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TAXING JOINT TENANCY PROPERTY

— by Neil E. Harl*

Although joint tenancy (and tenancy by the entirety in the few states where that form of co-ownership is recognized) is apparently used less frequently than three or four decades ago, joint ownership is still widely used, particularly for real property co-ownership.¹

A recent decision has focused attention on the issue of income tax basis of joint tenancy (or tenancy by the entirety) property after the death of the first joint tenant to die.²

"Consideration furnished" rule

Before 1977, the consideration furnished rule applied generally to federal estate taxation of joint tenancy and tenancy by the entirety property.³ Since 1976, a "fractional share" rule has been available for property acquired by a husband and wife in joint tenancy or tenancy by the entirety.⁴

Under the consideration furnished rule, joint tenancy property is subject to federal estate tax in the estate of the first to die except to the extent it can be proved that the survivor contributed to its acquisition.⁵ The burden of proving the survivor's contribution is placed on the estate.⁶ In many cases, sufficient records or other evidence of payments made years earlier may be difficult to produce. It should be noted that the death tax burden on the death of the first joint tenant to die is generally no greater than if the property had been owned solely by the decedent, however, and left to the survivor by will or by intestate succession.

The burden was especially heavy for husband-wife joint tenancies and tenancies by the entirety before 1982 when the so-called "fractional share" rule became fully effective in amended form.

"Fractional share" rule

As enacted in 1976, effective in 1977, acquisitions of property by a husband and wife in joint tenancy or tenancy by the entirety were treated as belonging 50 percent to each for federal estate tax purposes *if the joint interest was created by a transfer subject to federal gift tax.*⁷ Several categories of joint ownership acquisitions were not then (and some are not yet) subject to federal gift tax on acquisition —

• Before 1982, the creation of husband-wife joint interests in real estate was not subject to federal gift tax unless so

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reported on a federal gift tax return timely filed.⁸

• Purchase of a United States Government savings bond in joint ownership is not a taxable gift until and unless the one not providing consideration redeems the bond without any obligation to account for the proceeds to the other owner.⁹ This exception was not changed in 1981.

• Transfer of funds into a joint bank account does not produce a taxable gift until and unless the one not providing the funds withdraws amounts for his or her own benefit.¹⁰

Under the 1976 amendment, pre-1977 joint tenancies between husband and wife could be subjected to the fractional share rule by election on a timely filed federal gift tax return filed for any quarter through 1979 if the donor was still living.¹¹ Any gift involved had to be duly reported and federal gift tax, if any, paid. If death occurred within three years of the election, one-half the value of the property would be included in the decedent's gross estate.¹² For acquisitions of property after 1976 in joint tenancy within three years of death where the joint tenancy was a qualified joint interest, one-half was includible under I.R.C. § 2040(b) and the other half was includible under I.R.C. § 2035 as a gift within three years of death if the deceased provided all of the consideration.¹³

For deaths after 1981, the fractional share rule for husband-wife joint tenancies or tenancies by the entirety applies even though the transfer was not subject to federal gift tax.¹⁴ Thus, one-half the value is taxed at the death of the first spouse to die if the husband and wife are the only joint tenants.¹⁵ The one-half includible in the gross estate of the first joint owner to die receives a new income tax basis.¹⁶

The Sixth Circuit Court of Appeals has now held that the consideration furnished rule applies to joint interests created before 1976 where the decedent died after 1981.¹⁷ Thus, the entire value of the property receives a new income tax basis.¹⁸ The court did not find that the 1981 enactment repealed the consideration furnished rule for husbands and wives for the pre-1977 period.

The case presents an opportunity, until reversed or the result is changed by statute, to obtain a new income tax basis for possibly the entire value of the property. If the federal estate tax marital deduction is available, that result comes at little or no federal estate tax cost.

The next issue will be published on December 11, 1992.

FOOTNOTES

- ¹ See generally 5 Harl, Agricultural Law § 43.02[2] (1992). See also Hines, Estate Planning Iowa Joint Tenancies, Monograph No. 7, Agricultural Law Center, University of Iowa (1960).
- ² Gallenstein v. U.S., 91-2 U.S.T.C. ¶ 60,088 (E.D. Ky. 1991), *aff'd*, 92-2 U.S.T.C. ¶ 60,114 (6th Cir. 1992).
- ³ I.R.C. § 2040, before amendment by the Tax Reform Act of 1976.
- ⁴ I.R.C. § 2040(b).
- ⁵ I.R.C. § 2040(a). See Est. of Stimson v. Comm'r, T.C. Memo. 1992-242 (balance in joint bank accounts included in gross estate even though daughters' names on account for convenience in managing their affairs); Est. of Hicks v. Comm'r, T.C. Memo. 1977-215 (father-son stock margin account).
- ⁶ Treas. Reg. § 20.2040-1(a)(2). See Est. of Hatchett v. Comm'r, T.C. Memo. 1989-637 (estate met burden of proof to extent of one-quarter of value that was attributable to surviving spouse's inheritance from parent); Hudson v. U.S., 79-1 U.S.T.C. ¶ 13,292 (W.D. Okla. 1979) (evidence did not show exact amount contributed by survivor).
- ⁷ I.R.C. § 2040(b)(1), as enacted by Pub. L. 94-455, § 2002.
- ⁸ I.R.C. § 2515, before repeal by the Economic Recovery Tax Act of 1981, Pub. L. 97-34, § 403(c)(3)(B). See Treas. Reg. § 25.2515-1(b), -1(c)(1)(i).
- ⁹ Treas. Reg. § 25.2511-1(h)(4). See Rev. Rul. 68-269, 1968-1 C.B. 399.
- ¹⁰ Treas. Reg. § 25.2511-1(h)(4). See Est. of McCammon v. Comm'r, T.C. Memo. 1980-327 (withdrawal not in contemplation of death). See also Ltr. Rul. 8302020, Oct. 5, 1982 (either mother (the contributor) or daughter as joint tenants could withdraw from savings account; gift occurred on withdrawal by daughter).
- ¹¹ I.R.C. § 2040(d), before amendment by the Economic Recovery Tax Act of 1981, Pub. L. 97-34, § 403(c)(i).
- ¹² Rev. Rul. 82-159, 1982-2 C.B. 210 (same rule if joint tenancy terminated and reformed after 1979 and election filed).
- ¹³ Rev. Rul. 82-159, 1982-2 C.B. 210.
- ¹⁴ I.R.C. § 2040(b).
- ¹⁵ *Id.*
- ¹⁶ See I.R.C. § 1014(b).
- ¹⁷ Gallenstein v. U.S., n. 2 *supra*.
- ¹⁸ *Id.*

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

HORSE. The plaintiff was injured when thrown from a horse owned by the defendant. The court upheld a summary judgment for the defendant because the plaintiff had no evidence that the defendant had any knowledge of the horse's propensity to throw its riders. **Berneathy v. Pursley**, 832 S.W.2d 524 (Mo. Ct. App. 1992).

The plaintiff was injured when thrown from a horse owned by the defendant. The plaintiff alleged that the defendant was liable under the Animal Control Act, Ill. Rev. Stat. ch. 8, ¶ 366, which holds animal owners liable for the attacks and injuries caused by the animal. The court held that the Act did not apply to horse riders who voluntarily assume control of the animal which injured them. **Ennen v. White**, 598 N.E.2d 416 (Ill. Ct. App. 1992).

BANKRUPTCY

GENERAL

AVOIDABLE TRANSFERS. Prior to filing for bankruptcy, the debtor was involved in a suit against a manufacturer of cattle feed for damages resulting from defective feed. Prior to 90 days before filing for bankruptcy, the debtor assigned to a creditor a portion of the anticipated damages. The debtor received the damage award within the 90 days before filing for bankruptcy and the creditor received the portion of the award before the bankruptcy case commenced. The court held that the transfer to the creditor was not avoidable as a preferential transfer because the effective date of the transfer was the date the assignment of the damage

award was executed, not the date the award was paid to the creditor. **In re Wagner**, 144 B.R. 430 (Bankr. N.D. Iowa 1992).

DISCHARGE. The debtors had leased dairy cows from the creditor under contract. Over the several years of the contract relationship, the parties kept informal and often inaccurate account of the number of cows under the lease. The creditor terminated the lease and recovered most of the cows and sued for damages for the missing cows. A state court judgment awarded the creditor damages and the debtor filed for bankruptcy. The creditor sought to have the judgment declared nondischargeable under Sections 523(a)(4), (6). The court held that the debt was dischargeable because (1) the lease did not give rise to a fiduciary relationship as required by Section 523(a)(4) and (2) the loss of the cows, while a breach of contract, was more the result of sloppy accounting over the years by both parties than embezzlement or larceny as required by Section 523(a)(6). **In re Hoffman**, 144 B.R. 459 (Bankr. D. N.D. 1992).

ESTATE PROPERTY. The debtor had received a life estate in a farm by testamentary bequest from the debtor's parent. The debtor mortgaged the farm and after defaulting on the secured loan, entered into a settlement with the lender for \$80,000 which was placed in a spendthrift trust for the debtor. A bankruptcy creditor challenged the trust as fraudulent because a settlor cannot be a beneficiary of a spendthrift trust. The debtor argued that the trust was established by either the lender or the court and was valid. The court held that the trust was established by the debtor as part of the default settlement and was included the trust