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Property and Tax Effects of a Conveyance to Husband and Wife and the Survivor of Them, Where the Husband Pays the Full Consideration

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PROPERTY AND TAX EFFECTS OF A CONVEYANCE TO HUSBAND AND WIFE AND THE SURVIVOR OF THEM, WHERE THE HUSBAND PAYS THE FULL CONSIDERATION

Recently there has arisen in South Carolina a question as to the nature of the interests created by a conveyance to a husband and wife and the survivor of them. Where the husband has paid the full consideration for the property involved, certain estate and gift tax considerations also come into the picture and the purpose of this article is to explore these considerations and to estimate their effects.

The 1953 case of *Davis v. Davis*[1] supposedly settled the property law in this area.

The case involved the construction of a deed to land in Williamsburg County sold to husband and wife and for which the husband paid the full consideration. This deed recited in the granting clause "to W. N. Parks and his wife Emma, as tenants by the entirety and the survivor of them," and in the habendum "To have and to hold by the parties of the second part and the survivor of them, their heirs and assigns in fee simple forever." Two years later, the wife died intestate, leaving as her heirs at law her husband and a daughter by an earlier marriage. The husband later died intestate leaving his second wife and a child by their marriage. The plaintiffs, grandchildren of the wife, brought this action against the latter wife and daughter, seeking one half of the property of the estate, claiming that the husband and wife held it as tenants in common and one half belonged to the wife's heirs at law. The defendants' contention was that the husband became the sole owner by survivorship and the wife's heirs had no interest. The circuit judge sustained the defendants' demurrer and dismissed the action. On appeal, the South Carolina Supreme Court in a three-two decision, affirmed the court below. Judge Oxner writing for the majority stated that although the estate of tenancy by the entirety had been abolished by statute in South Carolina, the intention of the grantor was clear and that the survivor would take the entire estate upon the death of the other spouse either on the theory of viewing this conveyance as a tenancy in common for life with a contingent remainder in the survivor, or as a tenancy in common in fee with an executory limitation in the surviving spouse.

1. 223 S. C. 182, 75 S. E. 2d 46 (1953).

Justices Baker and Taylor dissented on the ground that this language created a joint tenancy which was severable by the death of one of the joint tenants and distributable as a tenancy in common.

This case, to a large degree, settled the law in this state as to the interest created by a deed or devise which at common law would have made the parties tenants by the entirety. Indeed, the earlier cases in this state are all to the effect that where land is conveyed to husband and wife, with provision for survivorship or with nothing else appearing, the husband and wife became seised of an estate by the entirety. Neither could alien so as to bind the other and the survivor took the whole.[2] The Married Women's Separate Property Owners Acts and the Constitutions of 1868 and 1895 exerted a profound effect on the estate of tenancy by the entirety in South Carolina. Under these provisions, the wife's interest in her property during coverture was made absolute. Her property was no longer subject to levy and sale for her husband's debts, but were held as her separate property and could be dealt with by her in the same manner as if she were unmarried.[3]

In 1907 was decided the case of *Green v. Cannady*[4] which held that the Constitutions and the above mentioned legislation destroyed the oneness of husband and wife as to their property rights and, therefore, that a married woman may become a tenant in common with her husband upon a grant to both.

The *Green* case, however, only involved a conveyance to husband and wife (and other third parties) with nothing else appearing. The question of a conveyance to husband and wife with an express provision for survivorship was left open by this decision. The *Davis* case was the first case in this state since the separate property owners acts to deal with this type of limitation.

In both the *Davis* and *Green* cases the court excluded the possibility of joint tenancy in these situations because of an act of the Legislature in 1791 providing that at the death of one joint tenant the property is to be distributable as a tenancy in common.[5] A number of other states in this situation have held that the limitation in question creates a joint tenancy with the right of survivorship.[6] Even in states where tenancy by the entirety no longer exists, this has

2. Bomar v. Mullins, 4 Rich. Eq. 80 (S. C. 1851); Railway Company v. Scott, 38 S. C. 34, 16 S. E. 185 (1892); McLeod v. Tarrant, 39 S. C. 275, 17 S. E. 773 (1892).
3. CONSTITUTION OF 1868, ART. XIV, § 8.
4. 77 S. C. 193, 56 S. E. 954 (1907).
5. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 19-55.
6. Stambaugh v. Stambaugh, 288 Ky. 291, 156 S. W. 2d 827 (1941).

been the favored interpretation of such a deed or will which would have created a tenancy by the entirety at common law.[7] Only in limited situations have other states allowed an express provision for survivorship to be attached to a joint interest and still construed the interest as a tenancy in common, and these decisions have all been based on the fact that the parties expressed a clear intention to treat the tenancy as a tenancy in common.[8]

In the *Davis* case, it would appear that the Supreme Court was faced with a dilemma. The entire court agreed that the estate of tenancy by the entirety has been abolished in this state. They then had two possible alternatives: first, to treat the conveyance as a joint tenancy which, due to the act of 1791, would be distributable as a tenancy in common with the result that that intention of the grantor would be clearly thwarted; or second, to give effect to the grantor's intention by creating in favor of the survivor a contingent remainder or an executory limitation. If this were done, the tenancy, by necessity, must be treated as a tenancy in common, for if treated as a joint tenancy, the statute would apply and the death of the joint tenant would sever it. This was the position of the majority of the court but the two dissenting justices expressed a preference for the former interpretation.

The majority of the court quoted with approval from *Corpus Juris Secundum*:[9]

> "An estate of survivorship will be created by a deed manifesting an intention to create such an estate. Where such intention is clearly stated, it will be effective *regardless of the nature of the estate* otherwise conveyed." (emphasis added).

and again from *Tiffany on Real Property*:[10]

> ". . . when one makes a gift to two or more with the right of survivorship, it appears to be a reasonable conclusion that he has in mind an indestructible right of survivorship. This view that there is in such a case a tenancy in common for life with a contingent remainder in favor of the survivor, or even that there is a tenancy in common in fee simple with an executory limitation in favor of the survivor, might seem more in accord with the intention of the grantor or testator." (italics omitted).

7. Hughes v. Lumber Company, 19 Conn. Supp. 138, 110 A. 2d 499 (1954); Bouska v. Bouska, 159 Kan. 276, 153 P. 2d 923 (1944); In re Richardson's Estate, 229 Wis. 426, 282 N. W. 585 (1938).
8. Douds v. Fresen, 392 Ill. 477, 64 N. E. 2d 729 (1946).
9. 26 C. J. S., *Deeds* § 127, p. 429 (pp. 970-971 in 1956 ed.), quoted at 223 S. C. 188.
10. 2 TIFFANY, REAL PROPERTY § 424, pp. 207-208 (3rd ed. 1939), quoted at 223 S. C. 190-191.

This then, would seem to be the law in this state today that when land is given to a husband and wife and the survivor of them, the type of tenancy created is a tenancy in common, but the estate will pass to the surviving spouse in the same manner as if the conveyance had created a tenancy by the entirety or a joint tenancy.

A conveyance of this type poses at least three tax problems. First, to what extent will the deceased spouse's interest be includible in his gross estate for estate tax purposes, presuming that it was the decedent who paid the full consideration for the property conveyed to him and his wife in this form?

The Internal Revenue Code has a special provision for taxing the gross estate of a deceased joint tenant or tenant by the entirety. In these situations, his gross estate includes that "interest" in the property for which he paid the consideration.

> The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants by the decedent and any other person, or as tenants by the entirety by the decedent and spouse except such part thereof as may be shown to have originally belonged to such other person (or spouse) and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or in money's worth.
>
> PROVIDED, that where such property, or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time to have been acquired, by any other person from the decedent *for less than an adequate and full consideration* in money or in money's worth, there shall be excepted only such part of the value of such property *as is proportionate to the consideration furnished by such other person.*[11] (emphasis added)

Where the decedent and spouse hold land as joint tenants, or as tenants by the entirety, only the proportion shown to have belonged originally to the surviving spouse or to have been acquired by her for an adequate and full consideration in money or in money's worth can be excluded from the gross estate of the deceased husband, and if the husband paid the full consideration, the *entire value* of the joint property is includible in the gross estate of the deceased husband.[12]

On the other hand, there is no express provision in either the 1939 or the 1954 Internal Revenue Codes dealing with property held

11. INT. REV. CODE OF 1954, § 2040.
12. Estate of J. H. Heidt, 170 F. 2d 1021 (9th Cir. 1948); Steen v. United States, 195 F. 2d 379, *cert. den.* 344 U. S. 822 (1952).

as tenants in common, but through judicial decisions it has become settled that where one tenant in common dies, only the decedent's fractional interest is includible in his gross estate. Where the decedent and another (or his spouse) hold property as tenants in common, only one half of the property so held may be included in his gross estate for estate tax purposes.[13]

The different tax effects are obvious here. If, on the one hand, the conveyance in question is viewed as a tenancy in common, only one half of the value of the property will be included in the husband's gross estate. If, on the other hand the Commissioner views this as a joint tenancy, as did the dissenting two justices in the *Davis* case (and as would the rest of the court but for the South Carolina statute abolishing survivorship in joint tenancies), the entire value of the property in question would be includible in the deceased husband's gross estate. Furthermore, under the Federal statute, the burden of proof is on the survivor to show the consideration furnished.[14] If the decedent's gross estate be taxed viewing the estate as a joint tenancy or a tenancy by the entirety, only if the wife's contributions can be shown to be equal to those of her deceased husband, can she obtain the same tax advantage as she would taking as a tenant in common — namely having only one half of the value of such property included in the decedent's gross estate.[15]

The form of ownership is decisive in these cases. Generally the question of whether or not property is held by a decedent and another as joint tenants, tenants by the entirety, or tenants in common is a question of local property law.[16]

We have examined the state of the local property law in South Carolina. In the *Davis* case, the transaction was regarded as creating a tenancy in common with a contingent remainder or an executory interest in the survivor as a matter of form. In substance, however, our Supreme Court allowed the interest to pass by survivorship. Though survivorship is not the only characteristic of a joint tenancy and may be annexed to a tenancy in common, as pointed out by Justice Oxner in the majority opinion, it is the characteristic which gave rise to the different manner of taxing the gross estate of the decedent in the law of estate taxation.[17] The gross estate cannot be measured until the decedent's death, so the factor of alienability or severance

13. Harvey v. United States, 185 F. 2d 463 (7th Cir. 1953).
14. Estate of S. Silberstein, 21 B. T. A. 188, Dec. 6450.
15. Drummond v. Paschal, 75 F. Supp. 46 (D. C. Ark. 1947).
16. Greenwood v. Commissioner, 134 F. 2d 915, 918 (9th Cir. 1943).
17. Estate of Brockway v. Commissioner, 219 F. 2d 400 (9th Cir. 1954).

would play no part in its consideration. The section of the Internal Revenue Code dealing with "joint interests" was formulated solely to keep a man from escaping estate tax liability on lands purchased solely by him but the title to which was "shared" with another who would take the whole estate at his death and one half free and clear from estate taxes. Is it not arguable then, that by giving effect to a survivorship provision in a conveyance to husband and wife, our Supreme Court has made this a "joint interest" within the purview of the Federal statute?

There is, moreover, a trend toward the courts being guided more by the substance than the form in evaluating certain transactions for tax consequences. This is aptly reflected in the following excerpt from a recent opinion:

> In dealing with a tax matter, we must be guided by the substance and not the effect of what was done. . . . This is not to say that we are to disregard the language used in the contract which may be involved, or the methods used to effect the transaction. But, rather, we must consider the form and steps used in their relation to the intended and accomplished entire transaction.[18]

This reasoning has been applied also when dealing with the question of what type of interest is created when two or more persons hold property concurrently. Courts have even disregarded the type interest designated by state courts when deciding property questions, when the substance of the transaction showed that another type interest was intended. In the case of *Pierotti v. United States*[19] the California state court had held that husband and wife owned property as joint tenants with the right of survivorship. The Commissioner then tried to include the entire value of the property in the deceased husband's gross estate. The surviving spouse's claim for refund was granted and affirmed by the Ninth Circuit Court of Appeals, the court holding that in spite of the state court's decision, in the light of the form of the conveyance and the surrounding circumstances, the intent of the spouses to hold the land as "community property" governed the transaction and the "joint interest" section of the 1939 Code did not apply. Might not the court have applied the same reasoning if the converse of this situation had been in question?

In the *Brockway* case[20] the court held the determinative feature to be the type of interests which the parties intended to create. When

18. Hatch's Estate v. Commissioner, 198 F. 2d 26, 28 (5th Cir. 1952).
19. 154 F. 2d 758 (9th Cir. 1946).
20. Estate of Brockway v. Commissioner, 219 F. 2d 400 (9th Cir. 1954).

the argument was made that this interest should be treated as a tenancy in common, the court replied:[21]

> If a competent lawyer, such as he who drew the instrument, had intended to create a "tenancy in common with cross remainders for life with remainder in fee to the ultimate survivor," or "a tenancy in common in fee simple with an executory limitation in favor of the survivor," as petitioner now suggests, the lawyer could have used appropriate language. If it be thought his testimony is competent to interpret the instrument he actually drew, he is positive that he intended to create a joint tenancy.

The editors of Prentice-Hall's Estate and Gift Tax loose leaf service express an opinion that in those states which have abolished the estate of tenancy by the entirety, but which do allow the creation of tenancies with the right of survivorship in husband and wife, these tenancies should fall within the tax purview of section 2040 of the 1954 Internal Revenue Code.[22]

The foregoing and other authorities lead the writer to believe that should this problem be litigated in this state, that the Federal District Court or the Tax Court might well hold that this type interest is a "joint interest" within the meaning of the Federal statute and where the decedent spouse has paid the whole consideration, his gross estate will include the full value of the property held under such a tenancy. Even if a result favorable to the surviving spouse is reached, the expenses of litigation might be avoided if the estate planner or his counsel adopted some other means to effect this plan.

Two further tax problems which might possibly arise involve the marital deduction for estate tax purposes and possible gift tax consequences under a transfer of this type. Section 2056 of the 1954 Internal Revenue Code allows the surviving spouse to deduct from her husband's gross estate an amount equal to the value of any interest in property which has passed or passes from the decedent to the survivor to the extent that such interest is used in determining the decedent's gross estate and so long as it and other deductions do not exceed fifty percent of the decedent's adjusted gross estate.

Does the interest of the survivor here "pass from the decedent" so as to allow the marital deduction? If this be construed as a joint tenancy or a tenancy by the entirety, clearly it does. The Code so provides:[23]

> Definition. — For purposes of this section, an interest in

21. *Id.* at 402-403.
22. 4-A PRENTICE-HALL, FEDERAL TAX SERVICE ¶ 125,151, p. 125,351 (1956).
23. INT. REV. CODE OF 1954, § 2056 (e).

property shall be considered as passing from the decedent to any person if and only if —

. . . (5) such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship. . . .

In the case of *Awtry's Estate v. Commissioner*[24] the court held that real estate taken by survivorship by virtue of the parties being joint tenants (or tenants by the entirety) passed from the decedent so as to comply with the statute and the marital deduction was allowed. It is interesting to note that this case arose in Iowa where in a joint tenancy situation the survivor does not acquire title from the deceased but from the deed.[25] The survivor acquires title from the *deed* in a contingent remainderman or executory limitation situation. The further question remains: if this be construed as a tenancy in common with a survivorship arrangement can the surviving spouse take the marital deduction? Again the answer would appear to be in the affirmative. Perhaps such a tenancy comes within the language of the statute "joint ownership with right of survivorship." Even if it does not come within the statute, the Commissioner has construed this requirement most liberally. The Commissioner has ruled that exempt property set off to the widow by local statute constitutes an interest in property "passing from the decedent" and which she can deduct from the gross estate of the deceased spouse.[26] It would seem then, that whether the survivor received it on the theory of a contingent remainder or an executory limitation, the wife could claim the marital deduction in this situation.

There is also a gift tax problem involved here. We have assumed that the husband paid the full consideration for the property so conveyed. As the wife paid no part of the consideration for the property, her interest therein would seem to arise by virtue of a "gift" from her husband. Is this gift taxable to the husband in the year of the transfer? For the answer again we must look to the Code. Section 2515 specifically exempts the creation of tenancies by the entirety or joint tenancies between husband and wife with the right of survivorship from gift tax liability unless the donor should elect to treat it as taxable, which he may wish to do under certain circumstances. If the property is subsequently sold by the spouses, however, gift tax liability will immediately arise in the same manner as if the husband had made a gift to his wife in the amount of the entire proceeds

24. Awtry's Estate v. Commissioner, 221 F. 2d 749 (8th Cir. 1955).
25. Wood v. Logue, 167 Iowa 436, 149 N. W. 613 (1914).
26. REV. RUL. 55-419, CUM. BULL. 458.

of the sale. No gift tax liability arises at the death of the husband, however.[27]

If this transfer is looked upon as creating a tenancy in common between the husband and wife the result will be different.

At the time of purchase, if the wife takes as a tenant in common, she takes one half of the property as a "gift" and the husband will be liable to pay taxes on that gift at the end of the year. The donor shall be, of course, entitled to a one half deduction for a gift to his spouse of an interest in property.[28] Nevertheless, if the amount paid for the property is substantial, the tax on the gift might still be heavy and could have been avoided entirely had the husband and wife not taken the property as tenants in common here.

These are problems which will continue to be with the estate planner or his attorney until the courts rule on the tax effects of this type of conveyance in South Carolina under the present state of the law.

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27. INT. REV. CODE OF 1954, § 2515 (b).
28. *Id.* § 2523.