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FEDERAL TRANSFER TAXES ON PROPERTY OWNED JOINTLY WITH RIGHT OF SURVIVORSHIP

Part 2—Federal Estate Tax

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This is the second part of comments on federal transfer taxes (gift and estate) on property owned jointly with right of survivorship. Part 1 (Federal Gift Tax), published in an earlier issue of this *Review*,[1] includes a brief discussion of some of the principal features of the 1976 reform legislation of federal estate and gift taxes and a review of Missouri law on the property rights of survivorship and severance. The comments in Part 2 discuss the federal estate tax consequences of coownership with right of survivorship with emphasis on changes introduced in the Revenue Acts of 1976 and 1978. The latter part of these comments includes some planning considerations for guidance on whether to own or continue to own property in this form.

I. FEDERAL ESTATE TAX

A. *Gross Estate—General Principles*

Five separate rules may now apply for federal estate tax purposes on the death of a coowner of property survived by one or more coowners having a right (rights) of survivorship in the property. The rules are designed

1. Lowe, *Federal Transfer Taxes on Property Owned Jointly with Right of Survivorship*, 44 MO. L. REV. 371 (1979).

to cover these situations: (1) the coowners acquire property by purchase in whole or in part and one or more of them contribute to the acquisition price of the property; (2) the coowners acquire property entirely by gift from a third person; (3) husband and wife acquire property as coowners and the property becomes a "qualified joint interest"; (4) husband and wife acquire a farm or other business property as coowners and during the decedent's lifetime the surviving spouse materially participated in the business; and (5) coowners (husband and wife or others) acquire property in whole or in part by purchase and a contributing coowner dies within three years of the date of acquisition of the property. The following paragraphs set forth a brief description of each of the rules designed to cover these situations.

1. Acquisition by Purchase in Whole or Part—Proportionate Contribution Test

From its inception in 1916[2] the federal estate tax has included a proportionate contribution test[3] for property acquired by two or more owners with right of survivorship where one or more of the coowners contributed to the acquisition of the property. Under this rule if A, the decedent, contributed 100 percent of the acquisition cost of the property and B, the other coowner, contributed nothing, on A's death before B, the entire value of the property at the time of A's death becomes a part of A's gross estate for federal estate tax purposes.[4] Similarly if A contributed 75 percent of the acquisition cost and B contributed 25 percent, on A's death before B 75 percent of the value of the property at the time of A's death becomes a part of A's gross estate.[5] If A made no contribution and B contributed 100 percent of the acquisition cost of the property, on A's death before B no part of the value of the property at the time of A's death is included in A's gross estate.[6] The proportionate contribution test does not apply on the death of the surviving coowner. If the survivor, B, is the sole owner of the property on B's death, the entire value of the property is included in the gross estate of B, the survivor, whether B contributed all, a part, or nothing to the acquisition cost of the property.[7]

Originally, the contribution of the survivor, B, included only property which originally belonged to B and never belonged to A, the decedent.[8]

2. Revenue Act of 1916, ch. 463, 39 Stat. 777.
3. I.R.C. § 2040(a).
4. Treas. Reg. § 20.2040-1(c)(1) (1972).
5. *Id.* § 20.2040-1(c)(2).
6. *Id.* § 20.2040-1(c)(3).
7. I.R.C. §§ 2031, 2033.
8. *See* Revenue Act of 1916, ch. 463, § 202(c), 39 Stat. 778 (now I.R.C. § 2040(a)).

An early amendment permitted B to count as a contribution property acquired from A for "a fair consideration in money or money's worth,"[9] and a later amendment changed the statute to its present form to permit B to count as B's contribution property acquired from A for "an adequate and full consideration."[10]

Since 1916 the proportionate contribution test has been and now is[11] the primary test for the federal estate tax on the death of a coowner who is survived by one or more coowners having a right or rights of survivorship.

2. Acquisition by Gift—Fractional Interest Test

Where two or more coowners acquire property "by gift, bequest, devise or inheritance" from another individual a fractional interest test applies when one coowner dies survived by one or more coowners with a right (rights) of survivorship.[12] The acquisition by gift may be lifetime or deathtime. Thus if A and B acquire property by deed or by will[13] from C, either as joint tenants or as tenants by the entirety, on A's death before B one-half the value of the property at A's death is included in A's gross estate.[14] And if A, B, and C acquire the property as joint tenants by deed or by will from D, on A's death before that of B or C one-third of the value of the property at A's death is included in A's gross estate.[15] If the survivor owns the property at death, the entire value of the property is included in the gross estate of the survivor.[16]

3. Qualified Joint Interest—Husband and Wife—Fractional Interest Test

In the Tax Reform Act of 1976[17] Congress enacted the first major change in the estate taxation of coownership property with right of survivorship since 1916. It extended the fractional interest rule to "qualified joint interests."[18] The committee reports give two reasons for the amend-

9. Revenue Act of 1918, ch. 18, § 402(e), 40 Stat. 1097 (1919).
10. Revenue Act of 1926, ch. 27, § 302(e), 44 Stat. 71 (now I.R.C. § 2040).
11. I.R.C. § 2040(a).
12. *Id.*
13. Treas. Reg. § 20.2040-1(a)(1), -1(c)(7) (1972).
14. *Id.*
15. *Id.* § 20.2040-1(c)(8).
16. I.R.C. §§ 2031, 2033.
17. Pub. L. No. 94-455, 90 Stat. 1520. *See also* Maxfield, *Some Reflections on the Gift and Estate Taxation of Jointly Held Property*, 34 TAX LAW. 47, 71-83 (1981).
18. I.R.C. § 2040(b).

ment: to lessen the impact of gift and estate taxes on the same property, and to avoid the difficulties involved in applying the proportionate contribution test.[19]

A qualified joint interest may be either a real or personal property interest, and is "qualified" only if the following conditions are satisfied: (1) the coowners are limited to husband and wife; (2) the interest was created by either or both of them; (3) for personal property the creation of the interest was a completed gift in whole or in part for federal gift tax purposes; and (4) for real property the creation of the interest was a completed gift in whole or in part for federal gift tax purposes and the donor spouse made a timely federal gift tax election.[20]

A qualified joint interest may be either a joint tenancy[21] or a tenancy by the entirety,[22] and for either form of ownership on the death of one spouse survived by the other the gross estate of the decedent spouse shall include one-half the value of the property.[23] The fractional interest rule will not apply on the death of the survivor spouse. If the survivor owns the property at death, the entire value of the property is included in the gross estate of the survivor.[24]

4. Farm or Business Property—Husband and Wife—Material Participation Valuation

In the Revenue Act of 1978[25] Congress added a second major change in the estate taxation of joint ownership property. The estate of a decedent may now receive estate tax relief (reduction in the amount reflected on the estate tax return) for an amount attributable to services rendered by a surviving spouse with respect to a farm or other business where the business property, real property, or tangible personal property is held in the coownership form with right of survivorship.[26] The amount of the relief available to the estate of the decedent shall not exceed the lesser of $500,000 or one-half the value of the property.[27] The method to be used in computing the amount of the reduction is set forth at a later point in these comments,[28] and is referred to in these comments as "material participation valuation."

19. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 19, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3356, 3373.
20. I.R.C. § 2040(b)(2).
21. *Id.*
22. *Id.*
23. *Id.* § 2040(b)(1).
24. *Id.* §§ 2031, 2033.
25. Pub. L. No. 95-600, § 511(a), 92 Stat. 2881 (now I.R.C. § 2040(c)).
26. I.R.C. § 2040(c).
27. *Id.* § 2040(c)(2).
28. *See* notes 146-59 and accompanying text *infra*.

Material participation valuation is elective within the time permitted for filing the federal estate tax return.[29] Property is eligible for this elective valuation method if the following conditions are satisfied: (1) the coowners are husband and wife; (2) husband and wife, or either of them, created the property interest; (3) the property is either real property or tangible personal property; (4) the property is used in a farm or other business; and (5) the surviving spouse participated materially in the farm or other business.[30]

Originally the new method was available for property where there was no "spread" between the estate tax value and the amount of the separate contributions of the spouses adjusted by a six percent simple interest factor.[31] A 1979 amendment[32] limits the new method to situations involving a "spread" between the estate tax value and the adjusted contributions of the spouses.

An estate will not ordinarily elect material participation valuation if the property is a qualified joint interest. The reduction in the gross estate of the decedent under material participation valuation cannot exceed the lesser of $500,000 or 50 percent of the value of the property[33] and in most instances[34] will be substantially less than one-half of the value of the property. For a qualified joint interest the fractional interest rule limits the amount to be included in the estate of the decedent spouse to 50 percent of the value of the property, which may exceed $500,000. Material participation valuation will not apply on the death of the survivor spouse. If the survivor spouse owns the property at death, the entire value of the property is included in the gross estate of the survivor.[35]

5. Three-Year Rule Valuation

In the Tax Reform Act of 1976[36] Congress repealed the contemplation of death rule[37] and replaced it with a rule that includes in the gross estate of a decedent transfers made by the decedent within three years of death.[38]

29. I.R.C. § 2040(c)(9).
30. *Id.* § 2040(c)(3)-(5).
31. *Id.* § 2040(c)(2).
32. Technical Corrections Act of 1979, Pub. L. No. 96-222, § 105(a)(3), 94 Stat. 218 (codified at I.R.C. § 2040(c)(2)(c)).
33. I.R.C. § 2040(c)(2).
34. See notes 146-59 and accompanying text *infra* for discussion of material participation valuation.
35. I.R.C. §§ 2031, 2033.
36. Pub. L. No. 94-455, 90 Stat. 1520 (codified in scattered sections of I.R.C.).
37. *Id.* § 2001(a)(5), 90 Stat. 1848 (now I.R.C. § 2035).
38. I.R.C. § 2035.

If an individual, A, within three years of death acquires property by purchase and takes title in the names of A and B as joint tenants or as tenants by the entirety it is likely the Internal Revenue Service and the courts will apply the three-year rule to the transfer by A.[39]

If A and B are not husband and wife, the application of the three-year rule may yield the same result as the proportionate contribution test. But if A and B are married and the property would otherwise be a qualified joint interest subject to the fractional interest rule, the application of the three-year rule may override the application of the fractional interest rule.[40] Three-year rule valuation may also conflict with material participation valuation where a decedent spouse acquires or makes payments on farm or business property within three years of death. By analogy to cases involving life insurance contracts,[41] material participation valuation should apply to spousal services rendered within three years of the death of a decedent's spouse if property was acquired more than three years before death.[42] But in view of the extensive litigation with respect to life insurance policies transferred or acquired within three years of death,[43] one may anticipate that the Internal Revenue Service will at some time assert the priority of the three-year rule over the material participation rule for property acquired within three years of the death of the contributing spouse.[44]

B. *Marital Deduction*

The limit on the amount of the federal estate tax marital deduction is now the greater of $250,000 or 50 percent of the adjusted gross estate.[45] Property held by a decedent with a spouse in the coownership form with right of survivorship qualifies for the marital deduction but only to the extent that the value of the property is included in the decedent's gross estate.[46] Thus under each of the five rules described above, where the coowners are husband and wife, the federal estate tax marital deduction will be available for the value of the property included in the gross estate of

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39. *See* authorities cited note 41 *infra.*
40. *See* authorities cited note 41 *infra.*
41. *See In Re* Estate of Silverman, 521 F.2d 574 (2d Cir. 1975); Berman v. United States, 487 F.2d 70 (5th Cir. 1973); Bel v. United States, 452 F.2d 683 (5th Cir. 1971); Detroit Bank & Trust Co. v. United States, 467 F.2d 964 (6th Cir. 1972); First Nat'l Bank v. United States, 488 F.2d 575 (9th Cir. 1973). *See also* Rev. Rul. 71-497, 1971-2 C.B. 329, which revoked Rev. Rul. 67-463, 1967-2 C.B. 327.
42. *See* authorities cited note 41 *supra.*
43. *See* authorities cited note 41 *supra.*
44. *See* authorities cited note 41 *supra.*
45. I.R.C. § 2056(c)(1)(A).
46. *Id.* § 2056(a), (d)(5).

the decedent spouse, subject to the overall limitation of the greater of $250,000 or 50 percent of the adjusted gross estate. For an estate in excess of $500,000 the marital deduction is limited to one-half the value of any additional items passing to the surviving spouse. Survivorship property in such an estate may not escape the federal estate tax entirely (*i.e.*, one-half the value of the property is taxed at marginal rates for the estate), and the opportunity to minimize the amount of the tax through the valuation procedures is important. The use of the new procedures must also take account of federal gift tax consequences, if any, attaching to the creation of the coownership interest.[47]

C. *Coordination—Federal Gift Tax*

The federal gift tax consequences of the creation and termination of coownership property interests with right of survivorship are set out in Part 1 of these comments.[48] A transfer for federal gift tax purposes may occur on the creation, termination, or qualification of such an interest, and in assessing the gift tax impact of a transfer one must consider the availability of the annual exclusion,[49] the gift tax marital deduction,[50] the split gift privilege for married persons,[51] the specific exemption for transfers made before 1977,[52] and the unified transfer tax credit for transfers made after 1976.[53] A transfer reduced by these available allowances may involve the payment of a federal gift tax, and under the estate tax rules the property may also be subject to the federal estate tax on the death of one of the coowners.

For transfers by gift before 1977 coordination between gift and estate taxes was necessary when the same transfer was subject to both taxes. For example, when one coowner before 1977 paid all or a disproportionate part of the acquisition cost of property and the property passed at death to the other coowner by right of survivorship, it was possible for both taxes to apply to the same property—a gift tax on acquisition[54] and an estate tax at death.[55] In this situation the executor on the estate tax return could claim a credit against the estate tax for the gift tax, if any, previously paid.[56]

47. *See* Lowe, *supra* note 1, at 375-76.
48. *Id.* at 386-405.
49. *Id.* at 393. *See also* I.R.C. § 2503(b).
50. *See* I.R.C. § 2523(a); Lowe, *supra* note 1, at 375-76.
51. I.R.C. § 2513.
52. Treas. Reg. § 25.2521-1(a) (1972).
53. *See* I.R.C. §§ 2010, 2505; Lowe, *supra* note 1, at 373 n.18, 374 n.24.
54. *See* Lowe, *supra* note 1, at 386-401.
55. I.R.C. § 2040(a). *See* text accompanying notes 2-11 *supra.*
56. I.R.C. § 2012.

After 1976 a transfer by gift may occur on the acquisition of property in the coownership form with right of survivorship,[57] the termination of the right of survivorship,[58] or in the qualification of joint interests held in the names of husband and wife.[59] If not offset by the allowable exclusion, deductions, or credit, a transfer may involve the payment of federal gift tax. Any gift tax payable with respect to gifts made after 1976 is an offset on the estate tax return of the decedent donor.[60]

II. Problems of Interpretation

The comments to follow address several recurring factual patterns. For property acquired by gift or by purchase the discussion treats separately the problems for coowners who are husband and wife (H and W) from those who are not husband and wife (A and B). Other common problems include the effect of agreements between the coowners for compensation for services and otherwise, the application of the three-year rule to the creation and termination of coownership interests with right of survivorship, and problems involving simultaneous death and murder.

A. *Acquisition by Gift from Third Person*

If the coowners are not married the estate tax rules which apply on the death of one coowner are the same for real and personal property. Either the fractional interest[61] or the proportionate contribution[62] rules will apply on the death of the first coowner.

The fractional interest rule will apply where A and B, who are not married, acquire property by lifetime or deathtime gift from a third person as coowners with right of survivorship.[63] On the death of A, survived by B, one-half the value of the property at A's death must be reflected on the federal estate tax return of A.[64] The entire value of the property will be subject to the federal estate tax on B's death if B continues to hold the property until the time of his or her death.[65]

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57. *See* Lowe, *supra* note 1, at 386-405.
58. *Id.* at 401.
59. *Id.* at 393-401.
60. I.R.C. § 2001(b)(2).
61. *See* text accompanying note 12 *supra*.
62. *See* text accompanying notes 2-11 *supra*.
63. *See* I.R.C. § 2040(a); Treas. Reg. § 20.2040-1(a)(1), -1(c)(7) (1972).
64. *See* Treas. Reg. § 20.2040-1(a)(1), -1(c)(7) (1972).
65. I.R.C. §§ 2031, 2033.

The fractional interest rule applies if A and B are "joint tenants," and that relationship is to be determined by state law.[66] In Missouri each joint tenant has a right of severance or partition[67] and a right of survivorship.[68]

If the donor by gift to A and B does not establish or create a joint tenancy, the federal estate tax consequences to A and B will depend on the nature of their interests under Missouri law.[69] If the effect of the gift is to make A and B tenants in common, the fractional interest rule will apply on the death of either A or B, both of whom will have a transmissible interest in the property with no right of survivorship.[70]

Instead of a joint tenancy or tenancy in common the effect of the gift may be to create a joint life estate in A and B while both are living with a contingent remainder to the whole of the property in the survivor of them.[71] For such an interest A and B would have equal rights to the income, use, or possession of the property while both are living,[72] neither of them would have a right of partition or severance,[73] but each would have a contingent right to survive to the entire interest.[74] For federal estate tax purposes the fractional interest rule may not apply on the death of the first life tenant, and no part of the value of the gift property would be reflected in the federal estate tax return of the decedent under the interpretation that a life tenant with a contingent remainder is not the owner of the property for federal estate tax purposes.[75]

If a donor by inter vivos gift or will establishes a trust with income payable equally to A and B during their joint lives, with the trust to terminate on the death of the first income beneficiary and the corpus to pass to the survivor, the donor has created a "right of survivorship" to the whole of the trust fund in the form of a contingent remainder. This arrangement is not, however, a joint tenancy under Missouri law.[76] By construction the same result is possible where a donor devises Blackacre to A and B as joint tenants with right of survivorship. In *Hunter v. Hunter*,[77] the Missouri Supreme Court held that such a devise created a joint life estate with a con-

66. *See* Lowe, *supra* note 1, at 378-86.
67. *See id.* at 384.
68. *See id.* at 378-82.
69. *Id.*
70. I.R.C. § 2033.
71. *See* Hunter v. Hunter, 320 S.W.2d 529 (Mo. 1959).
72. *Id.*
73. *Id.*
74. *Id.*
75. *See* Commissioner v. Rosser, 64 F.2d 631 (3d Cir. 1933); Davis v. United States, 27 F. Supp. 698 (S.D.N.Y. 1939); Estate of Williams v. Commissioner, 62 T.C. 400 (1974).
76. *See* Hunter v. Hunter, 320 S.W.2d 529 (Mo. 1959).
77. *Id.*

tingent remainder to the survivor. The result in *Hunter v. Hunter* has been criticized,[78] and in a later opinion the Missouri Supreme Court refused to apply the holding to a deed to A and B as "joint tenants and not as tenants in common with right of survivorship" and held that the deed created a joint tenancy.[79] But in *Johnson v. Woodard*,[80] a residuary devise to A, B, and C "to share equally, or to the survivor of them" was held to create a joint estate for life with a contingent remainder in fee to the survivor.

Thus a donor willing to forgo the right of severance or partition in the donees may establish equal rights to income or possession in A and B while both are living and confer on each a right to survive to the whole of the property. And this transfer may avoid the imposition of the federal estate tax on the death of the first life tenant.[81] Even though the courts in the future may not follow the construction adopted by the court in *Hunter v. Hunter*,[82] it appears that a donor in Missouri by a choice of appropriate language may make A and B equal tenants for life with contingent remainders to the whole of the property and that this interest may be legal or equitable.

The fractional interest rule applies where H and W acquire property by lifetime or deathtime gift as coowners with right of survivorship.[83] On the death of H survived by W one-half the value of the property at H's death must be reflected on the federal estate tax return for H.[84] The entire value of the property will be subject to the federal estate tax on W's death if she continues to hold the property until the time of her death.[85]

The possibility under Missouri law of creating in two coowners a joint life estate with a contingent remainder to the whole of the property in the survivor of them exists where the coowners are husband and wife. Although it is unlikely that a court would construe a gift to "H and W" as creating a joint life estate with a contingent remainder to the whole of the property in the survivor,[86] it appears that a donor by the use of a trust or by appropriate language clearly expressed in a deed may create the same interests for H and W as may be created for A and B, who are unmarried.[87]

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78. *See* Eckhardt, *Property Law in Missouri*, 24 MO. L. REV. 456, 458 (1959).
79. McClendon v. Johnson, 337 S.W.2d 77, 82 (Mo. 1960).
80. 356 S.W.2d 526, 531 (Mo. App., St. L. 1962).
81. *See* cases cited note 75 *supra*.
82. 320 S.W.2d 529 (Mo. 1959).
83. *See* I.R.C. § 2040(a); Treas. Reg. § 20.2040-1(a)(1), -1(c)(7) (1972).
84. *See* Treas. Reg. § 20.2040-1(a)(1), -1(c)(7) (1972).
85. I.R.C. §§ 2031, 2033.
86. *See* Lowe, *supra* note 1, at 379 n.62.
87. *See* Hunter v. Hunter, 320 S.W.2d 529 (Mo. 1959).

B. *Acquisition by Purchase—Coowners Are Not Husband and Wife*

If A and B acquire property as joint tenants by purchase and one or both of them contributes to the acquisition price of the property, on the death of A survived by B the proportionate contribution rule[88] will apply for federal estate tax purposes in the estate of A. If A contributed the entire acquisition cost of the property, the entire value of the property at A's death will be subject to the federal estate tax. And if A contributed nothing to the acquisition cost of the property, no part of the property will be subject to the federal estate tax in the estate of A. The proportionate contribution test has no application to the estate of the surviving joint tenant B.[89] Rules for determining the respective contributions of A and B are found in the federal estate tax statute, regulations and rulings of the Internal Revenue Service, and court decisions. The comments to follow discuss these rules and some common problems involved in their application.

1. Gift Property—Appreciation in Value After the Gift

If A dies before B and both have contributed to the acquisition of property held by them as coowners with right of survivorship, B is entitled to contribution credit if he can establish that his contribution "originally belonged" to B and was never "received or acquired" from A "for less than an adequate and full consideration in money or money's worth."[90] A may give property to B, and thereafter when the gift property has appreciated in value the original property may be converted into property held by A and B as coowners with right of survivorship at the death of A. In this situation is B entitled to contribution credit for appreciation in value of the original property that occurs after the gift? The estate tax regulations answer that question in the negative; they deny any contribution credit for a gift from A even though the gift 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."[91] The courts have not always accepted this interpretation, particularly where B can establish that the post-gift appreciation has been severed or realized in a transaction that yielded income to B. Many courts have given B contribution credit for an "income" contribution derived from property originally given by A to B.

The recent decision of the Tax Court in *Estate of Goldsborough v. Commissioner*[92] illustrates the prevailing view which is contrary to that ex-

88. I.R.C. § 2040(a). *See also* authorities cited notes 2-11 *supra*.
89. I.R.C. §§ 2031, 2033.
90. *Id.* § 2040(a).
91. Treas. Reg. § 20.2040-1(c)(4) (1972).
92. 70 T.C. 1077 (1978).

pressed in the regulation. A gave real property to B and C, her daughters, when the real property had value of $25,000. Three years later B and C sold the property for $32,500 and each daughter reinvested her share of the proceeds in new property owned as joint tenants with A. The new property had an estate tax value at A's death of $160,000. Under the regulation the entire acquisition cost of the property was attributable to A and A's proportionate contribution was 100 percent. The court, however, held that the appreciation of the gift property after the gift ($7,500) should be attributed to B and C.[93] Accordingly the proportionate contribution of A was approximately 77 percent ($25,000 divided by $32,500) and the proportionate contribution of B and C was approximately 23 percent ($7,500 divided by $32,500).

A Missouri federal district court has expressed an opinion[94] similar to that expressed by the Tax Court in *Goldsborough*. A gave shares to B, who later sold them and reinvested the proceeds in other property owned jointly with right of survivorship with A. On A's death the court held that A's contribution included the value of the original gift stock at the time of the gift, and indicated that any appreciation in the value of the gift stock after the date of the gift was B's contribution.[95] There should be no difference in result if B as an intermediate step to the investment of the proceeds of a sale of the gift property places the proceeds in a joint bank account maintained with A.

A recent ruling[96] indicates the Internal Revenue Service may be revising its attitude on the question. The ruling involves a gift of cash ($10) from A to B, who invested the cash in property which appreciated in value while owned by B. Later B sold the property and placed the sale proceeds ($100) in a joint account with A. On the death of A before B the Service ruled that the amount to be reflected in A's estate for federal estate tax purposes was $10, the amount of the original cash gift of A to B; the post-gift appreciation ($90) was B's contribution. The ruling involves an initial transfer of cash, not investment property, but it does support the "income" test in attributing to B post-gift income or gain realized and apparently recognized by B.

If the gift property from A to B is not converted into other property in an "income" transaction, B does not receive contribution credit if the original property is transferred into the names of A and B as coowners with right of survivorship, even though at the later transfer the original property has a value higher than at the date of the gift. Thus in a decision affirmed by the Supreme Court of the United States[97] the full value of co-ownership property was subject to the federal estate tax in the estate of A

93. *Id.* at 1084.

94. First Nat'l Bank v. United States, 223 F. Supp. 963 (W.D. Mo. 1963).

95. *Id.* at 966.

96. Rev. Rul. 79-372, 1979-2 C.B. 330.

97. Dimock v. Corwin, 19 F. Supp. 56 (E.D.N.Y. 1937), *aff'd*, 99 F.2d 799 (2d Cir. 1938), *aff'd sub nom.* United States v. Jacobs, 306 U.S. 363 (1939).

where A originally gave the property to B who later transferred the property into the joint ownership of A and B. A similar result should be expected if B exchanges the original gift property for other property to be transferred to the names of A and B as coowners with right of survivorship.[98] The exchange transaction will not ordinarily be an "income" transaction to B.

The "income analysis" apparently does not apply where the original transaction is a transfer of property to A and B as coowners with right of survivorship and A pays the entire acquisition cost of the property. A has made a gift to B for federal gift tax purposes, but B has made no contribution for federal estate tax purposes.[99] If later the original property is exchanged for other property held by A and B as coowners with right of survivorship at the time of A's death, B has made no contribution for federal estate tax purposes even though the original property appreciated in value from the date of the original acquisition to the date of the exchange.[100] The exchange transaction will not ordinarily be an "income" event for B.[101] If the original coownership property is sold by A and B and the proceeds reinvested in other coownership property in the names of A and B, B can argue for a separate contribution to the new property to the extent of B's share of any post-gift gain or income realized on the sale of the original property. However, the federal district court in *Endicott Trust Co. v. United States*[102] did not reach this conclusion. In that case A, from his separate funds, acquired shares of stock in the names of A and B. Later A and B sold the shares at a gain, deposited the sales proceeds in a joint bank account in the names of A and B, and then invested the sales proceeds in other shares owned at A's death by A and B as coowners with right of survivorship. The federal district court denied any contribution credit to B for her share of the gain from the sale of the original shares and held that the entire value of the shares owned at A's death was attributable to A's contribution.[103] In the court's view the important distinction from other cases was that A and B had always retained the original investment in the coownership form with right of survivorship—first in the original shares, next in a joint bank account, and finally in the shares owned at A's death. B was not entitled to contribution credit unless her share of the gain from the sale of the original shares belonged to her outright, with "no strings attached."

98. *See* Estate of Kelley v. Commissioner, 22 B.T.A. 421 (1931).

99. *See* Treas. Reg. § 20.2040-1(c)(1) (1972); Lowe, *supra* note 1, at 386-401.

100. *See* Endicott Trust Co. v. United States, 305 F. Supp. 943 (N.D.N.Y. 1969); First Nat'l Bank v. United States, 223 F. Supp. 963 (W.D. Mo. 1963). *See also* Estate of Peters v. Commissioner, 386 F.2d 404 (4th Cir. 1967); Tuck v. United States, 282 F.2d 405 (9th Cir. 1960); Treas. Reg. § 20.2040-1(c)(4) (1972); Rev. Rul. 79-372, 1979-2 C.B. 330.

101. I.R.C. § 1031(a). *See also id.* §§ 354, 356.

102. 305 F. Supp. 943 (N.D.N.Y. 1969).

103. *Id.* at 945.

The *Endicott* result is questionable. If, as was likely the case, B could withdraw her share of the sales proceeds from the joint bank account, then B may be viewed realistically as having made a separate contribution for federal estate tax purposes to the acquisition of the new shares. A different result from *Goldsborough* should not depend on the maintenance of separate bank accounts by A and B for deposit of the sales proceeds from the sale of the original shares.

The post-gift income analysis appears to be the prevailing view of the courts for a gift from A to B which is later converted by B into other property held by A and B as coowners with right of survivorship on the death of A. This analysis accords a capital gain realized by B the same status for contribution purposes as that accorded ordinary income receipts discussed below. The application of the post-gift income approach involves an allocation of the total taxable gain on the sale of the original gift property between appreciation occurring before and after the date of the original gift. Only B's share of the post-gift gain should count as a contribution.

2. Gift Property—Post-Gift Ordinary Income

The estate tax regulations acknowledge that if A gives income producing property to B and B contributes post-gift ordinary income from the property to the acquisition of property in the names of A and B as coowners with right of survivorship, the income contributed by B is B's contribution for purposes of the proportionate contribution rule.[104]

A may give income producing property to B, who contributes the income to the acquisition of property owned at A's death by A and B as coowners with right of survivorship. As an intermediate step B may deposit the income in a separate account or in a joint account in the names of A and B. Also A, from his separate funds, may acquire income producing property in the names of A and B as coowners with the right of survivorship, and B may contribute his share of the income from that property to the acquisition of additional property owned at A's death by A and B as coowners with right of survivorship.

In *Estate of Howard v. Commissioner*,[105] A transferred income producing property to B, who deposited the income therefrom in a joint account maintained by A and B and later contributed the income to the acquisition of property held in the joint names of A and B at the time of A's death. Recognizing the difficulty in tracing B's contribution to funds withdrawn from the joint account, the court nevertheless held that B should receive contribution credit for the income so used. Apparently if B had deposited the income in a separate account of B prior to investing it in the

104. Treas. Reg. § 20.2040-1(c)(5) (1972).
105. 9 T.C. 1192 (1947).

joint property, there would be no question concerning its status for purposes of contribution credit.

Where A from his separate funds acquires income producing property in the joint names of A and B and ordinary income from this property is deposited in the joint account of A and B and thereafter invested in additional property held by A and B as coowners with right of survivorship at A's death, the *Endicott* argument noted above[106] may be made to deny any contribution credit to B.

The income test[107] simplifies the analysis of cases involving the receipt of tax-free corporate distributions—stock dividends and splits, securities received in tax-free reorganizations, and other tax-free distributions. The Court of Appeals for the Seventh Circuit in effect applied that test in *English v. United States*,[108] and denied contribution credit to B for stock dividends received on gift property acquired from A and later transferred to the names of A and B as coowners with right of survivorship. The Ninth Circuit reached the same result in *Tuck v. United States*,[109] where B, the donee of shares from A, received additional corporate shares as the result of a six for one stock split distributed in the form of a stock dividend, and later transferred the shares to the names of A and B as coowners with right of survivorship. Opinions in both cases suggest the possibility that B might establish a separate contribution to the extent that the dividend shares represented corporate income accumulated after the date of the original gift from A to B. The income test avoids this additional complication; if the corporate distribution is not income to B, then B will receive no contribution credit regardless of the size of the distribution or the source by date of any corporate earnings that may be capitalized as a part of the transaction.

Apparently the Internal Revenue Service has for the present accepted the "income analysis." In Revenue Ruling 80-142,[110] it refused contribution credit to B for common stock dividends (not subject to federal income tax or distribution) distributed to A and B as joint tenants, and stated that "the period to which capitalized profits are attributable should not be controlling." In the same ruling B received contribution credit for his share of an elective common stock dividend taken in lieu of a cash dividend, the elective stock dividend being subject to federal income tax at the time of distribution. The ruling states without comment that "income tax considerations are relevant to the determination of includability for estate tax purposes in this case."[111]

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106. *See* text accompanying note 102 *supra*.
107. *See* text accompanying notes 97-103 *supra*.
108. 270 F.2d 876 (7th Cir. 1959).
109. 282 F.2d 405 (9th Cir. 1960).
110. 1980-22 I.R.B. 11.
111. *Id.*

C. *Acquisition by Purchase—Coowners Are Husband and Wife*

In the discussion to follow examples are used to illustrate the estate tax rules where the coowners are husband and wife.

1. Personal Property

Example 1. At the time of H's death in 1980 H and W own P, an item of personal property, as coowners with right of survivorship. H made the sole contribution to the acquisition cost of P and P has an estate tax value in H's estate of $10,000. W survives H.

If P is a bank account, certificate of deposit, or United States Savings Bond, the proportionate contribution rule will apply, and $10,000 will be reflected as the value of the item on H's federal estate tax return, and the entire $10,000 will qualify for the federal estate tax marital deduction[112] subject to the maximum limitation.[113] Since the creation of the interest did not constitute a gift from H to W, in whole or in part,[114] P cannot be a qualified joint interest[115] whether created or acquired before 1977 or after 1976.

If P is corporate stocks or bonds, or United States Government securities (other than savings bonds), the date of acquisition becomes important. If H and W acquired P before 1977, P is not a qualified joint interest unless H and W elected after 1976 to make it a qualified joint interest.[116] If there was no election, the proportionate contribution rule[117] will apply and $10,000 will be reflected on H's federal estate tax return, and the entire amount will qualify for the estate tax marital deduction[118] subject to the maximum limitation.[119] If H and W acquired P after 1976, P is a qualified joint interest,[120] and $5,000[121] will be reflected as the value of the item on

112. *See* text accompanying notes 45-47 *supra*.
113. I.R.C. § 2056(c)(1)(A).
114. *See* Lowe, *supra* note 1, at 394, 396.
115. I.R.C. § 2040(b)(2).
116. *See* Lowe, *supra* note 1, at 392-97.
117. *See* text accompanying notes 2-11 *supra*.
118. *See* text accompanying notes 45-47 *supra*.
119. I.R.C. § 2056(c)(1)(A).
120. *See* Revenue Act of 1978, Pub. L. No. 95-600, § 702(k)(1)(D), 92 Stat. 2932 (codified at I.R.C. § 2515); I.R.C. § 2040(b)(2).
121. *See* I.R.C. § 2040(b)(1).

H's federal estate tax return, and only $5,000 will qualify for the estate tax marital deduction[122] subject to the maximum limitation.[123] In this case P is a qualified joint interest even if H does not file a federal gift tax return for the period when P was acquired.[124] If H and W acquired P within three years of H's death, the Internal Revenue Service may seek to thwart the application of the fractional interest rule by insisting on valuation under the three-year rule.[125] If W continues to own P at the time of her later death, the entire value of P at her death is subject to the federal estate tax in her estate[126] regardless of the amount reflected on H's federal estate tax return.

If P is tangible personal property, the comments in the preceding paragraph apply to P, and the date of acquisition is important. In addition, "material participation valuation" will be available if P is used for farming purposes or in a trade or business.[127] An illustration of material participation valuation is set out below.[128]

The example assumes that H made the entire contribution to the acquisition cost of P. W would be entitled to establish her separate contribution under the rules and principles discussed above.[129] In the example if H paid any federal gift tax attributable to the acquisition of P, the gift tax payment will be coordinated in the manner discussed above.[130]

2. Real Property

Example 2. H and W acquire Blackacre for $50,000. Blackacre has an estate tax value in H's estate of $100,000. Blackacre is not farm property or property used in a trade or business. W survives H.

Since Blackacre is not farm or other business property H's estate will use either the proportionate contribution,[131] or if Blackacre is a qualified

122. *Id.* § 2056(a), (d)(5).
123. *Id.* § 2056(c)(1)(A).
124. *See* Revenue Act of 1978, Pub. L. No. 95-600, § 702(k)(1)(D), 92 Stat. 2932 (codified at I.R.C. § 2515); I.R.C. § 2040(b)(2).
125. *See* text accompanying notes 36-44 *supra.*
126. I.R.C. §§ 2031, 2033.
127. *See* text accompanying notes 25-35 *supra.*
128. For illustrations of material participation valuation, see text accompanying notes 145 & 159 *infra.*
129. *See* text accompanying notes 88-111 *supra.*
130. *See* text accompanying notes 48-60 *supra.*
131. *See* text accompanying notes 2-11 *supra.*

joint interest, the fractional interest rule.[132] Under the contribution rule valuation will depend on the proportionate contributions of H and W to the acquisition cost of Blackacre and the interpretations of the contribution rule mentioned before will apply.[133] Under the fractional interest rule H's estate will include $50,000[134] and that amount will qualify for the federal estate tax marital deduction[135] subject to the maximum limitation.[136] If W continues to own Blackacre at her later death, the entire value of Blackacre at her death will be subject to the federal estate tax in her estate.[137]

Blackacre is not a qualified joint interest if acquired before 1977 unless a timely election to qualify the property is made after 1976.[138] If H and W acquire Blackacre after 1976, Blackacre is not a qualified joint interest unless a timely election to qualify the property is made.[139] Any gift tax payment attributable to the acquisition of Blackacre is taken into account in the manner mentioned above.[140]

> **Example 3. H and W acquire Blackacre, farm or business property, as coowners with right of survivorship in 1960 for $50,000 to be paid by an initial payment of 30% ($15,000) and the balance to be paid by monthly payments over a period of 20 years. H from his separate funds makes an initial contribution of $10,000 and W from her separate funds (not derived from H) makes an initial contribution of $5,000; subsequent payments come from business or farm income. W participates materially in the business each year from the date of acquisition until H's death in 1980. Blackacre has a value of $300,000 for federal estate tax purposes at H's death. W survives H.**

Since Blackacre is farm or business property for federal estate tax purposes the estate may value Blackacre under any of three methods: (1) the contribution rule;[141] (2) the fractional interest rule if Blackacre is a qualified joint interest;[142] and (3) material participation valuation.[143]

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132. *See* text accompanying notes 17-24 *supra.*
133. *See* text accompanying notes 88-111 *supra. See also* Rev. Rul. 79-302, 1979-2 C.B. 328.
134. *See* I.R.C. § 2040(b)(1).
135. *Id.* § 2056(a), (d)(5).
136. *Id.* § 2056(c)(1)(A).
137. *Id.* §§ 2031, 2033.
138. *Id.* § 2040(c), (d)(2).
139. *Id.* § 2040(b)(2).
140. *See* text accompanying notes 48-60 *supra.*
141. *See* text accompanying notes 2-11 *supra.*
142. *See* text accompanying notes 17-24 *supra.*
143. *See* text accompanying notes 25-35 *supra.*

Blackacre will not be a qualified joint interest unless there was a timely election to qualify the property made after 1976.[144] If, as will likely be the case, Blackacre is not a qualified joint interest, the choices are between the contribution and the material participation valuation rules. As indicated below, there are cases which give substantial contribution credit to W for her participation in a business,[145] but there is no assurance the courts will follow these decisions in the future or that the Internal Revenue Service will accept them without litigation. Thus material participation valuation will be an important option to consider, and the discussion to follow indicates how the rule operates.

Material participation valuation divides the value of the business property at the time of H's death ($300,000 in the example) into three components: (1) H's separate contribution ($10,000) adjusted by a simple interest factor of 6 percent for 20 years, or a total of $22,000;[146] (2) W's separate contribution ($5,000) adjusted by a simple interest factor of 6 percent for 20 years, or a total of $11,000;[147] and (3) the balance of $267,000 representing the combined contribution of H and W attributable to their material participation in the business.[148] For the third component W receives credit of 2 percent for each year (not to exceed 25 years)[149] for her material participation which in the example (20 years) would be 40 percent of $267,000 or $106,800. The balance of the third component, 60 percent of $267,000 or $160,200, is attributed to H.[150] Thus in H's estate the material participation value is the sum of (1) $22,000 and H's part of (3) $160,200, or a total of $182,200.[151] Put another way, H's estate will reflect the total value of the property ($300,000) less the value attributable to W of $117,800—her separate adjusted contribution of $11,000 and her share of the combined contribution of H and W of $106,800.

The statute provides that the rules developed under the proportionate contribution test shall apply to establish the separate contributions of H and W (the first two components).[152] The statute imposes three limits on the amount of the value to be attributed to the surviving spouse, but none of these limits applies to the example: (1) the decrease in the value of the gross estate as a result of material participation valuation may not exceed $500,000;[153] (2) at least one-half of the value of the property must be in-

144. *See* I.R.C. § 2040(b)(2).
145. *See* text accompanying notes 165-82 *infra*.
146. I.R.C. § 2040(c)(1)(B), (c)(6).
147. *Id.*
148. *Id.* § 2040(c)(1)(B), (c)(5)-(6).
149. *Id.* § 2040(c)(5)(B).
150. *Id.* § 2040(c)(5).
151. *Id.* § 2040(c)(1).
152. *Id.* § 2040(c)(6)(A).
153. *Id.* § 2040(c)(2)(B).

cluded in the decedent's gross estate;[154] and (3) the percentage credit the surviving spouse may receive for the third component (the joint contribution) may not exceed 50 percent (2 percent each year for 25 years).[155]

The term "material participation" is given the same meaning found in the tax on self-employment income derived by an owner or tenant of land for the production of farm products by another where the owner or tenant participates materially in the production.[156] Material participation is actual participation to a material degree, and may involve activities in production, advice and consultation, inspection, and furnishing capital (money or property).[157] Presumably on facts like those in the *Otte*[158] case the surviving spouse would be a material participant. "Material participation" will be a source of dispute between executors and the Internal Revenue Service, and available evidence to establish material participation by the survivor should be preserved and accumulated.

The federal estate tax advantage of material participation value will depend on several factors: the relative size of the separate contributions of H and W; the date or dates of their contributions; the number of years of material participation by the survivor spouse; and the "spread" between the estate tax value of the property and the "adjusted" contributions of the spouses.

Material participation valuation can apply where H and W finance the acquisition of the property by a purchase money installment debt and business income is used to pay the debt. In that common situation the material participation valuation rule eliminates the need to trace the income to either spouse. But the method is not limited to debt-financed property. If there is no purchase money installment debt, and the separate contributions of H and W adjusted by a 6 percent simple interest factor are less than the value of the property at the time of the death of the first decedent, the survivor may receive contribution credit for the third component based on years of material participation.[159]

D. *Improvements to Property*

When A and B or H and W acquire real property as coowners with right of survivorship they may share the acquisition cost of the property

154. *Id.* § 2040(c)(2)(A).
155. *Id.* § 2040(c)(5)(B). For "spread" requirement, see Technical Corrections Act of 1979, § 105(a)(3), I.R.C. § 2040(c)(2)(C).
156. I.R.C. §§ 1402(a)(1), 2040(c)(7).
157. Treas. Reg. § 1.1402(a)-4(b)(4) (1963).
158. Estate of Otte v. Commissioner, 31 T.C.M. (CCH) 301, 307 (1972).
159. I.R.C. § 2040(c)(1). *See* Messinger, *Taxation of Jointly Held Interest*, 34 TAX LAW. 89 (1981).

equally or one of them may pay all or a disproportionate part of the acquisition cost of the property. Thereafter if improvements are added to the property, the cost of the improvements may be shared equally or one of them may pay all or a disproportionate part of the improvements. If the original cost of the property and the cost of later improvements do not reflect the same proportionate contributions by the coowners, it will be necessary on the death of the first coowner to apply the contribution rule separately to the original property and to the improvements.[160] Thus where A contributed 100 percent to the original cost of acquisition of the property and later A contributed 38 and B contributed 62 percent to the cost of the improvements added to the property, the proportionate contribution of B was 62 percent of the value of the improvements at A's death.[161]

If the property is a qualified joint interest, the gift tax election will cover not only the original gift but any subsequent gift(s) made by the spouses.[162] Fractional interest valuation should apply to the value of the entire property at the time of the death of the first spouse to die.[163] For purposes of material participation valuation the cost of improvements which is traceable to the separate contribution of either spouse should constitute part of the separate contribution of that spouse and be adjusted by a 6 percent simple interest factor as indicated above.[164]

E. *Agreements to Own Property Jointly—Services*

The application of the contribution rule has been uncertain where A and B or more commonly H and W acquire property in the coownership form and the survivor claims contribution credit pursuant to a prior agreement. For convenience the discussion to follow considers cases involving married persons (H and W); the same principles should apply to unmarried persons (A and B). The cases reflect three separate theories: (1) H and W agree to share the profits of a business while both were living, and business income was the source for the acquisition of the coownership property; (2) H and W agree that property acquired through their separate efforts will be held as coowners with right of survivorship; and (3) H and W agree that services rendered by one to the other shall be compensated by the acquisition of property in the coownership form with right of survivorship. These theories are not mutually exclusive and in a particular case the decision may not be clearly based on any one of the three theories.

160. *See* Estate of Peters v. Commissioner, 386 F.2d 404, 407 (4th Cir. 1967).
161. *Id.* For further discussion, see Maxfield, *supra* note 17, at 63-66.
162. I.R.C. § 2515(c)(2).
163. *Id.* § 2040(b)(1).
164. *Id.* § 2040(c)(6).

1. Partnership—Profit Sharing

In order for a survivor spouse to establish contribution credit under a partnership or profit-sharing agreement the survivor must establish an agreement with the decedent during their joint lives. In *Berkowitz v. Commissioner*,[165] H and W had operated a retail grocery business for 43 years. Although the Board of Tax Appeals refused to grant any contribution credit to W, the survivor, the Court of Appeals for the Third Circuit held that even if H and W were not general partners in the strict sense under state law, the Board should nevertheless consider whether H and W had an agreement to share profits and should recognize such an agreement for purposes of the contribution rule.[166] In later cases[167] the Board of Tax Appeals and the Tax Court have applied this theory in similar situations.

In *Singer v. Shaughnessy*,[168] H and W executed a formal written partnership agreement shortly before H's death in 1944. In the estate tax proceeding W asserted and the jury found that H and W operated the family business as partners from the time of their marriage in 1926 until H's death in 1944. The Court of Appeals for the Second Circuit sustained the judgment of the federal district court allowing W contribution credit for one-half of the jointly owned property attributable to the earnings of the business.[169]

2. Agreement to Hold Property in Coownership Form

In *Lucas v. Earle*,[170] the Supreme Court of the United States rejected an attempt by H and W to split income for federal income tax reporting by an agreement that earnings of either spouse would be owned jointly with right of survivorship. But in *Rogan v. Kammerdiner*,[171] the Court of Appeals for the Ninth Circuit held an oral agreement between H and W at the time of their marriage to hold all property acquired by them as coowners with right of survivorship was effective for federal estate tax purposes and attributed one-half the value of coownership property to W, who died before H. The evidence showed that the coownership property owned at death was attributable to a business conducted by H and W dur-

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165. 108 F.2d 319 (3d Cir. 1939).
166. *Id.* at 322.
167. Estate of Fletcher v. Commissioner, 44 B.T.A. 429, 435 (1941); Estate of Giuliani v. Commissioner, 11 T.C.M. (CCH) 673, 680 (1952).
168. 198 F.2d 178 (2d Cir. 1952).
169. *Id.* at 182.
170. 281 U.S. 111 (1930).
171. 140 F.2d 569 (9th Cir. 1944).

ing their joint lives. The Tax Court[172] reached a similar result under Maine law where W actively participated with H in various enterprises through 45 years of marriage.

3. Services as Contribution

If the survivor spouse cannot establish a partnership agreement, an agreement to share profits, or an agreement to hold property as coowners with right of survivorship, contribution credit may be sought for services rendered during the marriage. Proof by the survivor of the rendition of services to the decedent is not sufficient. The services must be extraordinary and rendered pursuant to an agreement, oral or written. Thus services rendered by W to H, a lawyer, in assisting in his law practice and managing investments did not qualify for contribution credit.[173] The evidence did not disclose that the services "were ever considered, valued or estimated by either the decedent or the wife."[174] Courts have reached a similar conclusion for nursing services rendered over a long period of time[175] and for unpaid services performed in a family business.[176] In a recent decision affirmed in an unpublished opinion[177] by the Court of Appeals for the Seventh Circuit, the Tax Court in the *Ensley*[178] case denied contribution credit to W for services rendered to H in family businesses where W was unable to establish the value of her services or that the funds used to acquire the properties came from the family businesses.

Despite decisions denying credit to W for certain services rendered to H, the Tax Court in *Otte*, a frequently cited Memorandum opinion, did award contribution credit to W for services rendered in a farming business.[179] W established that the coownership property held at H's death was acquired from farm earnings. The court did not require "absolute certainty" as to the source of particular funds and found the contributions of W were "far in excess of those of a housewife discharging ordinary domestic responsibilities."[180] The court's decision in this case is cited in the

172. Estate of Trafton v. Commissioner, 27 T.C. 610 (1956).

173. Bushman v. United States, 8 F. Supp. 694, 698 (Ct. Cl. 1934), *cert. denied*, 295 U.S. 756 (1935).

174. *Id.*

175. Estate of Loveland v. Commissioner, 13 T.C. 5 (1949).

176. Estate of Silvester v. Commissioner, 36 T.C.M. (CCH) 1815, 1818 (1977); Estate of Ehret v. Commissioner, 35 T.C.M. (CCH) 1432, 1434 (1976).

177. Estate of Ensley v. Commissioner, No. ____ (7th Cir. Feb. 20, 1979).

178. Estate of Ensley v. Commissioner, 36 T.C.M. (CCH) 1627 (1977), *aff'd*, No. ____ (7th Cir. Feb. 20, 1979).

179. *See also* Craig v. United States, 451 F. Supp. 378 (D.S.D. 1978) (title in H's name).

180. *Id.* at 307.

committee reports[181] as a reason for enacting the 1976 legislation on qualified joint interests.

The Internal Revenue Service may assert the enactment of the 1978 material participation valuation rule precludes the use by the survivor spouse of any of the theories discussed in this section. But neither the legislation nor the committee reports indicate that Congress intended material participation valuation to be an exclusive method for giving contribution credit to the survivor spouse for services rendered in a family business.[182]

F. *Transfers Within Three Years of Death*

The Tax Reform Act of 1976 repealed the contemplation of death rule and replaced it with a rule that any transfer made within three years of death is a deathtime (estate tax) transfer and not a lifetime (adjusted taxable gift) transfer.[183] The new rule avoids any inquiry into the age, state of mind, or state of health of the donor. Regardless of age, health, or motive of the donor, a transfer within three years of the donor's death is a federal estate tax transfer to be valued for federal estate tax purposes at the time of the transferor's death or at a date six months later.[184]

If the creation or termination of a coownership interest with right of survivorship occurs within three years of the death of the one who creates or terminates the interest, the application of the three-year rule may be involved.[185]

1. Creation Within Three Years of Death

If A furnishes all or a disproportionate share of the acquisition cost of property to be held by A and B as coowners with right of survivorship, and if A and B are not married, A has in many instances made a transfer to B

181. HOUSE WAYS AND MEANS COMM., THE ESTATE AND GIFT TAX REFORM ACT OF 1976, H.R. REP. NO. 1380, 94th Cong., 2d Sess. 19, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3373.

182. I.R.C. § 2040(c). *See also* S. REP. NO. 1263, 95th Cong., 2d Sess. 214 (1978); Messinger, *supra* note 159, at 111-17. In Ltr. Rul. (P-H) 7907018, ¶ 674(79) (slip op.), the IRS indicated its intention to follow *Otte*.

183. I.R.C. § 2035.

184. *See* HOUSE WAYS AND MEANS COMM., THE ESTATE AND GIFT TAX REFORM ACT OF 1976, H.R. REP. NO. 1380, 94th Cong., 2d Sess. 10-15 (adopted in the conference report on H.R. 10612 (Tax Reform Act of 1976)), *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3364-69, 4247.

185. *See* text accompanying notes 36-44 *supra*.

for federal gift tax purposes.[186] If the transfer occurs after 1976 and within three years of A's death, the three-year rule can apply to the transfer; but the contribution rule would also apply on A's death, and if A's proportionate contribution is applied to the estate tax value of the property, three-year rule valuation would not differ from the usual valuation procedure.[187]

Application of the three-year rule may make a difference, however, in other cases. Assume A transfers property outright to B and more than three years before the death of either of them B transfers the property into the names of A and B as coowners with right of survivorship. Creation of coownership will likely be a gift tax transfer from B to A, but if B dies before A it will not be an estate tax transfer as to B since B has made no separate contribution.[188] If, however, the creation of the coownership interest by B occurs within three years of B's death, the Internal Revenue Service will likely assert, and there is case authority[189] to support, an application of the three-year rule to the transfer by B, and the entire value of the property at B's death will be included in the estate of B.[190] In this case the entire value of the property is subject to the federal estate tax if A dies first, or if B dies first and within three years of the time of the creation of the coownership interest by B.

A similar problem exists if A transfers property by gift outright to B and more than three years before B's death B sells the property and reinvests the proceeds in property held by A and B as coowners with right of survivorship. In this situation under the contribution rule there is case law support for attributing to B some part of the value of the property if A dies before B,[191] and if B dies before A and more than three years after the creation of the joint interest, B's proportionate contribution will limit the amount reflected in B's estate for federal estate tax purposes.[192] But if B creates the joint interest within three years of B's death, and if B dies before A, the entire value of the property at B's death may be exposed to the federal estate tax in B's estate.[193]

The application of the three-year rule may be even more disruptive if the coowners with right of survivorship are husband (H) and wife (W). If H creates the joint interest within three years of his death and pays all or a disproportionate part of the purchase price, the Internal Revenue Service

186. *See* Lowe, *supra* note 1, at 386-91.
187. *See* text accompanying notes 2-11 *supra*.
188. *See* Treas. Reg. § 20.2040-1(c)(3) (1972); Lowe, *supra* note 1, at 386-91.
189. Drake v. Commissioner, 67 T.C. 844 (1977); Koussevitsky v. Commissioner, 5 T.C. 650 (1945); Rev. Rul. 76-348, 1976-2 C.B. 267.
190. *See* I.R.C. § 2035; authorities cited note 41 *supra*.
191. *See* cases cited notes 92 & 94 *supra*.
192. I.R.C. § 2040(a).
193. I.R.C. § 2035. *See also* authorities cited note 189 *supra*.

may assert three-year rule valuation to override the application of the fractional interest rule for a qualified joint interest or material participation valuation for a farm or other business interest. At this time there is no clear answer for the application of three-year rule valuation in these situations. If H transfers property by gift outright to W and after the gift but within three years of her death leaving H the survivor W transfers the property to the joint names of H and W or sells the property and invests the proceeds in property in the joint names of H and W, three-year valuation may yield a worse result in the estate of W than proportionate contribution, fractional interest, or material participation valuation.

2. Termination Within Three Years of Death

If the termination of a right of survivorship involves a federal gift tax transfer and occurs after 1976 and more than three years before the donor's death, for federal transfer tax purposes the transfer is treated as a gift tax transfer (adjusted taxable gift).[194] But if a termination after 1976 is a gift tax transfer and occurs within three years of the donor's death, the transfer will also be an estate tax transfer under the three-year rule and the transferred property will receive an estate tax value (date of death or alternate valuation date) rather than a gift tax value (date of transfer).[195] An important question in estate planning is whether a coowner may reduce estate taxes by terminating a right of survivorship within three years of death in such a manner as not to involve a gift tax transfer.

Example 4. A and B, not married, own P, an item of property, as joint tenants with right of survivorship. A, from his separate funds, furnished the entire acquisition price of P. P cost $25,000 and is now worth $100,000.

If the joint tenancy continues until A dies, and if A dies before B, the entire value of P ($100,000) will be reflected on A's federal estate tax return.[196] If A terminates the right of survivorship within three years of his death so that A and B are tenants in common or own equal separate parts of P when A dies, A has made no gift tax transfer.[197] And unless A has made an estate tax transfer by virtue of the termination only $50,000 will

194. *See* Lowe, *supra* note 1, at 374 n.24, 386-405.
195. I.R.C. § 2035.
196. *See* Treas. Reg. § 20.2040-1(c)(1) (1972).
197. *See* Treas. Reg. § 25.2515-4(b) (1972); *id.* § 25.2511-1(h)(5) (1973).

be reflected on A's federal estate tax return as a deathtime transfer.[198] Before the Tax Reform Act of 1976 the Internal Revenue Service in some cases[199] asserted that the termination of a right of survivorship involved an estate tax transfer even though it did not involve a gift tax transfer. But in the well known *Sullivan*[200] case the Court of Appeals for the Ninth Circuit held there was no estate tax transfer on termination of a right of survivorship in contemplation of A's death when A and B became tenants in common in certain real estate previously held by them as joint tenants. Other courts of appeals[201] and the Tax Court[202] have followed this decision and have refused to find an estate tax transfer on termination of a right of survivorship where there was no gift tax transfer.

For a termination occurring after 1976 the Internal Revenue Service may still assert its "estate tax" transfer theory where the right of survivorship is terminated within three years of the death of a coowner and no gift tax transfer is involved.[203] But *Sullivan*[204] and other decisions[205] remain good authority for the taxpayer's position that termination of a right of survivorship is not an estate tax transfer under the three-year rule unless it involves a gift tax transfer. The unification in 1976 of the transfer taxes (gift and estate) through common rates and a single exemption (credit) is a further reason for rejecting the notion that there can be an estate tax transfer when there is no gift tax transfer. A ruling in 1976[206] indicates the Internal Revenue Service may still be unwilling to equate estate tax and gift tax transfers where a right of survivorship is terminated within three years of the death of one coowner. The ruling involved a tenancy by the entirety where H in 1961 had paid the entire purchase price of real property from his separate funds. The acquisition was not a gift tax transfer from H to W since H did not elect to treat it was a gift. In 1975 H and W gratui-

198. I.R.C. §§ 2031, 2033.

199. Glaser v. United States, 306 F.2d 57, 60 (7th Cir. 1962); Sullivan's Estate v. Commissioner, 175 F.2d 657, 658-60 (9th Cir. 1949); United States v. Heasty, 370 F.2d 525, 526-27 (10th Cir. 1966); Baltimore Nat'l Bank v. United States, 136 F. Supp. 642, 646 (D. Md. 1955); Estate of Carnall v. Commissioner, 25 T.C. 654, 655-56 (1955), *acq.*, 1956-1 C.B. 3, 1956-2 C.B. 5, *not acq.*, 1962-1 C.B. 4, 1962-2 C.B. 6, *acq.*, 1969-2 C.B. XXIV; Estate of Borner v. Commissioner, 25 T.C. 584, 587 (1955), *acq.*, 1957-2 C.B. 4, *not acq.*, 1962-1 C.B. 4, 1962-2 C.B. 6, *acq.*, 1969-2 C.B. 6. *Contra*, Harris v. United States, 193 F. Supp. 736, 738-40 (D. Neb. 1961).

200. Sullivan's Estate v. Commissioner, 175 F.2d 657, 660 (9th Cir. 1949).

201. Glaser v. United States, 306 F.2d 57, 59-60 (7th Cir. 1962); United States v. Heasty, 370 F.2d 525, 528 (10th Cir. 1966).

202. Estate of Carnall v. Commissioner, 25 T.C. 654, 656 (1955); Estate of Borner v. Commissioner, 25 T.C. 584, 588-89 (1955).

203. *See* Harris v. United States, 193 F. Supp. 736, 739 (D. Neb. 1961).

204. 175 F.2d 657 (9th Cir. 1949).

205. *See* cases cited note 199 *supra*.

206. Rev. Rul. 76-348, 1976-2 C.B. 267.

tously transferred the property to their children and W died nine months later of an incurable disease. The ruling holds that W made a transfer in contemplation of her death of one-half the value of the property, even though H made no gift tax transfer to W either in 1961 or in 1975 and for federal gift tax purposes was always the owner of the property. The ruling bases the estate tax transfer by W on her one-half interest in the property under state law. The ruling is subject to question. If the survivorship interest were terminated by placing the property solely in H's name and if H thereafter transferred the property to the children, W would have made no transfer for gift[207] or estate tax[208] purposes to either H or the children. A direct conveyance by H and W to the children should yield no different result unless the 1975 transaction may be viewed as (1) a gift tax transfer from H to W, and then transfers by H and W to the children, or (2) a transfer by H which W elected to treat as made one-half by her. There is no indication that the author of the ruling interpreted the transaction in that way.

If the separate estate tax transfer theory is rejected, the impact of the three-year rule on the termination of a right of survivorship should depend on the presence of a gift tax transfer. This question is examined in Part 1 of these comments.[209] Several factors are important in the gift tax inquiry: the type of property involved;[210] the marital relationship, if any, of the coowners;[211] the date of acquisition of the property;[212] the proportionate contributions of the coowners to the acquisition cost of the property;[213] and the division or other disposition of the coownership property or the proceeds attributable to it when the termination of the right of survivorship occurs.[214] The gift tax transfer analysis is illustrated in the following example.

Example 5.. A and B or H and W acquire property, P, as coowners with right of survivorship by purchase, and A or H furnishes the entire acquisition cost of P. The right of survivorship is terminated within three years of the death of one coowner.

When A and B terminate the right of survivorship they may dispose of P in whatever manner they choose. The discussion to follow explores only

207. *See* I.R.C. § 2515(b); Treas. Reg. § 25.2515-3(a)(2) (1972).
208. I.R.C. § 2035.
209. *See* Lowe, *supra* note 1, at 386-405.
210. *Id.* at 386-91, 394-401.
211. *Id.* at 386-405.
212. *Id.*
213. *Id.*
214. *Id.*

three of these possibilities with respect to the common types of investment property: (1) A and B remain coowners of P as tenants in common or divide P in a manner to reflect their separate property interests in P under state law; (2) A becomes the sole owner of P or of proceeds derived from the sale or other disposition of P; and (3) B becomes the sole owner of P or of proceeds derived from the sale or other disposition of P.

If P is real property and if A and B are not married, A and B will hold P as joint tenants.[215] A made a gift tax transfer to B on the acquisition of P, and in Missouri either A or B may terminate the tenancy and become equal coowners through severance or partition.[216] If A and B become tenants in common or separate owners of equal parts of P within three years of A's death, at termination A has made no gift tax transfer to B,[217] and if this occurs within three years of B's death B has made no gift tax transfer to A.[218] Apparently the Internal Revenue Service will not assert that B has made an estate tax transfer to A.[219] If A becomes the sole owner of P, B has made a gift tax[220] and if B dies within three years of the termination an estate tax[221] transfer to A of one-half of the value of P. If B becomes the sole owner of P, A has made a gift tax[222] and if A dies within three years of the termination probably an estate tax[223] transfer to B of one-half the value of P.

If P is real property and H and W are husband and wife, H and W will be tenants by the entirety or joint tenants.[224] Whether H made a gift tax transfer to W on the acquisition of P depends upon the date of acquisition[225] and whether H filed a timely gift tax election for an acquisition made after 1954.[226] The comments to follow assume H did *not* make a gift tax transfer to W on acquisition of P, and that H and W have equal interests in P under Missouri law. If H and W become tenants in common or separate coowners of equal parts of P within three years of H's death, H has made a gift tax[227] and probably an estate tax[228] transfer to W of one-half

215. *Id.* at 378-79.
216. *Id.* at 384-85.
217. *Id.* at 390-91.
218. *Id.*
219. Rev. Rul. 76-348, 1976-2 C.B. 267.
220. *See* Treas. Reg. § 25.2515-4(a), -4(b) (1972).
221. I.R.C. § 2035.
222. *See* Treas. Reg. § 25.2515-4(a), -4(b) (1972).
223. I.R.C. § 2035.
224. *See* Powers v. Buckowitz, 347 S.W.2d 174 (Mo. En Banc 1961); Davidson v. Eubanks, 354 Mo. 301, 189 S.W.2d 295 (1945).
225. *See* Lowe, *supra* note 1, at 397-401.
226. *Id.*
227. I.R.C. § 2515(b); Treas. Reg. § 25.2515-3(a)(2), -3(c) (example 1) (1972).
228. I.R.C. § 2035.

the value of P, and if this occurs within three years of W's death W has made no gift tax or estate tax transfer to A.[229] If H becomes the sole owner of P, W has made no gift tax transfer to A, but apparently the Internal Revenue Service will assert that W has made an estate tax transfer to H if W dies within three years of the termination.[230] If W becomes the sole owner of P and H dies within three years of the termination, H has made a gift tax transfer to W of the entire value of P,[231] and the Internal Revenue Service will likely assert that the entire value of P is also an estate tax transfer to W,[232] although the estate may urge that at most one-half the value of P is an estate tax transfer by H.[233]

If P is corporate securities, A made a gift tax transfer to B on acquisition of P whether or not A filed a federal gift tax return.[234] The termination of the right of survivorship within three years of the death of either A or B should result in transfer tax consequences similar to those described above for real estate owned by A and B who are not married.[235] The same results should follow if H and W own P and terminate the right of survivorship.[236]

If P is a joint bank account, A has made no gift to B on creation of or deposits to the account.[237] An equal division of the account within three years of A's death will be a gift tax[238] and an estate tax[239] transfer from A to B. A voluntary withdrawal by B of funds from the account within three years of the death of A may be both a gift and an estate tax transfer from A to B.[240] The same results should follow if H and W own P and terminate the right of survivorship.[241]

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229. *See* I.R.C. § 2515(b); Treas. Reg. § 25.2515-3(a)(2), -3(c) (example 1) (1972). *See also* I.R.C. § 2035.

230. Rev. Rul. 76-348, 1976-2 C.B. 267.

231. *See* I.R.C. § 2515(b); Treas. Reg. § 25.2515-3(a)(2), -3(c) (example 1) (1972). *See also* I.R.C. § 2035.

232. I.R.C. § 2035.

233. Rev. Rul. 76-348, 1976-2 C.B. 267.

234. *See* Treas. Reg. § 25.2511-1(h)(5) (1973); *id.* § 25.2515-2(b)(1) (1972). *See also* Charles Guzy, 8 T.C.M. (CCH) 681 (1949).

235. *See* notes 215-21 and accompanying text *supra.*

236. *Id. See also* Treas. Reg. §§ 25.2515-2(b)(1), -4(b) (1972).

237. *See* Lowe, *supra* note 1, at 386-87.

238. *Id.*

239. I.R.C. § 2035.

240. *Id. See also* Green v. Commissioner, 64 T.C. 1049, 1065 (1975), *acq.*, 1976-2 C.B. 2; Wilson v. Commissioner, 56 T.C. 579, 587-88 (1971), *acq.*, 1972-1 C.B. 2, 1976-2 C.B. 3, *not acq.*, 1976-2 C.B. 4.

241. *See* I.R.C. § 2035. *See also* cases cited note 240 *supra.*

G. *Homicide—Simultaneous Death*

1. Homicide

One coowner may feloniously cause the death of the other coowner and by virtue of survivorship assert a claim to the entire interest. For federal estate tax purposes the Internal Revenue Service has announced that it will follow state law in determining the amounts to be reflected on the respective federal estate tax returns of the felon and the victim.[242]

In Missouri if one coowner feloniously causes the death of the other coowner, the felonious act converts the coownership interest into a tenancy in common even though the coowners are husband and wife and by virtue of their ages have disproportionate interests in the property prior to the victim's death.[243] Thus, in Missouri if there are two coowners, one-half of the property will pass through and be subject to the federal estate tax in the estate of the victim, and the other one-half will pass through and be subject to the federal estate tax in the estate of the survivor.[244]

The Missouri rule may add insult to injury if the felon husband has furnished the entire consideration for the property, and if the proportionate contribution rule would otherwise apply on the death of either H or W. If H kills W, her federal estate tax return will apparently reflect one-half the value of the property, but if W dies by natural cause before H, her federal estate tax return will reflect no part of the value of the property. This transfer tax consequence of the homicide is not present if the property is a qualified joint interest[245] or if the fractional interest rule would otherwise apply on the death of W before H.[246]

2. Simultaneous Death

The Internal Revenue Service has indicated it will follow state law in determining the amounts to be reflected on the respective federal estate

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242. *See* Rev. Ruls. 78-166, 1978-1 C.B. 283; 78-167, 1978-1 C.B. 288.

243. *See* Grose v. Holland, 357 Mo. 874, 881, 211 S.W.2d 464, 467 (1948); Barnett v. Couey, 224 Mo. App. 913, 923, 27 S.W.2d 757, 762 (K.C. 1930); *Tenancy by the Entirety—Disposition of Property Where One Co-Tenant Murders the Other*, 13 MO. L. REV. 463 (1948); *Estates by Entirety—Surviving Tenant's Right to Estate Where He Causes Death of Other Tenant*, 43 U. MO. BULL. 31 (1931); *Real Property—Effect of Murder of One Co-Tenant by Another on the Right of Survivorship*, 1951 WASH. U.L.Q. 582.

244. *See* Rev. Ruls. 78-166, 1978-1 C.B. 283; 78-167, 1978-1 C.B. 288.

245. *See* I.R.C. § 2040(b)(2).

246. *See* notes 12-16 and accompanying text *supra*.

tax returns of the coowners where they die simultaneously or it is not possible to establish the order of their deaths.[247]

Missouri has adopted the Uniform Simultaneous Death Act,[248] which provides in the absence of an effective presumption of survivorship in a will or other estate planning document the coownership property shall be distributed one-half "as if" A had survived and one-half "as if" B had survived.[249] The wording of the legislation "as if one had survived" is ambiguous. Does it mean that at the instant of death each coowner is viewed as owning one-half the property, similar to tenants in common? Or does it mean that each coowner is viewed as taking one-half of the property by survivorship? The Internal Revenue Service originally opted for the latter view[250] but now apparently takes both points of view.[251] The Service rules that if A was sole contributor to the acquisition of the property and the proportionate contribution rule would apply if A died before B, on the simultaneous death of A and B the entire value of the property is included in the gross estate of A (subject to a possible marital deduction if A and B are married) and one-half of the value of the property is included in the gross estate of B.[252] The advantage of this approach to the Service and the disadvantage to the estate is that if A and B are not married the entire value of the property is reflected in the estate of A and one-half of the value is reflected in the estate of B.[253] Relief from double taxation of one-half of the value of the property is limited to the credit for property previously taxed.[254] Further, even if A and B are married, the marital deduction in the estate of A may not be available to the estate because of limits placed on the maximum marital deduction allowable,[255] and if the marital deduction is not available, relief from double taxation of some part of the property is limited to the credit for property previously taxed.[256]

A preferable approach would ignore the right of survivorship in the event of simultaneous death and tax one-half the value of the property to the estate of A and one-half to the estate of B as in the case of a tenancy in common.[257] If A and B are not married, the entire value of the property is taxed once, one-half to the estate of A and one-half to the estate of B. If A and B are married and if their estate plans have no presumption as to the

247. Rev. Ruls. 76-303, 1976-2 C.B. 266; 66-60, 1966-1 C.B. 221.

248. RSMo §§ 471.010-.080 (1978). *See also id.* § 474.015.2 (Cum. Supp. 1980).

249. *Id.* § 471.030 (1978).

250. Rev. Rul. 66-60, 1966-1 C.B. 221.

251. Rev. Rul. 76-303, 1976-2 C.B. 266.

252. *Id.*

253. *Id.*

254. I.R.C. § 2013.

255. *Id.* § 2056(c). *See also* notes 45-47 and accompanying text *supra.*

256. I.R.C. § 2013.

257. *Id.* §§ 2031, 2033. *See* Grose v. Holland, 357 Mo. 874, 881, 211 S.W.2d 464, 467 (1948).

order of death, the same result will follow and one-half of the value of the property will be subject to tax in the estate of A and one-half will be subject to tax in the estate of B.[258]

III. MISSOURI DEATH TAXES

The state of Missouri has no tax on lifetime gift transfers.[259] For individuals who die before January 1, 1981, the Missouri inheritance tax statute[260] remains in effect. For individuals who die on or after January 1, 1981, the newly enacted Missouri Estate Tax[261] will apply.

The Missouri Supreme Court has held that the Missouri inheritance tax does not apply to property held in the names of two or more individuals as coowners with right of survivorship when one coowner dies and is survived by one or more coowners.[262] Even though the inheritance tax includes a contemplation of death provision,[263] the creation by A in contemplation of her death of ownership interests in names of A and B as joint tenants with right of survivorship was not subject to the inheritance tax on the death of A before B.[264] Where a decedent bequeaths or devises property to A and B as joint tenants with right of survivorship one-half of the value of the property is an inheritance tax transfer to A and one-half of the value of the property is an inheritance tax transfer to B.[265] If the bequest or devise is to H and W as tenants by the entirety, one-half the value of the property is an inheritance tax transfer to each spouse, even though neither spouse has a right of severance or partition and because of a difference in ages the spouses have unequal actuarial rights of survivorship in the property.[266]

The enactment of the Missouri estate tax legislation changes the death tax status of property owned by two or more coowners with right of survivorship. The new legislation imposes a Missouri estate tax equal to the maximum credit for state death taxes allowable by Internal Revenue Code section 2011.[267] If the estate of a Missouri decedent who dies after December 31, 1980, includes property held as a coowner with another (others)

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258. *See* authorities cited note 257 *supra*.
259. Many states do have gift tax legislation to complement their inheritance and estate taxes.
260. RSMO § 145.009 (Cum. Supp. 1980).
261. *Id.*
262. *In re* Estate of Gerling, 303 S.W.2d 915, 920 (Mo. 1957).
263. RSMO § 145.020.1(3) (1978) (repealed 1980).
264. Estate of Osterloh v. Carpenter, 337 S.W.2d 942, 947 (Mo. 1960).
265. *In re* Estate of Armack, 561 S.W.2d 109, 112 (Mo. 1978).
266. *Id.*
267. RSMO § 145.011 (Cum. Supp. 1980).

with right of survivorship, the coownership property may be subject to the Missouri estate tax.[268]

Under the new legislation the executor of the estate has the duty to file the return and pay the tax.[269] The term "executor" is given the same meaning it has in the federal estate tax law.[270] If no executor or administrator is appointed, a person in actual possession of property of the decedent has the duty to file the return and pay the tax.[271] Thus after 1980 a surviving coowner(s) under Missouri law may have a return and tax payment obligation where none existed before.

The Missouri estate tax applies to property having a "tax situs" in Missouri, which includes real and tangible personal property with an actual situs in the state and the intangible personal property of a resident decedent.[272] If a decedent's estate has property with a tax situs outside the state, the Missouri estate tax is reduced proportionately.[273]

The intent of the legislation is to simplify the determination and administration of the Missouri death tax by incorporation of and reference to federal law.[274] Death tax questions involving joint ownership property are to be resolved by application of the federal statutes and rules and regulations interpreting those statutes.[275]

For a resident decedent a Missouri estate tax return is required of every executor "who is required to file a federal estate tax return."[276] In 1981 and later years a federal return is required where the gross estate exceeds $175,000.[277] Thus no Missouri return is required and no Missouri estate tax is due for any estate under $175,000.[278] For an estate in excess of $175,000 the Missouri estate tax will depend on the amount of the federal taxable estate and the amount, if any, of the federal estate tax payable by the estate. In assessing the potential impact of the Missouri estate tax one should consider four factors: (1) The tax base for determining the federal estate tax return and payment obligations is the taxable estate *plus* the amount of any adjusted taxable gifts of the decedent.[279] (2) The Missouri estate tax (the section 2011 credit) may not exceed the federal tax reduced

268. To the extent the federal estate tax is attributable to such property, the Missouri estate tax will likewise be a tax attributable to such property.

269. RSMO § 145.051 (Cum. Supp. 1980).

270. *Id.* §§ 145.091-.101.1.

271. *Id.* § 145.101.1.

272. *Id.* §§ 145.011, .102.

273. *Id.* § 145.041.

274. *Id.* § 145.961.2.

275. *Id.* §§ 145.091, .961.2.

276. *Id.* § 145.481(1).

277. I.R.C. § 6018(a).

278. *Id. But see* text accompanying notes 287 & 288 *infra.*

279. I.R.C. §§ 2001(b), 6018(a)(4).

by the unified transfer tax credit.[280] (3) The amount of the Missouri estate tax (the section 2011 credit) is based on the amount of the taxable estate of the decedent and *not* on the total tax base used in determining the federal tax.[281] (4) The section 2011 credit is available only if the federal taxable estate exceeds $100,000.[282]

Example. A, a single person, dies after December 31, 1980, and leaves an estate for federal estate tax reporting of $275,000. The only federal estate tax credits available to A's estate are the unified transfer tax credit and the section 2011 credit for state of Missouri death taxes.

If the entire $275,000 are deathtime transfers by A (*i.e.*, the federal taxable estate is $275,000), A's executor must file federal[283] and state of Missouri[284] returns and pay federal estate tax of $29,300 and Missouri estate tax of $3,000.

If the federal tax base of $275,000 consists entirely of lifetime transfers by A made after 1976 (*i.e.*, adjusted taxable gifts), A's executor must file federal and state of Missouri returns. The federal estate tax will be reduced by any federal gift tax paid by A during lifetime.[285] There will be no Missouri estate tax payable because the Missouri tax is based on the federal taxable estate of A (deathtime transfers) which would be zero.

If A's federal taxable estate is $175,000, and if A made post-1976 lifetime transfers (adjusted taxable gifts) of $100,000, A's executor must file federal and state of Missouri returns.[286] The federal tax base is $275,000, the federal tax will be $31,500, and there will be a small Missouri estate tax of $800.

If A's federal taxable estate is $100,000, and if A made post-1976 lifetime transfers (adjusted taxable gifts) of $175,000, A's executor must file federal and state of Missouri returns.[287] The federal tax base is $275,000 and the federal tax will be $32,300 reduced by any federal gift tax paid by A during his lifetime.[288] There will be no Missouri estate tax on the estate

280. *Id.* § 2011(f).
281. *Id.* § 2011(b).
282. *Id.* The federal credit is based on the "adjusted taxable estate" (the taxable estate reduced by $60,000). There is no credit until the adjusted taxable estate exceeds $40,000.
283. *Id.* § 6018(a)(1).
284. RSMO § 145.481(1) (Cum. Supp. 1980).
285. *See* notes 48-60 and accompanying text *supra*.
286. *See* notes 276 & 277 and accompanying text *supra*.
287. *Id.*
288. *See* notes 48-60 and accompanying text *supra*.

because there is no section 2011 credit available unless the federal taxable estate *exceeds* $100,000 (adjusted taxable estate exceeds $40,000).

Although Missouri has no transfer tax on lifetime gifts, the example illustrates that the Missouri estate tax may be based in part on lifetime transfers by a decedent made after December 31, 1976. There is no Missouri estate tax unless the federal tax base exceeds $175,000, but there may be a Missouri estate tax where the federal tax base exceeds $175,000 and the federal taxable estate (deathtime transfers) exceeds $100,000. Where the federal taxable estate is between $100,000 and $175,000, the Missouri estate tax cannot exceed $800 regardless of the amount of lifetime transfers made by a decedent after 1976. In the usual situation where a decedent has made no significant lifetime transfers, there will be no Missouri estate tax unless the federal taxable estate exceeds $175,000.

IV. ESTATE PLANNING CONSIDERATIONS

A. *The Estate Tax Penalty on Coownership With Right of Survivorship for Husband and Wife*

The advantages of coownership with right of survivorship—avoidance of the expense and delay associated with probate—may well be offset by the estate tax penalty on this form of ownership. If two persons hold property as coowners with right of survivorship, the entire value of the property or some portion of it may be subject to the federal estate tax in the estate of the first of the coowners to die,[289] and the entire value of the property will be subject to the federal estate tax in the estate of the survivor if the survivor retains the property until death. If the coowners are husband and wife, the availability of the marital deduction[290] may diminish or even remove altogether the federal estate tax on the estate of the first coowner to die. But the right of survivorship places the entire value of the property in the estate of the survivor and exposes it to the full impact of the federal estate tax. Since the enactment of the unified transfer tax legislation in 1976 the survivor has few opportunities to avoid or diminish the federal estate tax on his or her estate.[291] By comparison, the typical family estate plan for husband and wife with no significant amount of property held as coowners with right of survivorship shelters at least one-half of the estate from the estate tax in the estate of the survivor. The estate tax shelter may

289. *See* text accompanying notes 2-44 *supra*.
290. *See* text accompanying notes 45-47 *supra*.
291. *See* Lowe, *supra* note 1, at 374 n.24.

be in the form of trust[292] or other property dispositions, which are not available for property which passes by right of survivorship to the surviving coowner.

An example will illustrate the estate tax penalty on an estate of $750,000 held by husband (H) and wife (W) as coowners with right of survivorship. These assumptions are made: (1) W is younger than H, survives H, and does not remarry after H's death; (2) the federal estate tax credit for property previously taxed is not available in the estate of W; and (3) on her death the estate of W is $750,000 reduced only by estate taxes paid from property passing to W.[293] Estate tax calculations used in the discussion to follow are approximate figures which take into account the available marital deduction in the estate of H. Estate tax figures include both the federal and state of Missouri estate tax liabilities.

If the entire value of the property is subject to the federal estate tax in H's estate, federal and state of Missouri death taxes will be $66,000 on H's estate and $177,000 on W's estate, for a total of $243,000. By comparison, if H owned the property in his name at his death and his estate plan sheltered one-half of his estate from the federal estate tax on W's death, federal and state of Missouri estate taxes would be $66,000 on H's estate and $66,000 on W's estate, for a total of $132,000. The estate tax penalty on the two estates in this example of coownership with right of survivorship is $111,000 ($243,000-$132,000).

H's estate tax estate may not include the entire value of the coownership property by application of the proportionate contribution,[294] fractional interest,[295] or material participation rules.[296] If H's estate tax estate includes one-half the value of the coownership property ($375,000), federal and state of Missouri estate taxes are zero on H's estate and $201,000 on W's estate, for a total of $201,000. By comparison, if H and W each owned individually one-half the value of the property at H's death

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292. This is commonly referred to as a by-pass trust, in which a trust beneficiary has significant economic rights to the trust income and principal, but is not an owner of the property for federal estate tax purposes.

293. Property passing to W from H may be decreased by death tax and other transfer costs at H's death. The size of W's estate on her death will depend on many factors: market gains and losses, consumption expenditures, transfers from and to W, etc. The credit for property previously taxed in H's estate (I.R.C. § 2013) decreases in two-year increments, and disappears 10 years after H's death. It is not unreasonable to assume that these factors will tend to offset one another and that W's estate tax estate will at least equal the estate tax size of H's estate. If inflation continues at its recent rate it is likely that W's estate tax estate will exceed that of H's.

294. *See* text accompanying notes 2-11 *supra*.

295. *See* text accompanying notes 12-24 *supra*.

296. *See* text accompanying notes 25-35 *supra*.

and H's estate plan reflected a typical tax deferral and tax shelter plan,[297] federal and state of Missouri estate taxes would be zero on H's estate and $136,000 on W's estate, for a total of $136,000. The estate tax penalty on coownership is $65,000 ($201,000-$136,000), but is less severe than under the previous assumption.

It is possible, but unlikely, that by application of the contribution rule H's estate tax estate will include no part of the value of the coownership property. In that case federal and state of Missouri estate taxes would be zero on H's estate and $201,000 on W's estate, for a total of $201,000. Even here there is an estate penalty on coownership with right of survivorship if before H's death $175,000 of the property is placed in H's name[298] and the balance in W's name[299] and H's estate plan uses the common estate tax shelter.[300] Federal and state of Missouri death taxes would then be zero on H's estate and $165,000 on W's estate, for a total of $165,000. The estate tax penalty on coownership with right of survivorship is $36,000.

The example illustrates the common situation of coownership with right of survivorship between husband and wife where the wife survives. If the coowners are not husband and wife, the estate tax penalty on the right of survivorship is present but other factors may argue in favor of retaining the right of survivorship. If coowners, A and B, are parent and child, the absence of the estate tax marital deduction in the estate of A, the difference in their ages, and the desire of A to retain control of the property during A's lifetime may be reasons for retaining the property in the coownership form with right of survivorship. A *possible* estate tax penalty should be balanced against the advantages available through retention of the coownership form with right of survivorship.

For most married individuals, however, the magnitude of the estate tax penalty on the two estates illustrated in the example will outweigh the advantages to be derived from retaining the right of survivorship. Married persons should consider ways to avoid the estate tax penalty, and the comments to follow address this situation.

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297. The typical family estate plan for a married individual contains an optimal marital deduction bequest for the surviving spouse and a by-pass trust or trusts; the latter gives the surviving spouse (beneficiary) important economic rights to the trust income and corpus without exposing the trust property to the federal estate tax in the estate of the trust beneficiary.

298. This may constitute a gift tax transfer from W to H. *See* I.R.C. § 2515(b); Treas. Reg. § 25.2515-3(a)(2) (1972). The transfer, however, would not involve the payment of any federal gift tax by W if she had made no prior gift tax transfers. *See* Lowe, *supra* note 1, at 375-76.

299. This usually does not constitute a gift tax transfer from H to W. *See* Lowe, *supra* note 1, at 394-405.

300. *See* note 292 *supra*. H can shelter $175,000 from estate tax exposure in H's estate and W's estate. *See* Lowe, *supra* note 1, at 374 n.24.

B. *The Qualified Joint Interest—Material Participation Valuation*

In 1976 Congress enacted the qualified joint interest rule[301] for property held as coowners with right of survivorship by husband and wife. A qualified joint interest receives the benefit of fractional interest valuation (one-half the value of the property) in the estate of the first coowner to die.[302]

For coownership property acquired before 1977, both real and personal, qualified joint interest valuation is elective.[303] For coownership property acquired after 1976 qualified joint interest valuation is elective as to real property, but as to many common forms of personal property it will apply as a matter of course.

The election to qualify a joint interest or the acquisition after 1976 of some kinds of personal property in the joint form will constitute a transfer for federal gift tax purposes if one spouse contributes all or a disproportionate part of the acquisition cost of the property.[304] From a gift tax standpoint this may or may not be desirable and will depend on the amounts involved, and the availability to the donor spouse of the annual exclusion,[305] the gift tax marital deduction,[306] and the unified transfer tax credit.[307] An advantage from a gift tax standpoint may occur on termination of the joint interest; if at some later time the spouses choose to terminate the right of survivorship and divide the property equally between them, there will be no gift tax transfer at that time.[308] And if the property appreciates in value from the date or dates of acquisition, a maximum of one-half of the appreciation in value of the property may be excluded as a transfer for federal gift tax purposes. Without the qualified joint interest election, such equal division may involve a substantial gift tax cost.[309] This cost has important estate planning implications. As a consequence if husband and wife acquire residential, farm, investment or business real estate and take title in the coownership form, they should consider making the qualified joint interest election, particularly if the election will involve no present or anticipated gift tax costs.[310]

301. *See* text accompanying notes 17-24 *supra.*
302. *See* text accompanying note 23 *supra.*
303. *See* I.R.C. § 2040(a), (c), (d)(2).
304. *See id.* § 2515A.
305. *Id.* § 2503(b).
306. *See* Lowe, *supra* note 1, at 375-76.
307. *Id.* at 374 n.24.
308. Treas. Reg. §§ 25.2515-2(b)(1), -4(b) (1972).
309. I.R.C. § 2515(b); Treas. Reg. § 25.2515-3(a)(2) (1972).
310. Under current legislation a spouse (H) may make a $6,000 annual present interest transfer to the other spouse (W) without having made a taxable gift tax transfer because of the annual exclusion and the gift tax marital deduction. *See* Lowe, *supra* note 1, at 375-76.

From an estate tax standpoint, if all or substantially all of the estate is held in the coownership form with right of survivorship the qualified joint interest rule does not remove, but only lessens the estate tax penalty. In the example, if all the items of property were qualified joint interests and if the acquisition of the property did not involve significant transfers for gift tax purposes, the estate tax penalty might be reduced from as much as $111,000[311] to $64,000,[312] but a significant estate tax penalty remains.

Although the qualified joint interest rule only lessens and does not remove the estate tax penalty in the example, it does result in the *deferral* of as much as $66,000 of estate tax.[313] This deferral feature is one of the principal advantages of the qualified joint interest. The deferral feature may, however, turn out to be a tax acceleration feature in larger estates if the noncontributing spouse dies first.[314] This may be an unwanted and unintended consequence of the qualified joint interest.

Material participation valuation is elective for the estate.[315] Its use will not have the unwanted consequence of estate tax acceleration referred to above.[316] Otherwise the election by an estate of material participation valuation for farm or other business property only lessens and does not remove the estate tax penalty on coownership with right of survivorship.[317]

In the example, where all or substantially all of the estate is held in the coownership form with right of survivorship, neither the qualified joint interest rule nor material participation valuation addresses the principal estate planning problem of minimizing to the greatest extent possible estate tax costs for the two estates. To accomplish this basic objective the coowners must terminate or negate the right of survivorship as to some or all of the coownership property.

C. *Termination of the Right of Survivorship*

While H and W are both living they may terminate the right of sur-

311. *See* Table II in text *infra. See also* text accompanying notes 293-300 *supra.*

312. *See* Table II in text *infra. See also* text accompanying notes 293-300 *supra.*

313. *See* Table II in text *infra. See also* text accompanying notes 293-300 *supra.*

314. For a qualified joint interest the spouse who dies first is considered a one-half owner of the property for estate tax purposes. If W dies first and her estate tax estate exceeds $425,000, her estate will become subject to some federal estate tax costs.

315. *See* text accompanying note 29 *supra.*

316. *See* note 314 *supra.*

317. *See* Table II in text *infra. See also* text accompanying notes 293-300 *supra.*

vivorship in coownership property by their voluntary act.[318] Termination of a right of survivorship may have gift tax[319] or estate tax[320] consequences which H and W should consider carefully. After termination of a right of survivorship the spouses may remain coowners as equal or unequal tenants in common, they may divide the property with H becoming owner of part and W of the other part, either H or W may become the sole owner of the property, or they may make transfers of the property in trust or otherwise and create ownership interests in others. Estate planning for the family which holds substantially all of its property in the coownership form typically involves the termination of the right of survivorship as to some or all of the property and decisions as to appropriate property transfers to accomplish family objectives at minimum transfer costs, present and future. The discussion to follow examines in the context of the prior example some of the common alternatives available.

Example (restated). H and W have an estate of $750,000 held in the coownership form with right of survivorship. W is younger than H, survives him, and does not remarry after H's death. W's estate receives no credit for property previously taxed and has an estate tax value of $685,000. The estate tax penalty on the two estates for retaining the estate in this form may be as much as $111,000. The estate consists of two items of property, P1 and P2, with net estate tax values of $375,000 each.

1. Entire Value of Joint Property in H's Estate

If H was sole contributor to the acquisition cost of the items of property and the items are not qualified joint interests and do not qualify for material participation valuation in H's estate, the entire value of each item will be reflected on the estate tax return for H's estate.[321] If H dies first, the estate taxes on the two estates will be $66,000 on H's estate and $177,000 on W's estate, for a total of $243,000. The estate tax penalty in this case is the largest, $111,000. How might the coowners avoid the estate tax penalty?

Assume P1 is real estate acquired after 1954 for which no gift tax election has been made, that H and W transfer title to P1 from their joint names to the individual name of H, and H has an estate plan that utilizes available tax deferral and shelter techniques.[322] It is essential to know if

318. *See* Lowe, *supra* note 1, at 384-86.
319. *Id.* at 394-405.
320. *See* text accompanying notes 194-241 *supra*.
321. *See* text accompanying note 4 *supra*.
322. *See* text accompanying note 297 *supra*.

the transfer of title of P1 from their joint names to the sole name of H has any adverse transfer tax implications for H or W. The transfer should not be a gift tax transfer by W to H,[323] nor an estate tax transfer by W[324] or H,[325] unless W were to die within three years of the transfer, in which case the Internal Revenue Service apparently will assert that W has made an estate tax transfer.[326] If the title transfer of P1 is not a gift or estate tax transfer by W, the estate tax penalty on coownership of $111,000 may be avoided if H dies first.

The example assumes H dies before W. If W dies before H, the transfer of title to P1 does not avoid the estate tax penalty.[327] H and W may want to consider terminating the right of survivorship in P2, in order to create a separate estate tax estate in W to take advantage of the transfer tax credit available to W's estate and the federal gift tax marital deduction available to H. Assume P2 is personal property as to which H made gift tax transfers to W at the date(s) of acquisition at no gift tax cost.[328] The discussion to follow considers three alternatives for the disposition of P2: (1) an equal division of P2 between H and W; (2) the allocation of $287,500 to W and $87,500 to H; and (3) the transfer of the title of P2 to W.

(1) *Title to P1 in H; H and W take Equal Interests in P2*

If H dies first the combined estate tax costs are $132,000, and if W dies first the combined estate tax costs are $136,000. If the property transfers are not made and the right of survivorship in the property is retained until the death of the first spouse the combined transfer tax costs are $243,000 if H dies first, and $201,000 if W dies first.

(2) *Title to P1 in H; H takes $87,500 and W $287,500 of P2*

If H dies first the combined transfer tax costs are $133,000, and if W dies first the combined transfer tax costs are $136,000. These compare with $243,000 and $201,000 if coownership with right of survivorship is retained until the first spouse dies.

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323. *See* I.R.C. § 2515(b); Treas. Reg. § 25.2515-3(a)(2) (1972).
324. I.R.C. § 2035.
325. *Id.*
326. *See* Rev. Rul. 76-348, 1976-2 C.B. 267.
327. *See* Table I in text *infra*.
328. *See* note 310 *supra*.

(3) *Title to P1 in H; title to P2 in W*

The combined estate tax costs are $167,000 if H dies first, and $169,000 if W dies first. These compare to $243,000 and $201,000 if no change is made in the joint ownership interests.

Summary and Comparison

Table I summarizes the results of the various alternatives.

Table I

If right of survivorship is not terminated, the entire value of P1 and P2 is subject to the estate tax in H's estate if he dies first, and no part of the value of P1 and P2 is subject to the estate tax in W's estate if she dies first. (figures in thousands)

Situation	*H Dies First*			*W Dies First*		
	H	W	Total	W	H	Total
Joint ownership (survivorship) retained in P1 and P2	66	177	243	0	201	201
(1) Title to P1 in H; H and W take equal separate interests in P2	34	98	132	0	136	136
(2) Title to P1 in H; H takes $87,500 and W $287,500 in P2	28	105	133	0	136	136
(3) Title to P1 in H; title to P2 in W (gift tax transfer from H to W of $87,500)	14	153	167	0	169	169

With estate tax costs only one factor to be considered, there is no single best choice for the disposition of P2 after termination of the right of survivorship. From the transfer tax standpoint the choice may well depend on the likelihood or probability as to the order of deaths of the spouses. If H is the more likely to die first, either one of the first two alternatives is preferable to the third. As between the first two alternatives the second may be slightly more attractive; the total estate tax burden is roughly the same under either alternative, but the second alternative postpones until W's death $6,000 of the total tax burden not available under the first alternative.

2. One-Half the Value of Joint Property in H's Estate

In the example of a $750,000 estate the penalty on coownership with right of survivorship may be as much as $65,000 if H dies first with half the value of the joint property subject to the estate tax in his estate.[329] The comparison is to equal ownership by H and W of one-half of the property where H and W have estate plans that take optimal advantage of available tax deferral and shelter opportunities.[330]

If the federal estate tax rules remain in their present form, this situation (or some variation of it) will occur frequently in the future. The material participation rule for farm and business property[331] will make available to H's estate substantial reductions in the amounts to be included (not to exceed one-half the value of the property). The qualified joint interest rule[332] will limit the inclusion in H's estate to one-half of the value of certain types of jointly owned investment personal property acquired after 1976. And some coowners will make the qualified joint interest election for real property acquired after 1976.[333]

Assume P1 is farm or business property for which W would receive a full 50 percent contribution credit by operation of the material participation valuation rule and P2 is qualified joint interest personal property, the acquisition of which did not involve any federal gift tax costs to H. How might H and W avoid or lessen the estate tax penalty of coownership with right of survivorship? The discussion to follow examines four alternatives: (1) H takes title to P1 and W takes title to P2; (2) H and W take equal interests in P1 and P2; (3) title to P1 remains in the coownership form and H and W take equal interests in P2; and (4) title to P1 remains in the coownership form and W takes title to P2. For each assumption H and W have estate plans which utilize optimal estate tax deferral and shelter opportunities.[334]

(1) *H takes title to P1; W takes title to P2*

If this were done and as a result neither H nor W has made a gift tax transfer to the other, the estate is divided equally for federal estate tax purposes and the combined estate taxes on the two estates would be $136,000, regardless of the order of death of H and W, compared to $201,000 if coownership with right of survivorship remains until one spouse dies. Since the spouses are equal owners for estate tax purposes in two items of equal value before the title transfers,[335] it may be urged that no gift or estate tax transfers, by H or W, are involved by the title changes suggested. But the gift tax status of P1 is not clear, and it is possible that this suggestion may

329. *See* text accompanying notes 294-97 *supra*.
330. *Id.*
331. *See* text accompanying notes 25-35, 141-59 *supra*.
332. *See* text accompanying notes 17-24 *supra*.
333. *See* I.R.C. § 2040(b)(2). *See also* authorities cited notes 304-10 *supra*.
334. *See* note 297 *supra*.
335. *See* Table II in text *infra*.

involve a gift tax transfer from H to W of $187,500, one-half the value of P2.[336] If as a result of these changes in title H has made a gift tax transfer to W of $187,500, the combined estate taxes on the two estates will be $167,000 if H dies first, and $169,000 if W dies first, as compared to $201,000 if the coownership with right of survivorship is continued until the death of either H or W.

(2) *Equal Division of P1 and P2*

In the equal division of both items H and W become tenants in common or equal separate owners of the property. Since only one-half of each item will be subject to the federal estate tax in H's estate if the coownership with right of survivorship is continued until H's death, it would seem reasonable to conclude that for federal transfer tax purposes H and W are equal owners of each item and that an equal division of the items between them would involve no gift tax transfers for H or W. The conclusion is correct for the division of P2[337] but is questionable as to the division of P1.[338] Rendition of service and material participation in the farm or other business (P1) now counts as W's separate contribution for estate tax purposes, but *may not* count as contribution credit for gift tax purposes. Hence an equal division of P1 may involve a gift tax transfer from H to W of as much as $187,500. Such a transfer may not involve the payment of any federal gift tax,[339] but would decrease the potential transfer tax savings from $65,000 to $34,000 if H dies first. As indicated before, there are good reasons available for the conclusion that the division of P1 between H and W to accord with the arithmetic of the material participation valuation rule is not a gift tax transfer from H to W.[340] But until there is an authoritative interpretation to that effect doubt will remain.

(3) *Equal Division of P2—Retain Joint Ownership in P1*

In view of the doubt expressed concerning the gift tax status of P1, another alternative to consider is an equal division of P2 between H and W and retention of P1 in the coownership form with right of survivorship. Material participation valuation is elective.[341] If W were to die first, her

336. *See* Lowe, *supra* note 1, at 404-05.
337. Treas. Reg. §§ 25.2515-2(b)(1), -4(b) (1972).
338. *See* Lowe, *supra* note 1, at 404-05.
339. *See id.* at 374-76.
340. *See id.* at 404-05.
341. *See* text accompanying note 29 *supra.*

executor could assert that no part of P1 is subject to the federal estate tax in her estate and by owning one-half of P2, W has an estate tax estate of $187,500 at her death. The equal division of P2 involves no gift or estate tax transfers for H or W.[342] The combined transfer tax costs to H and W would be $136,000 if H dies first, and $132,000 if W dies first, compared to $201,000 if the coownership with right of survivorship is retained as to P1 and P2 and H dies first.

(4) *Title to P2 in W—Joint Ownership in P1 Retained*

This transfer decreases the size of H's estate to $187,500 if he dies first, and increases the size of W's estate to $375,000 if she dies first. This suggestion involves a gift tax transfer from H to W of $87,500,[343] and an estate tax transfer by H if he dies within three years.[344] The combined estate tax costs to the two estates are $201,000 if H dies first, and $169,000 if W dies first, compared to $201,000 if coownership with right of survivorship remains for both P1 and P2 until one spouse dies.

Summary and Comparison

Table II summarizes the results of the various alternatives.

Table II

If right of survivorship is not terminated, one-half the value of P1 and P2 are subject to the federal estate tax in H's estate if he dies first, and one-half the value of P2 is subject to the federal estate tax in W's estate if she dies first. (figures in thousands)

Situation	*H Dies First*			*W Dies First*		
	H	W	Total	W	H	Total
Joint ownership (survivorship) retained in P1 and P2	0	201	201	0	201	201
(1) Title to P1 in H, title to P2 in W (gift tax transfer by H of $87,500)	14	153	167	0	169	169
(2) H and W each take equal separate interests in P1 and P2 (gift tax transfer by H of $87,500)	14	153	167	0	169	169

342. *See* Treas. Reg. §§ 25.2515-2(b)(1), -4(b) (1972). *See also* text accompanying notes 203-08 *supra*.

343. Treas. Reg. §§ 25.2515-2(b)(1), -4(b) (1972).

344. *See* text accompanying notes 209-36 *supra*.

Situation	*H Dies First*			*W Dies First*		
	H	W	Total	W	H	Total
(3) Title to P1 unchanged; H and W take equal separate interests in P2	0	136	136	0	132	132
(4) Title to P1 unchanged; title to P2 in W (gift tax transfer by H of $87,500)	0	201	201	0	169	169

The example illustrates the estate tax penalty that remains with material participation valuation and qualified joint interest property in the estate of the first spouse to die. Material participation valuation and the qualified joint interest rule lessen but do not remove the estate tax penalty on coownership with right of survivorship.

Under either the first or second alternative there is a risk that the estate tax penalty on coownership with right of survivorship of $65,000 will be reduced to $34,000 instead of avoided, and that H's estate will incur some estate tax liability.[345] The third alternative seems preferable to the others and the fourth alternative the least desirable of the four.

Something more should be said about P1 in the example and the material participation valuation rule. For simplicity in the example, P1 is assigned a value equal to one-half of the estate, and W is given a full 50 percent contribution credit if H dies first. Neither of these assumptions may be present in actual cases. If the value of P1 exceeds one-half of the estate, it may be imprudent to leave the title to P1 in coownership with right of survivorship because the estate tax penalty on coownership will reappear.[346] Also it is not likely that W will receive a full 50 percent credit for her material participation in most cases because of the structure of the rule,[347] and this will affect the estate tax size of H's and W's estates and the potential for estate tax deferral and shelter. Another feature of material participation deserves attention. The discussion assumes that material participation valuation is a one-way (taxpayer) street, that if H dies first his estate may elect material participation valuation if it is advantageous to do so, but if W dies first the Internal Revenue Service may *not* assert that her material participation produces a contribution to be reflected in her estate tax estate. If the Internal Revenue Service should assert that W's services and participation in the farm or other business must count as a contribu-

345. *See* Table II in text *supra*.

346. The marital deduction property, P1, exceeds in value the optimal marital deduction (one-half of the estate). *See* note 297 *supra*. When the value of the coownership property in the estate of the first spouse to die exceeds the optimal marital deduction in that estate, some estate tax penalty may occur since the excess may otherwise be sheltered from the estate tax in the estate of the surviving spouse.

347. *See* text accompanying notes 146-59 *supra*.

tion if W dies first, then it would seem that her participation should also count as a contribution for federal gift tax purposes. Such an interpretation would reduce and perhaps remove altogether the risk present in the first and second alternatives discussed above. Legislation or an authoritative interpretation on the common and troublesome gift tax question is needed.

D. *Disclaimer*

The estate tax penalty on coownership with right of survivorship occurs when jointly owned and other property passing to a surviving spouse which qualifies for the marital deduction exceeds the optimal marital deduction in the estate tax estate of the first spouse to die. So long as the joint and other marital deduction property do not exceed in value the amount of the optimal marital deduction the potential for the estate tax penalty is not present. Within this limitation, ownership of *some* property in the joint form—for example, a residence, bank accounts, investment property—may be integral parts of estate tax efficient plans for husband and wife. The arithmetic of the estate tax marital deduction and a realistic assessment of the other marital deduction property dictate how much jointly owned property the family should prudently hold, and how much they should hold in the separate names of H or W, or in common ownership without a right of survivorship.

However, if the spouses fail to address the problem while both are living, another possibility remains. To avoid the estate tax penalty the surviving spouse may seek to disclaim the right of survivorship as to some or all of the joint property. The tax planning potential of this technique depends on the interpretation of newly enacted federal[348] and state of Missouri[349] legislation on disclaimers.

The federal disclaimer rule states that in the case of a qualified disclaimer of an interest in property, the estate and gift tax transfer provisions apply as if the interest had never been transferred to the disclaimant.[350] The new Missouri statute states the renounced interest passes as if the disclaimant had predeceased the decedent unless the decedent has otherwise indicated by his will.[351]

Legislative history for the federal statute indicates an intention that federal not state law should control the federal transfer tax consequences of a disclaimer or renunciation.[352] Since, however, property rights and in-

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348. I.R.C. § 2518.
349. RSMo § 474.490 (Cum. Supp. 1980).
350. I.R.C. § 2518(a).
351. RSMo § 474.490.3 (Cum. Supp. 1980).
352. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 65-68, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3419.

terests are creatures of state law it is likely that state and not federal law shall control on the question whether a particular interest (for example, a right of survivorship) is subject to disclaimer.[353]

The new Missouri disclaimer legislation does not mention coownership property with right of survivorship. Persons named in the statute who may disclaim are: an heir, devisee, person succeeding to renounced interest, beneficiary under a testamentary instrument, or person designed to take pursuant to a power of appointment exercised by a testamentary instrument.[354] A coowner with right of survivorship does not easily fit under any of the statutory descriptions. It is at least doubtful whether Missouri courts will recognize a disclaimer by the surviving coowner following the death of the other coowner.

Indications to date are that the Internal Revenue Service will assert that disclaimer of a right of survivorship is a gift tax transfer. In proposed regulations and a series of private letter rulings[355] the Service has held that a purported disclaimer by a surviving coowner was a gift tax transfer since the creation of the right of survivorship occurred at the date of acquisition of the property and had been accepted by the surviving coowner after its creation.

The letter rulings indicate the Service may recognize the disclaimer if state law is interpreted to permit a post-mortem disclaimer of the right of survivorship by a surviving coowner.[356] Also a post-mortem disclaimer may be effective for transfer tax purposes if the surviving coowner did not know of his or her survivorship right while the decedent lived and disclaimed promptly on learning of it.[357]

The stated Service position is generally hostile to the post-mortem disclaimer of a right of survivorship by a surviving coowner. Pending further clarification one may anticipate the opposition of the Service to any attempted disclaimer by a surviving coowner made for the purpose of avoiding transfer tax consequences, particularly in Missouri where the new disclaimer legislation does not expressly include the right of survivorship.

If a disclaimer is effective for federal transfer tax purposes, it is only the interest which the survivor takes by survivorship that is subject to the disclaimer.[358] Thus the effect of the disclaimer will likely be to create a tenancy in common in the property between the surviving coowner and those who take the disclaimed interest.

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353. Proposed regulations take this position. *See* 45 Fed. Reg. 48,925 (1980).
354. RSMo § 474.490.1 (Cum. Supp. 1980).
355. *See* Ltr. Ruls. (P-H) 7911005, ¶ 1083(79); 7933013, ¶ 3384(79); 7940062, ¶ 4196(79); Prop. Treas. Reg. § 25.2518-2(d)(3).
356. *See* Ltr. Rul. (P-H) 7911005, ¶ 1083(79).
357. *Id.*
358. *See* Ltr. Rul. (P-H) 7933013, ¶ 3384(79).