join in encumbering their property, and a tenancy by the entirety is subject to the claims of creditors to whom the tenants are jointly liable. Whitman et al., The Law of Property, §5.5 (4th ed. 2019). Thus, the discussion in this section of the Portfolio concerning the immunity of entireties property from creditors' claims relates only to obligations of one of the tenants. The general immunity of entireties property with respect to claims against only one spouse makes this form of ownership especially attractive to spouses, one of whom has a higher than average degree of exposure to personal liability (such as a physician, who may be concerned about large malpractice judgments).

As explained by one commentator, states that recognize the tenancy by the entirety fall into two basic categories with respect to the treatment of creditors' rights, so-called full bar and partial bar jurisdictions:

> There are approximately ten partial bar jurisdictions. In these jurisdictions, the liens of separate creditors can attach, but are subject to the rights of the other spouse. This means that the underlying property cannot be levied on until the entireties estate ends. For example, divorce converts an entireties estate into a tenancy in common, which would allow the separate creditor to proceed against the debtor's now separate interest. Or, death of one spouse leaves the survivor as the sole, fee simple owner of the property. Therefore, if the debtor spouse is the survivor, the creditor may act against the whole property; however, if the nondebtor spouse is the survivor, the creditor is left without recourse.

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one spouse alone cannot encumber either that spouse's right to possession (during the tenants' joint lives) or that spouse's survivorship interest.[59] This general rule applies both to encumbrances that might arise by the voluntary actions of the joint tenant (for example, a unilateral attempt by one tenant by the entirety to grant a mortgage on real property) and to encumbrances that might arise involuntarily (such as judgment liens or pre-judgment attachments).[60]

In a few jurisdictions, each spouse is considered to have a one-half interest that he or she unilaterally can encumber (and which, similarly, is subject to creditors' liens and to execution of those liens to satisfy the spouse's individual debts), but any encumbrance or execution of the spouse's interest cannot deprive the other spouse of his or her right to possession or right of survivorship.[61] In even fewer jurisdictions, the interest in a tenancy by the entirety that can be encumbered by one spouse alone or that is subject to the claims of the creditors of one spouse alone is only the contingent survivorship interest.[62]

Married couples who transfer their entireties property to joint or separate revocable or irrevocable trusts (for estate planning purposes) may inadvertently extinguish the creditor protection attributes of property previously held by them as tenants by the entirety. In an effort to protect their citizens from this consequence, some states have enacted legislation declaring that the property continues to be immune from creditors' claims as if it had remained a tenancy by the entirety.[63] For most purposes, however, the property would no longer be treated as a tenancy by the entirety. In most cases, for example, the transfer would have extinguished the survivorship feature, and the estate taxation of the property would no longer be governed by §2040.

The Supreme Court has held that, despite the state law fiction that a tenant by the entirety has no separate interest in entireties property, each tenant may possess individual rights in the estate sufficient to constitute "property" or "rights to property" for purposes of a §6321 lien.[64] Thus, contrary to the general state law rules concerning the rights of one spouse's creditor to reach entireties property, one spouse's federal tax delinquency can give rise to a federal tax lien against the property.[65] The

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> There are approximately sixteen full bar jurisdictions. In these jurisdictions, separate creditors have even less recourse. Their liens do not attach at all to, and they may not levy on, entireties property or interests.

Johnson, *Why Craft Isn't Scary*, 37 Real Prop., Prob. & Tr. J. 439 (Fall 2002) (citations omitted).

[59] Whitman et al., The Law of Property, §5.5 (4th ed. 2019). *See also Citizens Savings Bank, Inc. v. Astrin*, 61 A.2d 419 (Del. 1948); *Bloomfield v. Brown*, 25 A.2d 354 (R.I. 1942); *Sawada v. Endo*, 561 P.2d 1291 (Haw. 1977); *Stauffer v. Stauffer*, 351 A.2d 236 (Pa. 1976); *Elko v. Elko*, 49 A.2d 441 (Md. 1946); *Jones v. Conwell*, 314 S.E.2d 61 (Va. 1984). A similar proposition is illustrated by *Arbesam v. Winer*, 468 A.2d 633 (Md. 1983), which states that one spouse alone cannot subject entireties property to a lease. The *Citizen Savings Bank* case describes as follows the relationship between the non-severability of a tenancy by the entirety and the insulation of such tenancies from creditors' claims:

> Each spouse owns the whole while both live; neither can sell any interest except with the other's consent, and by their joint act; and at the death of either the other continues to own the whole, and does not acquire any new interest from the other. There can be no partition between them. From this is deduced the indivisibility and unseverability of the estate into two interests, and hence that the creditors of either spouse cannot during their joint lives reach by execution any interest which the debtor had in land so held. … [W]hen land is held by the entireties a judgment against the husband is not during the joint lives of the tenants of the estate a lien on the land, because his possibility of survivorship cannot be taken in execution.

Citizens Savings Bank, Inc., 61 A.2d at 421 (quoting *Hurd v. Hughes*, 109 A. 418, 419 (Del. Ch. 1920)).

[60] Massachusetts law draws a distinction between the right of a creditor to "attach" tenancy by the entirety property and the right of a creditor to seize or execute upon a lien with respect to tenancy by the entirety property. In *Peebles v. Minnis*, 521 N.E.2d 1372 (Mass. 1988), the court held that the creditors of a debtor-spouse (who were not the creditors of the other spouse) could, in order to obtain security for a possible later judgment, attach the debtor's interest in her residence (held as tenants by the entirety) notwithstanding a statutory prohibition against "seizure or execution" of such a residence by the creditor of only one of the spouses. The court stated that attachment was not the same as seizure or execution and that the creditors were entitled to attach the debtor's interest in the residence, noting that the interest could be subject to execution at some later date (if, for example, the non-debtor spouse predeceased the debtor spouse, or if the tenancy were terminated by divorce).

[61] Whitman et al., The Law of Property, §5.5 (4th ed. 2019). *See also Zanzonico v. Zanzonico*, 46 A.2d 565 (N.J. 1946); *Brownley v. Lincoln County*, 343 P.2d 529 (Or. 1959). In *Brownley*, the court elaborated upon this concept as follows:

> Although tenants by the entirety are held to be vested with a single title our legislation and cases have modified the common-law theory of the unity of ownership to the extent that each is regarded as the separate owner of one half the rents and profits and each spouse has the power to convey or encumber the whole title subject to the right of survivorship in the other spouse. …
>
> However, if one spouse conveys or encumbers his interest in the estate the grantee or encumbrancer has a right during coverture only to the grantor's share of the rents and profits. … In such cases it is proper to say that the interest conveyed by the granting spouse vests in the grantee or encumbrancer subject to the other spouse's contingent right of survivorship. If the grantor should predecease his spouse the interest of the grantee or encumbrancer in the estate ceases; but if the grantor survives his spouse then the surviving spouse's interest, freed from the interest of his cotenant, remains vested in the grantee or encumbrancer. …
>
> The same results obtain where the interest claimed by a third person in the estate of one spouse was acquired, not by voluntary conveyance, but by the legal devices available to creditors for reaching the interest of a debtor spouse.

Brownley v. Lincoln County, 343 P.2d at 531 (citations omitted).

[62] *See, e.g.*, *Robinson v. Trousdale Cnty.*, 516 S.W.2d 626 (Tenn. 1974).

[63] *See, e.g.*, Va. Code §55.1-136(C). Illinois has enacted a statute that permits a married couple to hold the marital homestead in this form. 765 ILCS 1005/1c. Hawaii enacted a similar statute. *See* Haw. Rev. Stat. §509-2. Other states that have similar statutes include: Delaware (Del. Code Ann. tit. 12, §3334), Maryland (Md. Code Ann. Estates and Trusts §14.5-511), and Missouri (Mo. Rev. Stat. §456.950).

[64] *United States v. Craft*, 535 U.S. 274 (2002). Following *Craft*, the IRS issued guidance concerning the procedures and practices it intends to follow in collecting tax deficiencies from entireties property when only one of the owners is liable for outstanding taxes. Notice 2003-60. *See, e.g., United States v. Tyler*, 528 F. App'x 193 (3d Cir. 2013) (applying *Craft* and Notice 2003-60, the Third Circuit held, in a nonprecedential opinion, that a federal tax lien on property that was formerly held in a tenancy by the entirety was not extinguished at the death of the husband, whose tax liabilities were the source of the lien, because (1) the spouses had severed tenancy by a transfer to the wife before the husband's death, and (2) the wife was not a "purchaser" of the property because the consideration furnished upon severance did not reasonably approximate the value of property); *Hatchett v. United States*, 330 F.3d 875 (6th Cir. 2003), cert. denied, 541 U.S. 1029 (2004) (applying *Craft* retroactively in case pending on direct review when *Craft* decided).

[65] *Craft* constitutes a reversal of what had been a firmly established majority rule, under which the tax liability of one spouse would not give rise to a federal tax lien with respect to property held as tenants by the entirety. *See, e.g., United States v. Am. Nat'l Bank of Jacksonville*, 255 F.2d 504 (5th Cir. 1958) (lien for husband's separate tax liability did not attach to entireties prop-

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Supreme Court has also held that a deceased spouse's interest in a tenancy by the entirety is subject to the §6324 lien for estate taxes.[66] For a detailed discussion of federal tax liens and tax levies, including the *Craft* decision, see 637 T.M., *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability* (U.S. Income Series).

c. Joint Tenancy

In most jurisdictions, jointly held property is subject to the claims of a creditor of only one of the joint owners.[67] The creditors may levy upon only the debtor joint tenant's share to satisfy the debt and cannot levy upon the share of the other joint tenants.[68]

As discussed earlier, the conveyance of one tenant's interest in a joint tenancy generally severs the joint tenancy as to that tenant.[69] Similarly, an involuntary transfer of a joint tenant's interest (for example, in the case of sale on execution of a judgment against the tenant) should sever the tenancy.[70] Conversely, merely docketing or recording a judgment against a joint tenant, thereby creating a judgment lien with respect to the tenant's jointly held property, without execution of the lien, should not trigger a severance of the joint tenancy.[71] There is a division of authority, however, as to whether the levying of a judgment lien, without an actual sale on execution, affects a severance.[72] Whether a severance has occurred is of principal significance for tax and estate planning purposes if the debtor joint tenant dies between the date that a judgment lien arises and the date on which the debtor's interest is sold or the lien foreclosed. If the joint tenancy has not been severed, then the property passes by right of survivorship to the surviving joint tenant and the estate taxation of the debtor's interest is determined under §2040. On the other hand, if the joint tenancy has been severed, the debtor's interest passes by testate or intestate succession and the estate taxation of the interest is determined under §2033. For purposes of determining creditors' rights, if there is no severance, at the death of the joint tenant the property passes to the survivor free of creditors' claims.[73]

A federal tax lien attributable to the tax liability of only one joint tenant in a joint tenancy attaches, not to the whole of the joint tenancy property, but only to the taxpayer's interest in the property.[74] Whether the tax lien survives the death of the taxpayer-joint tenant depends on state law. In *United States v. Librizzi*,[75] for example, the Seventh Circuit ruled that, under Wisconsin law, a lien attributable to the tax liability of a deceased joint tenant continues to encumber the property after the joint tenant's death. The survivorship right of the surviving joint tenant is not defeated by the lien, but the surviving joint tenant takes the property subject to the lien.[76]

If all joint tenants are jointly liable for the taxes at issue, the lien attaches to the entire property, and the government can seize and sell the entire property pursuant to its administrative authority under §6331. On the other hand, if the tax liability re-

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erty until wife's death, at which time property vested in husband and lien attached; applying Florida law), cert. denied, 358 U.S. 835 (1958); *United States v. Hutcherson*, 188 F.2d 326 (8th Cir. 1951) (applying Missouri law); *Craft v. United States*, 140 F.3d 638 (6th Cir. 1998) (applying Michigan law), rev'd, 535 U.S. 274 (2002); *Talbot v. United States*, 850 F. Supp. 969 (D. Wyo. 1994) (applying Wyoming law). In the case of joint tax liabilities, entireties property has been treated no differently than other types of property and, thus, has been subject to the federal tax lien. *See, e.g., Tony Thornton Auction Serv., Inc. v. United States*, 791 F.2d 635 (8th Cir. 1986) (applying Missouri law). Under pre-*Craft* law, if entireties property were not subject to the claims of creditors of the taxpayer under state law, the income from the property was also not subject to the federal tax lien, assuming that income was similarly treated as tenancy by the entirety property under local law. *Moore v. Glotzbach*, 188 F. Supp. 267 (E.D. Va. 1960) (rents derived from real property held as tenants by entirety not subject to federal tax lien for separate tax liability of husband; under Virginia law, rent was also entireties property); *United States v. Nathanson*, 60 F. Supp. 193 (E.D. Mich. 1945) (implicitly reaching same conclusion as to Michigan law). On the other hand, if the income were not treated under local law as a tenancy by the entirety, then the taxpayer's pro rata share of the income was subject to the tax lien. *See Bernstein v. United States*, 106 F. Supp. 233 (W.D. Mo. 1952) (federal tax lien valid to extent of taxpayer's share of income from property).

In a minority of the jurisdictions before *Craft*, a federal tax lien relating to one spouse's separate tax liability arose with respect to that spouse's interest in the property, subject to the other spouse's right of survivorship and right of possession. *See Geiselman v. United States*, 961 F.2d 1 (1st Cir. 1992) (per curiam) (applying former Massachusetts law, under which husband had exclusive right to possession, rents, and profits from tenancy by the entirety property; federal tax lien pertaining to husband's separate tax liability attaches to husband's interest in property); *United States v. Avila*, 88 F.3d 229 (3d Cir. 1996) (under New Jersey law, tax lien attaches to entireties property, subject to non-debtor spouse's right of survivorship; any execution of lien during joint lives of tenants would be subject to non-debtor spouse's right to possession and right of survivorship). As a practical matter, in those jurisdictions that applied the minority rule, the contingent survivorship rights and the lifetime right of possession of the nontaxpayer spouse would make the interest to which the lien attached difficult or impossible to sell. *But see United States v. Ragsdale*, 206 F. Supp. 613 (W.D. Tenn. 1962) (applying Tennessee law; government had right to require sale of husband and wife's interest in note, which they had received from the purchasers of tenancy by the entirety property to satisfy husband and wife's joint tax liability; balance of proceeds from note to be retained by clerk of court to protect government's right to satisfy husband's separate tax liability out of husband's right of survivorship interest in proceeds).

[66] *Detroit Bank v. United States*, 317 U.S. 329 (1942). *See also* CCA 200949001.

[67] *See* 2 Casner, American Law of Property, §6.3 (1952), Kurtz. et. al, The Law of Property: An Introductory Survey, §8.2 (7th ed. 2018).

[68] A related issue of significant practical importance is whether a bank, which is owed money by a borrower who has defaulted on his or her loan, may reimburse itself from the borrower's jointly held bank account, if the co-owner of the account owes the bank nothing. As a general rule, there is no right to set off against the joint bank account unless permitted by the account contractual arrangement or by state statutes regulating bank accounts. *See generally* Laurino, *Whose Money Is It Anyway? A Bank's Right to Set Off Against Joint Accounts*, Colum. Bus. L. Rev. 61 (1996).

[69] *See* I.B.2., above. There is a division of authority on the question whether a lease given by one joint tenant severs the tenancy. If the lease does not sever the tenancy, the death of the lessor during the lease term will terminate the lease. Whitman et al., The Law of Property, §5.4 (4th ed. 2019).

[70] 2 Casner, American Law of Property, §6.2 (1952), Roger H. Bernhardt & Ann M. Burkhart, Real Property in a Nutshell, 126 (7th ed. 2016).

[71] Whitman et al., The Law of Property, §5.4 (4th ed. 2019). *See, e.g., N. State Bank v. Toal*, 230 N.W.2d 153 (Wis. 1975) (creation of judgment lien did not sever tenancy; at debtor's death, property passed to survivor free of lien).

[72] 2 Casner, American Law of Property, §6.2 (1952); Whitman et al., The Law of Property, §5.4 (4th ed. 2019). If severance does not occur, at the debtor's death the property passes to the survivor free of the creditor's claim. *See, e.g., Knibb v. Security Ins. Co.*, 399 A.2d 1214 (R.I. 1979).

[73] *See* Fisher, *Creditors of a Joint Tenant: Is There a Lien After Death?*, 99 W. Va. L. Rev. 637 (1997) (describing this proposition as the "general rule"). If the deceased joint tenant's probate estate is insufficient to satisfy creditors' claims, however, state law may permit recovery of the joint property for purposes of satisfying those claims.

[74] *United States v. Trilling*, 328 F.2d 699 (7th Cir. 1964) (applying Illinois law); *United States v. Ridley*, 120 F. Supp. 530 (N.D. Ga. 1954) (applying Georgia law); *United States v. Third Nat'l Bank & Tr. Co.*, 111 F. Supp. 152 (M.D. Pa. 1953) (involving joint bank account).

[75] 108 F.3d 136 (7th Cir. 1997).

[76] *Librizzi*, 108 F.3d 136.

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lates to only one joint owner, the government can seize only the taxpayer's interest, and only the taxpayer's interest may be sold at an administrative sale.[77] Only the taxpayer's undivided interest is subject to the government's administrative collection procedures; these procedures do not permit the government to sell the entire property and to divide the proceeds among the taxpayer and the other owners.

It may be difficult or impossible for the government to sell a taxpayer's undivided interest in jointly owned property. For this reason, the government may elect to forgo the administrative sale option and instead institute a suit to sell the property under §7403, which permits judicial actions to enforce tax liens or to subject property to the payment of tax. At one time, the propriety of bringing a §7403 action to sell jointly owned property to satisfy a delinquency of one joint tenant was subject to question. It is now clear that such a suit is permissible, i.e., that the entire property can be sold and a portion of the proceeds paid to the nondelinquent joint tenant as compensation for the loss of his or her property interests.[78] On the other hand, before ordering such a sale, the court must consider the following factors: (1) the extent to which the government's interests would be compromised if it were forced to sell only the taxpayer's partial interest; (2) whether the non-taxpayer joint owner has a legally recognized expectation that the property would not be subject to forced sale by the delinquent joint owner or his or her creditors; (3) the likely prejudice to the non-taxpayer joint owner of ordering a sale; and (4) the relative character and value of the nonliable and liable interests in the property.[79] In an action under §7403, all persons claiming an interest in the property must be made parties to the proceeding,[80] and the sales proceeds must be distributed in accordance with those interests.[81]

d. Transferee Tax Liability of Surviving Joint Tenants

Section 6901 provides the IRS with a mechanism for enforcing the tax liability of a transferor of property, by permitting the IRS to assess the transferor's liability against the transferee. Whether a transferee of property is liable for the taxes of the transferor is a matter of state law and is beyond the scope of this Portfolio. Section 6901 focuses on neither the question of the transferor's liability nor the question of the transferee's liability, but rather on the authority of the IRS to assess the tax liability directly against the transferee. Under §6901, assessment against a transferee who is liable (under state law) for the transferor's taxes is permitted if, as a general rule: (1) there was a transfer of property to the person against whom transferee liability is sought, and (2) the taxpayer-transferor was liable for the tax both at the time of the transfer and at the time transferee liability is asserted.[82]

Whether the government can assert transferee liability against a surviving joint tenant or tenant by the entirety depends on whether there was a transfer of property to the surviving tenant within the meaning of §6901. This issue has been considered on several occasions and has consistently been resolved in the surviving joint tenant's favor. Applying the laws of several jurisdictions,[83] the courts have held that, because the surviving joint tenant or tenant by the entirety takes the property by virtue of the creation of the tenancy — and not by reason of the death of the co-tenant — the survivor is not a transferee for the purposes of §6901. In Rev. Rul. 78-299,[84] the IRS concurred with this approach as to those jurisdictions in which local law immunizes jointly held property from the claims of creditors of a deceased tenant.

e. Property Subject to Usufruct

Louisiana and Puerto Rico recognize the right of *usufruct*, which is akin to a life estate in that the right allows the usufructuary to use and enjoy another's property for a period of time without damaging it.[85] A usufruct combines two property rights: the use and the "fruits" of the property without the "naked" ownership of the property. Such property right lacks the right to dispose of the property, *abusus*.[86]

In *Goodrich v. United States*,[87] a deceased wife left her three children ownership of certain stock and options, mineral rights, and personal property subject to a usufruct granted to the surviving husband. During the husband's remaining life, he incurred a significant tax liability, and upon his death the IRS levied the usufruct proceeds and the property subject to the usufruct. The couple's children filed a wrongful levy action against the IRS, claiming that they were the owners of the usufruct property immediately upon the husband's death, and therefore, the property could not be levied. The court agreed with the children regarding the personal property and mineral rights, which it found were nonconsumables. As nonconsumables, the court stated that ownership of the property transferred to the children when the husband died, and the IRS wrongfully levied the proceeds from the estate sale of the personal property and the income from the mineral rights accruing after the husband's death. However, the court stated that

[77] Reg. §301.6335-1(d)(5)(iii), as redesignated without change from former Reg. §301.6335-1(c)(5)(iii) by T.D. 10011, 89 Fed. Reg. 87,784 (Nov. 5, 2024).

[78] *United States v. Rodgers*, 461 U.S. 677 (1983).

[79] *Rodgers*, 461 U.S. 677. *See also United States v. Dase*, No. 4:18-cv-00501, 2020 BL 72150 (N.D. Ala. Feb. 27, 2020) (after weighing *Rodgers* factors, joint tenant's sentimental interest in property did not outweigh government interest in collecting delinquent taxes from other joint tenant via forced sale of entire property); *United States v. Johnson*, 943 F. Supp. 1331 (D. Kan. 1996) (denying government's motion for summary judgment as to propriety of sale; whether harm to non-taxpayer joint tenant would outweigh prejudice to government in denying sale was genuine issue of material fact precluding summary judgment).

[80] §7403(b).

[81] §7403(c).

[82] For further discussion, see 628 T.M., *Transferee Liability* (U.S. Income Series).

[83] *Tooley v. Commissioner*, 121 F.2d 350 (9th Cir. 1941) (California law); *Irvine v. Helvering*, 99 F.2d 265 (8th Cir. 1938) (Minnesota law); *Fecarotta v. United States*, 154 F. Supp. 592 (D. Ariz. 1956) (Arizona law).

[84] *Citing Commissioner v. Stern*, 357 U.S. 39 (1958) (transferee liability depends on whether transferred asset is subject to claims of transferor's creditors under state law). The ruling bases its decision on an assumed fact that "the [jointly owned] assets that passed directly to the [surviving] spouse were not subject to the claims of decedent's creditors." As discussed at I.C.3.c., above, however, in general, jointly held property is subject to the claims of a joint tenant's creditors. In Rev. Rul. 78-299, no assessment of tax liability had been made before the deceased joint tenant's death, so no tax lien would have arisen before the decedent's death under §6321.

[85] Black's Law Dictionary (12th ed. 2024). *See, e.g.*, La. Civ. Code Ann. Art. §535 *et seq.*; P.R. Tax Code §1501, *et seq.* Usufruct is commonly founded in civil law.

[86] Black's Law Dictionary (12th ed. 2024).

[87] *Goodrich v. United States*, No. 17-cv-0610, 2020 BL 98837 (W.D. La. Mar. 17, 2020), aff'd, No. 20-30422, 2022 BL 24290 (5th Cir. Jan. 25, 2022).

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because the husband sold the stock and options during his lifetime, he was required to pay his children the value of the stock. Because cash is a consumable, the court held that the children did not immediately become the owners, and the husband's death only created a claim against the estate for them as creditors. The levy on the cash from the stock sale was not wrongful where the children were not the naked owners.

The Fifth Circuit affirmed the district court's holding because the children became unsecured creditors of the stock proceeds when the usufruct terminated upon the husband's death.[88] Because the children were unsecured creditors and not owners, the IRS did not wrongfully seize funds or property owned by the children and, therefore, properly levied the usufruct proceeds.

4. *State Inheritance, Estate, and Gift Tax Considerations*

Effective for estates of decedents dying after December 31, 2004, the deduction for state death taxes replaced the former §2011 state death tax credit.[89] Changing the state death tax offset from a credit to a deduction reduces the value of the offset, and thus increases the marginal cost of the state death tax to taxpayers. The change in federal law triggered a ripple effect of state legislatures reducing or eliminating their death taxes to correspond to the federal changes. As of the date of publication of this Portfolio, most states either impose an estate tax in an amount determined by reference to the federal credit (meaning that the tax is zero during any period in which the credit is zero) or have eliminated their estate tax altogether. A few states impose an estate tax equal to the amount of the federal credit in effect on January 1, 2001. A handful of jurisdictions impose an inheritance tax on the shares received by beneficiaries.[90]

In most states, the treatment of jointly held property for death and gift tax purposes follows the models established by federal tax laws. In a few jurisdictions, however, the tax treatment of joint interests differs from their treatment under federal law. For example, the Pennsylvania inheritance tax laws provide that if a joint tenancy was created at least one year before death, irrespective of which tenant was the source of the funds represented by the joint tenancy, the amount subject to tax at the decedent's death is the decedent's proportionate share of the whole, based on the number of joint owners.[91] Inheritance tax schemes also sometimes treat spousal joint tenancies as exempt from tax, even though other assets passing to a surviving spouse may not be exempt. Thus, owning property jointly with a spouse may produce a state death tax saving that could not be achieved by simply leaving assets to a surviving spouse under a will.

5. *Surviving Joint Tenant's Right to Contribution for Indebtedness*

State courts differ in their approaches to the question of whether a surviving joint tenant has a right to contribution from the deceased joint tenant's estate for a mortgage indebtedness on which the co-owners were jointly and severally liable.[92] The traditional (and still the majority) approach to this question has been to allow the surviving joint tenant to recover a pro rata share of the mortgage obligation.[93] The minority, but arguably the better, approach is to deny the right of contribution. Courts following the minority approach recognize that contribution toward a joint debt is an equitable right and that, in most circumstances, equity favors imposing the entire debt on the surviving joint tenant, who has become the outright and sole owner of the property.[94]

D. Estate Planning Considerations

Joint tenancies have long been a popular form of property ownership, particularly between spouses. The survivorship feature[95] is a simple and inexpensive means of avoiding estate administration, which in most cases is advantageous to a decedent's survivors.[96] Other factors[97] counseling in favor of joint ownership as part of a well-planned estate include:

- Joint ownership, particularly between spouses, provides the owners with a degree of comfort and security not achieved with separate property ownership. Although ef-

[88] *Goodrich v. United States*, No. 20-30422, 2022 BL 24290 (5th Cir. Jan. 25, 2022). *See also Succession of Majoue*, 705 So.2d 225, 229 (La. App. 5 Cir. 1997) ("At the termination of a usufruct of consumables, of which money is one, the usufructuary owes to the naked owners the value that the thing had at the commencement of the usufruct, La. Civ. Code, Arts. 536 and 538. This obligation is in the nature of a debt owed by the succession to the owners").

[89] *See* former §2011, permanently repealed as deadwood by Pub. L. No. 113-295, §221(a)(95)(A)(i).

[90] An estate tax is imposed on the transfer of property at death, while an inheritance tax is imposed on the receipt of property. Thus, the estate is liable for estate taxes imposed, whereas the beneficiary bears inheritance tax liability imposed. In general, inheritance tax statutes establish separate rate schedules for different categories of beneficiaries, usually based on the degree of consanguinity.

[91] 72 Pa. Stat. §9108(a), §9108(c).

[92] The question discussed in the text does not arise with respect to mortgages on which the deceased joint tenant was solely and personally liable. Under those circumstances, the estate would be obligated to discharge the decedent's personal liability. If the surviving joint tenant were forced to pay the indebtedness to avoid foreclosure, the survivor would have a right of recovery from the decedent's estate. The question discussed in the text is also distinguishable from the question whether specifically devised property is exonerated from a mortgage indebtedness, i.e., whether the residuary estate is obligated to pay the indebtedness, thus allowing the property to pass to the devisee free of the debt.

[93] *See generally* C.C. Marvel, Annotation, *Right of Surviving Spouse to Contribution, Exoneration, or Other Reimbursement Out of Decedent's Estate Respecting Liens on Estate By Entirety or Joint Tenancy*, 76 A.L.R. 2d 1004 (1961). *See also Mellor v. O'Connor*, 712 A.2d 375 (R.I. 1998) (describing and citing cases for majority and minority views).

[94] *See Mellor v. O'Connor*, 712 A.2d 375 (R.I. 1998).

[95] At the risk of stating the obvious, the right of survivorship controls the disposition of joint tenancy property only if there is a surviving joint tenant. In estate planning for a person who is a joint tenant, therefore, one must consider the possibility that the person will be the last joint tenant to die, which means that the property will pass as part of the person's probate estate. Because it is impossible to know in advance which joint tenant will be the survivor, estate planners must address the proper disposition of the joint tenancy property in each joint tenant's will. Moreover, in the event of simultaneous deaths, the will of each joint tenant controls the disposition of a portion of the property. *See* III.H., below. This possibility, too, must be taken into account when formulating the estate plan.

[96] The advantages may include (1) easier and quicker access to the property following death, (2) reduced administration expenses, such as court costs, executors' commissions, and attorneys' fees, (3) avoiding publicity concerning the nature and extent of the decedent's estate, and (4) avoiding the need for ancillary administration of real property owned in a jurisdiction other than that of the decedent's domicile.

[97] *See generally* Campfield, *Estate Planning for Joint Tenancies*, Duke L.J. 669 (1974).

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fective estate planning usually requires that some assets be held by spouses separately, spouses often wish for certain assets, such as the family residence, to be held jointly, which expresses the idea of the marriage as a partnership and communicates an impression of family harmony.

• Joint property may, under limited circumstances, avoid dower, curtesy, and elective share rights.[98]

• Joint ownership arrangements may provide an element of creditor protection, both during lifetime (in the case of tenants by the entirety) and at death (with respect to creditors of the decedent's estate).

• Joint property may be treated favorably under state inheritance tax rules.

Notwithstanding these advantages, jointly held property is not appropriate in every case, and often it is advisable to terminate joint ownership arrangements for estate planning purposes. Even though the American Taxpayer Relief Act of 2012 (ATRA)[99] made permanent spousal portability for decedents dying and gifts made after 2010, thus mitigating some of the estate tax benefits that could have previously been attained by severing a joint tenancy, there are still several situations where severance of joint tenancy can help a client reach his or her estate planning goals. The following is an example of how severing a joint tenancy mitigated estate tax liability for a married couple when spousal portability was not a part of the Code:

Example I-1: S1 and S2, spouses, own a residence worth $1,500,000 as tenants by the entirety and marketable securities worth $4,500,000 in a brokerage account held as joint tenants with right of survivorship. At S1's death, all of the assets pass by operation of law to S2; all of the assets includible in S1's estate are offset by a corresponding marital deduction and, thus, no estate taxes are due. At S2's subsequent death, all of the assets are includible in S2's estate. Assuming no changes in value and that S2 dies in a year in which the exemption equivalent is $5,000,000, using rates and credits as of 2009 (a tax year for which spousal portability was not in effect), S2's estate owes $1,125,000 in estate taxes.[100] If instead the spouses had severed their joint tenancies and divided their assets between them equally as tenants in common,[101] at S1's death S1's share of the assets could have been placed in a credit shelter trust for S2's benefit (structured to avoid inclusion in S2's estate at death). The taxes attributable to S1's share of the assets would be offset by the unified credit, so that no taxes would be owed at S1's death. Assuming no changes in value, S2's estate tax liability would also be fully offset by S2's unified credit, thus producing a tax savings of $1,125,000.

Moreover, even under circumstances in which portability is available, there may be advantages to gain from severing joint property for the purpose of funding a credit shelter trust. For one, the assets of the trust could appreciate in value between the date that the first spouse dies and the date that the second spouse dies, thus sheltering a larger amount of property from estate tax than if the first spouse's unused unified credit had simply passed to the surviving spouse. In addition, establishing a credit shelter trust allows for the use of the deceased spouse's GST exemption, which is not portable between spouses. There are also non-tax reasons for creating a credit shelter trust, including the ability to control the disposition of the property at the second spouse's death or to manage the assets for the surviving spouse's benefits. For these and other reasons, credit shelter trusts will not disappear, even if portability remains.

For non-married persons holding assets as joint tenants, the most significant potential disadvantage of the joint tenancy is the application of the consideration-furnished test of §2040(a). As discussed below at III.C., this test results in the full value of jointly held property's being included in the estate of the first joint tenant to die except to the extent that the survivor can establish that he or she contributed to the acquisition of the property. If the first to die did not in fact furnish the consideration, but the survivor's records are inadequate to rebut the §2040(a) presumption, the property is subject to estate taxes twice, once in the estate of the first to die (under §2040(a)) and again in the estate of the survivor (under §2033).

Practice Tip: Married couples who own appreciated property jointly may wish to terminate joint ownership and make the spouse with the shorter life expectancy the sole owner, in order to take advantage of the basis step up under §1014 at the sole owner's death. The termination of the joint ownership arrangement generally has no adverse gift tax consequences due to the availability of the gift tax marital deduction.[102] This technique is effective only if either (1) the decedent survives at least one year after the termination of the joint tenancy, or (2) the property interest does not pass at the decedent's death to the surviving spouse.[103]

Terminating a spousal joint tenancy is more complicated if one of the spouses is a non-U.S. citizen. In this case the unlimited gift tax marital deduction is not available,[104] which means that the severance of the joint ownership arrangement may either consume a portion of one spouse's unified credit or trigger the imposition of gift taxes. One means of avoiding this problem is to take advantage of the special annual exclusion available under §2523(i)(2) as follows:[105]

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[98] Some older versions of the elective share statutes subject only the decedent's probate estate to the surviving spouse's elective share. Assets not forming part of the probate estate, including jointly held property, would not therefore be subject to the elective share. Most modern versions of the elective share statutes, however, subject to the elective share not just assets subject to probate, but other assets in which the decedent had an interest, including jointly held property. *See generally* Danforth, *Estate Planning Implications of a Surviving Spouse's Elective Share Rights*, 22 Tax Mgmt. Est., Gifts & Tr. J. 235 (1997).

[99] Pub. L. No. 112-240, §101.

[100] This analysis assumes no deductible debts or expenses and no offsetting credits other than the unified credit.

[101] In most cases, the severance generates no gift taxes, either because there is no taxable gift or because any gift is offset by the marital deduction. If the donee spouse is a non-U.S. citizen, however, no marital deduction is available. See the text following in this section for a discussion of an alternative severance strategy if one spouse is a non-citizen.

[102] But see II.C.3.c., below (planning for non-citizen spouses).

[103] §1014(a), §1014(e).

[104] §2523(i).

[105] This example assumes that the §2523(i)(2) amount is $100,000. Note that this amount is adjusted for inflation under §2503(b)(2)(B), amended by the Tax Cuts and Jobs Act, Pub. L. No. 115-97, §11002(d)(1)(EE), applicable

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Example I-2: S1 and S2, spouses the latter of whom is a non-U.S. citizen, own a residence worth $1,000,000 as joint tenants with right of survivorship. They wish to retitle the residence as tenants in common, with each having a 50% interest. Based on the consideration furnished by each of them, S1's interest in the residence is $700,000, and S2's interest is $300,000. To avoid the imposition of gift taxes or the consumption of unified credit, the residence should first be retitled into their names as tenants in common, with S1 having a 70% interest and S2 a 30% interest. S1 may then make annual exclusion gifts of 10% tenancy-in-common interests in the residence to S2 over two calendar years. At the end of the two years, S1 and S2 each own 50% of the residence as tenants in common.

Other planning issues pertaining to the termination of joint tenancies are discussed at II.C.5., below.

to tax years beginning after 2017. For a complete list of the §2523(i)(2) inflation-adjusted amounts, see Gift Tax Annual Exclusion for Gifts to Non-Citizen Spouses in Tax Tables, Charts and Lists (Federal).

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II. Gift Taxation of Jointly Held Property

A. Overview of Gift Tax Principles

Section 2501(a)(1) imposes a tax on the transfer of property by gift, *i.e.*, on gratuitous transfers. Under §2512(b), a transfer is taxable only to the extent that it is not for "adequate and full consideration in money or money's worth."[106] If a donor transfers by gift less than his or her entire interest in the property, the gift tax applies only to the interest transferred.[107] Thus, if a donor transfers an undivided interest in property (which is the effect, in many cases, of the creation or termination of a joint tenancy), the tax applies only to the undivided interest.[108] The value of the interest transferred is determined in accordance with the general principles of §2512 and the accompanying regulations or, if actuarial calculations are needed, in accordance with the rules set forth in Reg. §25.2512-5 and §25.2512-5A.[109]

Several restrictions on the applicability of the gift tax are of particular relevance to the taxation of transactions involving jointly held property. First, the gift tax is imposed only with respect to completed transfers. Thus, if the donor reserves a power over the disposition of property transferred, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case.[110] Second, the gift tax is subject to a significant administrative exception, the gift tax annual exclusion set forth in §2503(b), which permits the tax-free transfer of up to the annual exclusion amount to each recipient every calendar year.[111]

The annual exclusion is available only for transfers of "present interests."[112] Whether the creation of a joint tenancy constitutes a transfer of a present interest is discussed at II.B.1., below. Third, a recipient of property who disclaims the property in a manner satisfying the requirements of §2518 is deemed not to have made a taxable transfer for gift tax purposes. For a more complete discussion of disclaimers of joint property interests, see II.E., and III.G., below.

Until 1954, the Code contained no special provisions that dealt specifically with the creation and termination of joint tenancies. Former §2515, which concerned the taxation of the creation or termination of certain tenancies by the entirety in real property, was enacted as a part of the 1954 Code. The Tax Reform Act of 1976 amended former §2515 and added former §2515A, which concerned the taxation of the creation of certain tenancies by the entirety in personal property.[113] These sections were repealed for gifts made after 1981,[114] but continue to be relevant when determining the taxation of joint property interests between spouses, one of whom is not a U.S. citizen.[115]

Regarding the valuation of transfers by gift, §2512(a) provides that "[i]f the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift." Thus, the time of valuation is the date of the gift; there is no alternate valuation rule for gift tax purposes, as there is for estate tax purposes under §2032. Chapter 14 of the Code establishes a set of special valuation rules for gift tax purposes, which apply generally to gratuitous transactions among family members involving (1) transfers of interests in partnerships and corporations, (2) transfers of or creation of interests in trust, (3) options, buy-sell agreements, and other restrictions on the use or transfer of property, and (4) certain lapsing rights and restrictions in property.[116] The Chapter 14 rules are not specifically applicable to the gift taxation of jointly held property, although the rules may be implicated if a transaction involving jointly held property also involves a type of property interest governed by Chapter 14 (for example, the creation of a joint tenancy in a family limited partnership interest). For an in-depth discussion of §2701, §2703 and §2704, see 835 T.M., *Transfers of Interests in Family Entities Under Chapter 14: Sections 2701, 2703 and 2704.* For a detailed discussion of §2702, see 836 T.M., *Partial Interests — GRATs, GRUTs, and QPRTs (Section 2702).*

The valuation of gifts of jointly held property in certain cases may be determined by actuarial calculations regarding partial temporal interests in property. For example, the creation of a non-severable joint interest in property, with each of two joint tenants contributing one-half of the acquisition costs, may produce a gift to the joint tenant with the longer life expectancy,[117] because the value of the interest received by that joint tenant is greater than his or her contribution to the property. Section 7520, which applies to transfers on or after May 1, 1989, generally requires that the value of partial temporal interests in property (for example, life estates and remainder interests) be determined under valuation tables promulgated by the IRS, which are set forth in part in the regulations.[118] The tables reflect

[106] *See* Reg. §25.2512-8 (also excluding from gift tax transfers "made in the ordinary course of business," which are deemed to be "for an adequate and full consideration in money or money's worth").

[107] Reg. §25.2511-1(e).

[108] Reg. §25.2511-1(e).

[109] Reg. §25.2511-1(f). *See* Reg. §25.2512-5, *amended by* T.D. 9974, 88 Fed. Reg. 37,424 (June 7, 2023) (applicable to valuation dates on or after June 1, 2023). *See also* Reg. §25.2512-5A(g) (applicable to valuation dates on or after May 1, 2009, and before June 1, 2023); Reg. §25.2512-5A(f) (applicable to valuation dates on or after May 1, 1999, and before May 1, 2009).

[110] Reg. §25.2511-2(b). This principle may be illustrated by the gift taxation of establishing a joint bank account: if the donor of the funds can recover them without the co-owner's consent, no gift occurs when the account is created. *See* Reg. §25.2511-1(h)(4) (observing that gift occurs only when co-owner withdraws funds). *See also* PLR 200101021 (no completed gift results from spouses' creation of joint revocable trust with tenancy by the entirety property because each spouse retained unilateral right to revoke his or her respective transfer and revest title in himself or herself; however, if one spouse receives lifetime distribution from trust during trust term, other spouse is deemed to make completed gift equal to 50% of value of assets distributed).

[111] For current and historical annual gift tax exclusion amounts, see *Gift Tax Annual Exclusion* in Tax Tables, Charts and Lists (Federal).

[112] *See* §2503(b); Reg. §25.2503-3.

[113] Pub. L. No. 94-455. For detailed discussions of former §2515 and §2515A, see II.B.2.b.(2) and II.B.2.b.(3), below.

[114] Economic Recovery Tax Act of 1981 (1981 ERTA), Pub. L. No. 97-34, §403(c)(3)(B). See the Worksheets, below, for the full text of §2515 and §2515A before repeal by the 1981 ERTA.

[115] *See* §2523(i)(3) (principles of former §2515 and §2515A apply to joint tenancies involving non-citizen spouse).

[116] *See generally* §2701–§2704.

[117] *See* II.B.2.b.(1), below. If the joint tenancy cannot be severed unilaterally, the interest held by the younger tenant is more valuable, because he or she is more likely to survive and thus become the outright owner. Illustrations of the results produced by actuarial calculations are set forth in II.B.1., below.

[118] For transfers on or after June 1, 2023, see Reg. §25.2512-5(d), *amended by* T.D. 9974, 88 Fed. Reg. 37,424 (June 7, 2023). For transfers after April 30, 2009, and before June 1, 2023, see Reg. §25.2512-5A(g). For transfers after April 30, 1999, and before May 1, 2009, see Reg. §25.2512-5A(f). For trans-

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certain assumptions regarding actuarial life expectancies[119] and discount rates, the latter of which are determined on a monthly basis by reference to the average yield of certain U.S. Treasury obligations.[120] Section 7520(c)(2) directs the Treasury to revise its actuarial assumptions every 10 years, to reflect the most recently available mortality experience.

B. Creation of Joint Tenancies

1. Tenancy Created by a Third Party

The transfer of property by a person to others when the transferor retains no interest in the property after the transfer constitutes a gift of the entire value of the property.[121] Thus, when a person transfers property to two or more other persons and designates that the persons shall own the transferred property as joint tenants with the right of survivorship, a taxable transfer occurs.[122] Gift taxes may not be payable, however, by reason of the annual exclusion, gift tax marital deduction, or unified gift tax credit.[123]

When property is acquired jointly by gift from a third party who retains no ownership interest, there are no gift tax implications to the new co-tenants. Each of the new co-tenants is considered to have contributed an amount equal to his or her property interest under local law. However, the transfer is a taxable gift by the donor, in the absence of any exclusion, deduction, or credit.

> *Example II-1:* M gives a house at the seashore to her son, S, and daughter, D, and places title to the property in S and D's names as joint tenants with right of survivorship. Neither S nor D incurs any gift tax liability; M has made a taxable transfer of the full value of the property.[124]

The value of the gift to each joint tenant and the extent to which the gift tax annual exclusion is available depends on the nature of the joint interest created. If, under state law, the joint tenancy is unilaterally severable by any joint tenant, the value of the gift to each tenant is that person's pro rata share of the whole property,[125] and each donee's share qualifies for the gift tax annual exclusion.[126] If the joint tenancy is not unilaterally severable (as is the case with most tenancies by the entirety), the value of the interest passing to each tenant depends on the tenants' relative life expectancies.[127] The tenant with the longest life expectancy is the one most likely to survive the other cotenants and accordingly is deemed to own a greater portion of the property transferred. The use of actuarial calculations to determine the value of a joint tenancy interest is illustrated by the following example:

> *Example II-2:* T transfers real property to B, C, and D as joint tenants with right of survivorship. Under local law, the consent of all joint tenants is required to sever the tenancy. The value of the gift to each tenant must be determined actuarially. B, C, and D are ages 42, 46, and 71, respectively. The value of the interest received by B is determined by calculating the present value of the right of a person age 42, if living, (1) to share equally in the income from the property with the survivor or survivors of two persons ages 46 and 71, and (2) to receive the property at the death of the last to die of two persons ages 46 and 71. Using a discount rate of 10%, the value of B's interest is 40.964% of the value of the entire property. Applying the same principles, the value of C's interest is 38.402% of the whole, and the value of D's interest is 20.634% of the whole.[128]

If the joint tenancy is not unilaterally severable, the interest of each recipient may only partially qualify for the gift tax annual exclusion, because only the "life estate" element of the joint tenancy would be considered a present interest; the "remainder" element would not. This principle is illustrated by the following example:

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fers after April 30, 1989, and before May 1, 1999, see Reg. §25.2512-5A(e). *See* 830 T.M., *Valuation: General and Real Estate*, for a detailed discussion of the valuation of annuities, interests for life or a term of years, remainders interests, and reversionary interests.

[119] As a general rule, life expectancies for purposes of these calculations are determined on an actuarial basis. If the person who serves as the measuring life is "terminally ill," however, the regulations under §7520 require the use of that person's actual, as opposed to actuarial, life expectancy for valuation purposes. Reg. §25.7520-3(b)(3) defines "terminally ill" as follows:

> For purposes of this paragraph (b)(3), an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year. However, if the individual survives for eighteen months or longer after the date the gift is completed, that individual shall be presumed to have not been terminally ill at the date the gift was completed unless the contrary is established by clear and convincing evidence.

The actuarial calculations illustrated in this Portfolio assume that each person who serves as a measuring life is not terminally ill within the meaning of the regulations.

[120] Section 7520(a)(2) prescribes a discount rate equal to "120 percent of the Federal midterm rate in effect under section 1274(d)(1) for the month in which the valuation date falls," rounded to the nearest 2/10 of 1 percent. The federal midterm rate under §1274(d)(1) is the rate determined by the Secretary based on the average market yield on outstanding marketable obligations of the United States with remaining periods to maturity over 3 years but not over 9 years.

[121] *See* §2512; Reg. §25.2511-1(e) (amount of gift is value of property transferred less value of retained interest).

[122] *See* Reg. §25.2511-1(h)(5) (involving similar transfer, in which donor becomes co-tenant).

[123] *See* §2503(b) (annual exclusion), §2523 (marital deduction), §2505 (unified credit).

[124] For income tax purposes, the basis of the beach property in the hands of S and D is M's adjusted cost basis, increased by any gift taxes paid. *See* §1015(d). For a more complete discussion of the income tax basis rules, see IV.C., below.

[125] *See* Reg. §25.2515-2(b)(1) (applicable to former §2515).

[126] *See Estate of Buder v. Commissioner*, 25 T.C. 1012 (1956) (allowing two annual exclusions for the donor's transfer of separate gifts to his son and daughter-in-law; rejecting the donor's claim of a third exclusion for the donor's transfer of bonds to his son and daughter-in-law as tenants by the entirety because the entirety is not a separate legal entity under state law).

[127] *See* Reg. §25.2515-2(b)(2) (applicable to former §2515).

[128] PLR 8746026. The ruling does not explain (nor do other similar rulings explain) how it derived the factors used to calculate each co-tenant's interest. Similarly, the regulations offer no guidance on how to derive these actuarial factors. Because the factors depend on multiple life expectancies, presumably they would qualify as "special factors" for purposes of Reg. §25.2512-5(d)(4), which provides that the IRS will, pursuant to a ruling request, furnish special factors in the case of completed gifts. Reg. §25.2512-5(d)(4), *amended by* T.D. 9974, 88 Fed. Reg. 37,424 (June 7, 2023).

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Example II-3: In *Example II-2*, the interest passing to B can be allocated between B's present interest right to share in the use or income of the property and B's future interest contingent right to the entire property (if B survives both C and D). Using a discount rate of 10% and the actuarial tables contained in the regulations, the value of B's present interest is equal to 1/3 multiplied by the applicable life estate factor for a 42 year old (0.93928),[129] or 0.31309, which translates into an annual exclusion for the gift to B of 31.309% of the total value transferred, subject to a maximum of $10,000, as indexed to inflation.[130]

If state property law restricts a joint tenant's rights to the use or income of the property, the annual exclusion may not be available at all. For example, in Rev. Rul. 74-345,[131] the IRS ruled that, if under local law one spouse had no enforceable rights to rents, profits, or control of tenancy by the entirety property, that spouse would have no present interest in the property, and only one annual exclusion (with respect to the other spouse) would be allowed.

2. Tenancy Created by a Co-tenant

a. In General

The transfer of a donor's separate property into the names of the donor and one or more others as joint tenants is a gift to the extent that the new co-tenants did not provide consideration[132] equal to the value of their property interest received, as determined under local law.[133] If the joint tenancy can be severed by any co-tenant, the value of each tenant's property interest is considered to be pro rata, as determined by the number of co-tenants.[134] If the joint tenancy cannot unilaterally be severed (as is true with most tenancies by the entirety), the value of each tenant's property interest is determined on an actuarial basis — in most cases, the interest owned by the youngest joint tenant is more valuable than those owned by older joint tenants, because the youngest is the most likely to survive and thus become the sole owner of the property. A special rule, providing that the interest owned by each spouse is deemed to be one-half, applies to certain tenancies by the entirety created after 1976 and before 1982.[135] A gift occurring upon the creation of a joint tenancy may qualify for the annual exclusion or the gift tax marital deduction, or the gift may consume a portion of the donor's unified credit.

Example II-4: F purchased a vacant lot for $50,000 with his own funds, taking title in the name of himself and his son, S, as joint tenants with right of survivorship. Under local law, the interests of the tenants are severable. F made a gift to S of a one-half undivided interest in the lot, having a fair market value of $25,000. The gift qualifies for the gift tax annual exclusion because it is a gift of a present interest under §2503(b), and the amount of the gift in excess of the annual exclusion amount is either subject to gift tax or consumes a portion of F's unified credit.

The IRS illustrated the tax consequences resulting from the purchase of property in the joint names of others in Rev. Rul. 78-362. Under the hypothetical facts of the ruling, D paid $30x as a down payment on real property that D caused to be titled in the names of D, A, and B, as joint tenants with right of survivorship. The property was subject to a mortgage of $120x, which D paid in regular monthly installments. The IRS summarized the tax consequences as follows:

> In the present situation, D, A, and B owned equal interests in the jointly owned property that could be unilaterally severed. Since D provided the funds for the down payment and received no consideration from A and B, D made taxable gifts of the one-third interests to A and B when the property was purchased and placed in joint ownership. Inasmuch as the expenses of the property were the obligations of D, A, and B in equal shares, D's monthly payments of the mortgage were gifts to A and B when D paid their respective one-third shares of the obliga-

[129] PLR 8746026. The life estate factor is derived from Table S, which is available online at https://www.irs.gov/retirement-plans/actuarial-tables. *See* Reg. §20.2031-7(d)(7), *amended by* T.D. 9974, 88 Fed. Reg. 37,424 (June 7, 2023). *See also* Reg. §25.2512-5(d)(2)(ii), Reg. §1.642(c)-6(e), *amended by* T.D. 9974, 88 Fed. Reg. 37,424 (June 7, 2023).

[130] §2503(b)(2)(B), *amended by* the Tax Cuts and Jobs Act, Pub. L. No. 115-97, §11002(d)(1)(EE).

[131] *Revoked by* Rev. Rul. 79-54, (due to change in Tennessee law giving each spouse "joint right to the use, possession, control and income of [tenancy by the entirety] property").

[132] Reg. §25.2511-1(h)(5) provides the following example: J, with his own funds, purchases property and has the title conveyed to himself and B as joint owners, with rights of survivorship, which rights may be defeated by either party severing his interest. J has made a gift to B in an amount equal to one-half the value of the property. If each cotenant has made a contribution to the joint tenancy equal to his or her proportionate interest, there is no gift upon the creation of the joint tenancy. *See Estate of Trafton v. Commissioner*, 27 T.C. 610 (1956) (securities purchased and transferred into joint names of husband and wife under oral agreement that whatever was earned or accumulated through their joint efforts was to belong to them jointly did not result in taxable gift; transfer of securities into joint ownership was supported by full and adequate consideration in money or money's worth by virtue of parties' oral agreement), *acq.*, 1957-2 C.B. 7.

[133] Consideration furnished can take the form of cash, property, or interests in property, as described in Reg. §25.2515-1(c) with respect to tenancies by the entirety. In contrast to the rules under §2040(a) concerning estate taxation, debt incurred in connection with the purchase or improvement of the property is not treated as consideration furnished for gift tax purposes. *See* Reg. §25.2515-1(d)(2)(i) (last sentence). Subsequent payments on any such debt, however, are treated as consideration furnished by the payor. *See* Reg. §25.2515-3(b). When consideration is furnished in the form of property (or an interest in property), the amount of the contribution is the fair market value of the property or interest at the time it was transferred to the tenancy or was exchanged for the tenancy property. *See* Reg. §25.2515-1(c)(1)(i). Note that although former §2515, governing tenants by the entirety ownership, was repealed, the IRS also applied the principles of Reg. §25.2515-1 to non-spousal joint tenancies. *See, e.g.*, PLR 7941046. Presumably, these principles remain applicable. The regulations under repealed former §2515 are accordingly set forth in the Worksheets, below.

[134] Reg. §25.2515-2(b)(1).

[135] Former §2515(c)(3), §2515A. Under former §2515, which applies to tenancies by the entirety in real property, the rule treating each spouse's interest as one-half applies only if the donor spouse makes an election under former §2515(c) to treat the creation of the tenancy as a taxable gift. The rule with respect to tenancies by the entirety in personal property applies automatically, unless "the fair market value of the interest or of the property … cannot reasonably be ascertained except by reference to the life expectancy of one or both spouses." Former §2515A(b). The Committee Report on this section uses a joint and survivor annuity as its example. S. Rep. No. 745, 95th Cong., 2d Sess. 93 (1978). For a more detailed discussion of former §2515 and §2515A, see II.B.2.b.(2) and II.B.2.b.(3), below.

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tions without the expectation of reimbursement from A and B.[136]

b. Spousal Joint Tenancies

(1) General Rules

A transfer of property by a donor to a joint tenancy or tenancy by the entirety with the donor and the donor's spouse in general constitutes a gift to the donor's spouse. If either spouse may sever the joint tenancy, the amount of the gift is one-half of the value of the property, assuming no contribution by the donee spouse.[137] If neither spouse may sever the tenancy, the amount of the gift depends upon the relative life expectancies of the tenants.[138] By reason of the §2523 unlimited gift tax marital deduction (available only if the donee spouse is a U.S. citizen), no gift taxes are due[139] at the time of the transfer.[140] If a non-contributing spouse has no enforceable interest in the rents, profits, income, or use of property held in a tenancy by the entirety, then the spouse's interest is a "future interest" and does not qualify for the gift tax annual exclusion.[141] In most cases, however, the lack of an annual exclusion is irrelevant, because the entire transfer qualifies for the gift tax marital deduction. The following examples illustrate these principles:

Example II-5: X purchased a townhouse for $500,000 with his own funds. After his marriage to B, a U.S. citizen, he transferred title into their joint names with right of survivorship. Under local law, each spouse has a severable one-half interest in the tenancy. The transfer into the joint tenancy constitutes a taxable gift of a one-half interest in the townhouse, but the gift is offset by the annual exclusion under §2503(b) and the gift tax marital deduction under §2523.

Example II-6: S1 and S2, spouses and both U.S. citizens, purchased a vacant lot for $100,000. S1 paid $20,000 and S2 paid $40,000 of the purchase price. They jointly borrowed $40,000 from Bank to pay the balance. Under local law, each owns a severable, undivided one-half interest in the property. S2 has made a taxable transfer to S1 of a fractional interest having a value of $10,000 (S1's one-half interest is worth $30,000, which is $10,000 more than S1's contribution). No gift taxes are payable by S2 because of the annual exclusion and gift tax marital deduction, as discussed in *Example II-5* above.

Example II-7: S1's father, F, died and left the family farm, which for estate tax purposes has a value of $500,000, to S1. S1 directs F's executor to issue a deed in the name of S1 and S2, spouses and both U.S. citizens, as tenants by the entirety. Under local law, each tenant's interest is indefeasible. S1 made a taxable transfer of an interest in the family farm, the value of which must be determined actuarially — based upon the ages of both spouses on the date of the transfer.[142] Because of the gift tax marital deduction, however, no tax is due.[143]

Special rules apply to spousal joint tenancies if one spouse is not a U.S. citizen, which are discussed in detail at II.B.2.b.(4), below.

(2) Transactions Implicating Former §2515

Former §2515 established special gift tax rules with respect to the creation and termination of tenancies by the entirety in real estate.[144] Although the provision was repealed by the 1981 ERTA, it has continued relevance by virtue of §2523(i)(3), under which the principles of both former §2515 and former §2515A (the latter of which is discussed below at II.B.2.b.(3)) apply for purposes of determining the gift taxation of tenancies by the entirety in which one of the co-tenants is not a U.S. citizen.

Some background on former §2515 (as well as on former §2515A) may be helpful in understanding its function. Before 1955, the contribution of either spouse to a spousal joint tenancy constituted a gift to the extent that the consideration furnished by either spouse exceeded the value of the interest retained by that spouse.[145] As noted earlier, determining the gift tax consequences of such a transaction requires one to value each spouse's interest in the joint tenancy. While this is a relatively easy proposition for tenancies that are severable under local law (the value of each tenant's interest under those circumstances is one-half of the value of the underlying property), valuation is more complicated for tenancies that are not severable (in which case the value of each tenant's interest must be

[136] Rev. Rul. 78-362 (citing *Estate of Woody v. Commissioner*, 36 T.C. 900 (1961)).

[137] Reg. §25.2515-2(b)(1) (under repealed §2515).

[138] Reg. §25.2515-2(b)(1). For a discussion of using actuarial factors to calculate the value of each tenant's interest, see II.B.1., above.

[139] In most cases, a gift tax return need not be filed. *See* §6019(2).

[140] Section 2523(d) provides that the interest of a donor in property that exists solely by reason of the possibility that the donor may survive the donee spouse or that there may be a severance of a joint tenancy is not considered an interest retained by the donor for purposes of the terminable interest rule under §2523(b). Most terminable interests do not qualify for the gift tax marital deduction. *See generally* 843 T.M., *Estate Tax Marital Deduction.* Because of the special rule under §2523(d), however, most transfers of property into joint tenancies with a spouse are not treated as a transfer of a terminable interest and thus qualify for the marital deduction.

[141] *See* II.B.1., above. With the advent of the Married Women's Property Acts, however, cases and rulings that support this proposition should be obsolete, because under present law both spouses have equal rights with respect to the enjoyment of and control over tenancy by the entirety property. *See* Whitman et. al., *The Law of Property*, §5.5 (4th ed. 2019).

[142] For further discussion of such calculations, see II.B.1., above.

[143] Note that, although no gift taxes are payable in any of the above examples, the spouses may have different bases in the property for income tax purposes. In *Example II-5*, each spouse would have a basis of $250,000, and in *Example II-6*, each spouse would have basis of $50,000 (note that in *Example II-6*, S1's basis in part is derived from his or her contribution to the property and in part reflects a carryover of S2's basis in the property he or she gave to S1). In *Example II-7*, the basis of $500,000 would be allocated between S1 and S2 in proportion to their actuarially determined interests in the property. For a more compete discussion of the basis rules pertaining to inter vivos gifts, see IV.C.1., below.

[144] Former §2515(d) defined "tenancy by the entirety" to include a joint tenancy with right of survivorship between spouses. Thus, former §2515 applied not just to the traditional, non-severable tenancy by the entirety. On the other hand, other features of former §2515 significantly limited its scope: the provision applied only to joint tenancies in real property and only to joint tenancies created by one or both of the spouses, not by third parties. *See* former §2515(a).

[145] See the discussion of this principle at II.B.2.a., and II.B.2.b.(1), above.

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determined on an actuarial basis). Many spousal tenancies are tenancies by the entirety, which in most cases are not unilaterally severable. Thus, in many cases, determining the gift tax consequences of the creation of a spousal tenancy requires that the interests be valued actuarially. The introduction of the unlimited marital deduction in 1981 obviated the need to perform such calculations in most cases — if any taxable transfer is fully offset by the deduction, then the size of the taxable gift is of lessened importance.[146] Before 1955, however, when there was no unlimited marital deduction, determining the amount of a transfer to spouse when creating a joint tenancy directly affected the donor spouse's gift tax liability.

Before 1955, many spouses, whether out of ignorance or for other reasons (perhaps, for example, a desire to avoid the actuarial calculations needed to calculate the gift tax), failed to report acquisitions of joint property as taxable transactions. Congress enacted former §2515 in part, therefore, to conform the law to what many married taxpayers supposed it to be.[147] Under former §2515, the creation of a tenancy by the entirety in real property was not deemed a transfer by gift, regardless of the proportion of consideration furnished by each spouse, unless the donor elected to treat the transfer as a gift on a timely filed gift tax return.[148] The provision applied both to tenancies created by one spouse alone and to tenancies created by both spouses.[149] Additions to the value of the property (whether in the form of improvements, reductions in the indebtedness, or otherwise) were subject to the same general rule,[150] although the election to treat the transfer as a gift, once made, applied both to the creation of the tenancy and to any subsequent additions in value.[151] The gift election, or non-gift in the absence of an election,[152] applied only to real property. Until the enactment of former §2515A in 1976,[153] if a donor created a joint tenancy in personal property with his or her spouse, a taxable gift would occur, if the spouse failed to contribute his or her pro-rata share of the costs of acquisition. In most cases, however, a joint tenancy in personal property was not a tenancy by the entirety and was unilaterally severable under local law. Under these circumstances, each spouse was deemed to own a one-half interest in the property; thus, the actuarial calculations associated with tenancies by the entirety were not necessary.

The Tax Reform Act of 1976 (1976 TRA)[154] introduced the concept of the "qualified joint interest" into the estate tax as §2040(b)(2).[155] Under the 1976 TRA version of former §2040(b)(2), if the joint interest had been created by a transfer subject to the gift tax, then one-half of the property would be includible in the estate of the first spouse to die, regardless of the relative contributions of the spouses to the acquisition of the joint tenancy. With the introduction of this estate tax rule, the 1976 TRA made a corresponding change to the gift tax rules: former §2515(c) was modified to provide that, if the donor spouse elected to treat the creation of joint tenancy in realty as a gift, then the interest of each spouse would be deemed to be one-half (thus obviating the need for actuarial calculations).[156] In the Technical Corrections Act of 1978 (1978 TCA),[157] Congress enacted former §2515A (discussed at II.B.2.b.(3), below) and thus extended the equal-value rule to the creation of joint tenancies in personal property.[158] The 1981 ERTA[159] introduced the unlimited marital deduction.[160] With the advent of the unlimited marital deduction, there was no need for concern about the gift tax consequences of the creation of spousal joint tenancies. Thus, the 1981 ERTA also repealed §2515 and §2515A, effective for gifts made after 1981.[161]

As noted earlier, under former §2515(c), the donor of a spousal joint tenancy in real property had the option of electing to treat the transaction as a taxable transfer. If the election was made, both the creation of the joint tenancy and any subsequent additions to the tenancy were treated as gifts under the usual gift tax principles (i.e., the transfer would in general constitute a gift to the extent the donor's interest in the joint tenancy was less than his or her proportionate contribution). Before the amendment of former §2515(c) by the 1976 TRA, an election to treat the creation of the tenancy as a gift would require actuarial calculations of the spouse's ownership interests, if the tenancy was not unilaterally severable. As modified by the 1976 TRA,[162] however, former §2515(c) provided that, in the event of an election to treat the creation of a tenancy as a taxable transfer, the retained interest of each spouse would be treated as one-half of the value of the property,[163] thus obviating the need for actuarial calculations, whether or not the joint interests were severable.

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[146] As discussed in the notes above, the amount of the gift may still be relevant for purposes of determining each spouse's income tax basis in the joint tenancy.

[147] *See* S. Rep. No. 1622, 83d Cong., at 128 (1954) (observing that "[m]any couples who elect [the tenancy by the entirety] 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").

[148] Former §2515(c).

[149] Former §2515(a).

[150] Former §2515(a).

[151] Former §2515(c)(2).

[152] The primary incentive to elect to treat the creation of the joint tenancy as a taxable gift was to avoid gift tax treatment upon termination of the tenancy. Assume, for example, that in 1960 Spouse 1 acquired a residence in both spouse's names, and that S1 furnished the entire $100,000 cost of acquisition. Assume further that no former §2515(c) election was made. If the residence was sold in 1970 for $200,000 and if, as required under local law, one-half of the proceeds passed to the Spouse 2, S1 was deemed under former §2515(b) to have made a gift of $100,000. The amount of the gift to S2 would have been less if S1 had elected to treat the creation of the tenancy as a gift — the potential increased gift tax cost of termination thus provided some incentive to treat the creation as a taxable gift. On the other hand, the gift upon termination could be avoided altogether simply by allocating all of the proceeds of termination to S1. Moreover, even if S1 elected to treat the creation of the tenancy as a gift, the full value of the property would be included in his or her estate at death under the consideration-furnished rule, unless the joint tenancy was subject to the pre-1981 ERTA qualified joint interest rules, as discussed at III.E.2., below. Thus, there was little incentive for most taxpayers to make the former §2515(c) election.

[153] See the discussion of former §2515A at II.B.2.b.(3), below.

[154] Pub. L. No. 94-455.

[155] The 1976 TRA version of the "qualified joint interest" should be distinguished from the version that exists under post-1981 ERTA law, as discussed at III.E.1., below. The post-1981 ERTA qualified joint interest rules apply to spousal joint tenancies, regardless of the gift tax treatment of the formation of the tenancy.

[156] *See* 1976 TRA, Pub. L. No. 94-455, §2002(c)(2) (amending §2515(c)).

[157] Pub. L. No. 95-600.

[158] 1978 TCA, Pub. L. No. 95-600, §702(k)(1)(A).

[159] Pub. L. No. 97-34.

[160] 1981 ERTA, Pub. L. No. 97-34, §403(b)(1) (amending §2523(a), which previously limited amount of gift tax marital deduction).

[161] 1981 ERTA, Pub. L. No. 97-34, §403(c)(3)(B).

[162] 1976 TRA, Pub. L. No. 94-455, §2002(c)(2).

[163] Former §2515(c)(3).

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(3) Transactions Implicating Former §2515A

Added by the Technical Corrections Act of 1978 (1978 TCA),[164] former §2515A provided that, upon the creation of a joint tenancy with right of survivorship between a married couple in personal property, or in the case of additions to the joint tenancy (in the form of improvements, reductions in indebtedness, or otherwise), the retained interest of each spouse was treated as one-half of the value of the joint property.[165] A transfer covered by former §2515A created a gift to the extent that the contribution by one spouse exceeded his or her retained one-half interest in the property. In most cases involving joint tenancies in personal property, the joint tenancy would not have been a tenancy by the entirety, and thus each spouse would have had the right under local law to sever his or her interest in the tenancy. Accordingly, even without former §2515A, the value of each spouse's interest would be one-half. The principal significance of former §2515A, therefore, was with respect to tenancies by the entirety (or non-severable joint tenancies) in personal property, for which one would normally have turned to actuarial calculations to measure the value of each spouse's interest. The practical effect of former §2515A was to treat the creation of joint tenancies and tenancies by the entirety in personal property in the same manner for gift tax purposes.

Former §2515A(b) established an exception to the equal interest rule if the fair market value of the "interest" created or of the "property" could not "reasonably be ascertained except by reference to the life expectancy of one or both spouses." Whether the values could be ascertained, however, was to be determined under the assumption (whether or not true) that "each spouse had a right to sever" the joint tenancy. If the value of the underlying property is known (whatever its value might be), the value of each "interest" in the property is always ascertainable, because of the assumption that the interests can be severed (in which case the interests are always of equal value). Thus, the former §2515A(b) exception appears to be significant only if it is the "property" itself that cannot be valued without reference to the life expectancy of one or both spouses. An example of such "property" would be a joint and survivor annuity, which can be valued only by reference to the life expectancies of both annuitants.[166] Thus, the equal interest rule of former §2515A would not apply to the creation of a joint interest in such an annuity; the amount of the gift from one spouse to the other would be measured by the contribution of the donor spouse, less the actuarial value of the interest retained.

Former §2515A was repealed by the 1981 ERTA for gifts of personal property made after 1981.[167]

(4) Special Rules for Non-Citizen Spouses

Transfers made on or after July 14, 1988, to donee spouses who are not U.S. citizens are not protected by the unlimited gift tax marital deduction.[168] However, for gifts to non-citizen spouses that would qualify for the marital deduction but for §2503(i), the §2503(b) annual exclusion amount is increased to $100,000 (indexed for inflation after 1998).[169]

Regarding the gift tax treatment of spousal joint tenancies, if the donee spouse is a non-citizen, §2523(i)(3) directs that the principles of former §2515 and §2515A apply, as those sections were in effect before their repeal by the 1981 ERTA. In applying former §2515 and §2515A, however, the donor spouse may not elect to treat the creation of a tenancy in real property as a gift, as provided in former §2515(c).[170] Former §2515 and §2515A are discussed at II.B.2.b.(2) and II.B.2.b.(3), above.

The general principles described in the preceding paragraph are elaborated upon in the regulations that accompany §2523(i).[171] Regarding joint tenancies in real property, the regulations establish different rules, the application of which depends on when the tenancy was created and whether an election was made under former §2515(c).[172] Section 25.2523(i)-2(b)(1) of the regulations provides that, under the principles of former §2515, the creation of a tenancy by the entirety or joint tenancy in real property (by either one or both spouses) on or after July 14, 1988, and any additions to the value of the tenancy (e.g., improvements, reductions in indebtedness, etc.) is deemed not to be a transfer of property for gift tax purposes, regardless of the proportion of the consideration furnished by each spouse, but only if the creation of the tenancy would otherwise be a gift to the non-citizen spouse at the time of the gift. Regarding the creation of a tenancy by the entirety or joint tenancy in personal property (by either one or both spouses, at least one of whom is not a U.S. citizen) and additions to such a tenancy, Reg. §25.2523(i)-2(c)(1) provides that the retained interest of each spouse, solely for purposes of determining whether there has been a gift by the donor to the non-citizen spouse at the time of the gift, is treated as one-half of the value of the joint interest. However, Reg. §25.2523(i)-2(c)(2) implements the principle of former §2515A(b) and provides that the general rule does not apply to any joint interest if the fair market value of the interest (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 of the spouses. Under these circumstances, the gift tax consequences of the transaction may be determined by actuarial principles. The circumstances under which this exception applies are discussed above in connection with former §2515A, at II.B.2.b.(3). Note, however, that §2523(i) does not disallow the marital deduction with respect to a transfer result-

[164] Pub. L. No. 95-600.

[165] 1978 TCA, Pub. L. No. 95-600, §702(k)(1)(A).

[166] *See* S. Rep. No. 745, 95th Cong., at 92, 93 (1978) (using joint and survivor annuity as example).

[167] 1981 ERTA, Pub. L. No. 97-34, §403(c)(3)(B).

[168] §2523(i), added by the Technical and Miscellaneous Revenue Act of 1988 (1988 TAMRA), Pub. L. No. 100-647, §5033(b).

[169] §2523(i)(2). The requirement that the gift must qualify for the marital deduction (for example, the gift cannot constitute a non-deductible terminable interest under §2523(b)) to be eligible for the $100,000 exclusion is effective for gifts made after June 29, 1989. The Omnibus Budget Reconciliation Act of 1989 (1989 OBRA), Pub. L. No. 101-239, §7815(d)(1)(A). *See* Reg. §25.2523(i)-1(c), §25.2523(i)-1(d) *Ex.* (4) (discussing gifts that qualify for increased annual exclusion). For current and historical inflation-adjusted amounts, see *Gift Tax Annual Exclusion for Gifts to Non-Citizen Spouses* in Tax Tables, Charts and Lists (Federal).

[170] §2523(i)(3); Reg. §25.2523(i)-2(a).

[171] *See* Reg. §25.2523(i)-2. The provisions of Reg. §25.2523(i)-2 regarding the gift tax treatment of spousal joint tenancies involving a non-citizen spouse are effective for gifts made after August 22, 1995. Reg. §25.2523(i)-3.

[172] For a discussion of former §2515(c), see II.B.2.b.(2), above.

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ing in the acquisition of rights by a non-citizen spouse under a joint and survivor annuity under §2523(f)(6).[173]

The following examples illustrate the gift tax treatment of spousal joint tenancies in real property for which the donee spouse is not a U.S. citizen:[174]

Example II-8: In Year 1 (on a date that is on or after July 14, 1988), J, a U.S. citizen, furnished $200,000 and J's spouse B, a resident alien, furnished $50,000 for the purchase and improvement of real property held by them as tenants by the entirety. The property is sold in Year 3 for $300,000. J receives $225,000 and B receives $75,000 of the sales proceeds. The termination results in a gift of $15,000 by J to B, computed as follows:

$$\frac{\$200{,}000 \text{ (consideration furnished by J)}}{\$250{,}000 \text{ (consideration furnished by both spouses)}} \times \$300{,}000 \text{ (proceeds of termination)} = \$240{,}000 \text{ (proceeds of termination attributable to J)}$$

$$\$240{,}000 - \$225{,}000 \text{ (proceeds received by J)} = \$15{,}000 \text{ gift by J to B}$$

Example II-9: In Year 1 (on a date that is before July 14, 1988), J purchased real property for $300,000 and took title in the names of J and B, J's spouse, as joint tenants. Under §2511 and Reg. §25.2511-1(h)(1), J was treated as making a gift of one-half of the value of the property ($150,000) to B. In Year 9 (on a date that is on or after July 14, 1988), the real property is sold for $400,000 and B receives the entire proceeds of sale. For purposes of determining the amount of the gift on termination of the tenancy under the principles of §2515 and its regulations, the amount treated as a gift to B on creation of the tenancy under §2511 is treated as B's contribution towards the purchase of the property. Accordingly, the termination of the tenancy results in a gift of $200,000 from J to B determined as follows:

$$\frac{\$150{,}000 \text{ (consideration furnished by J)}}{\$300{,}000 \text{ (consideration furnished by both spouses)}} \times \$400{,}000 \text{ (proceeds of termination)} = \$200{,}000 \text{ (proceeds of termination attributable to J)}$$

$$\$200{,}000 - \$0 \text{ (proceeds received by J)} = \$200{,}000 \text{ gift by J to B}$$

Note that in *Example II-8*, the creation of the tenancy by the entirety did not result in a taxable gift from J to B, notwithstanding that J furnished a disproportionate share of the consideration.[175] On the other hand, the termination of the tenancy in the manner described is a taxable event. Further, in *Example II-8*, J did not have the option, as J would have had under former §2525(c), to elect to treat the creation of the tenancy as a taxable gift.[176] In *Example II-9*, the creation of the joint tenancy was treated as a gift to B because the transaction occurred before the §2523(i) effective date. However, any gift from J to B before the effective date of §2523(i) would have been fully offset by a gift tax marital deduction, regardless of the citizenship of B.

The regulations do not provide examples of transactions involving the creation of joint tenancies in personal property. The operation of the rules for tenancies in personal property may be illustrated by the following example:

Example II-10: S1 purchases a painting for $1,000,000, taking title (as reflected in the bill of sale) in the names of S1 and S1's spouse, S2, who is not a citizen of the United States, as joint tenants with right of survivorship. Under Reg. §25.2523(i)-2(c)(1), the value of each spouse's interest in the joint tenancy is deemed to be one-half of the value of the whole. Accordingly, S1 has made a gift of $500,000 to S2, none of which qualifies for the gift tax marital deduction, but a portion of which may qualify for the annual exclusion, as discussed below. Note that this would have been the same result, notwithstanding Reg. §25.2523(i)-2(c)(1), if under local law either spouse unilaterally could sever the joint tenancy. If, on the other hand, the tenancy were not severable under local law, without Reg. §25.2523(i)-2(c)(1) the interests of each spouse would have had to be determined on an actuarial basis.

[173] §2523(i) (flush language); Reg. §25.2523(i)-1(b). The probable reason for this exception is that a joint and survivor annuity is a wasting asset, in the sense that no interest in property will remain at the death of the survivor. Thus, this type of asset does not present the same concern that led to the general disallowance of the marital deduction for assets passing to non-citizens — that the assets will escape estate taxation at the non-citizen's later death if he or she gives up U.S. residency. See the further discussion of this issue in the notes in III.E., below.

[174] *See* Reg. §25.2523(i)-2(b)(4) Exs. 1, 2.

[175] If the acquisition had been treated as a taxable event, the amount of any gift from J to B would be determined by comparing B's interest in the tenancy with B's contribution to the tenancy. B's interest in the tenancy would be determined by actuarial calculations, assuming (as would generally be true for tenancies by the entirety) that the tenancy was not unilaterally severable.

[176] Reg. §25.2523(i)-2(b)(3)(ii).

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The interests of each spouse in a personal property joint tenancy are treated as one-half of the property "solely for purposes of determining whether there has been a gift by the donor to the spouse who is not a citizen."[177] It is not clear, however, whether the one-half value rule of this provision also applies for purposes of determining the extent to which an annual exclusion is available. In order to take advantage of the $100,000 (indexed to inflation) annual exclusion for gifts to a non-citizen spouse, (1) the transfer to the spouse must otherwise qualify under §2503(b)[178] and, (2) for transfers occurring after June 29, 1989, the transfer must be in a form that qualifies for the gift tax marital deduction but for §2523(i).[179] Satisfying the second of these requirements does not generally present a problem, because there is a special exception to the terminable interest rule for joint property interests under §2523(d). Satisfying the first requirement may be problematic, however, if not all of the donee's interest in the joint tenancy qualifies as a present interest for purposes of §2503(b).[180] For purposes of determining the value of the gift received by the donee spouse, the donee's interest in the joint tenancy is treated as being one-half of the property, which is the same result that would have been reached if the tenancy were unilaterally severable.[181] The tenancy is not treated as if it were unilaterally severable for all purposes, such as for purposes of satisfying the present interest requirement of §2523(b).[182] It would appear, therefore, that the interest received by the donee spouse must be tested separately to determine whether, or to what extent, it qualifies for the $100,000 (indexed to inflation) annual exclusion.

In the preceding example, if the joint tenancy were severable under local law, the interest received by S2 upon creation of the tenancy would satisfy the present interest requirement of §2503(b).[183] If, however, the tenancy were not unilaterally severable,[184] then only a portion of the donee spouse's interest would be a present interest for annual exclusion purposes. For a non-severable joint tenancy, the present interest for annual exclusion purposes is limited to the value of the tenant's life estate in a fraction of the joint tenancy property. Thus, in the above example, if the tenancy were non-severable, the annual exclusion would be available for the value of W's life interest in one-half of the property, up to a maximum of $100,000 (indexed to inflation).

3. *Creation of Bank Accounts and Other Revocable Ownership Arrangements*

The gift tax does not apply to transfers with respect to which the donor retains "the power to revest the beneficial title to the property in himself."[185] The creation of a joint tenancy does not result in a taxable gift, therefore, if the ownership arrangement can be revoked by the donor. Under this principle, creating joint bank accounts and other similar arrangements does not result in taxable gifts.

With most joint bank accounts, the creator of the account is entitled to remove all of the funds without the other joint tenant's consent.[186] Under these circumstances, the donor's transfer of funds to the account is considered to be revocable, and there is no gift unless and until the non-contributing tenant withdraws funds from the account with no obligation to account for the proceeds to the contributor.[187] These general rules are subject to two exceptions. First, if a spouse withdraws money from a joint account established by the other spouse for the purpose of supporting the family, the withdrawal does not constitute a gift. A regulation that was proposed but never adopted by the IRS provided that "current expenditures by an individual on behalf of his spouse or minor children in satisfaction of his legal obligation to provide for their support are not taxable gifts."[188] This principle is widely recognized even though the regulation was not adopted. Any transfer that discharges a support obligation should be a transfer for "adequate and full consideration in money or money's worth" and thus not taxable under the principles of §2512(b).

The second exception is for bank accounts in jurisdictions in which local law treats the account as a "true" joint tenancy. Under the laws of some jurisdictions, the creation of a joint bank account gives each tenant an alienable one-half interest in the funds.[189] In these jurisdictions, a gift occurs upon the creation of a joint tenancy when only one party contributes funds.[190]

The same general principles apply to joint brokerage accounts. Whether joint brokerage accounts should be treated as true joint tenancy (giving the donee account holder an immediate ownership interest in one-half of the account at the time the account is created) or as a revocable tenancy is based on the particular facts and circumstances presented. In Rev. Rul. 69-148, for example, the IRS ruled that, when the securities held in a joint account are issued in the name of a nominee (e.g.,

[177] Reg. §25.2523(i)-1(c)(1).

[178] Reg. §25.2523(i)-1(c)(1).

[179] Reg. §25.2523(i)-1(c)(1).

[180] *See* Reg. §25.2503-3(a) (disallowing annual exclusion for gifts of "future interests," such as remainder interests). *See also* Reg. §25.2523(i)-1(d) *Exs.* (1), (3) (illustrating present interest requirement in context of gifts to non-citizen spouses).

[181] Reg. §25.2523(i)-2(c)(1).

[182] Reg. §25.2523(i)-2(c)(1).

[183] *See* Reg. §25.2503-3(b) (stating that unrestricted right to use, possession, or enjoyment of property is present interest). *See also* II.B.1., above.

[184] Note that, in some jurisdictions, it is possible to create a tenancy by the entirety in personal property. In most cases, a tenancy by the entirety cannot be severed by either tenant acting alone. Further, even if the tenancy in personal property were nominally designated a joint tenancy, rather than a tenancy by the entirety, it would be possible for the tenants contractually to agree that their tenancy not be unilaterally severable. Thus, the availability of the annual exclusion is a question of real, practical significance concerning the creation of spousal tenancies in personal property involving non-citizen spouses.

[185] Reg. §25.2511-2(c).

[186] State law typically provides that the funds in the account are owned by the tenants in proportion to their contributions. The account signature card, or other evidence of the contractual arrangement with the bank, usually permits either joint tenant to withdraw funds without the other tenant's consent, regardless of their proportionate contributions. A contractual provision such as this is designed, however, to protect the bank; it insulates the bank from charges that it improperly released funds to an account owner who was not entitled to the funds. The provision does not affect the rights of the joint owners with respect to each other; a non-contributing joint account holder would be obligated to account to the contributing account holder for funds withdrawn without the contributing account holder's permission.

[187] Reg. §25.2511-1(h)(4).

[188] Former Prop. Reg. §25.2511-1(f)(1).

[189] *See, e.g., Estate of Bucholtz v. Commissioner*, T.C. Memo. 1977-396 (applying New York law).

[190] *Estate of Bucholtz*, T.C. Memo. 1977-396.

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the brokerage firm), rather than in the names of the joint tenants, there is no gift for federal gift tax purposes unless and until the non-contributing joint owner draws on the account for his or her own benefit. In reaching its decision, the IRS analogized the joint brokerage account to joint bank accounts, noting that, because of the nominee ownership arrangement, the sole contributor to the account had not given up dominion and control over the account assets.

The manner in which a joint brokerage account is titled may suggest a true joint tenancy, but a non-contributing account holder may nevertheless have no or only limited rights under state law to withdraw account assets. In *Parker v. Commissioner*,[191] for example, the Board of Tax Appeals held that the wife did not have a an ownership interest in a joint brokerage account, noting that she "was merely accorded the right to withdraw money from the account, if the occasion required, for the same purposes she was permitted to write a check on the joint bank account, namely, to pay household expenses."[192] The Board of Tax Appeals further stated that the instruments creating the account, which gave the wife the power to withdraw without the husband's consent, "were for the protection and benefit of the brokers, and we think are not controlling here."[193]

These same principles apply to joint purchases of U.S. savings bonds. Thus, a gift does not occur upon the purchase of U.S. savings bonds when one person provides all of the purchase price and registers the bonds jointly with another until the non-contributing tenant surrenders the bond for cash without any obligation to account to the purchaser.[194] A gift also occurs if the bond is reissued in the name of the non-contributor as sole owner.[195]

> *Example II-11:* With his own funds, X purchases U.S. savings bonds for $25,000 and causes the bonds to be registered in the name of "X or Y, or to the survivor." X permits Y to redeem and keep the proceeds of one of the bonds, which has a redemption value of $5,000. Upon the redemption by Y, X has made a taxable gift to Y in the amount of $5,000. If X later permits one bond with a redemption value of $2,000 to be reissued solely in Y's name, X has made a taxable gift to Y in the amount of $2,000.

The interplay of local and federal law on this issue is reflected in Rev. Rul. 78-215, which concerns the joint registration of U.S. Treasury notes. In Rev. Rul. 78-215, X purchased U.S. Treasury notes and registered them in the names of "X or Y or the survivor." In Situation 1 of Rev. Rul. 78-215, local law provided that registration of the notes in this manner created a joint tenancy; X and Y were essentially equal co-owners of the notes. In Situation 2, local law provided that registration in this manner did not create a joint tenancy; nevertheless, the applicable Treasury regulations created certain rights in Y that could not be defeated by X without Y's consent. The degree to which there was a completed gift differed in the two situations. In Situation 1, there was a completed gift to Y of (1) an undivided one-half interest in the periodic interest payments and the redemption rights pertaining to the notes, and (2) the survivorship rights pertaining to the notes. In Situation 2, there was a completed gift to Y of (1) the survivorship rights in the periodic interest payments, and (2) the survivorship rights to the notes at maturity. In Situation 2, no portion of the gift qualified for the gift tax annual exclusion, because the survivorship rights were future interests for purposes of §2503(b).

4. *Nominal Joint Ownership/Convenience Accounts*

The general rule that the gift tax applies only to completed transfers may also prevent the imposition of tax upon the creation of a nominal joint tenancy. If the creator of a joint tenancy intends for the other joint tenant's interest to be nominal, rather than beneficial (for example, if the ownership arrangement is titled jointly for the convenience of the principal owner), there should be no gift tax consequences if a completed gift has not occurred. Whether a completed gift has occurred depends on how the joint tenancy is treated under local law. For example, in *Bouchard v. Commissioner*,[196] the court found that a gift did not occur when the sole stockholder of a family corporation transferred stock into a joint tenancy with his wife, but put the stock in a safe deposit box, did not intend to make a gift, and did not tell his wife about the transfer. Although donative intent is not an essential element of gift tax liability,[197] *Bouchard* illustrates that intent may be relevant for purposes of determining whether there has been a completed transfer, which is an essential element of gift tax liability.[198]

In determining whether the creation of a nominal joint tenancy constitutes a completed gift, the courts have considered such factors as:

- the name, address, and social security number appearing on the ownership papers;
- who owned the property prior to the creation of the joint tenancy;
- who had control over the tenancy, and whether there was a divestiture of control after the objective of the nominal ownership had been achieved;
- whether a written document relating to ownership was executed;
- whether there was a release of a survivorship interest in the account;
- whether gift tax returns were filed;
- how the income from the joint tenancy was reported; and
- the uses to which the funds were put during the period of the joint tenancy.[199]

[191] 39 B.T.A. 423 (1939).

[192] *Parker*, 39 B.T.A. at 429. At issue was whether the account constituted a joint venture between the spouses; if not a joint venture, the husband was entitled to deduct the losses sustained in the account from gains realized in another account.

[193] *Parker*, 39 B.T.A. at 429.

[194] Reg. §25.2511-1(h)(4).

[195] Rev. Rul. 55-278.

[196] 285 F.2d 556 (1st Cir. 1961) (applying Maine law).

[197] Reg. §25.2511-1(g)(1).

[198] Reg. §25.2511-2.

[199] *See* Stephens, Maxfield, Lind & Calfee, Federal Estate and Gift Taxation, ¶10.01[4]–[8] (Thomson Reuters Checkpoint) (discussing in detail factors that determine whether gift is complete). *See also* Reg. §25.2511-2.

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In essence, courts look at the substance, and not the form, of the transaction in determining the gift tax consequences.

Example II-12: F, who travels abroad frequently, established a joint bank account with his daughter, C, to pay monthly bills if he was out of the country when they were due. F entered into a nominee agreement with C, reciting the purpose for the account, indicating that his social security number was given to the bank for identification purposes, and that C had no beneficial interest in the bank account. These facts suggest that a gift has not occurred.

C. Inter Vivos Termination of Joint Tenancies

1. In General

A joint tenancy can terminate by operation of law (e.g., upon entry of a judicial decree of partition or divorce), by a consensual act of the joint tenants (e.g., a transfer that results in a severance of the joint tenancy),[200] or by the death of one joint tenant. The estate tax implications of a termination by death are analyzed at III., below. This portion of the Portfolio considers the gift tax consequences of a termination during the joint tenants' lifetimes.

As a general rule, the termination of a joint tenancy results in a gift from one joint tenant to the other to the extent that one of the joint tenants receives, as a result of the termination, property that is greater in value than the value of that tenant's interest in the joint property. Thus, if the proceeds of a termination are divided among the joint tenants in accordance with each tenant's property rights under local law, no gift occurs.[201] In general, if the interests of the joint tenants are severable under local law, each tenant is entitled to a pro-rata share of the property under local law; accordingly, a pro-rata division of the property at termination avoids any gift tax consequences.[202] If the joint tenants' interests are not severable, the value of each joint tenant's interest (and thus the amount each tenant must receive at termination to avoid gift tax consequences) may need to be determined on an actuarial basis.[203] Under certain circumstances, (e.g., establishing a joint bank account) the creation of a joint tenancy results in no property interest passing to the non-contributing joint tenant.[204] No taxable gift should occur if, when the tenancy is terminated, all of the property is returned to the contributing joint tenant. Similarly, upon the termination of a nominal joint interest that was established for convenience only, the transfer of legal title to the property back to the original owner is not a taxable transfer.

2. Nonspousal Joint Tenancies

To avoid a taxable transfer upon termination of a nonspousal joint tenancy, the proceeds must be divided in accordance with the property interests of each joint tenant under local law.[205] In general, if the joint tenancy is unilaterally severable, each joint tenant is deemed the owner of a pro-rata share of the property. If the joint tenancy cannot be severed, the value of each tenant's interest must be determined on an actuarial basis.

The IRS's analysis of this issue in Rev. Rul. 69-505 is illustrative. In this ruling, the IRS considered the gift tax treatment of the following transaction: J and B transferred joint tenancy property worth $20,000 to a trust that provided for one-half of the income to each for life, all of the income to the survivor for life, and, upon the death of the survivor, remainder to C. Under applicable state law, the joint tenancy could have been severed by the independent action of either J or B, but if not severed, the property would have passed to the survivor. At the date of transfer, J was age 50, and B was 47. The IRS determined that the value of the gift by each of J and B was the value of the property transferred, less the value of the respective donor's retained rights in the property. Because the joint tenancy was unilaterally severable, each was deemed to have transferred $10,000 (one-half of the value of the joint tenancy) to the trust. Also, each was deemed to have made a gift to C of the remainder interest in his share of the property. Further, each joint tenant transferred a contingent survivorship right to the other. Because the younger life tenant, B, had a greater life expectancy than J, the transfer resulted in a gift from J to B.

3. Spousal Joint Tenancies

a. In General

The same general principles that apply to the termination of non-spousal joint tenancies apply to the termination of spousal joint tenancies. As a general rule, if the proceeds of termination are divided in proportion to each spouse's ownership interest, no taxable transfer occurs. If, on the other hand, the termination proceeds are divided between the spouses on some other basis, the termination may result in a taxable gift.

If the spousal joint tenancy is unilaterally severable, each spouse is deemed the owner of one-half of the joint tenancy property. If the spousal joint tenancy is not unilaterally severable, the value of each spouse's interest must be determined on an actuarial basis, and the proceeds of termination must be divided on this basis in order to avoid a taxable transfer from one spouse to the other.

As a practical matter, even if a termination results in a taxable transfer from one spouse to the other, the transfer generally qualifies for the gift tax marital deduction.[206] Accordingly, in most cases involving non-severable joint tenancies, for pur-

[200] A joint tenancy can be terminated by converting it into a tenancy in common. For an unusual example of such a conversion, see *Estate of Stewart v. Commissioner*, 79 T.C. 1046 (1982). In *Stewart*, the court held that the execution of a joint and mutual will, which purported to dispose of one-half of certain jointly held property at the death of the first testator to die, converted the joint tenancy property into a tenancy in common. *Estate of Stewart*, 79 T.C. 1046. As a result, at the death of the first tenant to die, a one-half interest in the property passed to the beneficiaries under that tenant's will, and not by right of survivorship. *Estate of Stewart*, 79 T.C. 1046.

[201] *See* Reg. §25.2515-4(b) (addressing termination of spousal tenancies under prior law, as discussed at II.C.3.b., below).

[202] *See* Reg. §25.2515-2(b)(1) (addressing termination of spousal tenancies under prior law).

[203] For a more complete discussion of actuarial valuations of joint tenancy interests, see II.B.1., above.

[204] For a discussion of the circumstances in which creating such a joint tenancy results in no taxable gift, see II.B.3., above.

[205] Reg. §25.2515-4(b). *See* Rev. Rul. 56-437 (conversion of unilaterally severable joint tenancy into tenancy in common not taxable gift, because each joint tenant retained equal property interest following conversion).

[206] §2523(a).

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poses of ascertaining gift tax liability[207] the taxpayers can dispense with actuarial valuations, because a division of the termination proceeds on whatever basis they choose does not result in a taxable gift. The primary exception to this general rule is for terminations of spousal joint tenancies in which the donee spouse (i.e., the spouse who receives a disproportionate share of the termination proceeds) is not a U.S. citizen.[208] For further discussion of the termination of spousal joint tenancies involving non-citizen spouses, see II.C.3.c., below.

b. Terminations Implicating Former §2515 and §2515A

Before 1982, former §2515 and §2515A controlled the gift tax consequences of the creation of spousal joint tenancies in both real property and personal property.[209] The manner in which the creation of such joint tenancies was treated for gift tax purposes may affect the gift tax consequences of a termination of the joint tenancy.

With respect to spousal joint tenancies subject to former §2515 or former §2515A, the creation of which resulted in a taxable gift from one spouse to the other,[210] a termination of the joint tenancy that results in either spouse's receiving more than the value of his or her share of the termination proceeds would result in a taxable gift.

> *Example II-13:* S1 furnished all of the consideration to purchase real property in Year 1, taking title in S1's and S2's names as tenants by the entirety. The tenancy was not unilaterally severable under local law. S1 elected under former §2515(c) to treat the creation of the tenancy as a taxable gift to S2. Because the tenancy is not unilaterally severable, the value of S2's interest must be determined on an actuarial basis. The tenancy is terminated by sale in Year 14, producing proceeds of $100,000. The actuarial value of S1's and S2's interests immediately before termination are $46,000 and $54,000, respectively. If the termination proceeds are divided on that basis, no taxable gift occurs.[211]

With respect to a spousal joint tenancy subject to former §2515 the creation of which, by virtue of former §2515(a), was deemed not to be a taxable transfer, a termination of the joint tenancy is governed by former §2515(b), at least with respect to tenancies terminated before 1982.[212] Under former §2515(b), the termination of such a tenancy is deemed to be a gift to the extent the proceeds of termination are distributed in a manner disproportionate to the tenants' contributions. This principle may be illustrated by the following example:

> *Example II-14:* In Year 1, S1 purchased real property for $30,000, taking title in the names of S1 and S2, as tenants by the entirety. S1 made no former §2515(c) election and, accordingly, the creation of the tenancy was not treated as a transfer by virtue of former §2515(a). In Year 4, the property was sold. S1 would have been deemed to have made a gift to S2 of any portion of the proceeds distributed to S2. There was a deemed gift to S2 even if he or she received proceeds equal to the value of his or her interest in the property under local law.[213]

The termination of a tenancy subject to former §2515 for which no former §2515(c) election was made has different tax consequences if the termination occurs after 1981. The repeal of former §2515 in 1981 had the effect of causing such tenancies to be subject to the general gift tax rules regarding terminations (i.e., that no gift occurs if each tenant receives his or her proportionate share of the proceeds), if the termination occurs after 1981. This point is illustrated by the following example based on Rev. Rul. 83-178:

> *Example II-15:* In 1970, D purchased real property and placed title in the names of D and S, D's spouse, as tenants by the entirety. Under local law, each spouse is deemed to own a one-half interest in the property. D did not elect under former §2515(c) to treat the creation of the tenancy as a taxable gift to S. In 1983, the property is sold, with each of D and S receiving one-half of the proceeds. The termination does not result in a taxable gift by D to S.[214]

Rev. Rul. 83-178, which involved the termination of a tenancy by the entirety by transfer to a third party,[215] justified the result illustrated by this example by holding that the repeal of former §2515 was effective with respect to a post-1981 termination of a tenancy created before 1982. The gift tax treatment of the termination was, accordingly, determined solely by reference to the value of each spouse's interest in the property under local law, and not by reference to whether any gift occurred upon creation of the tenancy by virtue of former §2515. With the advent of the unlimited marital deduction, this ruling is of limited practical gift tax significance, because in most cases any transfer by one spouse to the other qualifies for the marital deduction.[216]

[207] Note, however, that if the termination of the joint tenancy constitutes a realization event for income tax purposes, it will be necessary to determine the spouses' income tax bases in the property. The basis held by each spouse may be different if the actuarial value of each spouse's interest is different. See the discussion of this issue in II.B.2.b.(1), above.

[208] *See* §2523(i) (disallowing gift tax marital deduction for most taxable transfers to non-citizen spouse).

[209] As discussed at II.B.2.b.(2) and II.B.2.b.(3), above.

[210] Under former §2515A, a taxable gift would occur if, upon the creation of a joint tenancy in personal property, either spouse contributed more than one-half of the consideration needed to acquire the joint tenancy. Under former §2515, a taxable gift would occur, if, upon the creation of a joint tenancy or tenancy by the entirety in real property, either spouse contributed more than the value of his or her co-ownership share, and then elected (under former §2515(c)) to treat the disproportionate contribution as a taxable gift.

[211] *See* Reg. §25.2515-4(b) (under former §2515, for purposes of determining tax consequences of termination, it is necessary to determine actuarial value of each spouse's interest at time of termination, not at time of creation).

[212] Regarding the tax consequences of terminating such tenancies after 1981, see the discussion of Rev. Rul. 83-178, below.

[213] *See* Reg. §25.2515-3(a)(2) (under former §2515).

[214] Note that, if the interests of both spouses had not been unilaterally severable, the value of each spouse's interest would likely have been not one-half, but rather a number determined on an actuarial basis. Under those circumstances, the proceeds of the tenancy would need to be divided in a manner consistent with the actuarial calculations in order to avoid a taxable transfer from one spouse to the other.

[215] With respect to this element of the transaction, the IRS ruled that each spouse made a gift of a one-half interest in the property to the third party.

[216] The rule set forth in Rev. Rul. 83-178 would be relevant with respect to a tenancy involving a non-citizen spouse (gifts to whom generally do not qualify for marital deduction), but for the fact that the ruling is directly contradicted by the provisions of Reg. §25.2523(i)-2(b)(2)(i), discussed below at II.C.3.d.

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c. *Terminations Involving Non-Citizen Spouses*

The same general principles that determine whether a termination of a joint tenancy results in a taxable transfer[217] apply equally to terminations in which the donee spouse is a non-citizen. Terminations involving non-citizen spouses simply convert what is a theoretical question (whether a taxable transfer occurs) into a practical question, because any taxable transfer that occurs is not offset by a corresponding marital deduction.[218] Note that, although the rules of former §2515 may protect against the imposition of a gift tax when a spousal tenancy with a non-citizen spouse is created,[219] the rules do not protect against the imposition of a gift tax when the tenancy is terminated.

With respect to spousal tenancies in personal property involving a non-citizen spouse, if one spouse furnished all of the consideration, the creation of the joint tenancy results in a taxable gift to the other spouse of a one-half interest in the property, unless the value of the spouses' interests in the property cannot be determined without reference to their life expectancies, as in the case of a tenancy involving a joint and survivor annuity.[220] Whether or not an additional gift occurs upon termination depends on the manner in which the proceeds are divided, applying the principles discussed earlier.[221]

Generally, with respect to tenancies in real property, no gift occurs upon creation of the tenancy,[222] but on termination the donor spouse is deemed to make a taxable gift to the extent that the proportion of the total consideration furnished by the donor spouse, multiplied by the value of the proceeds of termination, exceeds the value of the proceeds received by the donor spouse.[223] This principle may be illustrated by the following example:

> *Example II-16:* S2 is married to S1, a non-citizen. S2 furnished all of the consideration in purchasing some real estate, taking title in S1 and S2's joint names with right of survivorship. Several years later, the property is sold and the proceeds divided equally between S1 and S2. In the year of the sale, S2 is deemed to have made a gift of one-half of the proceeds to S1.

If the joint tenancy in the above example had been created before 1982 and S2 had made an election under former §2515(c) to treat the creation of the tenancy as a taxable gift, or if the tenancy had been created after 1981 and before July 14, 1988, in which case the creation of the tenancy similarly would have resulted in a taxable gift,[224] then upon termination the amount of the gift on the creation of the tenancy is treated as consideration originally belonging to and contributed by the non-citizen donee spouse.[225] In any case involving a gift to a non-citizen spouse, the gift likely qualifies for the $100,000 annual exclusion authorized by §2523(i)(2), as indexed for inflation.[226] The availability of the special annual exclusion suggests the following strategy for terminating spousal joint tenancies involving non-citizen spouses:

> *Example II-17:* S1 and S2 are married; S2 is a non-citizen. In Year 1, S1 purchased real property for $200,000, furnishing all of the consideration and taking title in S1 and S2's names as tenants by the entirety. The tenancy cannot be severed unilaterally. By virtue of §2523(i)(3) and former §2515, no gift occurred when the property was acquired. In Year 5, when the property is worth $300,000, S1 and S2 jointly decide to sever the tenancy into a tenancy in common and wish to allocate their interests in a manner that avoids making a taxable gift. Assume that, before the severance, applying actuarial principles the value of S1's interest is $160,000, and the value of S2's interest is $140,000 (S1 being younger than S2). If the tenancy in common interests were taken on the same basis as the pre-severance actuarial values, S1 would be deemed to have made a taxable transfer of $140,000, only $100,000 of which would qualify for the annual exclusion in Year 5. Instead, S1 and S2 should divide the tenancy in common interests so that S2 takes a 33% interest, thus limiting the value of his or her interest to $100,000. In subsequent years, if S1 wishes to increase S2's proportionate interest in the property, he or she can make gifts to S2 of a portion of his or her undivided tenancy in common interest, in each case making sure that the value of the total gifts to S2 does not exceed the §2523(i)(2) exclusion amount in any calendar year.

d. *Terminations Incident to Divorce*

Section 2516 applies to prevent the gift taxation of certain transfers between spouses (or former spouses) incident to a di-

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The rule set forth in the regulation applies only with respect to terminations of tenancies on or after July 14, 1988, for which the donee spouse in not a U.S. citizen.

[217] *See generally* II.C.1., above.

[218] *See* §2523(i).

[219] *See generally* II.B.2.b.(4), above. *See also* §2523(i)(3) (providing that principles of former §2515 apply to creation of spousal tenancies in real property if donee spouse is non-citizen).

[220] *See* Reg. §25.2523(i)-2(c).

[221] Although no law has developed concerning this issue, query whether the usual gift-tax termination principles should apply in the context of a termination of a tenancy by the entirety in personal property, the interests in which are not unilaterally severable under local law. For gift tax purposes, the creation of such a tenancy is deemed to give each spouse a one-half interest in the property. Reg. §25.2523(i)-2(c)(1). If, at termination, each spouse receives one-half of the proceeds, and if the elder spouse is a non-citizen, has the younger spouse made a gift to the elder equal to the difference between (1) one-half of the proceeds, and (2) the younger spouse's interest in the property determined on an actuarial basis? The regulations under §2523(i) do not answer this question. On the other hand, the regulations under former §2515 and §2515A, if they applied to a transaction involving a non-citizen spouse, would provide that a gift has occurred from the younger spouse to the elder. *See* Reg. §25.2515-4(b) (under former §2515) (indicating that, to avoid gift taxation upon termination of tenancy, creation of which was treated as taxable gift, each spouse must receive share of termination proceeds equal value of his or her property interest).

[222] *See* II.B.2.b.(4), above.

[223] Reg. §25.2523(i)-2(b)(1), §25.2523(i)-2(b)(2)(i), §25.2523(i)-2(b)(4) *Ex.* (1).

[224] Note, however, that in the latter case the taxable gift would likely have been fully offset by the marital deduction. *See* the Technical and Miscellaneous Revenue Act of 1988 (1988 TAMRA), Pub. L. No. 100-647, §5033(b) (adding §2523(i), applicable to gifts on or after July 14, 1988).

[225] Reg. §25.2523(i)-2(b)(2)(ii), §25.2523(i)-2(b)(4) *Ex.* (2).

[226] §2503(b)(2)(B), amended by the Tax Cuts and Jobs Act, Pub. L. No. 115-97, §11002(d)(1)(EE).

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vorce.[227] When there is a written agreement between spouses governing marital or property rights and their divorce occurs within the three-year period beginning on the date one year before such agreement is entered into, whether or not the agreement is approved by a divorce decree, any transfer of property or an interest in property of the following types made pursuant to the agreement is deemed to be for full and adequate consideration in money or money's worth:[228]

- a transfer to either spouse in settlement of his or her marital or property rights; or
- a transfer to provide a reasonable allowance for support of children of the marriage during minority.

With respect to transfers of property involving the termination of a joint tenancy, these rules apply regardless of whether there was a taxable transfer when the tenancy was created.[229]

Section 2516 offers a safe harbor for avoiding gift taxes on a transfer of property incident to a divorce. If the taxpayers comply with the statutory terms of §2516, then the transfer is deemed not a taxable gift, even if it would otherwise have been treated as a taxable gift under normal gift tax principles.[230] If the spouses fail to satisfy the requirements of §2516 (for example, by terminating a joint tenancy beyond the statutory three-year period), it may still be possible to avoid gift tax consequences if the taxpayers can establish that the transfer of property was founded on the divorce decree, rather than on a promise or agreement, or if the parties can establish that the transfer was in satisfaction of support rights, rather than marital or property rights.[231] For a more complete discussion of §2516 and related doctrines, see 515 T.M., *Divorce and Separation* (U.S. Income Series).

4. Revocable and Nominal Tenancies

The termination of bank accounts, stock brokerage accounts, and nominal joint tenancies are typically exceptions to the general rules explained above. If no gift occurred at the time of the creation of the tenancy, and if the contributor receives back the entire property upon the termination of the tenancy, then no taxable transfer occurs upon termination. On the other hand, if part of the property is distributed to the non-contributing tenant upon termination, a gift occurs as to that part.[232]

5. Termination Planning Strategies

The pre-death termination of a joint tenancy may present an opportunity for estate tax savings. Consider the following example:

> *Example II-18:* In Year 1, M purchases a residence, taking title in the names of M and D, M's daughter. The purchase price is $500,000. Under local law, the joint tenancy is unilaterally severable, so the creation of the tenancy constitutes a taxable transfer from M to D of $250,000. In Year 3, when the property is worth $600,000, M and D sever the joint tenancy into a tenancy in common. The severance does not result in a taxable gift. At M's death in Year 4, when the property is still worth $600,000, only one-half of the property is includible in her estate.[233] If the tenancy had not been severed, the full $600,000 value of the property would have been includible in her estate under §2040(a), because M furnished all of the consideration in acquiring the property.

What is the measure of the tax benefit of this strategy to M's estate? The benefit is that M has managed to exclude from the transfer tax base D's share of the appreciation in the value of the property between Year 1 and Year 4. As noted in the example, if the tenancy were not severed, the amount includible in M's estate would be $600,000. The $250,000 gift to D in Year 1 would not be treated as an "adjusted taxable gift" under §2001(b), because the term excludes from its definition "gifts which are includible in the gross estate of the decedent."[234] Thus, the tentative estate tax under §2001(b) would be calculated based on the $600,000 figure. If the tenancy were severed, on the other hand, the amount includible would be $300,000 (the value of M's tenancy in common interest). The $250,000 gift to D would be treated as an adjusted taxable gift under §2001(b), which means that it would be added to the $300,000 amount in calculating the tentative estate tax. Thus, if the tenancy is severed, the amount subject to the tentative estate tax under §2001(b) is $550,000. The difference between $600,000 and $550,000 ($50,000) represents D's share of the appreciation.

Note that the termination strategy in this example only makes sense if the estate tax savings of the strategy are greater than the income tax costs of not including the entire date-of-death value of the property in M's estate. By severing the joint tenancy, D in the above example has sacrificed a §1014 basis adjustment at M's death as to D's share of the tenancy in common. Note also that the severance strategy can backfire if the donee joint tenant predeceases the donor. If, following the severance in this example, D had predeceased M, D's $300,000 interest in the tenancy in common would be includible in her estate. If the tenancy had not been severed, none of the property

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[227] *See* Pub. L. No. 98-369, §425(b), amending §2516 with respect to transfers occurring after July 18, 1984. *Note:* Same-sex marriages are recognized for federal tax purposes. Reg. §301.7701-18, T.D. 9785, 81 Fed. Reg. 60,609 (Sept. 2, 2016); *United States v. Windsor*, 570 U.S. 744 (2013); *Obergefell v. Hodges*, 576 U.S. 644 (2015). Thus, although §2516 explicitly refers to husbands and wives, §2516 is also applicable to terminations of same-sex marriages.

[228] A transfer for full and adequate consideration in money or money's worth is not a taxable gift. §2512(b).

[229] *See* PLR 7922036 (applying pre-1984 version of §2516; former §2515 applied to creation of tenancy, and no former §2515(c) election was made).

[230] PLR 7922036 (division of jointly held property between spouses would ordinarily produce taxable gift if one spouse receives disproportionate interest upon division; otherwise taxable gift prevented by application of §2516).

[231] *See, e.g.*, *Harris v. Commissioner*, 340 U.S. 106 (1950) (finding no taxable transfer because transfer founded on divorce decree). *See also McMurtry v. Commissioner*, 203 F.2d 659 (1st Cir. 1953) (interpreting *Harris* broadly as supporting the proposition that, to the extent that the statute does not explicitly require adherence to formalities, all transfers agreed upon in contemplation of divorce and executed after approval by a proper divorce court should be exempt from gift tax).

[232] *See* Reg. §25.2515-3 (under former §2515).

[233] Note that transfers of interests in joint tenancies are not subject to the three-year rule under §2035. For further discussion of this issue, see III.F.2.a., below.

[234] §2001(b) (flush language).

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would be includible in D's estate.[235] On the other hand, not severing a joint tenancy can lead to adverse tax results for the donor joint tenant if the donee joint tenant predeceases the donor. Consider the following modified version of the preceding example:

Example II-19: In Year 1 M purchases a residence for $500,000, taking title in her name and the name of her daughter, D, as joint tenants with right of survivorship. The creation of the tenancy constitutes a taxable gift to D of $250,000. In Year 3, D unexpectedly predeceases M. None of the property is includible in D's estate under §2040(a). Assume that, at M's later death, the property is still worth $500,000. The full $500,000 value of the property is includible in M's estate under §2033. The earlier $250,000 gift to D is an "adjusted taxable gift" for purposes of §2001(b), because it is not a gift "includible in the gross estate of the decedent."[236] As a result, both the $500,000 interest under §2033 and M's prior taxable gift of $250,000 are included in determining the tentative estate tax under §2001(b). The property has accordingly been subject to transfer tax 1.5 times.

The existence of a revocable joint tenancy, such as a joint bank or brokerage account, may suggest the use of the termination strategy (in planning for the death of the joint tenant who was the source of the funds) illustrated by the following example:

Example II-20: S2, using $500,000 of his or her own funds, opens a joint "street name" brokerage account with S1. The account purchases securities which appreciate to $2,000,000 over several years. The securities remain in street name and no sales are made. S2 later becomes terminally ill. To avoid inclusion of only one-half the value of this account in S2's estate under §2040(b), with a resulting step-up in basis of only one-half, the couple removes S1's name from the account less than one year before S2's death. Under the principles of Rev. Rul. 69-148,[237] if S1 has not drawn on the account for his or her own benefit, there will be no gift under §2511 upon the removal of S1's name, because there was no gift to S1 on the creation of the account. Presumably, the securities are, therefore, not "acquired by the decedent by gift during the one-year period ending on the date of the decedent's death" under §1014(e). Thus, upon the inclusion of the entire value of the securities in S2's gross estate under §2033, a full step-up in basis for income tax purposes should occur. Such inclusion does not increase the estate taxes due if the §2056 unlimited marital deduction or §2010 unified credit is available. If the brokerage account were not a spousal account (e.g., a joint tenancy between a mother and a daughter), it would be unnecessary to remove the daughter's name from the account. The account would already be totally includible in the mother's estate under §2040(a), by reason of the consideration-furnished rule.

If local law treats the tenancy in this example as a "true" joint tenancy (i.e., the rights of each tenant vest immediately), as opposed to a revocable tenancy, the creation of the brokerage account would be a taxable transfer.[238] Thus, a later change of title within one year of death would likely trigger §1014(e), and the technique illustrated by this example would not be viable.

D. Gift Tax Implications of Income Generated by Joint Tenancies

The gift tax implications of the receipt and distribution of income earned during the existence of a joint tenancy, as well as upon termination of a joint tenancy, are determined by examining all of the facts and circumstances, in particular the relative rights of each joint tenant to receive the income under local law. Although there is little or no authority concerning this issue, no gift should occur if the income from joint tenancy property is distributed in proportion to the ownership interests of the joint tenants, both during and upon the termination of the tenancy. Thus, in the case of a joint bank account for which one party furnished all of the consideration at creation, no gift should occur if the income is distributed to the creator of the account. If the other joint tenant withdraws income, however, a taxable transfer would occur upon the withdrawal.[239] In the case of a nominal joint tenancy, if the social security or taxpayer identification number of the beneficial owner was used for reporting purposes and the property returned to the contributor upon termination, then the income earned during the tenancy would be taxable to the beneficial owner. No gift would occur as long as the income from the tenancy was actually distributed to the beneficial owner, either during the tenancy or upon its termination.

E. Disclaimers

For all transfer tax purposes, if a person makes a "qualified disclaimer" of an interest in property, the person is treated as if the interest in property had never been transferred to the person.[240] A "qualified disclaimer" is "an irrevocable and unqualified refusal by a person to accept an interest in property" that satisfies certain formalities:[241]

- the disclaimer must be in writing;
- the disclaimer must be received by the person making the transfer (or the transferor's legal representative) no later

[235] *See* §2040(a).

[236] There is no developed law concerning this issue, but presumably the earlier gift to D, which has returned to M by virtue of D's premature death, would be treated no differently from an outright gift (i.e., one not in joint tenancy) to D, with respect to which D (whether during life or at death) made a gratuitous transfer back to M. In the latter case, the property would simply be twice subject to the transfer tax.

[237] See the discussion of Rev. Rul. 69-148 at II.B.3., above.

[238] *See, e.g., First Wis. Tr. Co. v. United States*, 553 F. Supp. 26 (E.D. Wis. 1982) (state law gave each co-owner enforceable legal right to one-half of value of stock in brokerage account).

[239] *See* Reg. §25.2511-2(f) (cessation of control by donor completes taxable gift).

[240] §2518(a) (qualified disclaimer rules apply "[f]or purposes of this subtitle," which includes estate, gift, and generation-skipping transfer taxes).

[241] §2518(b). These requirements are discussed in detail in 848 T.M., *Disclaimers — Federal Estate, Gift and Generation-Skipping Tax and State Law Considerations.*

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than nine months after the later of the date of the transfer or the date on which the disclaimant reaches age 21;

• the disclaimant must not have accepted the interest in property or any of its benefits; and

• as a result of the disclaimer, the disclaimed interest must pass without direction on the part of the disclaimant to a person other than the disclaimant or to the spouse of the transferor.

This section of the Portfolio discusses the important timing issues that arise with respect to disclaimers following the creation of joint tenancy interests. For a discussion of the estate tax issues pertaining to disclaimers following the death of a joint tenant, see III.G., below.

In the case of an interest in a joint tenancy (other than joint bank, brokerage, and other investment accounts), a qualified disclaimer of the interest to which the disclaimant succeeds upon creation of the tenancy must be made no later than nine months after the creation of the tenancy, regardless of whether the interest can be unilaterally severed under local law.[242] For persons under the age of 21, the disclaimer may be made nine months after the date of transfer or the date the person turns 21, whichever is later.[243]

Note that the regulations do not distinguish between severable and non-severable joint tenancies with respect to the timing of disclaimers to avoid gift tax consequences. This approach is consistent with the gift tax rules, which generally treat the creation of a joint tenancy as a taxable transfer, regardless of whether the tenancy is severable. A disclaimer of the gift should therefore occur within nine months of the transaction in which the tenancy is created. The regulations establish a logical exception for the creation of joint bank, brokerage, and other investment accounts as follows:

> In the case of a transfer to a joint bank, brokerage, or other investment account (e.g., an account held at a mutual fund), if a transferor may unilaterally regain the transferor's own contributions to the account without the consent of the other cotenant, such that the transfer is not a completed gift under [Reg.] §25.2511-1(h)(4), the transfer creating the survivor's interest in the decedent's share of the account occurs on the death of the deceased cotenant. Accordingly, if a surviving joint tenant desires to make a qualified disclaimer with respect to funds contributed by a deceased cotenant, the disclaimer must be made within 9 months of the cotenant's death. The surviving joint tenant may not disclaim any portion of the joint account attributable to consideration furnished by that surviving joint tenant.[244]

Although this regulation expressly addresses only disclaimers occurring after the death of the first co-tenant to die (by referring to disclaimers by "a surviving joint tenant"), its logic should apply with equal force to disclaimers for gift tax purposes.[245] If, under local law, the contributing joint tenant has the right unilaterally to withdraw his or her contribution to the joint account, the creation of the joint account does not constitute a completed gift.[246] The nine-month period for a qualified disclaimer with respect to a gift by the contributing joint tenant should accordingly commence at such time as the transfer becomes complete. As long as the contributing co-tenant has the power to withdraw the assets contributed to the joint account, a completed transfer does not occur until the contributing co-tenant's death.[247]

[242] §2518(b)(2)(A); Reg. §25.2518-2(c)(4)(i).

[243] §2518(b)(2)(B).

[244] Reg. §25.2518-2(c)(4)(iii).

[245] This conclusion is bolstered by the express reference to this rule in Reg. §25.2518-2(c)(4)(i) (first sentence of paragraph (c)(4)(i), which concerns disclaimers for gift tax purposes, begins with the language "[e]xcept as provided in paragraph (c)(4)(iii)").

[246] Reg. §25.2511-2(c) ("A gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself.").

[247] Under the §2518 regulations as first proposed, the general rule regarding the disclaimer of non-severable tenancies (in which the donee's interest must be disclaimed within nine months of creation of the tenancy) was expressly subject to an exception for joint tenancies whose tax attributes are governed by former §2515. *See* former Prop. Reg. §25.2518-2(c)(4)(ii) (as proposed on Aug. 21, 1996). As discussed above, see II.B.2.b.(2) and II.B.2.b.(4), under former §2515 the creation of certain joint tenancies in real property were not treated as taxable gifts unless the parties elected to treat the transaction as a gift. The principles of former §2515 also apply to the creation of joint tenancies in real estate between spouses, if the donee spouse is not a U.S. citizen. §2523(i)(3). Because creating such a tenancy is not a taxable gift, the IRS apparently determined that no special gift tax rule applying to disclaimers of such tenancies was necessary. Thus, the express exception referred to earlier in this footnote was deleted in the final regulations. Note that the general rules regarding disclaimers of taxable gifts would apply if such a tenancy were terminated. Under former §2515(b), the termination of a joint tenancy subject to former §2515 constitutes a gift to the extent the proceeds of the termination are divided between the joint tenants on a basis other than their proportionate contributions. To avoid gift taxation of the transfer of property related to the termination of such a tenancy, the donee joint tenant would need to disclaim any interest otherwise distributed to him or her within nine months of the termination.

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III. Estate Taxation of Jointly Held Property

A. Introduction

Congress enacted §2040 to ensure that property held jointly with right of survivorship would not escape estate taxation at death. Other forms of concurrent property ownership, such as tenancies in common, form part of the probate estate at death and are thus taxable under the general estate tax inclusion rules of §2033.[248] Jointly held property, however, does not form part of the probate estate, and thus requires a special provision to ensure taxation at a joint tenant's death.

This section of the Portfolio describes the operation of §2040, which applies to joint tenancies with right of survivorship, to tenancies by the entirety, and to certain joint bank accounts and similar property arrangements. Several of the more unusual features of §2040 bear emphasis. First, the amount includible under §2040 at the death of a joint tenant may bear little or no relation to the value of the tenant's interest before death. Thus, notwithstanding that a deceased joint tenant prior to death owned only a one-half interest in the property, the entire joint property interest may be includible under §2040. Second, the estate tax treatment of jointly owned property is not coincident with its treatment for gift tax purposes. Thus, notwithstanding that a donor's creation of a joint tenancy may have constituted a completed gift to the donee joint tenant, the entire joint tenancy interest may be includible at the donor tenant's death.

B. Overview of §2040

Section 2040 provides that the value of the gross estate includes the value[249] of all property held as joint tenants with right of survivorship by the decedent and any other person, or as tenants by the entirety by the decedent and his or her spouse, except:

- If it can be established that the surviving co-tenant furnished consideration to acquire the property and did not receive that consideration from the decedent for less than adequate and full consideration in money or money's worth. Under these circumstances, that portion of the property attributable to the consideration furnished by the surviving co-tenant is excluded from the deceased tenant's estate. Under this so-called consideration-furnished test of §2040(a), if the decedent furnished none of the consideration and all was furnished by the surviving co-tenant, then none of the value of the property is includible in the decedent's estate;[250]

- If all of the co-tenants acquired their interests by gift, bequest, devise, or inheritance from a third party. Under these circumstances, the amount includible is the value of a fraction of the property determined by dividing the value of the entire property at the time of the decedent's death by the number of joint tenants; and

- If property is owned by spouses (as long as the surviving spouse is a U.S. citizen) either as tenants by the entirety or as joint tenants (in the latter case, as long as the spouses are the only joint tenants). Under these circumstances, the property is generally[251] treated as a "qualified joint interest" under §2040(b), under which the estate of the first spouse to die includes one-half of the value of the property.

The following discussion considers spousal tenancies and non-spousal tenancies separately, although in certain circumstances the principles discussed in the context of non-spousal tenancies apply to spousal tenancies.

C. Non-Spousal Tenancies — §2040(a)

1. Section 2040(a) Presumption

The general rule of §2040(a) provides that all jointly owned property is includible in the gross estate of the first joint tenant to die "except such part thereof as may be shown to have originally belonged" to the surviving joint tenant and "never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth." This general rule creates a presumption that the value of the entire jointly owned asset is includible in the deceased joint tenant's gross estate.[252] To overcome this presumption, the personal representative of the estate has the burden of showing[253] that the surviving joint tenant either (1) originally owned the asset, or (2) contributed to its acquisition.[254]

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[248] Section 2040 does not apply to property interests held as tenants in common. Reg. §20.2040-1(b).

[249] The focus of this Portfolio is on the operation of §2040, which determines what portion, if any, of jointly held property is subject to estate taxation at a deceased joint tenant's death. The Portfolio does not consider the question of how to value the property subject to the joint ownership arrangement. This question is discussed in 830 T.M., *Valuation: General and Real Estate.*

[250] The estate tax consequences of the non-contributing co-tenant dying first may be illustrated by an example. Assume that B from his own funds furnishes all of the consideration in acquiring real property, title to which B takes as joint tenants with right of survivorship in the names of B and S, B's sister. If S dies first, none of the property is includible in her estate, because B furnished all of the consideration for the property, and the source of the consideration was not a transfer from S to B for less than adequate consideration in money or money's worth. Note that none of the property is taxable in S's estate, notwithstanding that B made a gift to S when the joint tenancy was created and that S could have severed her joint interest and transmitted it by will at her death. S's right to sever the joint tenancy is not an interest in property taxable under §2033.

[251] The date of creation of the joint tenancy may affect its status as a qualified joint interest. See the discussion at III.E.3., below, of the *Gallenstein* rule, under which certain property acquired before 1977 is not treated as a qualified joint interest.

[252] *Hudson v. United States*, 79-1 USTC ¶ 13292 (W.D. Okla. 1979), illustrates the results of failing to prove the surviving joint tenant's contribution. The court stated:

> There is no reasonable doubt that the [surviving joint tenant] furnished at least part of the purchase price of the property, but what that portion is has not been established. The court has no basis for excluding a portion of the value without proof of what that part might be.

[253] *See* Reg. §20.2040-1(a)(2) (last sentence); *see also Estate of Heidt v. Commissioner*, 8 T.C. 969 (1947), aff'd per curiam, 170 F.2d 1021 (9th Cir. 1948).

[254] The presumption in effect establishes a tracing requirement, under which the decedent's estate may be required to produce canceled checks, deposit slips, and other evidence to establish the surviving joint tenant's relative contributions to the acquisition of the property. *See, e.g., Blood v. Commissioner*, 22 B.T.A. 1000 (1931) (holding entire value of property includible in estate of deceased co-tenant, because estate failed to establish surviving co-tenant's contribution); *Estate of Giacopuzzi v. Commissioner*, 29 T.C.M. 1777 (1970) (entire value of home jointly owned by mother and daughter was in-

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Section 2040(a) also provides that jointly owned property acquired by the owners by gift, bequest, devise, or inheritance from another is included in a deceased joint tenant's estate only to the extent of that joint tenant's interest, determined by dividing the value of the property by the number of joint tenants. In effect, this portion of §2040(a) recognizes that each joint tenant should be deemed to have contributed to the acquisition of the property to the extent that the property was not acquired from the deceased joint tenant. Again, however, the statute places the burden on the decedent's personal representative to establish that the property was acquired in this manner.[255] The estate taxation of joint property acquired by the decedent by gift or inheritance is discussed at III.C.4., below.

The difficulties of proof associated with §2040(a) have prompted some authorities to apply the principles of *Cohan v. Commissioner*[256] to the problem.[257] In *Cohan*, the Second Circuit was asked to consider the propriety of certain travel and entertainment expense deductions, for which the taxpayer had failed to furnish adequate substantiation. In its remand of the matter to the Board of Tax Appeals, the court (in an opinion by Judge Learned Hand) stated that "[a]bsolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making."[258] The *Cohan* ruling on the issue of deductibility of travel and entertainment expenses was eventually overturned by the enactment of §274, but its principle that a taxpayer should be able to satisfy a burden of proof by means of a reasonable estimate has currency in the §2040(a) context. Several courts have shown an inclination to follow this approach, permitting the survivor's contribution to jointly owned funds to be established by a reasonable estimate, when absolute precision was impossible.[259] Given that the Code and the regulations ultimately place the burden concerning this issue on the decedent's personal representative, one should rely on the *Cohan* principle with a high degree of caution; an estimate of the survivor's contribution is no substitute for a carefully assembled written record that establishes the contribution with certainty.

2. The Consideration-Furnished Rule

a. In General

Simply stated, the consideration-furnished rule of §2040(a) requires that property be included in the gross estate of the first joint tenant to die, except to the extent that the personal representative of the deceased joint tenant can establish that the surviving joint tenant or tenants contributed toward the acquisition or improvement of the property with funds not received gratuitously from the decedent.[260] This is the estate tax result regardless of any other factors, such as whether a gift was reported upon the creation of the tenancy, or whether the surviving joint tenant was considered the owner of a portion of the property under local law.[261] The brevity of both the Code and the regulations explaining how to apply the rule has spawned many controversies over the years.

Under the consideration-furnished rule, the entire value of property owned in joint tenancy is included in a decedent's gross estate except any portion of the property that originally belonged to the survivor and was not acquired by the survivor from the decedent for less than an adequate and full consideration in money or money's worth.[262] Thus, if a decedent furnished the entire purchase price of the jointly held property, the value of the entire property is included in the decedent's gross estate.[263] On the other hand, if it can be proved that the decedent furnished only part of the purchase price, only a corresponding portion of the value of the property is included.[264] If it can be proved that the decedent furnished no part of the purchase price, no part of the property's value is included in the decedent's estate.[265] If the property originally belonged to the survivor, and the decedent purchased his or her interest from the survivor, only that portion of the value of the property attributable to the consideration paid by the decedent is included in the decedent's estate.[266] Proof of contribution cannot be withheld by the survivor purposely to cause the inclusion of part or all of the property in the decedent's gross estate (for example, to receive a higher basis under §1014 than would otherwise be available).[267]

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cluded in mother's estate because daughter was unable to trace payments she had given her mother into payments her mother made on mortgage).

[255] *See* Reg. §20.2040-1(a)(2) (last sentence).

[256] 39 F.2d 540 (2d Cir. 1930).

[257] *See* Stephens, Maxfield, Lind, & Calfee, Federal Estate and Gift Taxation, ¶ 4.12[8] (Thomson Reuters Checkpoint).

[258] 39 F.2d 540.

[259] *See, e.g.*, *Estate of Fratini v. Commissioner*, T.C. Memo. 1998-308; *Estate of Otte v. Commissioner*, 31 T.C.M. 301 (1972) ("We are aware that absolute certainty as to the source of the particular funds used to purchase a particular parcel of realty or an item of personal property is difficult, but we also believe that it would be harsh and unrealistic to hold that petitioner must trace the funds earmarked to purchase each of the assets in dispute. … [W]e do not subscribe to the narrow view of respondent that [the surviving joint tenant's] exact money contribution must be traced with exactitude through each change in property").

[260] If the surviving joint tenant received funds gratuitously from the decedent during the decedent's lifetime, and the survivor formed a joint tenancy with the decedent using those funds, the joint tenancy property would be fully includible in the decedent's gross estate under §2040(a). *See* Reg. §20.2040-1(c) *Ex.* (4).

[261] The predecessors to §2040(a) were attacked on constitutional grounds, but the attacks were uniformly rejected by the Supreme Court. For example, in *Gwinn v. Commissioner*, 287 U.S. 224 (1932), the Court rejected the argument that a predecessor to §2040(a) should not apply to joint tenancies created before the enactment of the estate tax. Another early decision upholding the constitutionality of a predecessor to §2040(a) is *Tyler v. United States*, 281 U.S. 497 (1930), in which the Court, among other things, rejected a taxpayer's argument that it violated due process to tax an entire joint property in the estate of the first joint tenant to die. In *United States v. Jacobs*, 306 U.S. 363 (1939), the Supreme Court rejected the argument that, because the surviving joint tenant was the owner of a one-half interest in the joint tenancy under local property law, it was unconstitutional to tax the whole of the property at the deceased joint tenant's death.

[262] §2040(a); Reg. §20.2040-1(a)(2). The amount excluded from the decedent's gross estate is not limited to the amount of the survivor's contribution. The property's appreciation (determined at the date of death or at the alternate valuation date) attributable to the survivor's original contribution is also excluded. Reg. §20.2040-1(a)(2). The extent to which appreciation may be treated as a contribution by the surviving joint tenant is discussed below in greater detail, at III.C.3.a.(2).

[263] Reg. §20.2040-1(c)(1).

[264] Reg. §20.2040-1(c)(2).

[265] Reg. §20.2040-1(c)(3). See *Estate of Heidt v. Commissioner*, 8 T.C. 969, 975–978 (1947), aff'd per curiam, 170 F.2d 1021 (9th Cir. 1948).

[266] Reg. §20.2040-1(c)(6).

[267] The property must be "required to be included" in the gross estate in order to receive a step-up in basis under §1014(b)(9). *See, e.g.*, *Madden v. Com-*

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Example III-1: X and Y, who are not married, own personal property as joint tenants with right of survivorship. The property was purchased with funds provided solely by X. Upon X's death the property's full value is includible in X's gross estate. If Y predeceases X, no part of the property is includible in Y's gross estate.

Example III-2: Y purchased a boat and took title in his name alone. The next year, Y sold X, an unrelated party, a one-half interest in the boat, and title was transferred to X and Y as joint tenants with the right of survivorship. The purchase price that X paid was fair value. If Y predeceases X, one-half of the value of the boat is includible in Y's gross estate. If X predeceases Y, one-half of the value is includible in X's gross estate.

With respect to property that has appreciated or depreciated in value, the amount excluded is that part of the value of the property that bears the same ratio to the entire value of the property as the consideration furnished by the survivor bears to the entire consideration paid for the property. This can be expressed algebraically as follows:

$$\text{Amount Excluded} = \frac{\text{Survivor's Contribution}}{\text{Entire Consideration Paid}} \times \text{Entire Value of Property}$$

The ratio described above is applied to the date-of-death value or the alternate valuation date value of the property, whichever is applicable, whether that value is lower or higher than the acquisition value.

Example III-3: X and Y purchased securities as joint tenants with right of survivorship for $20,000. Each contributed one-half of the purchase price from his own funds. Upon X's death, the securities were valued at $60,000. The amount excluded from X's gross estate is $30,000. If at X's death the securities were valued at $15,000, the amount excluded from X's estate would be $7,500.

Unrealized appreciation of property received by gift from a decedent is not treated as consideration furnished by the surviving tenant.[268] On the other hand, appreciation in the value of property following the date of its receipt by the donee, to the extent realized through a sale of property by the donee and later furnished as consideration for new property jointly held with the donor, qualifies as consideration furnished by the donee for §2040(a) purposes.[269] For further discussion of this and related issues, see III.C.3.a.(2), below.

If, after applying the consideration-furnished test, only a portion of the value of jointly held property is includible in the estate of a deceased joint tenant, is the estate entitled to apply a fractional-interest discount or lack-of-marketability discount in determining the estate tax value of the portion includible? In *Estate of Young v. Commissioner*,[270] the Tax Court ruled that fractional-interest and lack-of-marketability valuation discounts were not available with respect to partial interests in property includible under §2040(a). The court explained its refusal to apply a fractional-interest discount as follows:

> Under the scheme of §2040(a), the amount includible in a decedent's gross estate does not depend on a valuation of property rights actually transferred at death, or on a valuation of the actual interest held by the decedent (legal title); instead, decedent's gross estate includes the entire value of property held in a joint tenancy by him and any other person, except to the extent the consideration for the property was furnished by such other person. … Contrary to petitioner's argument, the statute does not inquire how much a willing buyer would pay to purchase the decedent's interest in the joint tenancy at the date of his death, because, at the moment of death, decedent no longer holds any interest in the property. The property passes by right of survivorship, unlike property governed by §2033 [to which fractional-interest discounts do apply]. Even if prior to death, decedent sold his interest in the joint tenancy (and by doing so severed the joint tenancy with right of survivorship), the value that a willing buyer would pay does not necessarily compare to the approach taken by Congress in §2040. Section 2040(a) provides an artificial inclusion of the joint tenancy property: the entire value of the property less any contribution by the surviving joint tenant. Except for the statutory exclusions in §2040(a), there is no further allowance to account for the fact that less than the entire interest is being included.[271]

The court also rejected the taxpayer's argument that a lack-of-marketability discount should apply, noting simply that there was "no inherent difficulty" in selling any of the jointly held property in question.[272]

Applying the Tax Court's approach to a simple example, suppose that X and Y (who are not married) own Blackacre as joint tenants with right of survivorship. X contributed one-third of the consideration to purchase the property, and Y contributed the other two-thirds. At X's death, Blackacre is worth $1,000,000. The amount includible in X's estate under §2040(a) is $333,333.33. X's estate is entitled to no valuation discount to reflect X's fractional interest or its lack of marketability.

missioner, 52 T.C. 845 (1969), aff'd per curiam, 440 F.2d 784 (7th Cir. 1971). For a further discussion of this issue, see IV.C.2.b., below.

[268] *See* Reg. §20.2040-1(c)(4).

[269] Rev. Rul. 79-372.

[270] 110 T.C. 297 (1998). *See also Baillie v. Raoul*, 137 N.E.3d 240 (Ill. App. Ct. 2019) (Illinois court interpretation of §2040(b), following *Young*), *Estate of Fratini v. Commissioner*, T.C. Memo. 1998-308 (following *Young*; FSA 1993-84 (setting forth IRS's position that eventually won in *Young*).

[271] *Estate of Young v. Commissioner*, 110 T.C. at 315–316. *See also Estate of Fratini v. Commissioner*, T.C. Memo. 1998-308. The *Young* court also observed in dictum that the same reasoning would apply to amounts includible under §2040(b).

[272] *Estate of Young v. Commissioner*, 110 T.C. at 316.

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In the previous example, note that if X and Y had severed their interests before X's death, X's interest would be valued under §2033, to which fractional-interest and lack-of-marketability discounts *could* apply.[273] This same principle would apply if only one of the joint tenants had furnished all of the consideration for the acquisition of the property. For example, suppose that Father purchased property that he caused to be titled in his name and that of Daughter as joint tenants with right of survivorship. Since the purchase, the property has increased in value threefold. If nothing were to change, the entire value of the property will be included in Father's gross estate under §2040(a) when he dies. Yet note that if Father and Daughter were to sever the joint tenancy and instead hold title as tenants in common, only a one-half interest in the property would be included in Father's gross estate under §2033. In addition, fractional interest discounts would be available in valuing the one-half undivided interest. Note that the estate tax savings from this move comes at the expense of a full step-up in the property's income tax basis under §1014[274] and the potential detriment of subjecting Father's interest to probate administration.

Practice Tip: For a client whose assets will be subject to estate tax, the spread between estate tax rates and capital gain rates (and in the above example, Daughter's ability to defer recognition of the income tax liability lurking in her share by continuing to hold the property) counsel in favor of severing the joint tenancy.[275]

b. Bank Accounts, Savings Bonds, and Nominal Joint Tenancies

Applying the consideration-furnished rule to certain categories of joint ownership arrangements has engendered significant litigation, due in part to the unusual property law attributes of those arrangements and in part to the special problems of proof that are associated with establishing a survivor's contributions to one of these types of arrangements. This section of the Portfolio considers the application of §2040(a) to joint bank accounts, U.S. savings bonds that are titled in joint names, and nominal joint tenancy arrangements.

(1) Joint Bank Accounts

Section 2040(a) by its terms applies to "property … deposited, with any person carrying on the banking business" in the "joint names" of the decedent and any other person "and payable to either or the survivor." Under the general rule of §2040(a), the entire amount of a deposit in a joint account is included in the decedent's gross estate unless it can be demonstrated that all or a portion of the funds on deposit in the account "originally belonged" to the survivor and were not "received or acquired by the [survivor] from the decedent for less than an adequate and full consideration in money or money's worth."[276]

As is generally true with the consideration-furnished test, the burden is on the personal representative of the deceased joint tenant to establish that the survivor contributed to the acquisition of the joint account; the fact that local law may create a presumption in favor of equal ownership of the account has no effect on this burden of proof.[277] Joint accounts present significant problems of proof in establishing that the surviving joint owner contributed to the account. For example, a significant issue that arises in applying the consideration-furnished test to joint accounts is that, to overcome the presumption of full inclusion at the death of the first account owner, the decedent's estate must show not only that the survivor deposited funds into the joint account, but also that the survivor did not later withdraw the funds deposited.[278] Joint account owners, especially if the owners are married, frequently do not keep careful records of their relative contributions to the account. Before the enactment of the qualified joint interest rules of §2040(b), when the consideration-furnished rules applied to most spousal joint tenancies, the cases concerning joint bank accounts frequently held that the entire account was includible in the estate of the first joint tenant to die — spouses often did not keep records of their relative contributions to joint accounts and, even if the survivor could prove that he or she had contributed to an account, it was often difficult to establish that the deceased spouse was not the original source of the funds contributed by the surviving spouse.[279] This problem was exacerbated by the fact that the husband was usually the first to die, and wives in general had a more difficult time establishing that their contributions to joint account did not originate with funds received from their husbands.

Another problem of proof that arises in the joint bank account context is determining whether withdrawals from an account represent funds contributed by the surviving joint tenant (thus increasing the portion of the account includible under §2040(a)) or instead represent funds contributed by the decedent (thus decreasing the portion of the account includible). Joint bank accounts represent ownership of cash, which is a fungible good, and thus it is difficult or impossible to identify whose funds are represented by a particular withdrawal. This problem is illustrated by *Estate of Howard v. Commissioner*,[280]

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[273] *See Ludwick v. Commissioner*, T.C. Memo. 2010-104 (taxpayers transferred their undivided interests in vacation home to separate qualified personal residence trusts; court allowed 17% discount for gift tax purposes). For a detailed discussion of valuation, see 830 T.M., *Valuation: General and Real Estate*.

[274] See the discussion of §1014 at IV.C.2.a. below.

[275] In this example, note the apparent over-taxation of Father's transfers to Daughter. Father was treated as transferring one-half of the purchase price of the property to Daughter upon creation of the joint tenancy. Then, if the joint tenancy remains intact, the full value of the property will be included in Father's gross estate when he dies. While it appears that more than 100% of the property's value is being subject to federal transfer taxation, the exclusion of the prior gift from the definition of "adjusted taxable gifts" under §2001(b)(1)(B), coupled with the reduction to the tentative estate tax liability afforded for gift tax payable on gifts made by the decedent under §2001(b)(2) prevents this result. Through this computation, only the date-of-death value of the property is subject to federal transfer taxation. Compare the result in this example with the result in *Example II-19*, at II.C.5., above, in which the daughter dying first would be an unlikely order of deaths.

[276] §2040(a); Reg. §20.2040-1(a)(2). *See also* Reg. §20.2040-1(b) (noting that general rule of §2040(a) applies to joint bank accounts).

[277] *See Robinson v. Commissioner*, 63 F.2d 652 (6th Cir.), cert. denied, 289 U.S. 758 (1933).

[278] *See, e.g., Estate of Brandt v. Commissioner*, 8 T.C.M. 820 (1949) (resolving in favor of includability under predecessor to §2040(a) uncertainty over extent to which surviving joint tenant had contributed to and made withdrawals from joint bank accounts).

[279] *See, e.g., Estate of Drazen v. Commissioner*, 48 T.C. 1 (1967) (reviewing testimony of surviving spouse, which demonstrated that spouse could not establish that funds she contributed were from her separate funds).

[280] 9 T.C. 1192 (1947).

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in which the Tax Court held that the entire date-of-death value of a joint bank account was includible in the deceased spouse's estate. Although the parties could prove that the surviving spouse had contributed her separate funds to the account, certain withdrawals from the account to purchase other jointly held assets were deemed to be in-part withdrawals of the surviving spouse's funds, which reduced her relative contributions to the joint account to zero.[281] As a result, the entire joint account was includible in the deceased spouse's estate.

In a 1943 decision, the Tax Court construed the predecessor of §2040(a) as causing the estate taxation of jointly held bank accounts, notwithstanding that assets from the accounts had been withdrawn by the survivor while both joint tenants were living. In *Estate of Grant v. Commissioner*,[282] the decedent and his spouse owned several joint bank accounts. A few days before her husband's death, the spouse withdrew all of the assets from the accounts and placed them in accounts in her own name. The Tax Court relied on two alternative bases for its ruling that the assets were nevertheless fully includible under the predecessor to §2040(a). First, in a non-controversial portion of its decision, the court ruled that the withdrawn assets did not lose their character as joint property under applicable state law.[283] It is the alternative basis for its decision that is more controversial and that suggests an unusual and somewhat troubling construction of former §2040(a). The court ruled that the assets withdrawn by the spouse came within the literal language of the statute, which, according to the court, taxes assets "deposited with any person carrying on the banking business," and is not restricted to assets "on deposit at the time of the death of the decedent."[284] Thus, according to the court, the reach of former §2040(a), with respect to a bank account, extends to assets not literally within a joint account at the decedent's death. Although *Grant* has been distinguished in more recent cases,[285] no case has expressly contradicted its construction of §2040(a).[286] Nevertheless, the construction of the statute in *Grant* makes little sense and is arguably inconsistent with the principle that a withdrawal from a joint bank account constitutes a completed gift.[287] It is likely, therefore, that if the issue were raised directly, the controversial portion of *Grant* would be overruled.

Section 2040(a), as it applies to joint accounts, is by its terms limited to accounts "in … joint names [of the decedent and another] and payable to either or the survivor." The survivorship feature of an account is thus an essential requisite for the application of §2040(a); nevertheless, under certain circumstances the survivorship feature of an account may be implied from the circumstances in which the account was created. In *Estate of Doyle v. Commissioner*,[288] for example, the court ruled that §2040(a) applied to a joint account notwithstanding that the account documents did not specify that the funds would be paid to the survivor. The court based its decision on the fact that local law created a presumption of survivorship for accounts in the names of two persons.[289] Similarly, in *Estate of Freedman v. Commissioner*,[290] the court held that §2040(a) applied to an account in the names of the decedent and his brother in which the original signature card did not specify that a survivorship arrangement was intended. After the account was opened, the bank affixed an "either or survivor" stamp to the signature card. Under these circumstances, the court held that the estate had failed to meet its burden of establishing that a tenancy in common, rather than a joint tenancy, was intended.[291]

(2) Savings Bonds

The regulations under §2040(a) specifically provide that the statute applies to "a bond or other instrument, in the name of the decedent and any other person and payable to either or the survivor."[292] For some time, there was a controversy over whether U.S. savings bonds purchased by a decedent and held initially in the names of the decedent and another had successfully been transferred by the decedent to the survivor during the decedent's lifetime. If the transfer was successful, the bonds would not be subject to §2040(a). The source of the controversy was the Department of Treasury regulations[293] concerning bond transfers, which provided that no lifetime gift by a co-owner to another was effective unless the bonds were re-registered or re-issued by the government in the name of the new owner. In applying these regulations, courts disagreed on whether the decedent's delivery of the bonds, without actual re-issuance of the bonds in the donee's name, was sufficient to convert the bonds from jointly owned property, which would be taxed under §2040(a), to assets owned outright by the donee, which would escape taxation under §2040(a). In *United States v. Chandler*,[294] the Supreme Court resolved this issue in favor of the government, by holding that ownership of the bonds by the donee could not be established except in the manner specified by the regulations. Thus, the Supreme Court held, mere delivery of the bonds to the donee, without re-issuing or re-registering the bonds in the name of the donee, is not sufficient to avoid the application of §2040(a).[295]

(3) Nominal Joint Tenancies

Section 2040(a) applies by its terms to "all property … held as joint tenants with right of survivorship by the decedent and any other person." Despite the breadth of this language, there is authority for the proposition that §2040(a) does not ap-

[281] *Estate of Howard*, 9 T.C. 1192.
[282] 1 T.C. 731 (1943).
[283] *Estate of Grant*, 1 T.C. 731 (construing California law).
[284] *Estate of Grant*, 1 T.C. 731.
[285] *See, e.g., Haneke v. United States*, 404 F.Supp. 98 (D. Md. 1975) (distinguishing *Grant* on basis of its application of California law; in Maryland, withdrawal from joint bank account caused funds to lose their character as joint property), *aff'd in part and rev'd in part,* 548 F.2d 1138 (4th Cir. 1977) (noting that IRS did not raise on appeal district court's resolution of §2040 issue).
[286] *See, e.g., Estate of Green v. Commissioner*, 64 T.C. 1049 (1975) (noting that Commissioner had not asked court to reexamine *Grant*). *See also Estate of Sullivan v. Commissioner*, 10 T.C. 961 (1948) (expressly approving its earlier construction of statute in *Grant*).
[287] *See* Reg. §25.2511-1(h)(4) (gift occurs upon withdrawal to extent that there is no "obligation to account for a part of the proceeds" to other joint owner).
[288] 32 T.C. 1209 (1959).
[289] *Estate of Doyle*, 32 T.C. 1209 (applying New Jersey law to account titled in names of decedent "or" his son).
[290] T.C. Memo. 1964-268 (1964).
[291] *Estate of Freedman*, T.C. Memo. 1964-268.
[292] Reg. §20.2040-1(b).
[293] 31 C.F.R. §315, *quoted in United States v. Chandler*, 410 U.S. 257 (1973) (per curiam).
[294] 410 U.S. 257 (1973) (per curiam).
[295] *United States v. Chandler*, 410 U.S. 257.

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ply to so-called nominal joint tenancies,[296] if it is the decedent who is considered to hold the nominal interest. The leading case for this proposition, *Estate of Chrysler v. Commissioner*,[297] is illustrative. In *Chrysler*, the decedent had transferred securities into his and his children's names as joint tenants with right of survivorship. From time to time (after the enactment of a state statute authorizing custodial gifts to minors) the decedent would re-register some of the securities in his name as custodian for his children. The court held that §2040(a) did not apply to the securities that remained in the joint names of the decedent and his children. With respect to these assets, the court stated:

> It is apparent from the facts of this case that decedent's interest as a joint tenant was purely nominal. The joint tenancies were simply devices for making completed gifts to minors without going through the cumbersome machinery of guardianship or formal trusts which otherwise would have been necessary prior to the enactment of the … custodianship statute.[298]

The court further stated that it found "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."[299] Under these circumstances, the court ruled that the securities were not includible in the decedent's estate under §2040.

For several reasons, one would not want to rely on *Chrysler* for planning purposes. A significant factor behind the court's decision was that, at the time the joint ownership arrangements were created, there was no state custodial statute providing a simplified mechanism for making transfers to minors. Custodial gift statutes have now been enacted in every U.S. jurisdiction.[300] Moreover, the use of a joint ownership arrangement suggests that the donor does not intend to make an absolute transfer to the donee. The taxpayer managed to overcome this suggestion in *Chrysler*, but only by producing records establishing unequivocally that the decedent intended the donees to be treated as the sole and absolute owners of the jointly held property. It would be difficult to satisfy this burden in most cases.

3. *Consideration Defined*

For purposes of §2040(a), the consideration furnished by a surviving joint tenant is the value (in money or money's worth) of property contributed by the surviving tenant toward the investment in or the purchase of the joint tenancy property. The surviving joint tenant's contribution cannot have originally been obtained from the deceased joint tenant by gift.[301] This section of the Portfolio considers the extent to which a surviving joint tenant's contributions to the acquisition, improvement, or maintenance of the joint property is deemed consideration furnished for purposes of §2040(a).

a. *Prior Gifts from the Decedent*

If the decedent donated money or other property to the surviving joint tenant that thereafter became the survivor's entire contribution to the purchase price of joint property, the entire value of the property is includible in the decedent's gross estate.[302] In general, the result is the same notwithstanding that the gifted property may have appreciated in value between the time of the gift and the time of acquisition of the jointly owned property.[303] For a discussion of the circumstances in which the appreciation in value of assets previously gifted to the surviving joint tenant constitutes a "contribution" by that joint tenant, see III.C.3.a.(2), below.

> *Example III-4:* X and Y, who are not spouses, purchased securities as joint tenants with right of survivorship. Although X and Y each contributed one-half of the purchase price, Y's contribution consisted of funds previously acquired from X as a gift. At X's death, the full value of the securities is includible in X's estate. This is the result under §2040(a) notwithstanding that the earlier transfer to Y was a completed, taxable gift, that for all purposes Y was the absolute owner of the gifted funds, and that the subsequent acquisition of the joint property was not part of a prearranged plan.[304]

Section 2040(a) also disregards contributions made by the surviving joint tenant if the contributed property was acquired indirectly through a gratuitous transfer by the decedent. Thus, for example, the proceeds from the sale of property received gratuitously from the decedent are disregarded in measuring the surviving joint tenant's contribution to jointly held property,[305]

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[296] For further discussion of nominal joint tenancies, see I.B.6., above.

[297] 361 F.2d 508 (2d Cir. 1966).

[298] *Estate of Chrysler*, 361 F.2d at 510.

[299] *Estate of Chrysler*, 361 F.2d at 510 (citing as evidence of decedent's intention "decedent's careful records in separate ledgers of the transfers for each child; … the reporting of each transfer as a completed gift; … the reporting of income from the property … as income of the children; and … the fact that decedent never used any of the funds transferred for his own benefit").

[300] Zaritsky & Aghdami, Tax Planning for Family Wealth Transfers During Life, §4:11 (June 2024).

[301] In TAM 7953013, the IRS ruled that a wife did not furnish any consideration toward the acquisition of joint property when her cash contribution was traceable to a loan collateralized with property previously purchased for her by her husband (the decedent) and repaid by her husband. This ruling arose before the enactment of the qualified joint interest rules of §2040(b).

[302] Reg. §20.2040-1(c)(4).

[303] Reg. §20.2040-1(c)(4).

[304] If X's gift to Y were subject to an understanding that Y would later use the gift to acquire joint property, then it would be a relatively simple matter to attribute the contribution of funds to X — a portion of X's contribution would merely have moved through the hands of an intermediary, Y. If on the other hand, the gift to Y were subject to no such understanding, so that Y was under no obligation to use the funds to acquire joint property, one might be tempted to argue that the funds should be treated as having come from Y, rather than X. This argument was foreclosed, however, by the Supreme Court's decision in *United States v. Jacobs*, 306 U.S. 363 (1939). In *Jacobs*, the decedent transferred stock to his wife in 1913 and 1914. The wife transferred the stock into a joint tenancy with the decedent in 1916. There was no finding that the 1916 transfer was in any way related to the earlier gifts. The Supreme Court ruled that the assets contributed by the wife were "acquired … from the decedent for less than an adequate and full consideration" within the literal meaning of the statute and thus did not reduce the amount includible in the husband's estate, notwithstanding the absence of any linkage between the 1916 transfer and the earlier gifts. *See also Estate of Bendet v. Commissioner*, 5 T.C.M. 302 (1946) (funds received by wife from husband and later contributed by wife to joint account were not excludible from husband's gross estate, notwithstanding that "the decedent had given the money to [the wife] to do with as she pleased and [the wife later] voluntarily placed [the money] in [the] joint account").

[305] *See, e.g., Estate of Kelley v. Commissioner*, 22 B.T.A. 421 (1931), *acq.*, X-2 C.B. 37 (1931).

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except in certain circumstances in which the proceeds represent gains realized by the surviving joint tenant.[306]

(1) Income Received on Gifted Property

For purposes of determining the survivor's contribution to jointly owned property, amounts contributed by the survivor that originated as income from property received gratuitously from the decedent are treated as amounts contributed by the survivor. This rule is set forth in Reg. §20.2040-1(c)(5), which provides that when the survivor used income from property the decedent had given him to acquire the joint tenancy property, then the amount includible in the decedent's gross estate is reduced by the amount of income so contributed. Thus, the value of joint tenancy property attributable to the survivor's contribution of rents, interests, and cash dividends earned from property donated by the decedent is excludible from the decedent's gross estate.[307] Conversely, if the donee joint tenant dies first, any income earned by that tenant from gifted property that is used to acquire jointly held property is attributed to the donee, resulting in a portion of the joint property's being includible in the donee's estate under §2040(a).[308]

Stock dividends raise the question whether they constitute "income" attributable to the surviving joint tenant or constitute a division of capital attributable to property gratuitously transferred by the decedent. Both the Ninth Circuit and the Seventh Circuit have held that, when the decedent gave common stock to the survivor, and the survivor earned stock dividends and subsequently contributed both stock and the stock dividends to purchase joint tenancy property, the value of the joint tenancy property includible in the decedent's gross estate is not reduced by the value attributable to the contribution of the stock dividends.[309] In these two cases, the courts distinguished stock dividends from cash dividends, relying upon *Eisner v. Macomber*[310] for the proposition that a stock dividend is a division of the underlying stock ownership and merely increases the number of shares, in the nature of a stock split. The courts concluded that the stock dividends were acquired solely as a result of owning the underlying shares (given to the survivor by the decedent) and, therefore, could not be considered as income for this purpose. According to the IRS, the test of whether the stock dividend is consideration furnished by the survivor is whether the stock dividend is income for income tax purposes.[311]

There is little definitive authority regarding the treatment of income earned (and then reinvested) while the gifted property is held jointly. Suppose, for example, that a decedent transferred $50,000 to a joint savings account and directed the bank to reinvest all interest earned by the account. If at the decedent's death the account is worth $100,000, what portion is includible? In a case addressing the similar question of how to treat reinvested capital gains, the court held that the gains did not "belong" to the surviving joint tenant and thus would not be treated as having been contributed by her to the joint account.[312] The resolution of this question should turn on whether the income earned during the joint tenancy was taxable to the surviving joint tenant. If it was, then the income should be treated as if it were contributed by the survivor from his or her own funds. For a discussion of the income taxation of joint tenancies, see IV., below.

(2) Appreciation in Property Value

If property received by the survivor by gift from the decedent has appreciated in value between the date of the gift and the date on which the survivor contributes the property toward the acquisition of jointly held property, to what extent is the appreciation deemed to be "contributed" by the survivor? If the appreciated gifted property is used directly in the acquisition of the jointly held property, the regulations clearly provide that no portion of the gain constitutes a contribution by the survivor.[313]

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[306] *See* III.C.3.a.(2), below.

[307] *See, e.g., Estate of Harvey v. United States*, 185 F.2d 463 (7th Cir. 1950). In *Harvey*, the decedent had from time to time made gifts of money and other property to his wife. The court held that the joint property at issue was "not the gift property itself, in either its original or transmuted form, but property traceable to … the rents, interest and dividends produced by such property …, while title thereto was in the wife." According to the court, the wife's contributions of these funds should not be treated as funds "received … by [the wife] from the decedent for less than an adequate and full consideration in money or money's worth" within the meaning of the statute. In reaching its conclusion the court reasoned that "the income produced by property … belongs to the person who owns the property at the time it produces such income and does not originate with a donor who has made a completed gift of that property prior to its production of income."

[308] *See, e.g., Estate of Selecman v. Commissioner*, 9 T.C.M. 997 (1950) (jointly held property partially includible in estate of wife, who predeceased husband, because wife acquired property with income earned on funds previously received from husband by gift).

[309] *Tuck v. United States*, 282 F.2d 405 (9th Cir. 1960); *English v. United States*, 270 F.2d 876 (7th Cir. 1959). *Cf. McGehee v. Commissioner*, 260 F.2d 818 (5th Cir. 1958) (donee-survivor credited with stock dividends on jointly held stock purchased by decedent because dividends represented capitalization of corporation's post-gift earnings).

[310] 252 U.S. 189 (1920).

[311] *See* Rev. Rul. 80-142. *See also Estate of Schlosser v. Commissioner*, 277 F.2d 268 (3d Cir. 1960). In Rev. Rul. 80-142, the stock in question was contributed by the decedent to a joint tenancy. Two types of stock dividends were issued while the stock was in the joint tenancy, one that was not taxable to the joint owners (because the dividend did not change the owners' proportionate interests in the company), and one that was taxable (because the stockholders had the option of receiving the dividend in cash). Under local law, the income produced by the joint tenancy belonged to the joint tenants equally. The IRS ruled that the non-taxable dividends would not be treated as contributed by the surviving joint tenant, but that the taxable dividends would be, so that latter reduced the amount includible in the deceased joint tenant's estate.

[312] *Endicott Tr. Co. v. United States*, 305 F.Supp. 943 (N.D.N.Y. 1969) (mem.). *But see* Rev. Rul. 80-142.

[313] *See* Reg. §20.2040-1(c)(4). The regulation provides as follows:

> 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 [under §2040(a)], 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.

The position articulated in this regulation seems indefensible if the contribution of the appreciated property to acquire the jointly held property constitutes a realization event for the surviving joint tenant, as it would in most cases. To the extent that using the previously gifted property to acquire joint property subjects the surviving joint tenant to income taxes on the post-gift appreciation of the gifted property, those gains should be treated as contributed by the survivor for purposes of §2040(a). In other words, the use of the gifted property itself (as opposed to the proceeds from its sale) to acquire the jointly held property should be treated the same as if the gifted property is first sold and then the sales proceeds used to acquire the joint property. In the latter case, it is clear that the gains realized by the survivor are treated as contributed by the survivor. See the further discussion of this issue, below.

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However, in cases where the survivor realizes[314] gain from the sale of property gifted by the decedent and uses the proceeds to acquire joint tenancy property, the gain is treated as "originally belonging" to the survivor within the meaning of §2040(a), and the value of the jointly owned property attributable to such amount is excludible from the decedent's gross estate.[315]

> *Example III-5:* In Year One, M gave daughter D securities having a value of $20,000. In Year Two, D sold the securities for $25,000. Later in Year Two, M and D purchased other securities as joint tenants for a purchase price of $50,000, each contributing $25,000. D made her contribution with the proceeds from the sale of the securities previously received from M. When M died in Year Three, the value of the jointly held securities was $75,000. M's estate may exclude $7,500 of the $75,000, which is the value attributable to the amount of D's contribution representing realized appreciation on the gift from M to D. The excludible amount is computed as follows:

$$\frac{\$25{,}000 - 20{,}000}{\$50{,}000} \times \$75{,}000 = \$7{,}500$$

> *Example III-6:* Same facts as in *Example III-5*, except that instead of selling the securities given to her by M, D contributes the securities to the purchase price of the joint tenancy property when the securities have a value of $25,000. M's estate must include the entire $75,000; nothing may be excluded because no part of the securities' purchase price is attributable to gain realized by D from a sale or other disposition of the securities M gave her.[316]

To what extent is the survivor deemed to have contributed toward the acquisition of jointly held property under the following circumstances: the decedent furnishes all of the consideration for property owned jointly with another, the property appreciates in value and is then sold by the joint tenants, and the sales proceeds are used to acquire new joint property, which is owned by the decedent and the survivor at the decedent's death? At least one court has held under these circumstances that the full value of the property is includible in the decedent's estate.[317] The rationale of the decision is that the surviving joint tenant's portion of the realized appreciation should not be treated as a contribution by the survivor, because the survivor never owned a separate, as opposed to a joint, interest in the property. A reasonable argument could be made for a contrary result if the realized appreciation was treated as the survivor's separate property under local law.[318]

b. *Liability of Survivor for Indebtedness*

If jointly held property is subject to a mortgage or other indebtedness at a co-tenant's death, the surviving joint tenant's liability for that indebtedness may be treated as the survivor's contribution to the acquisition of the property.[319] Consider the following example:

> *Example III-7:* F and his son S purchase real property for $500,000. F furnishes the $50,000 down payment, and the balance of the purchase price is paid through a mortgage loan with respect to which F and S are jointly and severally liable. F dies before any principal payments have been made on the mortgage and when the real property is worth $625,000. Under the rule of *Bremer v. Luff*,[320] S is treated as having contributed toward the acquisition of the property a fraction of the estate tax value of the property. The numerator of the fraction is S's share of the mortgage indebtedness ($225,000), and the denominator is the original acquisition cost ($500,000). Accordingly, S is deemed to have contributed 225/500 × 625,000 ($281,250), and the total amount includible in F's estate is $343,750 ($625,000 − $281,250). F's estate is also likely to be entitled to an estate tax deduction under §2053(a)(3) for one-half of the outstanding mortgage indebtedness.[321]

Payment made during the joint tenancy on account of indebtedness and before the death of one of the co-tenants is generally treated as consideration furnished by the tenant actually making the payment,[322] or if the payments are made with the income derived from the jointly owned property, the payments are treated as consideration furnished equally by the joint tenants.[323] On the other hand, if one co-tenant contributes a disproportionate share of his or her own funds to discharge the mortgage debt, an adjustment is required in calculating the survivor's share of the indebtedness that exists at death:

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[314] The case and rulings holding that realized gains count in determining the survivor's contribution all involve gains that are both realized and recognized for income tax purposes. Simply realizing gains, however, should be sufficient for this purpose, even if the gains are not recognized because of some special tax rule.

[315] *Estate of Harvey v. United States*, 185 F.2d 463 (7th Cir. 1950); *Estate of Goldsborough v. Commissioner*, 70 T.C. 1077 (1978), aff'd without pub. op., 673 F.2d 1310 (4th Cir. 1982); Rev. Rul. 79-372. In *Harvey*, discussed above at III.C.3.a.(1), the court stated that "profit gained through a sale or conversion of capital assets" that were the subject of a gift from the decedent should be treated in the same manner as other income, "such as dividends, rentals and interest," from the gifted property. *Estate of Harvey v. United States*, 185 F.2d 463 (7th Cir. 1950). The court accordingly held that gains realized with respect to property that the decedent gave the surviving joint tenant and that was later used to acquire joint property with the decedent would be treated as the survivor's contribution for purposes of §2040(a). For purposes of this rule, the "gain" realized by the survivor should be measured by reference to the appreciation that occurred while the survivor owned the property, not by reference to the survivor's income tax basis of the property, which would be determined under §1015.

[316] This is the result dictated by the regulations. Query, however, whether the result should be different if D's contribution to the joint tenancy constituted a realization event.

[317] *Endicott Tr. Co. v. United States*, 305 F.Supp. 943 (N.D.N.Y. 1969). *See also* III.C.3.a.(1), above.

[318] *See* Rev. Rul. 80-142.

[319] Rev. Rul. 79-302; *Bremer v. Luff*, 7 F.Supp. 148, 156 (N.D.N.Y. 1933). In *Bremer*, despite the lack of evidence that the wife made any of the mortgage payments, she was credited with one-half the outstanding balance on the joint and several mortgage liability.

[320] 7 F.Supp. 148.

[321] Rev. Rul. 79-302.

[322] Rev. Rul. 79-302.

[323] *See Estate of Drummond v. Paschal*, 75 F.Supp. 46 (E.D. Ark. 1947) (use of joint income to repay loan).

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Example III-8: In the preceding example, assume that F paid a $50,000 portion of the mortgage from his own funds, so that the outstanding indebtedness at F's death is $400,000. S's deemed contribution to the property is limited to his one-half share the indebtedness ($200,000). The amount excluded based on S's contribution is $200,000/$500,000 × $625,000 ($250,000), and the amount included in F's estate is $375,000.[324] F's estate should be entitled to a $200,000 §2053(a)(3) deduction for F's one-half share of the mortgage indebtedness.

The analysis in both of these examples depends on S's being personally liable for the mortgage indebtedness. If the indebtedness in each case were a nonrecourse liability, S would be treated as having made no contribution, and the entire value of the property would be includible in F's estate. The amount includible would be offset by a §2053(a)(4) deduction for the amount of the mortgage indebtedness; alternatively, the same result could be reached by including only F's equity interest in the property.[325]

If joint property subject to debt is refinanced, or if the joint tenants obtain a second mortgage on the property, and if each joint tenant is personally liable for the indebtedness, the proceeds of the borrowing are treated as consideration furnished, but only to the extent used either to retire other indebtedness with respect to the property (in the case of the refinancing) or to make improvements to the property (in the case of either the refinancing or the second mortgage).[326] To the extent that the proceeds of the borrowing are used for purposes unrelated to the property, the proceeds are not treated as consideration furnished. The following example, based on Rev. Rul. 81-183 and Rev. Rul. 81-184, illustrates this principle in the context of a second mortgage:

Example III-9: In Year 1, B and S, brother and sister, purchased a residence as joint tenants with right of survivorship. Each furnished $50,000 toward the acquisition of the residence, and the balance of the $500,000 purchase price was financed through a $400,000 mortgage, on which B and S were jointly and severally liable. In Year 6, when the property was worth $750,000, B and S obtained a second mortgage on the property in the amount of $250,000, on which they were jointly and severally liable. A $150,000 portion of this loan was used to make improvements to the property, and the balance of the loan proceeds was divided between B and S in equal shares. As of the date of B's death in Year 9, B had made principal payments on the first mortgage of $75,000, and S had made principal payments on the second mortgage of $50,000. At B's death, the property was worth $1,000,000, the balance on the first mortgage was $325,000, and the balance on the second mortgage was $200,000. S's contribution is measured as follows:

Initial contribution	50,000
Payments on 1st mortgage	0
Share of 1st mortgage at B's death ((400,000 − 75,000) × 1/2)	162,500
Payments on 2d mortgage[327]	50,000
Share of 2d mortgage at B's death (to the extent attributable to improvements — (200,000 − 100,000) × 1/2)	50,000
Total contributions by S	312,500
Portion of acquisition costs (purchase price plus improvements, or 500,000 + 150,000) attributable to S's contribution — 312,500/ 650,000	0.48077
Portion of value at death attributable to S — 0.48077 × 1,000,000	480,770

The portion includible in B's estate is $519,230 ($1,000,000 − $480,770).

Note that, in this example, B's share of the proceeds of the second mortgage that were not used for improvements are represented by other assets includible in B's estate under §2033, except to the extent that the proceeds were consumed or given away by B before his death.

[324] Rev. Rul. 79-302.

[325] The latter approach, which excludes the amount of the debt rather than treating the debt as a deduction, is expressly permitted by Reg. §20.2053-7 (third sentence).

[326] Rev. Rul. 81-183 (involving second mortgage); Rev. Rul. 81-184 (involving refinanced mortgage).

[327] Crediting S with the full value of her payments on the second mortgage arguably inflates the extent of her contributions to the property, because her payments served to discharge a debt that was only partially used for improvements. This, however, is the approach taken in Rev. Rul. 81-184.

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c. *Survivor's Rendition of Services as Contribution*

The services of a surviving joint tenant can be treated as a contribution to the joint property for purposes of §2040(a).[328] For example, if the decedent and the survivor collaborated in a business with an agreement that the survivor's compensation or share of profits would be invested in joint property, the survivor's contribution is excluded from the decedent's estate.[329] If the arrangement involves an arm's length transaction between unrelated parties, then excluding the survivor's contribution should be relatively non-controversial.[330] If, however, the joint tenants are related, especially if they are spouses,[331] courts are more inclined to treat as gratuitous both the survivor's rendering of services and the decedent's transferring of any interest in the property to the survivor.[332] For purposes of carrying the personal representative's burden of proof under §2040(a), it would be preferable, especially in circumstances involving related parties, for the compensation or earnings to be first paid to the survivor and then, in a separate transaction, for the survivor to contribute the compensation or earnings to the joint property. As one commentator observes, however, this sort of arrangement might nevertheless be construed as involving reciprocal gifts, with the result that the survivor's contribution is not excluded under §2040(a).[333]

A dubious result regarding whether rendering services should constitute consideration is illustrated by the decision in *Spaeder v. United States*.[334] In *Spaeder*, the decedent furnished funds for his friends to purchase a home. The property was titled in the names of the decedent and his friends as joint tenants with right of survivorship, with the decedent possessing an undivided one-half interest in the property. As part of the transaction, the decedent's friends promised to provide the decedent with "care, comfort, and support" by residing with him.[335] The decedent's estate took the position that the agreement to provide care to the decedent amounted to consideration for the purchase of their interest in the house. The court disagreed, explaining that the consideration provided by the friends in the form of services to the decedent did not constitute consideration "in money or money's worth" as required by the statute.[336]

The court's holding in *Spaeder* on this front is highly questionable. If services rendered to a transferor did not amount to the provision of consideration in money or money's worth, then every payment for a service would amount to a gift under §2512(b), which clearly cannot be the case. Indeed, the Tax Court has held that a transferee's agreement to provide care and support to a transferor for the remainder of her life constitutes consideration in money or money's worth under §2512 to the extent of the present value of the future services.[337]

The estate tax consequences of consideration supplied by the surviving joint tenant through the provision of services can be more rationally determined by isolating the component aspects of the arrangement. Rather than providing the entire purchase price of the property, the decedent essentially pre-pays the present fair market value of the future services through a cash payment to the service provider. The service provider, in turn, contributes that amount of cash toward the purchase of his interest in the property. When the relevant cash flows of the arrangement are segregated in this manner, the financial contribution of the surviving joint tenant that invokes the exclusionary rule under §2040(a) is obvious.

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[328] In order to establish services as a contribution for purposes of §2040(a), the surviving joint tenant must establish not just the value of the services themselves, but also the acquisition costs of the deceased joint tenant. In *Estate of Van Tine v. Commissioner*, T.C. Memo. 1998-344, for example, although the surviving joint tenant could establish that she had provided valuable services in connection with certain jointly held property, she could not establish what the deceased joint tenant had paid for the properties in question. Thus, the court concluded that it would not be possible to exclude any portion of the jointly held property as the survivor's contribution. *See also Spaeder v. United States*, 478 F. Supp. 73, 78 (W.D. Pa. 1978) (finding that a promise to provide the decedent with "care, comfort, and support" by residing with him amongst friends in a joint tenancy was not consideration "in money or money's worth" as required by §2040(a)). *But see Estate of Bergan v. Commissioner*, 1 T.C. 543 (1943) (noting that an agreement to provide care and support to a transferor for the remainder of a lifetime constituted consideration in money's worth under §2512 predecessor to the extent of the present value of services).

[329] *See, e.g., Singer v. Shaughnessy*, 198 F.2d 178 (2d Cir. 1952) (finding that husband and wife acquired joint property as result of equal partnership in conduct of business); *Estate of Trafton v. Commissioner*, 27 T.C. 610 (1956) (involving oral agreement between spouses that property acquired through joint efforts would belong to them equally), *acq.*, 1957-2 C.B. 7; *Estate of Anderson v. Commissioner*, T.C. Memo. 1989-643. The court's handling of this issue in the *Anderson* case is illustrative. The decedent had granted to her son an undivided one-half joint tenancy interest in rental property pursuant to a verbal agreement that the son would collect rents, locate tenants, negotiate leases, and manage the property without pay. With respect to these properties, the court agreed to exclude one-half of the value from the decedent's estate under §2040(a). The court refused, however, to exclude one-half of the value of two real estate partnerships that were jointly held and with respect to which the son had a general partnership interest. Reasoning that the son's services on his own behalf as general partner could not be distinguished from his services on behalf of the decedent, the court concluded that the son's services in partnership matters were insufficient to constitute full and adequate consideration for his joint tenancy interest in the partnership.

[330] *See, e.g., Nashville Tr. Co. v. Commissioner*, 136 F.2d 148, 151 (6th Cir. 1943) (upholding deductibility of executor's payments to estate beneficiaries for services rendered to decedent; noting that, "[w]hile the presumption of a contract to pay for services will not ordinarily arise between near relations …, and a presumption of gratuitous service extend to all relatives living in the same family group, [the presumption] grows weaker and becomes more easily rebutted as the relationship recedes").

[331] See the additional separate discussion of this issue at III.D.3., below.

[332] *See, e.g., Bushman v. United States*, 8 F. Supp. 694 (Ct. Cl. 1934) (widow's services in husband's law practice and real estate business were in consideration of love and affection); *Estate of Awrey v. Commissioner*, 5 T.C. 222 (1945) (widow's services to husband's business were in consideration of "her general interest as a wife in the family welfare"), *acq.*, 1945 C.B. 1; *Campana v. Commissioner*, 524 N.E.2d 113 (Mass. App. Ct. 1988) (surviving child's consideration in form of taking care of his mother, while constituting consideration for contract law purposes, did not constitute consideration for purposes of §2040(a)). *But see Estate of Concordia v. Commissioner*, T.C. Memo. 2002-216 (portion of value of property owned jointly by decedent and her relatives could be excluded because relatives furnished consideration in allowing decedent to live with them rent-free; decedent's good health when she entered into arrangement indicated that transaction was arm's-length).

[333] Bittker & Lokken, Federal Taxation of Income, Estates and Gifts, ¶125.11.4 (Thomson Reuters Checkpoint). Professors Bittker and Lokken assert that the above-described transaction "might be restructured as (1) the voluntary rendition of services by [the survivor to the decedent] without any bargained-for compensation, (2) a purported salary that is 'really' a gift of cash by [the decedent to the survivor], (3) a constructive gift by [the survivor back to the decedent] of the cash, and (4) a gift by [the decedent to the survivor] of an interest in the jointly held property."

[334] 478 F. Supp. 73 (W.D. Pa. 1978).

[335] *Spaeder*, 478 F. Supp. at 79.

[336] *Spaeder*, 478 F. Supp. at 79.

[337] *See Estate of Bergan v. Commissioner*, 1 T.C. 543 (1943).

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d. Capital Additions

In determining the relative contributions of the decedent and the surviving joint tenant toward the acquisition of joint property, it is appropriate to take into account both the original acquisition costs and "capital additions."[338] The regulations provide no guidance, however, regarding how to handle capital additions if the property has appreciated in value before the addition has been made. In connection with this issue, consider the following set of facts:

> *Example III-10:* In Year 1, X and Y, who are not married to each other, each contribute $50,000 toward the purchase of real estate, to which they take title as joint tenants with right of survivorship. In Year 14, when the property is worth $1,000,000, X makes a capital improvement at a cost of $50,000. As a result of the improvement, the property increases in value to $1,050,000. X dies in Year 18, when the property is worth $1,500,000. What portion of the property is includible in X's estate?

Several approaches to answering this question are possible. The simplest approach would be to include in X's estate a fraction of the value of the property, the numerator of which is X's capital contributions, and the denominator of which is the total capital contributions, in each case ignoring appreciation.[339] Thus, under this approach, the total amount includible in X's estate would be:

$$\text{value of property} \times \frac{\text{X's capital contributions}}{\text{total capital contributions}}$$

$$\$1{,}500{,}000 \times \frac{\$100{,}000}{\$150{,}000} = \$1{,}000{,}000$$

The effect of this approach is to credit X with a percentage of the property's appreciation regardless of the fact that X's capital addition occurred after the property appreciated. Thus, a significant drawback to this approach is that it exaggerates the extent of X's Year 14 contribution[340] relative to the Year 14 (and Year 18) value of the property. Another significant drawback, from the IRS's perspective, is that this approach would permit a likely surviving joint tenant to make a relatively small capital contribution to joint property shortly before the decedent's death and thereby remove a significant portion of the value from the decedent's estate.[341]

A more reasonable approach is suggested by the gift tax regulations under now-repealed §2515.[342] Under those regulations, any appreciation in the value of the property occurring between an original capital contribution and a successive capital contribution is to be treated as additional consideration furnished by the person who made the original capital contribution. Thus, under this approach, as of Year 14 (before X's Year 14 capital improvement), each of X and Y would be deemed to have contributed $500,000 ($50,000 as an original contribution, and $450,000 as X or Y's share of the appreciation). Following X's Year 14 capital improvement, X's total capital contributions would be $550,000. The total cost of acquisition would be $1,050,000 (the fair market value of the property following the improvement). The amount included in X's estate would be:

$$\text{value of property} \times \frac{\text{X's capital contributions}}{\text{total capital contributions}}$$

$$\$1{,}500{,}000 \times \frac{\$550{,}000}{\$1{,}050{,}000} = \$785{,}714$$

The difficulties with this approach include (1) having to establish a value at the time of the capital addition, and (2) under certain circumstances, having to establish that the property's appreciation in value during any period was not directly traceable to the decedent's particular contribution, rather than to the contributions by the joint tenants generally. Thus, in the same example, X's executor may need to establish that the appreciation in value from Year 14 to Year 18 was not attributable solely to X's Year 14 improvement.[343]

A third approach would be to exclude under §2040(a) only that portion of the property representing the actual capital contributions of the surviving joint tenant.[344] Thus, under this approach, in the earlier example, $1,450,000 would be included in X's estate (only Y's $50,000 contribution would be excluded). The obvious drawback to this approach is that it unfairly undervalues Y's contribution relative to the value of the property at X's death. This approach may be appropriate, however, in unusual circumstances. In *Estate of Peters v. Commissioner*,[345] for example, the decedent by gift created a joint tenancy with her son in real property that she had inherited from her husband. The son expended approximately $16,000 of his own funds in improving the property's value before the decedent's death. At the time of the decedent's death, the property

[338] Reg. §20.2040-1(a)(2).

[339] This approach is suggested by a literal reading of the regulations, which define the excludible amount as "that portion of the entire [estate tax] value of the property … which the consideration in money or money's worth furnished by the [the surviving joint tenants] bears to the total cost of acquisition and capital additions." Reg. §20.2040-1(a)(2).

[340] *See* Stephens, Maxfield, Lind & Calfee, Federal Estate and Gift Taxation, ¶4.12[7][b] (Thomson Reuters Checkpoint).

[341] Stephens, Maxfield, Lind & Calfee, Federal Estate and Gift Taxation, ¶4.12[7][b] (Thomson Reuters Checkpoint).

[342] Reg. §25.2515-1(c)(2).

[343] The §2515 regulations similarly require appreciation to be so allocated, if appropriate. *See* Reg. §25.2515-1(c)(2).

[344] Stephens, Maxfield, Lind & Calfee, Federal Estate and Gift Taxation, ¶4.12[7][b] (Thomson Reuters Checkpoint).

[345] 46 T.C. 407 (1966), aff'd, 386 F.2d 404 (4th Cir. 1967).

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had a value of $95,000. The court held that the amount includible in the decedent's gross estate was the value of the property at her death ($95,000) less the amount paid by the surviving tenant for improvements ($16,000). For purposes of determining the amount excludible under §2040(a), the Tax Court held immaterial the ratio of actual cash expended by the decedent to that of the surviving tenant, as well as a ratio of the sum of the decedent's basis in the property and her actual cash expended to the cost of improvements made by the surviving tenant. The Tax Court found that the property did not appreciate in value after the survivor's contribution; thus, the court reasoned, the amount excluded should be limited to the actual contribution. The Tax Court properly indicated that, if there had been appreciation following the survivor's contribution, a formula or ratio (attributing a portion of that appreciation to the survivor) would have been appropriate.[346]

4. Joint Property Acquired by Gift or Inheritance

The last sentence of §2040(a) establishes a fractional-share rule for property acquired jointly by gift, bequest, devise, or inheritance. Upon the death of one joint tenant, a fractional share of the value of the property is includible in the decedent's gross estate.[347] The value of the decedent's fractional interest is determined by dividing the value of the property by the number of joint tenants.[348]

> *Example III-11:* F gives his vacation home to his children, J, B, and C with rights of survivorship. Upon C's death, one-third of the fair market value of the vacation home as of the applicable valuation date is includible in his gross estate. When B dies, predeceasing J, one-half of the value is includible in her estate.

If the co-owners make improvements to the property, the owners' proportionate interests remain unchanged if they pay for the improvements on a pro rata basis. If the property is acquired partially by purchase and partially by gift from a third party, the fractional-share rule applies if each of the co-owners contributes equally to the purchase. If the joint tenants do not contribute equally to the purchase of property or improvements, the fractional-share rule applies to that portion of the property acquired by gift, and the consideration-furnished rule applies to that portion of the property or the improvements acquired by purchase. As is generally true with respect to amounts excluded from the decedent's estate under §2040(a), the burden of proof is upon the personal representative of the estate to show that the property was acquired by the decedent and the other joint owners by gift, bequest, devise, or inheritance.[349]

D. Spousal Tenancies — §2040(a)

Under limited circumstances, the estate taxation of property held jointly by spouses is determined under the general rules of §2040(a), rather than under the specific rules of §2040(b). The most common of these circumstances is when the surviving spouse is not a U.S. citizen.[350] The other most common circumstance is when the spouses are not the sole joint tenants.[351] Spousal joint tenancies acquired by gratuitous transfers are governed by the fractional-share rule discussed above; this rule applies regardless of the citizenship of the surviving spouse, and it produces the same result as that produced by §2040(b). This section of the Portfolio discusses certain issues pertaining to the §2040(a) consideration-furnished test that may arise in the context of spousal joint tenancies.

1. Community Property

For purposes of the consideration-furnished test, joint tenancy property acquired with community property, or with the proceeds from the sale of community property, is treated as if each spouse furnished one-half of the consideration.[352] For the purpose of computing the basis of the property under §1014, the portion of the property not included in the decedent's estate under §2040(a) does not receive the basis step-up afforded to the survivor's one-half of community property under §1014(b)(6)[353] unless it can be shown that the property was not converted into a true joint tenancy and instead retained its status as community property under local law.[354]

2. Marital and Support Rights as Consideration

A relinquishment of dower, curtesy, or other statutory spousal rights in lieu of dower or curtesy (such as elective share rights) is not treated as "consideration 'in money or money's worth.'"[355] This rule applies "[f]or purposes of this chapter,"[356] which would include §2040(a). A relinquishment of marital support rights (as opposed to dower, curtesy, or elective share rights), on the other hand, would be treated as "consideration."[357]

3. Services

Often, the cases involving the question whether the value of joint tenancy property attributable to services performed by the surviving tenant may be excluded from the deceased tenant's gross estate relate to services performed by the decedent's surviving spouse.[358] When such services are rendered in consideration of a decedent spouse's love and affection, no part of the value of joint tenancy property may be excluded from the

[346] 46 T.C. 407.

[347] Reg. §20.2040-1(a)(1).

[348] §2040(a); Reg. §20.2040-1(c)(8). *See also Estate of Raimondi v. Commissioner*, T.C. Memo. 1970-25.

[349] Reg. §20.2040-1(a)(2).

[350] §2056(d)(1)(B). This rule is effective for decedents dying after November 10, 1988. See the further discussion of this issue at III.E.4., below.

[351] *See* §2040(b)(2) ("qualified joint interest" includes only interests held solely by spouses).

[352] Rev. Rul. 55-605 (joint property acquired with community funds); Rev. Rul. 78-418 (joint property acquired with proceeds from sale of community property). *See also Rogan v. Kammerdiner*, 140 F.2d 569 (9th Cir. 1944) (involving agreement between husband and wife that community property would be held as joint tenants).

[353] *See, e.g., Bordenave v. United States*, 150 F. Supp. 820 (N.D. Cal. 1957). *See also* Rev. Rul. 68-80 (involving New Mexico community property converted into Virginia tenancy in common; decedent's estate entitled to basis step up as to his one-half interest only).

[354] For further discussion of community property see 802 T.M., *Community Property: General Considerations.*

[355] §2043(b); Reg. §20.2043-1(b).

[356] §2043(b)(1).

[357] Rev. Rul. 68-379.

[358] *See generally* Kruse, *Estate Tax §2040: Homemaker's Contribution to Jointly Owned Property*, 29 Tax Law. 623 (1976).

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decedent spouse's gross estate.[359] Similarly, money earned by the surviving spouse from the decedent (as a result of performing services under the marriage contract) and that was used to acquire joint tenancy property is not money or other property "originally belonging" to the surviving spouse within the meaning of §2040(a).[360] For further discussion of the circumstances under which services are treated as consideration for purposes of §2040(a), see III.C.3.c., above.

E. Spousal Tenancies — §2040(b)

1. Qualified Joint Interests

Section 2040(b) establishes a special estate tax inclusion rule for "qualified joint interests."[361] A "qualified joint interest" is any interest in property held by the decedent's surviving spouse as:[362] (1) tenants by the entirety, or (2) joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants. Additionally, the surviving spouse must be a U.S. citizen.[363]

One-half of the value of a qualified joint interest is includible in the estate of the first spouse to die.[364] This rule applies regardless of which spouse may have furnished the consideration in acquiring the property, regardless of whether a gift occurred upon the formation of the joint tenancy, and regardless of whether the joint interest was severable under applicable state law.[365] The portion includible in the deceased spouse's estate qualifies for the estate tax marital deduction under §2056. The survivor's basis in the one-half interest includible under §2040(b) is determined under §1014; in most cases, this results in a stepped-up basis equal to fair market value with respect to one-half of the value of the property.

2. Qualified Joint Interests Under Prior Law

A "qualified joint interest" under the present version of §2040(b) must be distinguished from a "qualified joint interest" under the prior version of §2040(b), which was in effect from 1976 through 1980. Former §2040(b) similarly resulted in one-half of the jointly held property's being included in the deceased spouse's estate, although there were several requisites to its application that are not imposed by the present version of the statute. The most important of these requisites was that the formation of the joint tenancy must have constituted a completed gift.[366] With respect to a joint interest in personal property, the creation of the tenancy must have "constituted in whole or in part a gift."[367] It was immaterial under this rule whether a gift tax was actually paid; i.e., the use of an exclusion, deduction, or credit to avoid payment of the tax would not disqualify the property as a qualified joint interest. With respect to a joint interest in real property, the creation of the tenancy must have constituted a taxable gift by virtue of having made the election (to treat the creation of the tenancy as a gift) under §2515.[368] Again, it was immaterial whether a gift tax liability was actually incurred. Former §2040(b) was, as originally enacted, applicable only to joint interests created after 1976.[369] In the Technical Corrections Act of 1978 (1978 TCA), however, Congress added §2040(d), which authorized taxpayers to elect "qualified joint interest" treatment for joint interests created before 1977.[370]

3. Gallenstein Rule

Generally, the §2040(b) qualified joint interest rules apply to the estates of all decedents dying after 1981, however, in *Gallenstein v. United States*, the United States Court of Appeals for the Sixth Circuit carved out an exception.[371] Thus, pursuant to the *Gallenstein* rule, the qualified joint interest rules[372] are not applicable to joint interests acquired before January 1, 1977, the effective date of the 1976 TRA.[373]

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[359] *Bushman v. United States*, 8 F. Supp. 694 (Ct. Cl. 1934), cert. denied, 295 U.S. 756 (1935). The controversy surrounding the treatment of a surviving spouse's services provided part of the impetus for later enactment of the qualified joint interest rules of §2040(b).

[360] *Estate of Loveland v. Commissioner*, 13 T.C. 5 (1949). *See also Estate of Awrey v. Commissioner*, 5 T.C. 222 (1945) (surviving widow's services in her husband's business were in consideration of "her general interest as a wife in the family welfare"), *acq.*, 1945 C.B. 1; *Heidt v. Commissioner*, 8 T.C. 969 (1947), aff'd per curiam, 170 F.2d 1021 (9th Cir. 1948) (not allowing contributions having not been clearly shown to come from separate property to be included as consideration).

[361] There is an exception to this general rule for joint property acquired before 1977, the effective date of the Tax Reform Act of 1976 (TRA 1976), Pub. L. No. 94-455. *See* III.E.3., below.

[362] §2040(b)(2).

[363] §2056(d)(1)(B).

[364] §2040(b)(1). *See, e.g., Baillie v. Raoul*, 137 N.E.3d 240 (Ill. App. Ct. 2019) (Illinois court interpreting §2040(b)); *Estate of Young v. Commissioner*, 110 T.C. 297 (1998).

[365] One of the announced purposes of the qualified joint interest rules was simplification — to avoid the tracing difficulties associated with the consideration-furnished test. *See* S. Rep. No. 144, 97th Cong. (1981), *reprinted in* 1981-2 C.B. 412, 461 (stating that "the taxation of jointly held property between spouses is complicated unnecessarily" by existing law; noting that joint property is frequently "purchased with joint funds making it difficult to trace individual contributions," as required under the consideration-furnished test). Another announced purpose was more fairly to reflect the contribution each spouse makes toward the acquisition of joint property through his or her services: "including only one half of the property in the [estate of the first spouse to die] implicitly recognize[s] the services furnished by the [surviving] spouse toward the accumulation of the jointly owned property even though a monetary value of the services cannot be accurately determined." H.R. Rep. No. 1380, 94th Cong. (1976), *reprinted in* 1976-3 (Part 3) C.B. 735, 754 (concerning the 50-50 qualified joint interest rule under prior law, discussed in III.E.2., below).

[366] Former §2040(b)(2)(B) (before amendment by Economic Recovery Tax Act of 1981 (1981 ERTA), Pub. L. No. 97-34, §403(c)(1)).

[367] Former §2040(b)(2)(B)(i) (before amendment by 1981 ERTA, Pub. L. No. 97-34, §403(c)(1)).

[368] §2040(b)(2)(B)(ii) (before amendment by 1981 ERTA, Pub. L. No. 97-34, §403(c)(1)).

[369] The Tax Reform Act of 1976 (1976 TRA), Pub. L. No. 94-455, §2002(c)(1), §2002(d)(3).

[370] Pub. L. No. 95-600, §702(k)(2). The 1978 TCA, Pub. L. No. 95-600, §702(k)(2), also added to §2040 new subsections (c) and (e). Subsection (e) provided that, if a pre-1977 joint interest was severed and recreated (which was often done with joint interests before the 1978 TCA, in order to satisfy the requirements of a "qualified joint interest," under which the creation of the joint interest must have constituted a taxable gift), it would be treated as a "qualified joint interest" only if an election under §2040(d) were made. Subsection (c) allowed a reduction of the amount includible in the estate under §2040(a) in certain cases in which the surviving spouse participated in a firm or other business (i.e., the spouse's participation was treated as form of consideration for purposes of §2040(a)).

[371] 975 F.2d 286 (6th Cir. 1992), aff'g No. 90-22, 1991 BL 6023 (E.D. Ky. 1991).

[372] §2040(b).

[373] Pub. L. No. 94-455. *See also Patten v. United States*, 116 F.3d 1029 (4th Cir. 1997) (one judge dissenting), aff'g, 96-1 USTC ¶ 60,231 (W.D. Va. 1996); *Wilburn v. United States*, 97-2 USTC ¶ 50,881 (D. Md. 1997) (mem.); *Anderson v. United States*, 96-2 USTC ¶ 60,235 (D. Md. 1996); *Hahn v. Commissioner*, 110 T.C. 140 (1998), *acq.*, 2001-42 I.R.B. 319.

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At issue in *Gallenstein* was whether joint real estate purchased in 1955 by the taxpayer and her deceased husband received a full basis step-up under §1014 at the husband's death in 1987. The husband's estate had filed an estate tax return in which it had included one-half of the value of the real estate under §2040(b). Following a sale of the real estate by the taxpayer in 1988, the husband's estate filed an amended estate tax return, claiming that the full value of the real estate was includible in the husband's estate. On her income tax return, the taxpayer reported the 1988 sale as resulting in no capital gain, based on taking a basis equal to the fair market value of the property at her husband's death. In the ensuing litigation over her income tax return, the taxpayer argued that 100% of the value of the asset was includible in the husband's estate because (1) the old consideration-furnished test applies to joint property acquired before 1977, and (2) the husband furnished all of the consideration in acquiring the real estate.[374] Both the federal district court and the Sixth Circuit agreed with this analysis.

The Sixth Circuit described the history of §2040(b) and the rationale for its decision as follows. As originally enacted, §2040 established a consideration-furnished test, under which all of the value of joint property would be includible in the estate of the first joint tenant to die except to the extent that the deceased tenant's estate could establish that the survivor contributed to the acquisition of the property. Although the 1976 TRA amended §2040 by to create a new estate tax rule for spousal joint interests (the "qualified joint interest rule"),[375] the rule was not applicable to joint interests created before January 1, 1977.[376]

The Sixth Circuit then examined the changes to §2040 enacted as part of the Economic Recovery Tax Act of 1981[377] (1981 ERTA). In particular, the 1981 ERTA changed the definition of "qualified joint interest" contained in §2040(b)(2), applicable to estates of decedents dying after December 31, 1981. The amendment did not change the general rule applicable to "qualified joint interests" (as newly defined), which is set forth in §2040(b)(1). The crux of the Sixth Circuit's decision is that the 1981 ERTA effective date rule neither explicitly nor implicitly repealed the effective date rule of the 1976 TRA. According to the Sixth Circuit, although the 1981 ERTA amendment to §2040(b)(2) applies to the estates of all decedents dying after 1981, the general rule of §2040(b)(1) — that one-half of a qualified joint interest is includible in the decedent's gross estate — applies only to joint interest acquired after 1976. Because the taxpayer and her husband acquired the property before 1977, the old consideration-furnished test of §2040(a) applied, with the result that 100% of the value of the property was includible in the husband's estate at his death in 1987.

In *Hahn v. Commissioner*,[378] the Tax Court adopted the *Gallenstein* rule. Afterward, the IRS acquiesced to *Hahn*, thus removing the danger that the IRS will litigate the *Gallenstein* rule in the future. The IRS accepted the Tax Court's determination that, when enacted, the 50% inclusion rule of §2040(b)(1) was inapplicable to pre-1977 spousal joint interests. The IRS also accepted the court's conclusion that the 1981 ERTA amendment to §2040(b)(2) did not, either explicitly or implicitly, amend §2040(b)(1) to make the 50% inclusion rule applicable to pre-1977 spousal joint interests when the decedent spouse died after 1981. Accordingly, because §2040(b)(1) was inapplicable to pre-1977 spousal joint interests even if the decedent spouse died after 1981, the §2040(a) consideration-furnished test still applied.

Gallenstein and its progeny offer substantial planning opportunities. Due to the combined effects of §2056, §1014, and §2040(a), it is frequently to a taxpayer's advantage to claim that the full value of a jointly held interest is includible in the estate of the first spouse to die. If the deceased spouse furnished all of the consideration in acquiring property before 1977, including all of the property in the deceased spouse's estate poses no estate tax detriment, because the entire interest qualifies for the estate tax marital deduction (assuming that the surviving spouse is a U.S. citizen). Further, the surviving spouse obtains the benefit of a basis step-up under §1014 for the full value of the property.

Practice Tip: Carefully identifying eligible property can help taxpayers apply *Gallenstein* whenever possible, allowing taxpayers to capitalize on the income tax advantages of the rule. In many cases, especially when dealing with elderly clients, the first spouse to die (frequently the husband) is also the spouse who furnished the consideration in acquiring jointly held property. If that is the case, and if the property was acquired before 1977, the estate of the first spouse to die should include the full value of the property on the deceased spouse's estate tax return.

If an estate tax return has already been filed, the surviving spouse might also consider claiming (for income tax purposes) that *Gallenstein* applies, notwithstanding that the estate tax return reported only one-half of the value of the property as includible in the deceased spouse's estate. In other words, the surviving spouse may wish to take advantage of the full basis step-up under §1014, notwithstanding that the estate tax return reported only one-half as includible in the deceased spouse's estate. Although cases suggest that taxpayers have a duty to take consistent positions on estate tax returns and income tax returns, most of these cases involve instances in which the taxpayer (for income tax advantage) claims a basis in excess of the value of property reported on the estate tax return.[379] In the *Gallenstein* situation, the discrepancy between that which is reported on the estate tax return and that which is reported on the income tax return is based on the legal issue of what portion of the property was subject to estate tax, not on the factual issue of what is the date-of-death value of the property. This distinction suggests that a taxpayer should not be bound by the earlier estate tax reporting position.[380]

[374] The taxpayer's position presented her with no tax disadvantage, because all of the property includible in her husband's estate qualified for an offsetting marital deduction. On the other hand, if the full value of the property were includible in the husband's estate, the full value of property would determine its basis under §1014.

[375] *See* §2040(b).

[376] See III.E.2., above, for a more complete discussion of the qualified joint interest rule.

[377] Pub. L. No. 97-34.

[378] 110 T.C. 140 (1998), *acq.*, AOD 2001-06.

[379] *See, e.g.*, *Cluck v. Commissioner*, 105 T.C. 324 (1995) (taxpayer's husband precluded, by duty of consistency, from contending that basis of inherited property was greater than value of property to which he stipulated in estate tax proceedings).

[380] Moreover, in the *Gallenstein* situation, the change in reporting position on the estate tax return would produce no harm to the government, because the

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Until recently, the estate tax value of property was not conclusive for purposes of determining basis. Rather, the estate tax value was merely a presumptive value, which could be rebutted by clear and convincing evidence that the date-of-death value was actually greater than the value reported for estate tax purposes. Because the estate tax value was only presumptively the value of the property for basis purposes, the government was sometimes whipsawed by executors, who would report one value for estate tax purposes, and the beneficiaries of an estate, who would claim a higher value for basis purposes. Congress stepped in to address this problem by enacting new § 1014(f).[381] Section 1014(f)(1) provides that the basis of property acquired from a decedent shall not exceed: (1) the value of the property as finally determined for estate tax purposes or, (2) if the final value has not been determined, the value of the property as reported in a statement furnished by the estate to the beneficiaries. This new basis consistency rule applies only to property whose inclusion in the decedent's estate increased the estate tax liability for the estate.[382] It is not certain to what extent §1014(f) would apply to the circumstances described in the immediately preceding paragraph. In the hypothetical described in that paragraph, the surviving taxpayer is making an argument not about the "value" of the jointly held property, but rather about the percentage of the property that should be included in the estate of the first to die.

The *Gallenstein* rule has an adverse effect on taxpayers if the spouse who did not contribute to the acquisition of pre-1977 joint property dies first. Under those circumstances, the consideration-furnished test of §2040(a) results in no portion of the joint property's being includible in the deceased spouse's estate. Under these circumstances, an aggressive taxpayer may wish to take the position taken by the IRS in *Gallenstein*, i.e., that the qualified joint interest rules apply to all joint property, even property acquired before 1977. Depending on the particular circumstances, it may be advisable for the surviving spouse, in the event of a sale of the property following the deceased spouse's death, to disclose the position he or she has taken on the income tax return, in order to avoid the imposition of the substantial understatement penalty.[383]

4. *Non-Citizen Spouse Exception*

If the surviving co-tenant of a spousal joint tenancy is not a U.S. citizen, the estate tax consequences are determined by the §2040(a) consideration-furnished rules, rather than the §2040(b) qualified joint interest rules.[384] This general rule is subject to two principal statutory exceptions. First, under certain circumstances, if the surviving spouse becomes a U.S. citizen before the due date of the decedent's estate tax return, the qualified joint interest rules of §2040(b), rather than the consideration furnished rules of §2040(a), apply.[385] Second, if property passing to the surviving spouse is transferred to a qualified domestic trust (QDOT), the general rule of §2056(d)(1) — under which the §2040(b) qualified joint interest rule is deemed not to apply — does not apply.[386] Thus, based on a literal reading of this portion of the statute, if jointly held property is transferred to a QDOT, the estate taxation of the joint property should be governed by §2040(b), not §2040(a). As discussed in greater detail below, however, this statutory exception appears to have been ignored by the §2056(d) regulations.

Reg. §20.2056A-8 elaborates on the application of the consideration-furnished rules in this context. The regulations provide that, if the surviving spouse is a non-citizen, "the rules contained in section 2040(a) and [Reg.] Section 20.2040-1 govern the extent to which … joint interests are includible in the gross estate of a decedent who was a citizen or resident of the United States."[387] Thus, "the entire value of jointly held property is included in the decedent's gross estate unless the executor submits facts sufficient to show that [the] property was not entirely acquired with consideration furnished by the decedent."[388] The regulations further provide that, in determining the amount of the consideration furnished by the surviving spouse, any consideration furnished by the decedent with respect to the property before July 14, 1988, is treated as consideration furnished by the surviving spouse to the extent that the consideration was treated as a gift to the spouse under §2511 or to the extent that the decedent elected under §2515(c)[389] to treat the transfer as a gift.[390] This rule applies only if the donor spouse predeceases the donee spouse. If the donee spouse predeceases the donor spouse, any portion of the consideration treated as a gift to the donee, regardless of the date the tenancy was cre-

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entire amount includible for estate tax purposes would be offset by the marital deduction.

[381] Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L No. 114-41, §2004.

[382] §1042(f)(2). For further discussion of the basis consistency rules see 822 T.M., *Estate, Gift, and Generation-Skipping Transfer Tax Returns and Audits.*

[383] *See generally* 634 T.M., *Civil Tax Penalties* (U.S. Income Series).

[384] §2056(d)(1)(B). This rule is effective for decedents dying after November 10, 1988. The legislative history of §2056(d), the primary purpose of which is to deny the marital deduction if the surviving spouse is a non-citizen, states that Congress was concerned that property passing to a non-citizen surviving spouse was less likely to be subject to transfer tax in the surviving spouse's gross estate, noting that to avoid federal estate taxation, the surviving spouse could simply give up U.S. residency. *See* H.R. Rep. No. 795, 100th Cong. 592 (1988). *See also* §2001(a) (estate tax generally applies only to persons who are citizens or residents of United States). To prevent this result, §2056(d)(1)(A) provides that the marital deduction is not available if the spouse is not a U.S. citizen. A marital deduction is available under §2056(d)(2), however, if the decedent's property passes to (or if the surviving spouse transfers the property to) a qualified domestic trust (QDOT) for the benefit of the surviving spouse. The use of a QDOT essentially allows the payment of estate tax on the decedent's property to be postponed during the lifetime of the surviving spouse. To the extent that the property is included in the gross estates of both spouses, the surviving spouse is entitled to a §2013 credit, without regard to the time that has passed between the spouses' deaths. *See* §2056(d)(3); Reg. §20.2056A-7. For a more in-depth discussion of QDOTs, see 843 T.M., *Estate Tax Marital Deduction.*

[385] §2056(d)(4). This special rule applies only if the surviving spouse "was a resident of the United States at all times after the date of the death of the decedent and before becoming a citizen of the United States." §2056(d)(4)(B).

[386] §2056(d)(2)(B).

[387] Reg. §20.2056A-8(a)(1) (further noting that, if decedent is non-resident alien, "the rules of this paragraph (a)(1) [which mandate use of the consideration-furnished rule] apply pursuant to sections 2103, 2031, 2040(a), and 2056(d)(1)(B)").

[388] Reg. §20.2056A-8(a)(1) (stating further that entire value of joint property is not includible if property "was acquired by the decedent and the other joint owner by gift, bequest, devise or inheritance").

[389] For a discussion of the former §2515(c) election, see II.B.2.b.(2), above.

[390] Reg. §20.2056A-8(a)(2). This rule restates a non-codified provision of the Omnibus Budget Reconciliation Act of 1989 (1989 OBRA), Pub. L. No. 101-239. *See* Pub. L. No. 101-239, §7815(d)(16) (setting forth language essentially identical to language now contained in regulations).

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ated, is not treated as consideration furnished by the donee for §2040(a) purposes.[391]

As noted earlier, under §2056(d)(2)(B), the general rule under §2056(d)(1) — which provides that the consideration-furnished rules, rather than the qualified joint interest rules, apply to spousal joint tenancies when the survivor is a non-citizen — does not apply if the property passing to the surviving spouse is transferred by the spouse into a QDOT.[392] Thus, if the surviving spouse transfers jointly held property to a QDOT, the estate taxation of the property is governed by §2040(b). Under §2040(b), however, only 50% of the property is includible in the deceased spouse's estate. In order to obtain the benefits of the qualified joint interest rules of §2040(b), all of the joint property must be transferred to the QDOT. If all of the property is transferred to a QDOT, however, this defeats the advantage gained by having the 50% rule apply, because all of the property transferred to the QDOT would qualify for the marital deduction in any event. Consider the following example:

> *Example III-12:* In Year 1, S1 uses $500,000 of his or her own funds to purchase a residence, taking title in the names of S1 and S1's spouse, S2, a non-citizen, as tenants by the entirety. S1 dies in Year 9, when the residence is worth $1,000,000. If S2 does not transfer the residence to a QDOT, the amount includible in H's estate under §2040(a) is $1,000,000 (because S1 furnished all of the consideration for the purchase of the residence), and no marital deduction is available. If S2 transfers the residence to a QDOT, under §2056(d)(2)(B), the amount includible in S1's estate under §2040(b) is $500,000 (one-half of the value of the residence). To qualify for the special estate tax rules of §2040(b), S2 has had to transfer the entire residence to the QDOT, notwithstanding that a marital deduction is not needed with respect to the portion of the property (one-half) that was not included in S1's estate. S2 has thus overfunded the QDOT by $500,000.

The §2056(d) regulations handle this problem in the statute essentially by ignoring it and, in effect, reading out of the statute the proposition that one can qualify for §2040(b) treatment by transferring joint property to a QDOT. Under the regulations, the amount that a surviving spouse is entitled to transfer to a QDOT, thus qualifying it for the marital deduction, is only the portion of the property that is includible in the deceased spouse's estate, determined by applying the rules of §2040(a).[393] Thus, a transfer of jointly held property to a QDOT does not trigger the application of the qualified joint interest rules of §2040(b).[394]

The regulations illustrate the operation of these rules with the following examples:

> *Example III-13:* In 1987, D, a U.S. citizen, purchases real property and takes title in the names of D and S, D's spouse (a non-citizen, but a U.S. resident), as joint tenants with right of survivorship. In accordance with Reg. §25.2511-1(h)(5), one-half of the value of the property is a gift to S.[395] D dies in 2016. Because S is not a U.S. citizen, the provisions of §2040(a) are determinative of the extent to which the real property is includible in D's gross estate. Because the joint tenancy was established before July 14, 1988, and under applicable provisions of the Code and regulations the transfer was treated as a gift of one-half of the property, one-half of the value of the property is deemed attributable to consideration furnished by S for purposes of §2040(a). Accordingly, only one-half of the value of the property is includible in D's gross estate under §2040(a).[396]

> *Example III-14:* The facts are the same as in *Example III-13,* except that S dies in 2016 survived by D who is not a citizen of the United States. For purposes of applying §2040(a), D's gift to S on the creation of the tenancy is not treated as consideration furnished by S toward the acquisition of the property. Accordingly, since S made no other contributions with respect to the property, no portion of the property is includible in S's gross estate.[397]

> *Example III-15:* The facts are the same as in *Example III-13,* except that D and S purchase real property in 2011 making the down payment with funds from a joint bank account. All subsequent mortgage payments and improvements are paid from the joint bank account. The only funds deposited in the joint bank account are the earnings of D and S. It is established that D earned approximately 60% of the funds and S earned approximately 40% of the funds. D dies in 2016. The establishment of S's contribution to the joint bank account is sufficient to show that S contributed 40% of the consideration for the property. Thus, under Reg. §20.2040-1(a)(2), 60% of the value of the property is includible in D's gross estate.[398]

Note that, in *Examples III-13* and *III-15,* the interest includible in the decedent's estate does not qualify for the marital deduction. In each case, however, the surviving spouse could qualify the interest for the marital deduction by transferring the interest to a QDOT. In *Example III-13,* if the real property had been acquired in 1989 (instead of 1987), the purchase would not have been treated as a transfer by gift, by virtue of former §2515, which applies to the creation of real property spousal tenancies in which the donee spouse is a non-citizen.[399] As a result, no portion of the property would be deemed attribut-

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[391] Reg. §20.2056A-8(a)(2).

[392] To qualify under this exception, the property must either be transferred to or irrevocably assigned to a QDOT before the due date of the estate tax return. §2056(d)(2)(B).

[393] Reg. §20.2056A-8(a)(3). *See also* §20.2056A-4(d)(3), *as redesignated by* T.D. 9974, 88 Fed. Reg. 37,424 (June 7, 2023).

[394] An alternative approach, which the IRS apparently rejected, would be to tax the joint property under the rules of §2040(b) if the spouse transferred the portion includible (i.e., one-half of the property) to a QDOT. This approach would have the virtue of permitting the decedent's estate to take advantage of the §2040(b) rules, but at the same time, would not require the surviving spouse to transfer the entire joint property to the QDOT (thus avoiding the overfunding problem illustrated in *Example III-10* (III.C.3.d.), above). *See* Rubin, *Proposed QDOT Regulations Provide No Relief on §2040(b) Joint Property 'Circularity' Problem,* 18 Est., Gifts & Tr. J. 127 (1993).

[395] Note that, because the transfer in this example occurred before 1988, the gift to S qualified for the gift tax marital deduction.

[396] Reg. §20.2056A-8(c) *Ex.* (1).

[397] Reg. §20.2056A-8(c) *Ex.* (2).

[398] Reg. §20.2056A-8(c) *Ex.* (3).

[399] See the further discussion of this issue at II.B.2.b.(4), above.

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able to consideration furnished by the surviving spouse, and the full value of the property would be includible in the deceased spouse's estate. The result in *Example III-14,* however, would not be different if the property had been acquired in 1989 — the property would still be fully excludible from the donee spouse's estate.

The interplay of these complicated rules may be illustrated by the facts of and conclusions reached in PLR 9551014, which involved properties acquired both before and after the effective date of the §2056(d) rules concerning non-citizen spouses. In PLR 9551014, the decedent (D) and the decedent's spouse (S), both non-citizen residents, owned four parcels of real estate. The four parcels were acquired by D and S as tenants by the entirety in 1979, 1983, 1985, and 1993. Only the parcel acquired in 1979 was subject to a mortgage, on which S and D were jointly and severally liable. D's separate funds were used to buy the 1983 and 1985 properties and to make the down payment on the 1979 property. The 1993 property was bought with separate funds of both D and S. No gift tax returns were filed with respect to the acquisitions of any of the properties. At issue in the ruling was the extent to which each of the four properties was includible in D's estate.[400]

Regarding the property acquired in 1979, the IRS noted that, under Reg. §20.2056A-8(a)(2), because the tenancy was created before July 14, 1988, the consideration deemed furnished by S and D depended in part on the federal gift tax treatment of the creation of the tenancy. D did not elect under former §2515(c) to treat the creation of the tenancy as a gift of one-half of the property. Thus, no consideration could be attributed to S as a consequence of there having been a taxable gift to S at formation of the tenancy. Nevertheless, the IRS determined that only a portion of the 1979 property was includible in D's estate, explaining that S's personal liability on the mortgage would be treated as consideration furnished by S. Citing Rev. Rul. 79-302, the IRS ruled that S's contribution is determined by multiplying the fair market value of the property at D's death by a fraction, the numerator of which is one-half the amount of the note as of D's death and the denominator of which is the purchase price of the property in 1979. The portion not attributable to S's contribution was the amount includible in D's estate under §2040(a).

Regarding the properties acquired in 1983 and 1985, the IRS explained that, under Reg. §25.2511-1(h)(5), the creation of the tenancies with funds that came exclusively from D constituted a gift from D to S of one-half of the value of the property.[401] Under Reg. §20.2056A-8(a)(2), any consideration furnished by a decedent before July 14, 1988, is treated as consideration furnished by the surviving spouse to the extent that the consideration was treated as a gift to the spouse under §2511. Applying these rules, the IRS determined that D's 1983 and 1985 gifts to S would be treated as consideration furnished by S for purposes of §2040(a). Accordingly, the IRS ruled that one-half of the value of each property was includible in D's estate.

Regarding the property acquired in 1993, the IRS explained that the general consideration-furnished test of §2040(a) applied.[402] Because both D and S had acquired the property with their separate funds, only the portion attributable to consideration furnished by D was includible in his estate.

F. Relation to Other Code Sections

1. Section 2033

A decedent's gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of his death.[403] Although the language of §2033 could be construed to cover all concurrent interests in property, including joint tenancies, only §2040 applies to interests that pass by right of survivorship. Section 2033 applies to a decedent's interest in a tenancy in common, the disposition of which at death passes by testate or intestate succession and not by right of survivorship.[404] Section 2033 also applies to a surviving joint tenant's outright ownership interest in property that was formerly held in joint tenancy. Sections 2033 and 2040 apply in combination in the case of joint tenants who die simultaneously.[405]

2. Section 2035

a. Current Law

In its current form,[406] the principal operative provision of §2035 includes in a decedent's gross estate transfers of interests in property or relinquishments of powers with respect to property within three years of death if the interest or power, if retained, would have caused the property to be includible in the decedent's estate.[407] This rule applies only to certain types of statutory retained interests or powers, however, and a §2040 interest in joint property is not among them.[408] Thus, a transfer of property either into or out of a joint tenancy within three years of death should not trigger application of §2035, unless the transaction also implicates one of the retained interests or retained power provisions[409] to which §2035 applies.

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[400] Armed with this information, the surviving spouse intended to transfer to a QDOT a fractional share of the properties sufficient to eliminate estate taxes at the deceased spouse's death, taking into account the unified credit and other credits available to the deceased spouse's estate.

[401] In reaching this conclusion, the IRS assumed that the tenancies were unilaterally severable. If they had not been, the value of the gifts to S would have depended on S and D's relative life expectancies.

[402] Note that no gift would have occurred upon the creation of this tenancy, even if D had furnished a disproportionate share of the consideration for the purchase. As discussed in greater detail at II.B.2.b.(4), above, the formation of a real property spousal joint tenancy, with respect to which the donee spouse is a non-citizen, does not constitute a gift. The same would be true if S had furnished a disproportionate share of the consideration, because D was also a non-citizen.

[403] §2033.

[404] *See, e.g., Harvey v. United States*, 185 F.2d 463 (7th Cir. 1950).

[405] For a discussion of the estate tax consequences of simultaneous deaths, see III.H., below.

[406] The operative provisions of §2035 described in this portion of the Portfolio have been in effect since the statute was amended by the Economic Recovery Tax Act of 1981 (1981 ERTA), Pub. L. No. 97-34, §424(a). Section 2035 was rewritten by the Taxpayer Relief Act of 1997 (1997 TRA), Pub. L. No. 105-34, §1310(a), but only one substantive change, not pertinent to the discussion in this Portfolio, was made at that time. *See* §2035(e), added by Pub. L. No. 105-34, §1310(a) (excluding from gross estate gifts from revocable trusts within three years of death).

[407] §2035(a).

[408] §2035(a)(2) (citing retained interests or powers under §2036, §2037, §2038, and §2042).

[409] §2035(a)(2) (citing retained interests or powers under §2036, §2037, §2038, and §2042).

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b. Historical Perspective

Recounting in detail the historical development of §2035 is beyond the scope of this Portfolio.[410] However, exposure to some of this history may be helpful in understanding some of the older cases that involved both §2035 and §2040.

In its original form, former §2035 generally applied to include in a decedent's estate gifts "in contemplation of his death."[411] In most cases, whether this rule applied to the creation of a joint tenancy was of little practical significance, because the consideration-furnished test of §2040 would usually cause the entire joint tenancy to be includible in the estate of the donor of the property, regardless of whether the donor created the joint tenancy in "contemplation of his death." The interplay of §2035 and §2040 under these rules became practically significant in two principal contexts. First, if the donee of property transferred that property into a joint tenancy with the donor (in an attempt to avoid estate taxation at the donee's death, by virtue of the consideration-furnished test),[412] §2035 could operate to cause the entire property to be includible in the donee's estate.[413] Second, in the case of a revocable joint tenancy, such as a joint bank account, if the donee joint tenant withdrew funds before the donor joint tenant's death (which would have the effect of avoiding estate taxation of those funds under §2040 at the donor's death), the funds could nevertheless be taxable under §2035, if the "transfer" to the donee was in contemplation of the donor's death.[414]

In 1976, Congress revised §2035 to include in a decedent's estate all post-1976 gifts within three years of death. As was true under prior law, in most cases involving the creation of joint tenancies, the interplay of §2035 and §2040 was of little practical significance — the consideration-furnished test of §2040 would cause the entire joint tenancy to be included in the estate of the person who created the joint tenancy, regardless of whether or not the transaction occurred within three years of death. The primary practical issue arose in the context of spousal joint tenancies, which under certain circumstances were subject to a "qualified joint interest" rule,[415] the effect of which was to cause one-half of the property to be includible in the estate of the first joint tenant to die. If the joint tenancy were created within three years of death, the combination of §2035 and §2040 could cause the entire joint tenancy, rather than just one-half of the joint tenancy, to be includible at the death of the first joint tenant to die.[416]

3. Sections 2036, 2038, and 2041

Sections 2036, 2038, and 2041 potentially apply to many transactions involving §2040. If §2040 and another Code section both apply to a particular transaction, which provision is controlling? Consider the questions raised by the following examples:

> *Example III-16:* Using his own funds, S1 opens a joint brokerage account with his spouse, S2, a U.S. citizen. Under local law, S1 retained the right to withdraw the account assets. If S1 dies survived by S2, is all of the account includible in his estate under §2038(a)(1), by virtue of S1's power of revocation, or is one-half of the value of the account includible under §2040(b)?

> *Example III-17:* S2 uses his or her own funds to purchase a residence, taking title as tenants by the entirety in the names of S2 and S2's spouse, S1, who is a non-citizen. If S2 dies survived by S1, the full value of the residence is includible in his or her estate under §2040(a). Suppose S2 and S1 jointly transfer the residence to a trust, under which they reserve a right to income for their joint lives, remainder to their children? S1 dies, survived by S2, who by virtue of S1's death becomes the sole income beneficiary. At S2's death, is the full value of the trust, or only a portion, includible in his or her estate? Under one theory, S2 would be deemed the sole "transferor" of the trust assets, because prior to the creation of the trust the full value of the assets formed a part of her transfer tax base under the consideration-furnished test of §2040(a). Under another theory, S2 would be deemed the transferor of only a portion of the trust assets, because under local law S1 was the owner of the other portion before its transfer to the trust.

This author is aware of no cases or rulings that have considered the question posed in the *Example III-16.*[417] The estate of S1 in this example presumably therefore could take the po-

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[410] For a more detailed discussion of this history, see 818 T.M., *Section 2035 Transfers.*

[411] Former §2035(a) (before its amendment by the Tax Reform Act of 1976, Pub. L. No. 94-455, §2001(a)(5), §2001(d)(1)).

[412] Section 2035, in its present form, would permit this planning technique. Consider, for example, a person (X) who received property by gift during his or her lifetime and who wishes to leave the property at death to the original owner (Y). In these circumstances, X could take advantage of the consideration-furnished test of §2040(a) to avoid estate taxation of the property at X's death. If the property is transferred to a joint tenancy with Y, at X's death the property passes by operation of the law to Y, and no portion of the property is includible in X's estate under either §2035 or §2040. Under most circumstances, however, the transfer of the property into the joint tenancy would be treated as a taxable gift of one-half of the property, so it is probably not possible for X to avoid transfer taxation of the property altogether. X could avoid gift taxation on the transfer by using a revocable form of joint tenancy, but this exposes X's estate to the argument that X held a §2038 retained power at death, thus subjecting the entire property to estate taxation. Concerning the relationship between §2040 and §2038, see III.F.3., below.

[413] *See Estate of Drake v. Commissioner*, 67 T.C. 844 (1977) (finding that decedent's interest in jointly held property was not includible under consideration-furnished test of §2040, but that entire property was includible under §2035); *Estate of Koussevitsky v. Commissioner*, 5 T.C. 650 (1945) (acknowledging validity of this analysis, but finding that decedent did not transfer property in contemplation of death), *acq.*, 1945 C.B. 4.

[414] *See Haneke v. United States*, 548 F.2d 1138 (4th Cir. 1977) (funds from joint account, which were withdrawn by surviving widow before her husband's death, were includible in husband's estate under §2035).

[415] The reference here is to the pre-1981 "qualified joint interest" rule, which is discussed briefly at III.E.2., above. Property subject to the post-1980 "qualified joint interest" rule would be governed by the post-1980 version of §2035, under which most transfers within three years of death are not includible in the donor's estate.

[416] *See* Rev. Rul. 82-159 (full value of joint tenancy includible at death of tenancy who created tenancy; noting that result would be different if donor joint tenant had died after 1981, due to changes in §2035).

[417] The absence of guidance concerning this issue highlights the fact that the IRS has never issued regulations concerning the qualified joint interest rules of §2040(b). The question is answered indirectly, however, by the regulations concerning disclaimers of joint property under §2518. In Reg. §25.2518-2(c)(5) *Ex.* (14), the example indicates that the amount includible at the death of the joint bank account owner who could have revoked the joint account is determined under §2040(b), so that only one-half of the account is includible.

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sition in good faith that the entire account is includible under §2038. If the estate were successful in this position, it would give S2 a stepped-up basis as to the whole of the account, with no offsetting estate tax cost (due to the marital deduction). On balance, however, the IRS would probably have the better argument that only one-half of the account is includible, on the principle that the more specific tax provision (§2040) rather than the more general (§2038) should control.[418] Consider, however, what position the IRS would take if the account had declined, rather than appreciated, in value. Under those circumstances, the IRS could be expected to argue that the whole account is includible, thus giving S2 a stepped-down basis as to the whole.

The question posed in the *Example III-17* may be answered indirectly by case law. In *United States v. Heasty*,[419] for example, the decedent-husband supplied the entire consideration for several tracts of land and later conveyed them to himself and his wife as joint tenants with right of survivorship. The decedent and his wife later conveyed the properties to several individuals (children and grandchildren), reserving to themselves joint and survivor life estates. At the decedent's death, the government sought to tax the full value of the properties in his estate. The government argued that, for purposes of §2036, the decedent should be deemed to have transferred the whole of the property, because the whole would have been includible in his estate under §2040.[420] The court rejected this argument, noting that under state law the decedent's wife was the owner of one-half of the jointly owned property. It concluded that the wife, accordingly, should be treated as the transferor of one-half of the property for purposes of §2036. As a result, the decedent was determined to have a retained §2036 interest in only one-half of the trust property.[421]

The IRS has in effect conceded that *Heasty* was correctly decided.[422] Applying this analysis to *Example III-17,* S2 would be treated as the transferor of only a portion[423] of the trust assets and, accordingly, only that portion would be includible at his or her death. Similarly, at S1's earlier death, the portion of the trust with respect to which he or she is deemed the transferor would be includible in his or her estate.[424]

Suppose a spouse transfers assets into a tenancy by the entirety, and local law grants the donor spouse certain powers over the assets, such that §2036 arguably applies to the transfer? If the donor spouse dies first, are the estate tax consequences controlled by §2036 or by §2040? Consider the following example:

> *Example III-18:* S1 uses $100,000 of his or her own funds to form X Corporation, Inc., taking title to the stock in the names of S1 and his or her spouse, S2, as tenants by the entireties. S2 is a U.S. citizen. S1 dies, survived by S2. If under local law S1 is deemed to have retained the right to vote all of the shares of stock held as tenants by the entireties,[425] §2036(b) and §2040(b) both potentially apply. If §2040(b) applies, one-half of the value of the property on the date of S1's death is includible. If §2036(b) applies, the entire value of the property on the date of S1's death is includible.

Assuming that the stock has appreciated in value, S1's estate would prefer the result under §2036(b), because it would entitle the estate to a stepped-up basis as to the whole of the property. The IRS would similarly prefer to apply §2036(b) if the stock had declined in value. This author is aware of no cases or rulings that address this issue. Presumably §2036(b) is the more specific of the two provisions and thus would be controlling.

Arguably, the power to sever one's interest in a joint tenancy looks like a general power of appointment captured by §2041. Consider the following example:

> *Example III-19:* Sister (S) and Brother (B) purchase a residence, using funds furnished by S and taking title as joint tenants with right of survivorship. Assume that, under local law, S and B each hold a unilateral power to sever the joint tenancy. B dies survived by S. Under §2040(a), no portion of the property is includible in B's estate. Under §2041(a)(2), arguably one-half of the property is includible in B's estate, because of B's power to sever the joint tenancy.

The author is aware of no cases or rulings to have considered this question. Presumably, the IRS has not pursued this theory, because it deems the more specific provision — §2040(a) — to be controlling.

G. Disclaimers

This section of the Portfolio considers the rules pertaining to disclaimers of joint property by surviving joint tenants. Section 2518, which concerns qualified disclaimers for gift tax purposes, is made expressly applicable to the estate tax by virtue of §2046. Thus, whether a surviving joint tenant makes a qualified disclaimer of jointly held property for either gift tax or estate tax purposes is governed by §2518.

The principal issues that arise concerning disclaimers of joint property by surviving co-tenants are (1) whether the disclaimer is timely within the meaning of §2518(b)(2), which requires that the disclaimer occur no later than nine months after the later of the date of the "transfer creating the interest" or the day on which the disclaimant reaches age 21, and (2) whether the disclaimant has "accepted the interest or any of its benefits"

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[418] *See, e.g., Bulova Watch Co. v. United States*, 365 U.S. 753 (1961) ("it is familiar law that a specific statute controls over a general one").

[419] 370 F.2d 525 (10th Cir. 1966).

[420] *Heasty*, 370 F.2d 525. Note that the case predated the qualified joint interest rules of §2040(b).

[421] *Heasty*, 370 F.2d 525.

[422] Rev. Rul. 69-577 (involving tenancy by the entirety rather than joint tenancy and concluding that one-half of property would be includible in each person's estate under §2036(a)(1)).

[423] The "portion" would presumably be determined by reference to the actuarial value of S2's one-half life estate and contingent remainder interest in the transferred property. Note, however, that Rev. Rul. 69-577, discussed above, involved tenancy by the entirety property, but implicitly assumed that the value of each spouse's interest was one-half of the whole.

[424] *Miller v. United States*, 325 F. Supp. 1287 (E.D. Pa. 1971).

[425] These assumed facts are somewhat anachronistic, given the passage of the Married Women's Property Acts. Nevertheless, it is conceivable that S1 could have retained the voting rights as part of a written contractual agreement with S2.

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within the meaning of §2518(b)(3). Each of these issues is addressed in turn in the materials that follow.

1. Timing

a. In General

Generally, a qualified disclaimer must occur no later than nine months after the date of the transfer creating the disclaimed interest.[426] However, for disclaimants who have not reached age 21, the qualified disclaimer period is extended until nine months after the disclaimant's 21st birthday.[427] The answer to the question of when the "transfer" occurs with respect to jointly held property has had a contentious history,[428] which appears to have been resolved finally by the issuance of regulations in 1997.[429] At issue throughout this history has been the question whether the starting point for determining the timeliness of a disclaimer of jointly held property should be the date of the creation of the joint tenancy or the date of the death of the deceased joint tenant. The regulations resolve this question by establishing several relatively simple rules, which generally permit disclaimers of survivorship interests within nine months of the deceased joint tenant's death.

The regulations establish the following general rule concerning disclaimers by surviving joint tenants:

> A qualified disclaimer of the survivorship interest to which the survivor succeeds by operation of law upon the death of the first joint tenant to die must be made no later than 9 months after the death of the first joint tenant to die regardless of whether such interest can be unilaterally severed under local law and, except as provided in [Reg. §25.2518-2(c)(4)(ii)] (with respect to certain tenancies created on or after July 14, 1988), such interest is deemed to be a one-half interest in the property. (*See,* however, §2518(b)(2)(B) for a special rule in the case of disclaimers by persons under age 21). This is the case regardless of the portion of the property attributable to consideration furnished by the disclaimant and regardless of the portion of the property that is included in the decedent's gross estate under §2040 and regardless of whether the interest can be unilaterally severed under local law.[430]

The operation of this rule is illustrated by the following examples from the regulations:

> *Example III-20:* On February 1, Year 1, J purchased real property with J's funds. Title to the property was conveyed to "J and B, as joint tenants with right of survivorship." Under applicable state law, the joint interest is unilaterally severable by either tenant. B dies on May 1, Year 8, and is survived by J. On January 1, Year 9, J disclaims the one-half survivorship interest in the property to which J succeeds as a result of B's death. Assuming that the other requirements of §2518(b) are satisfied, J has made a qualified disclaimer of the one-half survivorship interest (but not the interest retained by J upon the creation of the tenancy, which may not be disclaimed by J). The result is the same whether or not J and B are married and regardless of the proportion of consideration furnished by J and B in purchasing the property.[431]

> *Example III-21:* Assume the same facts as in *Example III-20,* except that J and B are married and title to the property was conveyed to "J and B, as tenants by the entirety." Under applicable state law, the tenancy cannot be unilaterally severed by either tenant. Assuming that the other requirements of §2518(b) are satisfied, J has made a qualified disclaimer of the one-half survivorship interest (but not the interest retained by J upon the creation of the tenancy, which may not be disclaimed by J). The result is the same regardless of the proportion of consideration furnished by J and B in purchasing the property.[432]

Note that under the circumstances described in *Example III-20,* if J and B were not married, in the absence of a disclaimer by J, no taxable transfer would occur at B's death, because under §2040(a) no portion of the joint property would be includible in B's estate.[433] Nevertheless, the regulations measure the timeliness of J's disclaimer from the point of B's death, which is consistent with state property law principles (under which the "transfer" of the survivorship interest occurs at B's death). Note also that J's disclaimer causes a portion of the jointly held property to be includible in B's estate; as a result of the disclaimer, the one-half survivorship interest will form part of B's probate estate and is accordingly subject to estate

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[426] §2518(b)(2).

[427] §2518(b)(2)(B).

[428] Between 1986 and 1990, the Tax Court considered on five different occasions the question of the starting point for determining the validity of a disclaimer by a surviving joint tenant following the death of a deceased joint tenant. In three of the cases, the Tax Court held that the relevant date for satisfying the disclaimer timing requirement was the date on which the joint tenancy was created, not the date of the deceased joint tenant's death. *McDonald v. Commissioner*, 89 T.C. 293 (1987), rev'd and rem'd, 853 F.2d 1494 (8th Cir. 1988); *Estate of O'Brien v. Commissioner*, 55 T.C.M. 977 (1988); *Kennedy v. Commissioner*, T.C. Memo. 1986-3, rev'd, 804 F.2d 1332 (7th Cir. 1986). A fourth case was decided against the taxpayer on the basis that the disclaimers were not valid under state (North Carolina) law. *Estate of Dancy v. Commissioner*, 89 T.C. 550 (1987), rev'd and rem'd, 872 F.2d 84 (4th Cir. 1989). In the fifth case — the *McDonald* case on remand after being reversed by the Eighth Circuit — the Tax Court held for the taxpayer, ruling that the starting point is the date of the deceased joint tenant's death. *McDonald v. Commissioner*, T.C. Memo. 1989-140. The IRS conceded its acceptance of the substance of the *McDonald* holding in its AOD 1990-06. In AOD 1990-06, the IRS stated that it would no longer litigate the timeliness of a disclaimer by a joint tenant of the survivorship interest if the deceased joint tenant had the right, under local law, to sever the joint tenancy or partition the property. The IRS further stated that it would no longer contend that a joint tenant may not make a qualified disclaimer of any portion of the joint interest attributable to consideration furnished by that joint tenant. The AOD also indicated that Reg. §25.2518-2(c)(4)(i) (prior to its amendment in 1997), which provided to the contrary concerning these two propositions, would be revised. The regulations under §2518 eventually implemented each of the AOD 1990-06 concessions, although with respect to joint bank accounts and similar revocable contractual arrangements, the IRS continues to take the position that a surviving joint tenant cannot disclaim a survivorship interest attributable to that joint tenant's contribution. Reg. §25.2518-2(c)(4)(iii).

[429] T.D. 8744, 62 Fed. Reg. 68,183 (Dec. 31, 1997).

[430] Reg. §25.2518-2(c)(4)(i).

[431] Reg. §25.2518-2(c)(5) *Ex.* (7).

[432] Reg. §25.2518-2(c)(5) *Ex.* (8).

[433] *See* III.C., above.

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taxation under §2033.[434] The fact that J furnished all of the consideration in acquiring the property is appropriately treated as irrelevant by the example. When the joint tenancy was formed, the one-half interest of which B became the owner would have been treated as a taxable gift from J to B.[435] The fact that B's interest in the property represents an earlier gift from J should not preclude J from disclaiming the passage of that interest back to J. Note that B's interest in the joint tenancy is subject to transfer taxation twice, regardless of whether J disclaims. A gift tax was imposed on the interest when the tenancy was created. If J disclaims the interest at B's death, the interest is taxed in B's estate. If J does not disclaim, the interest is taxed again to J, either as a gift, if J gives away the interest during life, or in J's estate, if J retains the interest until death.[436] *Example III-21* illustrates that the same general rules apply to non-severable tenancies.[437]

Note: For disclaimers by surviving joint tenants involving tenancies with more than two owners, it is safe to assume that the disclaimable interest is a fraction of the whole joint tenancy, determined by dividing the entire tenancy by the number of joint tenants.

b. Joint Bank, Brokerage, and Other Investment Accounts

In the case of a transfer to a joint bank, brokerage, or other investment account (e.g., an account held at a mutual fund), if the transferor may unilaterally regain the transferor's own contributions to the account without the consent of the other cotenant, such that the transfer is not a completed gift under Reg. §25.2511-1(h)(4), the transfer creating the survivor's interest in a decedent's share of the account occurs on the death of the deceased cotenant.[438] Accordingly, if a surviving joint tenant desires to make a qualified disclaimer with respect to funds contributed by a deceased cotenant, the disclaimer must be made within 9 months of the cotenant's death.[439] The surviving joint tenant may not disclaim any portion of the joint account attributable to consideration furnished by that surviving joint tenant.[440]

The manner in which Reg. §25.2518-2(c)(4)(iii) handles the question of timing comports with established tax law concerning when a transfer of property has occurred. For gift tax purposes, no taxable transfer occurs if the donor of property "reserves the power to revest the beneficial title to the property in himself."[441] In other words, the gift tax laws treat the creation of this type of bank or investment account as a revocable transfer. If one joint tenant has furnished all of the consideration to acquire a revocable joint bank or investment account, then no transfer at all occurrs if the donee joint tenant is the first to die. Similarly, if the donor joint tenant is the first to die, the transfer of funds to the account becomes irrevocable at that point, which is a logical time to begin the nine-month qualified disclaimer period.

The prohibition against a disclaimer of any interest attributable to consideration furnished by the surviving joint tenant may produce an unfair result, however, in the case of married joint tenants, if the surviving spouse is a U.S. citizen. Under these circumstances, 50% of the joint account is included in the estate of the first spouse to die, notwithstanding that no portion of the account is attributable to funds contributed by the deceased spouse.[442] Thus, for estate tax purposes, the deceased joint tenant is treated as the transferor of one-half of the account as of that tenant's death. Nevertheless, the deceased joint tenant is not treated as having transferred the property for disclaimer purposes. Of course, in all such cases no estate taxes are owed with respect to the joint account, because 100% of the includible interest qualifies for the estate tax marital deduction.

The regulations set forth the following example to illustrate the operation of the joint bank and investment account[443] rules:

> *Example III-22:* On July 1, Year 1, J opens a bank account that is held jointly with B, J's spouse, and transfers $50,000 of J's money to the account. J and B are U.S. citizens. J can regain the entire account without B's consent, such that the transfer is not a completed gift under Reg. §25.2511-1(h)(4). J dies on August 15, Year 9, and B disclaims the entire amount in the bank account on October 15, Year 9. Assuming that the remaining requirements of §2518(b) are satisfied, B made a qualified disclaimer under §2518(a) because the disclaimer was made within 9 months after J's death at which time B had succeeded to full dominion and control over the account. Under

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[434] If J and B were not married and if J furnished all of the consideration in acquiring the property, in the absence of a disclaimer no portion of the property would be included in B's estate. *See* §2040(a).

[435] This would not be true if J and B were married and B were a non-citizen. Under those circumstances, the gift tax consequences of the formation of the tenancy would be controlled by the principles of former §2515, as discussed at II.B.2.b.(4), above.

[436] If J retains the interest until death, the earlier gift of the interest to B would be treated as an "adjusted taxable gift" for purposes of the estate tax calculations under §2001(b). This means that the earlier gift to B would be included in the tax base for purposes of calculating the estate tax due at J's death. The earlier gift to B would presumably not be treated as a post-1976 "gift which [is] includible in the gross estate of the decedent" for purposes of §2001(b) (flush language); if it were so treated it would not be included in the tax base for purposes of calculating the estate tax. The treatment of the property interest as an adjusted taxable gift, notwithstanding that the interest is also part of J's gross estate, means that the same property interest is subject to transfer tax twice. See the additional discussion of this issue in the context of terminations of joint tenancies, at II.C.5., above.

[437] With respect to non-severable tenancies, the regulations measure the timeliness of the disclaimer not from the date that the survivorship interest became indefeasible, but instead from the date of the taxable transfer of the survivorship interest. Most non-severable joint tenancies are tenancies by the entirety, one-half of which are includible in the estate of the first joint tenant to die, regardless of which joint tenant furnished the consideration for the property. §2040(b). The regulations properly establish a different rule with respect to tenancies involving non-citizen spouses, for which the disclaimable amount is the amount includible in the deceased joint tenant's estate.

[438] Reg. §25.2518-2(c)(4)(iii).

[439] Reg. §25.2518-2(c)(4)(iii).

[440] Reg. §25.2518-2(c)(4)(iii).

[441] Reg. §25.2511-2(c).

[442] §2040(b).

[443] Joint ownership arrangements that operate in a similar manner to joint bank and investment accounts should be treated the same as joint bank and investment accounts for disclaimer purposes. *See, e.g.,* Rev. Rul. 69-148 (securities held in brokerage account registered in name of nominee of brokerage firm, rather than in names of account owners; nevertheless, either account owner could unilaterally make withdrawals from account; IRS treated account same as joint bank account for purposes of measuring timeliness of disclaimer); PLR 9336011 (applying former Reg. §25.2518-2(c)(5) *Ex.* 9, to certificate of deposit; certificate had attributes similar to joint bank account).

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state law, B is treated as predeceasing J with respect to the disclaimed interest. The disclaimed account balance passes through J's probate estate and is no longer joint property includible in J's gross estate under §2040. The entire account is, instead, includible in J's gross estate under §2033. The result would be the same if J and B were not married.[444]

The following example illustrates the result if the donee joint tenant dies first:

Example III-23: The facts are the same as *Example III-22,* except that B, rather than J, dies on August 15, Year 9. J may not make a qualified disclaimer with respect to any of the funds in the bank account, because J furnished the funds for the entire account and J did not relinquish dominion and control over the funds.[445]

As noted earlier, the result produced by this rule is unfair in the case of married joint tenants if the survivor is a U.S. citizen, because under §2040(b) 50% of the account is treated as part of the estate of the deceased joint tenant, notwithstanding that the deceased joint tenant furnished none of the consideration. The language of the example provides some comfort, however, that the surviving joint tenant is not deemed to have made a transfer of a portion of the account at the deceased joint tenant's death. As a matter of tax logic, if 50% of the account is includible in the deceased joint tenant's estate, then the survivor should be treated as having transferred that portion of the account to the deceased joint tenant. If the survivor has made such a transfer, however, it raises the question whether the transfer would qualify for the marital deduction. Under §2523, a gift tax marital deduction is allowed only for transfers to a spouse; at the time of this deemed transfer, however, the deceased joint tenant is no longer a spouse (in effect, this would be a deemed transfer to the deceased joint tenant's estate). The language of *Example III-23,* which states that "J did not relinquish dominion and control over the funds," suggests that J should not be treated as having made a complete gift under these circumstances.

Another example in Reg. §25.2518-2(c)(5) elaborates on these rules by illustrating the effect of a partial disclaimer of a joint account:

Example III-24: The facts are the same as *Example III-22,* except that B disclaims 40% of the funds in the account. Because, under state law, B is treated as predeceasing J with respect to the disclaimed interest, the 40% portion of the account balance that was disclaimed passes as part of J's probate estate, and is no longer characterized as joint property. This 40% portion of the account balance is, therefore, includible in J's gross estate under §2033. The remaining 60% of the account balance that was not disclaimed retains its character as joint property and, therefore, is includible in J's gross estate as provided in §2040(b). Therefore, 30% (1/2 × 60%) of the account balance is includible in J's gross estate under §2040(b), and a total of 70% of the aggregate account balance is includible in J's gross estate. If J and B were not married, then the 40% portion of the account subject to the disclaimer would be includible in J's gross estate as provided in §2033 and the 60% portion of the account not subject to the disclaimer would be includible in J's gross estate as provided in §2040(a), because J furnished all the funds with respect to the account.[446]

The rules pertaining to disclaimers of joint investment accounts may afford an opportunity to obtain a larger basis step up under §1014 at the death of the first co-tenant to die. For example, assume that a deceased spouse and a surviving spouse owned a joint brokerage account worth $1,000,000 with a basis of zero. If the surviving spouse is a U.S. citizen, one-half of the account is includible in the deceased spouse's estate, and the surviving spouse receives a basis in the account of $500,000.[447] If the deceased spouse furnished all of the consideration for the account, the surviving spouse could disclaim his or her entire interest in the account, which would cause the entire account to be includible in the deceased spouse's estate.[448] This would correspondingly produce a basis in the property of $1,000,000. Of course, a disclaimer would be appropriate only if otherwise consistent with other estate planning objectives (e.g., ensuring an appropriate balance between a marital deduction disposition and a credit shelter disposition under the deceased spouse's estate planning documents).

c. Certain Joint Tenancies in Which Surviving Spouse Is Not U.S. Citizen

In the case of a joint tenancy between spouses or a tenancy by the entirety in real property created on or after July 14, 1988, to which §2523(i)(3) applies (relating to the creation of a tenancy where the spouse of the donor is not a U.S. citizen), the surviving spouse may disclaim any portion of the joint interest that is includible in the decedent's gross estate under §2040.[449]

The regulations provide the following example concerning joint tenancies in real property in which the surviving spouse is not a U.S. citizen:

Example III-25: On March 1, Year 1, spouses purchase a tract of vacant land which is conveyed to them as tenants by the entirety. The entire consideration is paid by S1. S2 is not a U.S. citizen. S1 dies on June 1, Year 7 (a date that is on or after July 14, 1988). S2 can disclaim the entire joint interest because this is the interest includible in S1's gross estate under §2040(a). Assuming that S2's disclaimer is received by the executor of S1's estate no later than nine months after June 1, Year 7, and the other requirements of §2518(b) are satisfied, S2's disclaimer of the property would be a qualified disclaimer. The result would be the same if the property was held in joint tenancy

[444] Reg. §25.2518-2(c)(5) *Ex.* (12).
[445] Reg. §25.2518-2(c)(5) *Ex.* (13).
[446] Reg. §25.2518-2(c)(5) *Ex.* (14).
[447] *See* §2040(b).
[448] *See* §2033.
[449] Reg. §25.2518-2(c)(4)(ii).

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with right of survivorship that was unilaterally severable under local law.[450]

Under this example, the timeliness of S2's disclaimer is measured from the date of S1's death, notwithstanding that (in the case of the tenancy by the entirety) under local property law S2 received an indefeasible survivorship interest as of the date that the tenancy was created. Thus, the timeliness of the disclaimer is measured by the date of the taxable transfer, and no taxable transfer occurred when the tenancy was created, because the principles of former §2515 applied to the acquisition of the property;[451] the initial taxable transfer occurs at S1's death, because the property is includible in his or her estate at that time.[452]

2. Acceptance of Benefits

A qualified disclaimer can occur only if the disclaimant has not accepted the disclaimed interest or any of its benefits.[453] Acceptance of the interest or any of its benefits is manifested by an affirmative act that is consistent with ownership of the interest in property.[454] Because jointly held property vests in the surviving joint tenant automatically at the death of the first joint tenant to die, the survivor must plan carefully to avoid "accepting" the disclaimed interest.

Example III-26: D and S owned a brokerage account as joint tenants with right of survivorship. D furnished all of the funds in the account and was entitled to withdraw any portion of the account at any time. At D's death, the brokerage firm followed its general practice and, without S's direction or consent, transferred the assets from the joint account to a previously existing account in S's sole name. S did not accept any interest in the joint account by virtue of the transfer to S's sole account, because the transfer was accomplished without S's direction or consent.[455] S may make a qualified disclaimer.

Example III-27: The same facts as *Example III-26* except that, after the transfer of the assets from the joint brokerage account to S's sole account, some of the stock from the joint account was sold and the proceeds reinvested with S's permission. S has exercised control over and thus may not make a qualified disclaimer of the stock that was sold. S also may not disclaim any dividends or income attributable to the stock that was sold.[456]

A surviving joint tenant may continue to live in jointly held residential property without being considered to have accepted the survivorship interest or any of its benefits.[457] The surviving joint tenant's payment of mortgage principal and interest, real estate taxes, and other expenses related to the residence also are not considered an acceptance of benefits.[458]

H. Simultaneous Deaths of Joint Tenants

What are the estate tax results if two joint tenants are killed in an accident under circumstances that make it impossible to determine the order of deaths? If the jurisdiction has adopted the Uniform Simultaneous Death Act (USDA), the jointly held property is distributed at the joint tenants' deaths "one-half as if one [co-tenant] had survived and one-half as if the other had survived."[459] The estate tax results depend on the extent to which each joint tenant contributed toward the acquisition of the property and on whether the special spousal joint tenancy rules of §2040(b) apply.

If one joint tenant furnished all of the consideration for the property and if the joint tenants were not husband and wife, the full value of the property is included in the estate of the tenant who furnished the consideration, and one-half of the value is included in the estate of the other tenant. This result is dictated by Rev. Rul. 76-303,[460] which analyzed the estate tax consequences as follows:

(i) In each co-tenant's estate, one-half of the property is deemed to have passed from that co-tenant to the other cotenant by right of survivorship. Thus, the estate taxation of that one-half interest must be determined by application of §2040. For the co-tenant who furnished all of the consideration, the full value of the one-half interest is includible. For the co-tenant who furnished none of the consideration, none of the value of the one-half interest is includible.

(ii) In each co-tenant's estate, one-half of the property is treated as if that co-tenant survived as to that interest. Thus, the estate taxation of that interest is determined by application of §2033 and is fully includible in the co-tenant's estate. Accordingly, one-half of the value of the

[450] Reg. §25.2518-2(c)(5) *Ex.* (9).

[451] *See* §2523(i)(3) (applying principles of former §2515 to acquisitions of tenancies in real property involving non-citizen spouses).

[452] Because both severable and non-severable tenancies can be disclaimed within nine months of the joint tenant's death, the important point made by *Example III-25*, therefore, is not the timing of the disclaimer, but the amount of property than can be disclaimed. Note that if S2 had been the first joint tenant to die, no portion of the joint tenancy could have been disclaimed by S1, because no portion of the property would be includible in S2's estate under the consideration-furnished test of §2040(a).

[453] §2518(b)(3).

[454] Reg. §25.2518-2(d)(1).

[455] The transfer of funds into S's account in the example should not constitute an "affirmative act" by S; accordingly, S should not be deemed to have accepted the property or any of its benefits. *See* Reg. §25.2518-2(d)(1). *See also* PLR 200003023 (surviving spouse made valid disclaimer of her survivorship interest in joint bank accounts, brokerage investment accounts, and Treasury Direct accounts; surviving spouse had not accepted any benefits or exercised control over decedent's interest in accounts).

[456] *See* 848 T.M., *Disclaimers — Federal Estate, Gift and Generation-Skipping Tax and State Law Considerations.*

[457] Reg. §25.2518-2(d)(1), §25.2518-2(c)(5) *Ex.* (10).

[458] PLR 9135043.

[459] Unif. Simultaneous Death Act §3, 8B U.L.A. 284 (1993). Under the 1991 version of the Act, which treats one person as having predeceased another if the first person does not survive the other by 120 hours, jointly owned property of co-tenants who die within 120 hours of each other is distributed as follows: "one-half of the property passes as if one had survived by 120 hours and one-half as if the other had survived by 120 hours." Unif. Simultaneous Death Act §4 (1991), 8B U.L.A. 259 (1993). Thus, in the case of true simultaneous deaths, or deaths for which the order cannot be determined, the distribution of the joint property under either version of the Act would be the same.

[460] Rev. Rul. 76-303 involved joint tenants who were married, but the ruling arose before the enactment of the qualified joint interest rules of §2040(b). Thus, to the extent that a portion of the joint property was includible in the estate of either joint tenant by virtue of §2040, Rev. Rul. 76-303 applied the consideration-furnished test of present §2040(a).

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property is includible in the estate of each co-tenant by virtue of the co-tenant's deemed outright ownership of the property.

The operation of these rules may be illustrated by the following example:

Example III-28: F purchased a farm in Year 1 for $250,000 with his own funds and placed title to the farm in the names of F and his son, S, as joint tenants with right of survivorship. In Year 5 they died as a result of a common disaster, to which the USDA applied. The farm was then worth $500,000. The estate tax consequences to F's estate are as follows. F is deemed to have survived S with respect to one-half of the property and is deemed to have predeceased S with respect to the other half. For the portion with respect to which F is deemed to have survived, F is treated as having received that interest by operation of law at S's death. F is then deemed to have died holding that one-half interest, which is includible (at a value of $250,000) under §2033. For the portion with respect to which F is deemed to have predeceased S, that portion is treated as having passed to S by operation of law. That portion is includible in F's estate (at a value of $250,000) by applying the consideration-furnished test of §2040(a). The estate tax consequences to S's estate are as follows. S is deemed to have survived F as to one-half of the property. With respect to that portion, S is treated as having succeeded to the property by operation of law at F's death and then having died holding the interest. That portion is includible in S's estate (at a value of $250,000) under §2033. S is deemed to have predeceased F as to one-half of the property, which is treated as having passed to F by operation of law. The estate taxation of this portion is determined by applying the consideration-furnished test of §2040(a), under which nothing is includible (because F furnished all of the consideration to acquire the property). The total amount subject to estate tax in both estates is $750,000.

Although there have been no cases of rulings concerning this issue, the estate of S in the above example would presumably be entitled to a credit under §2013[461] with respect to the one-half interest in the property that is deemed to have passed from F to S and that was taxable in both F's estate (under §2040(a)) and S's estate (under §2033). Section 2013 allows a credit for the federal estate tax paid "with respect to the transfer of property" to a decedent by or from a person who has died within ten years before or two years after the decedent's death.[462] For this purpose, the term "transfer" includes those circumstances in which the decedent is a "surviving tenant of a tenancy by the entirety or joint tenancy with survivorship rights."[463] For a more detailed discussion of §2013, see 844 T.M., *Estate Tax Credits and Computations.*

If the joint tenancy is subject to the qualified joint interest rules of §2040(b), the analytical framework of Rev. Rul. 76-303 should still apply, but the tax results will be different. In this connection, consider the following example:

Example III-29: S2 purchased real property in Year 1 with $500,000 of his or her own funds and took title to the property as tenants by the entirety with spouse, S1. Both die as the result of a common accident in Year 5. (Assume that both spouses are both U.S. citizens, so that the qualified joint interest rules of §2040(b) apply to each, to the extent that each is presumed to have died survived by the other.) Under the USDA, S2 is treated as having predeceased S1 as to one-half of the property. As to this one-half interest, the interest is treated as having passed to S1 by right of survivorship and is thus tested for estate tax inclusion (with respect to S2's estate) under §2040(b). The amount includible is one-half of the value of the one-half interest ($125,000). As to this same one-half interest, S2's estate is entitled to an offsetting marital deduction. S2 is also treated under the USDA as having survived S1 as to one-half of the property. S2 is thus treated as having received this one-half interest at S1's death and having died owning the interest. The full value of the one-half interest ($250,000) is includible in S2's estate under §2033, and there is no offsetting marital deduction. An identical analysis applies with respect to S1's estate, with the result that each estate includes a $375,000 portion of the property, and each estate is entitled to a $125,000 marital deduction. The net result is that the full value of the property ($500,000) is subject to taxation once.

The estate of neither spouse would be entitled to a credit under §2013, because the portion each spouse is deemed to have received from the predeceasing spouse was subject to the marital deduction and therefore not subject to estate taxation in the predeceasing spouse's estate. Note how the results would differ if S1 in the above example were not a U.S. citizen:

Example III-30: S2 is treated as having predeceased S1 as to one-half of the property. As to this one-half, the interest is treated as having passed to S1 by right of survivorship. Because S1 is a non-citizen, the measure of its includability in S2's estate is tested under §2040(a), not §2040(b). Applying the consideration-furnished test, the amount includible is the full value of the one-half interest ($250,000), and there is no offsetting marital deduction. S2 is treated as having survived S1 as to the other one-half interest, which is includible in his or her estate under §2033 (at a value of $250,000), with no offsetting marital deduction. Regarding S1's estate, S1 is treated as having predeceased S2 as to one-half of the property. Because S2 (the deemed surviving spouse with respect to this one-half interest) is a U.S. citizen, the qualified joint interest rules apply, with the result that one-half of the value of the one-half interest ($125,000) is includible, with an offsetting marital deduction. H is treated has having survived W as to one-half of the property. The full value of this one-half interest ($250,000) will be included under §2033, with no offsetting marital deduction. The net result is that a total of $750,000 in value is subject to estate taxation.

[461] *See* Harris, *Federal Estate Consequences of Common Disasters or Closely Proximate Deaths*, 47 Tax Law. 763, 775–78 (1994) (discussing availability of §2013 credit).

[462] §2013(a).

[463] Reg. §20.2013-5(b).

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S1's estate should be entitled to a §2013 credit with respect to the one-half interest for which S1 is the deemed survivor, this same interest having been taxed in S2's estate at its full value under §2040(a).

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IV. Income Taxation of Jointly Held Property

A. *Allocation of Income, Gains, and Credits*

1. In General

As a general rule, taxable income and gains with respect to jointly held property and property held as tenants by the entirety are allocated among the owners based on the proportion of income to which each co-owner is entitled under local law.[464] Each joint tenant is generally entitled to receive a pro-rata share of the income from the property, although an agreement among the joint tenants to allocate the income on a non-pro-rata basis may be respected for income tax purposes.[465]

There are few recent cases and rulings that concern the proper allocation of income and gains among joint tenants and tenants by the entirety. This absence of recent cases and rulings is likely attributable to the fact that most joint property arrangements are between spouses, who typically file joint returns. Filing joint returns is an option that has been available to spouses since 1948.[466]

Joint tenancies offer a simple means of splitting income and gains among multiple taxpayers who file separate returns. A transfer of property into joint tenancy immediately before a sale (in order to split the gain among several taxpayers) may be disregarded, however, and the full amount of the gain taxed to the original owner.[467]

Tax credits are generally allowed to the person who is exposed to the risk of loss from supplying the capital for acquisition of the asset for which a credit is available.[468] As a general rule, a tax credit is allowable to each joint tenant in proportion to the consideration furnished in connection with the acquisition of the asset,[469] or in the case of a tenancy in which the transferor does not remain as a co-tenant, in proportion to each joint tenant's legal interest in the property.[470]

2. Joint Bank and Brokerage Accounts

The taxation of income from joint bank and brokerage accounts depends on how the income is allocated under local law and may vary considerably depending upon how the account is titled. If a co-owner's rights to the assets vest immediately upon creation of the account, so that all co-owners are considered to be equal owners of the account assets, then the income normally is taxed equally to the co-owners.[471] If, however, each co-owner's rights in the account are in proportion to the amounts contributed to the account, then the income is taxed in that same proportion.[472] If the non-contributing co-owner's rights do not vest until the contributing co-owner's death, then all of the income from the account is taxed to the contributing co-owner during his or her lifetime.[473]

3. United States Savings Bonds

In Rev. Rul. 54-143, the IRS ruled that, when a Series E bond is issued to two persons as co-owners, the interest increment on the bond is taxed to the owners in proportion to the amount of the purchase price contributed by each.[474] If a bond is reissued in the sole name of a non-contributing co-owner, the contributing co-owner is taxed on income earned up to the date of the change and, thereafter, the income is taxed to the non-contributing co-owner.[475]

The income tax on Series E or EE savings bonds can be deferred by cash basis taxpayers under the authority of §454. Any untaxed income attributable to a deceased co-owner of a bond is taxed to the surviving co-owner as income in respect of a decedent under §691. In *Apkin v. Commissioner*,[476] for example, the decedent had purchased Series E bonds[477] during life and had them issued in the names of the decedent and the decedent's child. The bonds were redeemed by the child after the decedent's death. None of the income that had accrued during the decedent's lifetime had been reported on the decedent's income tax returns. The income that accrued before the decedent's death and that was received by the child upon redemption was taxed to the child as income in respect of a decedent.[478]

4. Income Paid After Death of Joint Tenant

Because joint tenancy property passes to the surviving tenant by right of survivorship, no part of the income relating to the property that arises after death is allocated to the estate of the deceased tenant. Assuming that all of the joint tenants are cash basis taxpayers, any income paid after a joint tenant's death is taxable to the surviving joint tenants. Under certain circumstances, however, a portion of the income — for example, rent on jointly owned property that is due before death but received after death — may be taxed as income in respect of a decedent under §691.[479]

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[464] *See, e.g., Lipsitz v. Commissioner*, 220 F.2d 871 (4th Cir. 1955) (applying Maryland law); *Morgan v. Finnegan*, 182 F.2d 649 (8th Cir. 1950) (applying Missouri law); *Parsons v. Commissioner*, 43 T.C. 378 (1964) (applying laws of Delaware and Maryland); *Webster v. Commissioner*, 4 T.C. 1169 (1945) (applying Michigan law), *nonacq.*, 1975-1 C.B. 3 (withdrawing earlier acquiescence, which was reported at 1945 C.B. 7); *Brennen v. Commissioner*, 4 T.C. 1260 (1945) (applying Pennsylvania law), *acq.*, 1945 C.B. 2; Rev. Rul. 74-209 (applying Wisconsin law).

[465] *See, e.g., Lipsitz v. Commissioner*, 220 F.2d 871 (4th Cir. 1955).

[466] *See* §6013.

[467] *Lannan v. Kelm*, 221 F.2d 725 (8th Cir. 1955) (refusing to allocate gain between co-tenants because transaction creating joint tenancy not bona fide; allocating all gain to one co-tenant, original owner of property).

[468] *See Carnegie Prods., Inc. v. Commissioner*, 59 T.C. 642 (1973).

[469] *Hanna Barbera Prods., Inc. v. United States*, 77-1 USTC ¶9365 (C.D. Cal. 1977) (most important facts in determining availability of investment tax credit was source of capital used to acquire asset).

[470] For further discussion of this issue, see 583 T.M., *Cost Segregation and the Former Investment Tax Credit* (U.S. Income Series).

[471] *Hafner v. Commissioner*, 31 B.T.A. 338 (1934); *Dunham v. Commissioner*, 27 B.T.A. 1068 (1933), acq., XII-1 C.B. 4; Rev. Rul. 76-97.

[472] *Estate of Freedman v. Commissioner*, T.C. Memo. 2007-61; *Emmons v. Commissioner*, T.C. Memo. 1961-290.

[473] *Estate of Robinson v. Commissioner*, 4 B.T.A. 47 (1926); *Bohnenkamp v. Commissioner*, 2 B.T.A. 172 (1925).

[474] *See also* Rev. Rul. 55-278.

[475] Rev. Rul. 55-278. *See also* Rev. Rul. 70-428, Rev. Rul. 68-81.

[476] 86 T.C. 692 (1986).

[477] Series E bonds are no longer available for purchase, though a decedent may have an interest in one that was purchased earlier.

[478] *Apkin*, 86 T.C. 692. *See also Hitchman v. Commissioner*, T.C. Summ. Opin. 2023-18 (where petitioner inherited savings bond upon death of father and no §454 election was made, savings bond interest constituted income in respect of decedent when petitioner redeemed bond; savings bond did not receive step-up in basis). For further discussion of the tax treatment of income in respect of a decedent, see 862 T.M., *Income in Respect of a Decedent.*

[479] See 862 T.M., *Income in Respect of a Decedent.*

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B. Allocation of Deductions and Losses

1. In General

The extent to which a co-tenant is entitled to deduct taxes, interest, and other expenses should be limited to the amounts paid by the co-tenant that are not reimbursable by the other co-tenants.[480] On the other hand, the IRS has permitted a co-tenant to deduct all expenses actually paid by that co-tenant (as long as no other co-tenant claims the same expenses), in situations in which the co-tenants are jointly and severally liable for all expenses.[481] As in the case of the question of how to allocate income among joint tenants, there is little recent law on this topic, presumably due to the fact that most joint tenants are spouses, most of whom file joint returns.

2. Interest and Taxes

Subject to certain statutory limitations,[482] co-owners are generally entitled to deduct interest and taxes paid on jointly owned property to the extent that they have actually paid for these items and provided that no other co-owner has claimed a deduction for the same items.[483] The basis for treating interest and taxes differently from other types of expenses and losses is that, even though a co-owner may not be personally liable for the entire amount of the interest and taxes (and thus may be entitled to reimbursement from the other co-tenants for a portion of the interest and taxes paid), payment may be necessary to preserve that co-owner's rights in the entire property, and thus permitting a deduction for the entire payment is appropriate.[484]

3. Casualties and Other Losses

In general, losses are deductible by individual taxpayers only if they are incurred in a trade or business or in a transaction entered into for profit.[485] Losses with respect to property not used in a trade or business or other profit-seeking activity are deductible only if the loss arises from a casualty and only if the loss exceeds certain limits.[486] Because most jointly held property is personal-use property, there is little law concerning the deductibility of losses relating to joint property, and most of the law available concerns casualty losses. Moreover, in most cases the joint owners are spouses filing joint returns, so that the proper allocation of the loss between them is irrelevant.

As a general rule, joint tenants should apportion a loss deduction among themselves according to their relative ownership interests. Thus, for example, in Rev. Rul. 75-347, the IRS ruled that when a husband and wife owned property as tenants by the entirety, any casualty loss to the property must be deducted one-half by each, even if one of the two paid the entire cost of repair. The result was justified on the basis of local law, which provided that property held as tenants by the entirety was considered to be equally owned. In the case of a casualty loss experienced by joint owners who are not married, the loss must be allocated between or among the tenants in proportion to their interests.[487] In general, local law deems each joint tenant to own a pro-rata share of the property, and the casualty loss is allocated accordingly. Similarly, losses on the sale of property owned in joint tenancy are usually split equally.[488]

For a more detailed discussion of the treatment of casualty losses, see 527 T.M., *Loss Deductions* (U.S. Income Series).

4. Depreciation and Depletion

a. Allowance

As a general rule, the depreciation or depletion deduction is allowed to the person who has an economic investment in the property and will sustain an economic loss by reason of its obsolescence.[489] In the case of life tenants or beneficiaries of estates and trusts, the depreciation deduction is allowable to the person or entity liable for income taxes.[490] While no specific rule exists with respect to joint tenancies, the same general principles should apply, with the result that the deduction should be allocated among the owners in proportion to their rights to income from the property.

b. Recapture — §1245 and §1250

As a general rule, depreciation taken before death is not recaptured (either at death or upon a later disposition) for §1245 or §1250 property received from a decedent and for which a step-up in basis was allowed under §1014(a), except in the case of a sale contracted before death to which §691 applies (e.g., an installment sale creating income in respect of a decedent).[491]

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[480] 2 Casner & Pennell, Estate Planning, §10.4 (7th ed. 2011).

[481] *See, e.g.,* Rev. Rul. 71-268.

[482] *See, e.g.,* §163(h) (generally disallowing deductions for payments of "personal interest"). For a detailed discussion of the deductibility of interest expenses, see 536 T.M., *Interest Expense Deductions* (U.S. Income Series).

[483] *Blackburn v. Commissioner*, T.C. Memo. 1979-266, aff'd, 681 F.2d 461 (6th Cir. 1982); *Finney v. Commissioner*, T.C. Memo. 1976-329; *Blunt v. Commissioner*, T.C. Memo. 1966-280; *Nicodemus v. Commissioner*, 26 B.T.A. 125 (1932); Rev. Rul. 72-79; Rev. Rul. 71-268. *But see Higgins v. Commissioner*, 16 T.C. 140 (1951) (husband was not allowed to take full deduction for mortgage interest paid on property held as tenants by the entirety because payments were made from joint bank account and there was no special agreement between husband and wife allocating all of mortgage interest to husband).

[484] *Powell v. Commissioner*, T.C. Memo. 1967-32; Rev. Rul. 71-268. *See also* Rev. Rul. 75-347 (husband was not permitted to take full casualty loss deduction on property held with his wife as tenants by the entirety even though he paid for repairs necessary to restore property to its prior condition; this situation was distinguished from Rev. Rul. 71-268, in which interest and taxes were paid).

[485] §165(c)(1), §165(c)(2).

[486] §165(c)(3), §165(h). Note that for tax years beginning after 2017 and before 2026, any personal casualty loss deduction for individual income tax purposes is permitted only if it is attributable to a federally declared disaster under §165(i)(5). Former §165(h)(5), *added by* TCJA, Pub. L. No. 115-97, §11044. For tax years beginning after 2025, any personal casualty loss deduction for individual income tax purposes is permitted if it is attributable to either a federally declared disaster under §165(i)(5) or a state declared disaster under §165(h)(5)(C). §165(h)(5), as amended by the One Big Beautiful Bill Act (OBBBA), Pub. L. No. 119-21, §70109, applicable to tax years beginning after December 31, 2025. Personal casualty losses incurred before 2018 were not required to be attributable to a federally or state declared disaster.

[487] *See, e.g., Harrell v. Commissioner*, T.C. Memo. 1978-211. *See also Kraus v. Commissioner*, 10 T.C.M. 1071 (1951) (each joint tenant was allowed to deduct one-half of loss).

[488] *See* I.T. 3898, 1948-1 C.B. 55 (applying Indiana law); I.T. 3825, 1946-2 C.B. 5 (applying Colorado law); I.T. 3754, 1945 C.B. 143 (applying Wisconsin law).

[489] *See Narver v. Commissioner*, 75 T.C. 53 (1980), aff'd, 670 F.2d 855 (9th Cir. 1982).

[490] §167(d); Reg. §1.167(h)-1.

[491] §1245(b)(2), §1250(d)(2); Reg. §1.1245-4(b)(2) *Ex.* (2). *See also* Reg. §1.1245-4(a)(1) (no recapture for §1245 property received from decedent and for which former §1022 modified carryover basis was elected by executor (for

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On the other hand, as discussed at IV.C.2.c., below, to the extent that depreciation deductions were allowed to the surviving joint tenant, the basis of joint tenancy property includible in a deceased joint tenant's estate is adjusted under §1014(b)(9).

C. Income Tax Basis Rules

1. Joint Tenancies Created by Gifts — §1015 and §1041

As a general rule, the basis of property acquired by gift is the basis of the property in the hands of the donor or of the last preceding owner who did not acquire the property by gift.[492] For determining loss, the basis of property acquired by gift is the lesser of the donor's basis or the fair market value of the property at the time of gift.[493] Thus, in most instances, the basis of a joint tenant's interest in joint tenancy property is the adjusted cost basis of the donor, or a portion thereof, depending on the relative interests of the donor and the other joint tenants in the property. Under §1015(d)(6), the donor's adjusted basis immediately before the gift is increased by a portion of any gift taxes paid, but not above the fair market value of the property.[494]

For transfers between spouses (or former spouses, if the transfer is "incident to [their] divorce"),[495] basis is determined under §1041, not §1015.[496] Transfers covered by §1041 are treated as gifts, with the result that no gain or loss is recognized (whether or not the transfer is for consideration)[497] and the transferee takes the transferor's adjusted basis.[498]

> *Example IV-1:* S1 buys real estate with $500,000 of his or her own funds and takes title to the property with S2, as joint tenants. S2 is a U.S. citizen. Under local law, the interests of the spouses are severable. Each spouse is, therefore, considered to own a one-half interest in the property. The fair market value of the gift to S2 is $250,000, but the gift is not taxable because of the §2523 marital deduction. S1's adjusted cost basis determines the basis of the property received by gift, so S2's basis for her one-half of the property is $250,000.[499]

The carryover basis rule of §1041 applies even if the adjusted basis of the transferred property exceeds the fair market value of the property at the time of the transfer;[500] in this respect, transfers under §1041 produce a different result than transfers subject to §1015.

2. Property Received by Right of Survivorship — §1014

a. In General

Before its substantial revision in 1954, the Code permitted the basis of a decedent's property to be increased to the property's fair market value at the date of death (or on the alternate valuation date, if so elected) only if the property passed from the decedent by "bequest, devise, or inheritance."[501] Because a joint interest in property was acquired by a lifetime transfer, and not by "bequest, devise, or inheritance," before 1954 the basis of the survivor was the decedent's adjusted basis, even though all or a significant portion of the value of the property might have been included in the decedent's gross estate for estate tax purposes.[502]

In enacting the 1954 Code, Congress recognized that there was "no justification for denying property included in a decedent's gross estate for estate tax purposes a new basis at date of death."[503] Accordingly, Congress changed the Code to provide that property passing to the survivor of a joint interest acquires a basis equal to the property's fair market value at the date of death (or on the alternate valuation date, if so elected) to the extent that the value of such property is included in the decedent's gross estate.[504] This rule has remained in effect since 1954, with the exception of a brief period in the 1970s during which property acquired from a decedent was subject to a carryover basis regime. The rule was also replaced by an optional carryover basis regime for decedents dying in 2010.

Under the present statutory scheme, if only a portion of the joint property is includible in the estate of the first joint tenant to die, the survivor's basis is determined in part by the rules of §1014 and in part by reference to the basis that the survivor had in the property before the deceased joint tenant's death. With respect to certain jointly held assets, determining the survivor's basis in the portion not includible for estate tax purposes can be problematic. Consider the following example:

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estates of decedents dying in 2010)), §1.1245-2(c)(2)(ii)(D) (upon later disposition of §1245 property acquired with former §1022 basis, beneficiary is subject to recapture), as amended by T.D. 9811, 82 Fed. Reg. 6235 (Jan. 19, 2017).

[492] §1015(a).

[493] §1015(a).

[494] *See* Reg. §1.1015-5(c). The increase in basis for gift taxes paid is limited to the amount that bears the same ratio to the amount of gift taxes paid as the net appreciation in value of the gift bears to the amount of the gift. Reg. §1.1015-5(c)(1).

[495] A transfer is "incident to" a divorce if the transfer occurs within one year after the date that the marriage ceases or is related to cessation of the marriage. §1041(c).

[496] §1015(e).

[497] *See* Reg. §1.1041-1T(a), Q&A-2 ("Section 1041 applies to any transfer of property between spouses regardless of whether the transfer is a gift or is a sale or exchange between spouses acting at arm's length").

[498] §1041(b).

[499] Because no gift taxes would be paid in connection with this transaction, there would be no need to consider whether S2's basis would be subject to adjustment under §1015(d)(6) (which would not be applicable in any event, because there is no "net appreciation" associated with this gift). In the unusual case in which the transfer subject to §1041 also triggers gift tax — i.e., a transfer to a resident alien spouse in excess of the special annual exclusion allowed under §2503(b) and §2523(i)(2) — one would need to address this question. Presumably the basis adjustment mandated by §1015(d)(6) would not apply, by virtue of §1015(e).

[500] Reg. §1.1041-1T(a), Q&A-11.

[501] Former §113(a)(5) (1939 Code).

[502] *See, e.g., Faraco v. Commissioner*, 261 F.2d 387 (4th Cir. 1958) (property fully includible in deceased tenant's estate, but no basis step up under applicable Code provision); *Lang v. Commissioner*, 289 U.S. 109 (1933) (88% of joint property includible in deceased joint tenant's estate, but no basis adjustment appropriate because property not acquired "by bequest, devise, or inheritance" within meaning of §204(a) of the Revenue Act of 1924).

[503] S. Rep. No. 1622, 83d Cong. (1954).

[504] §1014(a), §1014(b)(9). Joint tenancy property treated under §691 as income in respect of a decedent is, of course, an exception to this rule. *See* §1014(c).

In Rev. Rul. 56-215, the IRS ruled that the step up in basis was permitted notwithstanding the fact that no estate tax was due or that no estate tax return was required to be filed, provided that the property was required to be included in the decedent's gross estate. However, note that in Rev. Rul. 56-60, the IRS ruled that the estate must file a federal estate tax return in order for the §2032 alternate valuation date to be elected.

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Example IV-2: In 1978, S1, with $100,000 of S1's own funds, purchased a residence, taking title in the names of S1 and S2 (S1's spouse), as tenants by the entirety. S2 is a U.S. citizen. S1 did not elect under former §2515(c) to treat the purchase of the residence as a gift to S2. S1 died in 2016, when the residence was worth $1,000,000. Because S2 is a U.S. citizen, one-half of the value of the residence is includable in S1's gross estate under §2040(b). As to that one-half of the property, S2 takes a basis equal to fair market value of one-half of the property ($500,000). How does S2 determine S2's basis in the other half of the property? If S2 had received the one-half interest by gift, then S2 would take S1's basis in the interest ($50,000) by virtue of §1015, because the transfer predates the 1984 enactment of §1041. Under former §2515, however, the creation of the tenancy did not constitute a gift to S2. Is S2's basis zero, because, under the general cost basis rule of §1012, S2's investment in the property is zero?

No cases or rulings offer any guidance on the proper resolution of this issue. A commentator suggests that each spouse in the above example should be deemed to own one-half of the basis, despite the fact that there was no gift from S1 to S2 when the tenancy was created.[505] Otherwise, the commentator observes, the basis held by the surviving spouse would differ depending on who died first.[506] Under this approach, S2 in the above example would have a combined basis in the property of $550,000, which is the same basis that S1 would have if S1 were the survivor. That would also seem to be the result mandated by §1041 — S2 would take S1's adjusted basis in the interest placed in S2's name during S1's lifetime.

When both joint tenants provide consideration toward the purchase of property but under local law share income in a proportion that differs from their contribution ratio, determining the surviving joint tenant's basis in the property can be complicated. In Rev. Rul. 56-519, for example, the taxpayer purchased a farm, taking title in the names of herself and her husband as tenants by the entirety. One-third of the purchase price was paid with the taxpayer's own funds, and the balance was paid with a purchase money mortgage, the payments on which came from farm earnings and the husband's outside work. Payments for improvements to the farm similarly came from farm earnings and the husband's outside earnings. Ten years later, the taxpayer purchased an apartment house with farm earnings, the husband's outside earnings, and rental income from the apartment house. The taxpayer and her husband took title to the apartment house as tenants by the entirety. Under Indiana law, income from property held in tenancy by the entirety belonged to the spouses in equal shares. Therefore, each spouse was deemed to have paid from his or her separate funds one-half of the consideration furnished through the reinvestment of income from the properties.

At the husband's death, the portion of the farm and apartment house includible in his gross estate was determined under the consideration-furnished test. The IRS ruled that the amount includible in the husband's estate was that proportion of the fair market value of the properties that (1) the aggregate of the investment in the properties of his separate income (because he furnished no part of the original purchase price), bore to (2) the properties' total cost, including improvements. One-half of the income from both properties was considered to be the husband's separate income. Thus, at the date of the husband's death, the taxpayer's basis in each of the properties consisted of two parts: (1) the stepped-up basis on the portion of the property that passed through the husband's estate (based on the amount includible in the husband's estate), and (2) the consideration paid by the taxpayer, less the depreciation allowable to her under local law before her husband's death.[507]

Whatever the basis is determined to be, for estate tax returns filed after July 31, 2015, the basis of the property acquired by the surviving joint tenant must be consistent with the basis reported on the deceased joint tenant's estate tax return (if one is required to be filed).[508] To ensure consistency, the executor must report property values by filing Form 8971, *Information Regarding Beneficiaries Acquiring Property From a Decedent*, with the IRS, and furnishing Schedule A to Form 8971 to the surviving joint tenant, no later than the earlier of 30 days after the date the estate tax return was required to be filed (including extensions) or was actually filed.[509]

b. Burden on Taxpayer to Establish Basis Step Up

Section 2040(a) requires the inclusion of all jointly owned property in the estate of a decedent "except such part thereof as may be shown to have originally belonged to [the surviving joint tenant] and never to have been received or acquired by the latter from the decedent for less than adequate and full consideration in money and money's worth." In general, §1014 gives the surviving joint tenant a step up in basis as to that portion of the joint property includible in the decedent's estate. Under certain circumstances, the inclusion of joint property in a deceased joint tenant's estate may produce no estate taxes (due, for example, to the use of the deceased joint tenant's unified credit or to the availability of the marital deduction), but the fact that the property is includible nevertheless causes the surviving joint tenants to receive a step up in basis. This phenomenon may tempt surviving joint tenants to claim that a larger portion of the joint property was includible in the estate of the deceased joint tenant. This might be accomplished by, for example, failing to establish that the surviving joint tenants had contributed to the acquisition of the property, thus triggering full inclusion of the property in the deceased joint tenant's estate

[505] Harris, *Allocating Basis for Jointly-Owned Property Still Presents Unresolved Questions*, 58 J. Tax'n 234, 236 (1983).

[506] Harris, *Allocating Basis for Jointly-Owned Property Still Presents Unresolved Questions*, 58 J. Tax'n 234, 236 (1983).

[507] The depreciation deductions allowable to the taxpayer should not reduce the basis of that portion of the property includible in the husband's estate, unless a portion of the deductions taken by the taxpayer was attributable to amounts "acquired [by the taxpayer from her husband] before the death of the decedent" within the meaning of §1014(b)(9). For a further discussion of this issue, see IV.C.2.c., below.

[508] §1014(f). *See* T.D. 9991, 89 Fed. Reg. 76,356 (Sept. 17, 2024) (final regulations covering consistent basis reporting requirements for property acquired from decedent, which basis is determined by reference to property's federal estate tax value).

[509] §6035. Executors and other persons required to file or furnish Form 8971 and Schedule A after July 31, 2015, and before June 30, 2016, need not have done so until June 30, 2016. Reg. §1.6035-2(a). For discussion of the reporting requirements, see 822 T.M., *Estate, Gift, and Generation-Skipping Transfer Tax Returns and Audits.*

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under §2040(a). If the surviving joint tenant makes no attempt to establish his or her contribution to jointly owned property, is the survivor thereafter entitled to take advantage of the income tax benefits of an increased portion of the property's being includible in the deceased joint tenant's estate? The answer to this question is the subject of this section of the portfolio.

In *Madden v. Commissioner*,[510] a case that arose when the consideration-furnished test applied to spousal joint tenancies, the taxpayer included one-half of the value of jointly owned stock on his wife's federal estate tax return even though his wife furnished no consideration.[511] The taxpayer sold the stock and used the stepped-up basis in computing his gain. When the IRS later challenged the taxpayer's basis, the taxpayer argued that his wife's estate had not satisfied its burden of proving that the consideration was not furnished by the decedent, and therefore at least one-half of the jointly owned stock was required to be included in his wife's estate, with a resulting step-up in basis under §1014. The court rejected this argument, holding that the taxpayer had failed to satisfy his burden of establishing that the jointly held property was "required to be included" in his wife's estate, as required by §1014(b)(9).[512] The court observed that Congress had not intended to allow taxpayers to gain income tax advantages by electing whether to include jointly owned property in an estate (simply by meeting or failing to meet the burden of proof under §2040).[513]

Under present law, in most cases involving spousal joint tenancies the consideration-furnished rule does not apply, and one-half of the property will be included in the estate of the first spouse to die under §2040(b). The consideration-furnished test still applies, however, to non-spousal joint tenancies, and it also applies to some spousal joint tenancies.[514] In these latter contexts, therefore, *Madden* is of continued relevance.

c. *Depreciation Adjustments to Basis — §1014(b)(9)*

A survivor's basis in property acquired from a decedent prior to death and included in the decedent's estate for estate tax purposes is the property's fair market value at the applicable valuation date (i.e., date of death or §2032 alternate valuation date), reduced by the amount allowed to the survivor as deductions in computing taxable income for exhaustion, wear and tear, obsolescence, amortization, and depletion on the property before the death of the decedent.[515] Thus, if a co-owner of depreciable property receives the benefits of depreciation deductions on that property and later acquires complete ownership upon the other co-owner's death, the survivor must adjust the property's basis for the depreciation benefits received by the survivor before the co-owner's death. Under the laws of most jurisdictions, two joint tenants are each entitled to one-half of the income and are chargeable with one-half of the expenses of the property. Following the death of the first joint tenant, under §1014(b)(9), the surviving joint tenant's basis in the property would be reduced by one-half of the depreciation deductions that were allowed during the period of joint ownership.[516] If under local law all of the income was allowable to the deceased joint tenant (as may be the case under prior law with respect to certain tenancies by the entirety), then no adjustment would be necessary, because none of the depreciation deductions would have been allowed to the survivor during the period of joint ownership.[517]

> *Example IV-3:* In Year 1, B purchased depreciable property for $50,000, taking title in the names of B and B's sister, S, as joint tenants with right of survivorship. Depreciation deductions of $2,500 were allowable to B and S annually. B died in Year 5, when the property was worth $75,000. Under §2040(a), the full value of the property is includible in B's estate. S's basis in the property is $68,750 ($75,000 (the federal estate tax value of the property), less $6,250 (S's one-half share of the total depreciation deductions during the five years of joint ownership)). If local law had allocated all of the income from the property to B, the depreciation deductions would have been allowable only to B, and no §1014(b)(9) adjustment would be appropriate. Under those circumstances, S would take a basis of $75,000.

With respect to most joint tenancies between spouses, only one-half of the joint property is includible in the estate of the first joint tenant to die. The regulations under §1014(b)(9) include only an example involving joint property that was fully includible in the estate of the first joint tenant to die.[518] If only a portion of the joint property is includible in the estate of the first to die, then a portion of the survivor's basis is the basis held by the survivor before the deceased joint tenant's death, which would already reflect any depreciation deductions allowed to the survivor. Presumably, under these circumstances, there would be no further adjustment to basis under §1014(b)(9).

> *Example IV-4:* On July 1, Year 1, S1 purchased depreciable real property for $150,000, which he or she conveyed to himself or herself, and S2 as tenants by the entirety. S2 is a U.S. citizen. Under local law, each of the spouses is entitled to receive one-half of the income from the property. The spouses filed joint income tax returns for the tax years Year 1 through Year 5. The total depreciation allowance for each tax year was $2,500. S1 died on January 1, Year 6, when the property was worth $200,000. One-half of the value of the property is includible in S1's estate under §2040(b). S2's basis in the one-half interest in the property that was not includible in S1's estate should be $68,750 ($75,000 (one-half of the original cost) less

[510] 52 T.C. 845 (1969), aff'd, 440 F.2d 784 (7th Cir. 1971) (per curiam).

[511] *Madden*, 52 T.C. 845 (record failed to establish why taxpayer claimed that only one-half of property was includible in wife's estate). Based on the taxpayer's failure to prove that he made any contribution to the property, arguably he was entitled to report the full value of the property as includible in his wife's estate and it is unclear why only one-half of the property was originally reported on the estate tax return.

[512] *Madden*, 52 T.C. 845.

[513] *Madden*, 52 T.C. 845.

[514] See III.E.3. and III.E.4., above, discussing, respectively, joint property acquired before 1977 and joint tenancies involving non-citizen surviving spouse.

[515] §1014(b)(9).

[516] Reg. §1.1014-6(a)(3) *Ex.* (2).

[517] Reg. §1.1014-6(a)(3) *Ex.* (2). *See also* Rev. Rul. 75-142 (applying Michigan law).

[518] *See* Reg. §1.1014-6(a)(3) *Ex.* (2).

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$6,250 (one-half of the depreciation deductions)). S2's basis in the one-half interest that was includible in S1's estate should be $100,000 (one-half of the date-of-death value of the property). No adjustment to basis under §1014(b)(9) would be appropriate, because S2's basis in the property already reflects his or her portion of the depreciation deductions.

This approach is not inconsistent with §1014(b)(9), which requires a basis adjustment only with respect to property acquired from the decedent before death that is also includible in the decedent's estate — arguably, only the one-half non-survivorship interest was acquired by S2 in the above example before death, and that portion of the property was not includible in S1's estate. Accordingly, no basis adjustment under §1014(b)(9) is appropriate.

The application of the rule illustrated by the previous example is more complicated if a portion of the depreciation deductions taken by the surviving joint tenant during the deceased joint tenant's lifetime is attributable to property acquired by the survivor before the death of the decedent.[519] In Rev. Rul. 58-130, a husband and a wife owned property as tenants by the entirety. At the husband's death, the portion that was includible in his estate was determined under the consideration-furnished rule. Regarding the question of the wife's basis in the property after the husband's death, the IRS ruled that, as to the portion of the property attributable to the wife's consideration, her basis would be her cost (as determined under §1012), reduced by the greater of (1) amounts "allowed" to her as depreciation deductions, to the extent resulting in a reduction in her income tax liability, or (2) amounts "allowable" to her as depreciation deductions (as required by §1016(a)(2)). As to the portion of the property attributable to the husband's consideration (i.e., the portion includible in his estate), the wife's basis would be the estate tax value of the portion includible in the husband's estate, reduced by any depreciation deduction "allowed" to the wife with respect to the portion of the property that she had "acquired" from the husband before his death (as required by §1014(b)(9)). The IRS ruled that no adjustment to basis was necessary with respect to depreciation deductions allowed to the husband before his death.

Presumably the §1014(b)(9) adjustment described in Rev. Rul. 58-130 would come into play only if the surviving joint tenant had taken depreciation deductions that were disproportionately greater than the surviving joint tenant's contribution to the property. Thus, in Rev. Rul. 58-130, if S1 had furnished three-fourths of the consideration to acquire the property, but S2 had taken one-half of the allowable depreciation deductions, then presumably the §1014(b)(9) basis adjustment following the S1's death would be limited to one-half of the deductions taken by S2.

d. Gifts Within One Year of Donee's Death — §1014(e)

Section 1014(e) prohibits a basis step up with respect to certain appreciated property acquired by a decedent by gift within one year of death; that is, §1014(e) establishes a carryover basis regime for such property. Section 1014(e)(1) provides:

> In the case of a decedent dying after December 31, 1981, if —
>
> (A) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and
>
> (B) the property is acquired from the decedent by (or passes from the decedent to) the donor of the property (or the spouse of such donor),
>
> the basis of the property in the hands of such donor (or spouse) is the adjusted basis of the property in the hands of the decedent immediately before the death of the decedent.

Appreciated property is defined as "any property if the fair market value of such property on the day it was transferred to the decedent by gift exceeds its adjusted basis."[520] The §1014(e)(1) carryover basis rule also applies if the appreciated property is sold by the decedent's estate or by a trust of which the decedent was the grantor, to the extent that the donor of the property (or the spouse of the donor) is entitled to the sale proceeds.[521] These rules apply to property acquired after August 13, 1981, by decedents dying after 1981.[522]

The primary purpose of §1014(e) is to prevent a planning technique that would otherwise be available because of the unlimited marital deduction. Congress was concerned that, with the enactment of the unlimited marital deduction, taxpayers would make gift tax-free transfers to terminally ill spouses and then receive the gifted property back upon the spouse's death (estate tax-free) with a stepped-up basis.[523] Section 1014(e) limits the availability of this technique by requiring that the donee spouse live at least one year. The application of §1014(e) to jointly owned property may be illustrated by the following examples:

> *Example IV-5:* S1 transferred appreciated property with a basis of $10,000 and a fair market value of $100,000 to S1 and S2 as tenants by the entirety. If S2 dies within one year of the transfer, assuming that S1 is a U.S. citizen, one-half of the property is includible in S2's gross estate under §2040(b). But for §1014(e), S1's basis in the property would be $50,000 for the one-half portion received upon S2's death (under §1014(a)(1)), and $5,000 for the other portion (representing one-half of S1's original basis). Section 1014(e), however, denies the step up in basis. S1's basis is $10,000: $5,000, which represents S1's portion of the original basis, plus $5,000, which represents S2's basis immediately before his or her death (i.e., one-half of S1's basis under §1015(a), because S2 acquired the property by gift).

[519] §1014(b)(9).

[520] §1014(e)(2)(A).

[521] §1014(e)(2)(B).

[522] The Economic Recovery Act of 1981 (1981 ERTA), Pub. L. No. 97-34, §425(a).

[523] H.R. Rep. No. 201, 97th Cong. 188–189 (1981).

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Example IV-6: S1 transferred appreciated property with a cost basis of $10,000 to E, who is unrelated, and to S1's spouse, S2, as joint tenants with right of survivorship. If E dies within one year of the gift, S2 succeeds to the ownership of the property, and one-half of the fair market value of property is includible in E's gross estate under the §2040(a) fractional-share rule. However, S2's basis in the property will be $10,000: $5,000, which represents one-half of S1's original basis in the property, which S2 acquired by gift from S1, plus $5,000, which represents E's portion of the original basis. S2 is not entitled to a step up in basis for one-half of the property because §1014(e) treats S2 (as S1's spouse) as the donor.

The IRS has ruled that §1014(e) applies to a portion of the property held in a joint revocable trust funded with assets that were held by the grantors as tenants by the entireties. In PLR 200101021, the grantors created a joint revocable trust, the terms of which granted the first grantor to die a general power to appoint all of the trust assets. The apparent planning objective of the arrangement was to obtain a §1014 basis adjustment for all of the assets of the trust at the death of the first spouse to die (as opposed to only one-half of the assets, as would clearly have occurred if the trust had not been created). The IRS undermined the taxpayers' objective by ruling that the surviving spouse was deemed to have made a gift of one-half of the trust assets to the deceased spouse as of the date of the deceased spouse's death; consequently, although those assets were also includible in the deceased spouse's estate by virtue of the deceased spouse's power of appointment, §1014(e) applied to deny a basis adjustment.

D. Holding Period — §1223

1. Gifts

Section 1223(2) provides that the holding period (for purposes of computing gains and losses) of a person from whom the taxpayer received property is tacked on to the taxpayer's holding period if the taxpayer's basis in the property, in whole or in part, is the same as the predecessor's basis. In most instances involving transfers by gift, the transferee's basis is determined by reference to the transferor's basis under §1015 or §1041. Accordingly, at least for purposes of jointly held property received by gift and disposed of at a gain, the donor's holding period is tacked on to the donee's holding period.

In the case of jointly held property disposed of at a loss, however, if the taxpayer is required under §1015(c) to use the fair market value of the property at the time of the gift (rather than the donee's basis) for purposes of calculating the loss, then the donor's holding period cannot be tacked to the donee's holding period, because the donee does not utilize a basis determined by reference to the donor's basis.[524]

The reference in §1223(2) to "the same basis in whole or in part" as that of the donor of property includes those circumstances in which the donee's basis has been increased as a result of gift taxes paid[525] and in which the donee's basis has been decreased as a result of depreciation deductions[526] during the period of the donee's ownership.

2. Transfers at Death

Section 1223(9) provides that, when property acquired from a decedent has a basis determined under §1014, the recipient is considered to have held the property for more than one year. Accordingly, a disposition of jointly held property after a deceased joint tenant's death should generate long-term gain or loss (as those terms are defined in §1222),[527] even if the deceased joint tenant acquired the property less than one year before the transaction.[528] If only a portion of the jointly held property was includible in the deceased joint tenant's estate (and thus eligible for a §1014 basis step up), then only that portion would be afforded long-term gain or loss treatment by virtue of §1223(9). The holding period of the remaining portion of the property would be determined under the usual holding period rules. If the surviving joint tenant's basis in that portion of the property is determined by reference to the deceased joint tenant's basis, as it would be under a §1022 modified carryover basis election for estates of decedents dying in 2010,[529] then the deceased joint tenant's holding period may be tacked on to the survivor's holding period, applying the rules described at IV.D.1., above.

E. Miscellaneous Additional Issues

1. Partnership Elections

Co-owners of property may be treated as partners for income tax purposes, without realizing that a partnership has been formed. Any time co-owners of property use property in a trade or business and divide profits among themselves, there is a possibility that the owners will be deemed to have formed a partnership for federal income tax purposes. In general, mere co-ownership of property does not in itself make the owners of the property partners for tax purposes.[530] On the other hand, the co-owners will be treated as partners if they "carry on a trade, business, financial operation, or venture and divide the profits

[524] §1223(2).

[525] §1015(d).

[526] §1016(a)(2).

[527] Long-term capital gains are taxed at favorable income tax rates. For tax years beginning after 2012, long-term capital gains are generally subject to income tax rates of 0%, 15%, or 20%. *See* §1(h). For a detailed discussion of the income tax rates relevant to long-term capital gains, see 507 T.M., *Income Tax Liability: Concepts and Calculation* (U.S. Income Series).

[528] To the extent that the jointly held property was includible in the deceased co-tenant's estate, the surviving joint tenant will receive a basis equal to fair market value under §1014. Thus, in general, only post-death gains or losses will be relevant in determining the income tax consequences of a disposition of the property. If the property is sold immediately after death, assuming that the entire joint tenancy was included in the deceased joint tenant's estate, there will be no gain or loss because the property will be disposed of at its date-of-death value, which will also be its basis. However, if the basis of the property received from the deceased co-tenant's estate is determined under former §1022 (for estates of decedents dying in 2010 whose executor elected the former §1022 modified carryover basis in place of the reinstated estate tax regime and §1014) then the holding period of the property recipient includes the decedent's holding period. *See* Reg. §1.1223-1(b), as amended by T.D. 9811, 82 Fed. Reg. 6235 (Jan. 19, 2017). The treatment of the basis is generally that of a gift.

[529] *See* Reg. §1.1223-1(b).

[530] *See* Reg. §1.761-1(a), §301.7701-1(a)(2). Entity classification under the simplified "check-the-box" regulations is discussed in 700 T.M., *Choice of Entity: Business and Tax Considerations.*

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therefrom."[531] One problem in failing to recognize the existence of a partnership lies in the fact that the tax elections available to a partnership must be made by the partnership and cannot be made by the partners. Section 703(b) provides, in general, that any election affecting the computation of taxable income derived from a partnership must be made by the partnership. For example, the partnership — and not the partners — must make the election not to be taxed as a partnership, as authorized by §761(a);[532] the allocation of book items attributable to contributed property pursuant to §704(c);[533] the election to expense depreciable business assets under §179; the election to defer the recognition of gain under §1033 in the event of an involuntary conversion of property; and a number of other important elections.

2. Divorce

Many income tax issues arise when jointly owned property is involved in a divorce. For example, if, as part of a divorce settlement, one spouse transfers his or her interest in jointly owned property to the other spouse, no gain or loss is recognized on the transfer if the transfer is "incident to the divorce" within the meaning of §1041(a).[534]

A transfer subject to §1041(a) is treated as a gift for income tax purposes,[535] and the transferee spouse takes the basis held by the transferor spouse at the time of the transfer.[536] For additional discussion of these issues, see the materials at IV.C.1., above. Other income tax problems arise in connection with a spouse's payments for interest, principal, and taxes on a home that continues to be jointly owned with the ex-spouse after the divorce.

For a full discussion of these and other income tax issues pertaining to jointly owned property in the context of divorce, see 515 T.M., *Divorce and Separation* (U.S. Income Series).

3. Tax Liens

For a discussion of the manner in which liens for the nonpayment of taxes can attach to jointly owned property or property held as tenants by the entities, see I.C.3., above.

4. Partitions and Related Transactions

The partition of jointly owned property may not constitute a disposition for income tax purposes. In a case involving a tenancy in common (rather than a joint tenancy), the IRS has ruled that if the co-owners of real property divide the property among themselves, the transaction is a non-taxable division of the property, rather than a taxable sale or disposition.[537] The same principle generally applies to the conversion of a joint tenancy into a tenancy in common.[538] The result may be different, however, if the joint tenants divide the property on a non-pro-rata basis. In PLR 9320037, for example, two owners of real property in joint tenancy divided the property between themselves on a non-pro-rata basis, with one joint tenant receiving all of a particular portion of the property, and the other receiving a different portion, plus cash to equalize the division. The IRS treated the transaction as a pure pro-rata division, followed by a sale of a portion of the property from one joint tenant to the other in exchange for cash. Gain was recognized to the extent the cash exceeded the basis in the portion of property deemed sold. The result may also differ in the case of joint owners of multiple properties who agree to divide ownership of the properties between them. For example, the IRS has ruled that an exchange in which one joint owner receives separate ownership of one asset and another joint owner receives separate ownership of another asset is a realization event.[539] On the other hand, if the joint owners are spouses (or former spouses in a transaction incident to a divorce), a partition or other division of property is non-taxable by virtue of §1041.

5. Purchase and Sale of Principal Residence

Section 121 permits taxpayers to exclude from gross income up to $250,000 ($500,000 for married persons filing joint returns who satisfy other requirements) of the gain from a sale or exchange of a principal residence.[540] The exclusion is allowed each time the taxpayer sells or exchanges a principal residence meeting the eligibility requirements,[541] but in general the exclusion is available no more frequently than once every two years.[542]

The §121 rules should apply equally to residences owned separately by taxpayers and to residences owned jointly. The benefits of §121 are available to joint filers, only one of whom must in general satisfy the §121 ownership requirements.[543] Presumably, the same benefits would be available if the residence

[531] Reg. §301.7701-1(a)(2). The regulations further provide that the "mere co-ownership of property that is maintained, kept in repair, and rented or leased does not constitute a separate entity for federal tax purposes." Reg. §301.7701-1(a)(2) (citing, as example, co-owners of farm who lease it to farmer for cash rental or for share of crops; co-owners do not necessarily form partnership). Under the so-called check-the-box regulations, a separate entity with two or more members can elect to be classified as either an association (and thus taxable as a corporation under Reg. §301.7701-2(b)(2)) or as a partnership; if no election is made, the entity is treated as a partnership. Reg. §301.7701-3(a), §301.7701-3(b)(1)(i).

[532] Reg. §1.761-2(b)(2) (describing method of making election, which takes form of statement attached to partnership return).

[533] *See* Reg. §1.704-3(d) (describing "remedial" allocation method for determining book items attributable to contributed property; allocation made by partnership).

[534] The transfer is "incident to the divorce" if the transfer occurs within one year of the date on which the marriage ceases, or if the transfer is related to the cessation of the marriage. §1041(c).

[535] §1041(b)(1). As a general rule, under §102, gross income does not include the value of property received by gift.

[536] §1041(b)(2).

[537] Rev. Rul. 55-77 (six joint tenants sold their property in partition sale in which five of tenants in common repurchased property; only tenant who was not involved in repurchase was treated as having sold interest in property and, hence, was required to recognize gain or loss on transaction).

[538] Rev. Rul. 56-437.

[539] Rev. Rul. 79-44 (holding, nevertheless, that exchange qualified for nonrecognition treatment under §1031).

[540] §121(a).

[541] The principal requirement is that, during the five-year period ending on the date of the sale or exchange, the property must have been owned and used by the taxpayer as his or her principal residence for periods aggregating two years or more. §121(a).

[542] §121(b)(3).

[543] *See* §121(d)(1) (joint filers benefit from exclusion if either spouse satisfies use and ownership rules); §121(b)(2) (special $500,000 exclusion in general available to joint filers if either spouse satisfies ownership requirements and both spouses satisfy use requirements).

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were owned by the spouses jointly or as tenants by the entirety. Section 121 does not expressly address the question of joint ownership by persons who are not married. Under prior law,[544] however, joint owners of a principal residence who were not married qualified for both the one-time exclusion of gain (for taxpayers over age 55) on the sale of a principal residence under former §121[545] and the capital gains deferral provisions of former §2034.[546] Presumably, these same principles should govern for purposes of present §121.

[544] The Taxpayer Relief Act of 1997 (1997 TRA), Pub. L. No. 105-34, repealed former §1034 (permitting the deferral of gain on the sale of a principal residence) and substantially modified former §121 (which permitted a one-time exclusion of gain on the sale of a principal residence for taxpayers age 55 or older). *See* 1997 TRA, Pub. L. No. 105-34, §312(b) (repealing former §1034), §312(a) (amending §121). The present version of §121 is as described in the text.

[545] Rev. Rul. 67-234 (each joint owner is treated separately for purposes of applying former §121 exclusion for taxpayers over same age 55); Rev. Rul. 67-235 (same).

[546] *See, e.g.,* PLR 8741066 (treating owners of cooperate housing partnership as individual co-owners of real property, who were thus eligible for both former §121 and §1034).

For a more detailed discussion of the tax ramifications of the ownership of a principal residence, see 594 T.M., *Tax Implications of Home Ownership* (U.S. Income Series).

6. Involuntary Conversions

The rules of §1033 regarding involuntary conversions of property apply to concurrent property interests.[547] For example, TAM 8750001 involved a tenancy in common interest in real property that was condemned, with the proceeds invested in property as joint tenants with right of survivorship. The IRS advised that the acquisition of the jointly held property constituted a qualified reinvestment (thus permitting non-recognition of gain) for purposes of §1033. For a full discussion of §1033, see 568 T.M., *Involuntary Conversions* (U.S. Income Series).

[547] *See, e.g.,* Rev. Rul. 74-273 (recognizing that each concurrent owner can independently determine whether to make §1033 election not to recognize gain; ruling involved two taxpayers, one with undivided one-half fee simple interest, and other with undivided one-half life estate).

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