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FEDERAL INCOME TAX TREATMENT OF DIVISIONS OF PROPERTY: MARITAL PROPERTY SETTLEMENTS, ESTATE AND TRUST DISTRIBUTIONS, AND OTHER TRANSACTIONS

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I. INTRODUCTION

Sharing of interests in property between two or more co-owners is among the most common legal relationships in our society. Probably a majority of adults in the United States have at least a rudimentary understanding of the law of joint tenancy or, in several states, community property. Tenancy in common and tenancy by the entirety are also familiar forms. Still other common forms

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of co-ownership are the interests of husband and wife in one another’s property in common-law states and the interests of residuary legatees in the assets of an estate.

Co-ownership interests of this kind are constantly created, modified, and terminated—often with little attention to legal consequences. This is especially true of termination of co-ownership, which ordinarily takes the form of a division of the property involved. The property held in some form of co-ownership is divided, with the result that each owner obtains complete ownership of a portion of the property, rather than a partial interest in the whole. For example, two persons owning a piece of real estate as tenants in common partition the property, so that each person obtains sole ownership of a part.

Such a division of property does not appear a likely candidate for income tax problems. Common sense suggests that after the transaction each owner has neither more nor less than he did before; only the form of ownership has been affected. This quite reasonable conclusion has produced one of the basic rules of income tax law: a division of property between co-owners is not a taxable event.¹

This rule has great practical importance. For example, it determines much of the tax treatment of a division of property between divorced or separated spouses. It is integrally involved in the tax treatment of distributions by estates and trusts. Whenever property is held in co-ownership by two or more persons, the rule may determine the tax effects of a division of the property or a modification of the form of ownership.

Although the rule that a division of property between co-owners is not a taxable event seems simple, its development as a useful and readily understandable part of tax law has been strangely deficient. Determination of the forms of co-ownership that qualify for treatment under the rule remains difficult in many cases. Despite the application of the rule to many common transactions, there has been almost no effort to assure that the rule will have equivalent meaning and application in the several fields in which it is applied.

This article is an attempt to remedy those deficiencies. The article begins with a statement of the generally accepted basic rules concerning property divisions. Then the application of the rules to each of the major types of property divisions is examined and compared in an effort to determine whether there is in fact one property division rule, or a number of separate rules, differing with the context in which the division occurs. Finally, some suggestions are made for improvement in the income tax treatment of property divisions.

II. The Consequences of Co-ownership or Its Absence: A General Statement of the Property Division Rule

A. Division Between Co-owners

Whenever a property division occurs, the first question is whether the division is between co-owners. If it is, the general rule dictates nontaxability be-

cause no sale, exchange, or other disposition\textsuperscript{2} is involved, subject to certain exceptions discussed below. If the division is not between co-owners, the transaction is a sale or exchange and the parties will realize gain or loss. To begin with, let us assume that the division is between co-owners and ask what tax treatment will result.

1. \textit{Single Asset}. The simplest case of co-ownership involves a single piece of property owned by two persons as equal tenants in common. Division of such property equally between the tenants, resulting in complete ownership of a portion by each, is not a sale or exchange. Each tenant has merely changed the form of his ownership, its substance and value remaining the same. After the division each tenant owns half the property outright, with a basis for his half consisting of half the co-tenants' combined basis for the entire co-owned property, assuming each co-owner contributed half the cost of the entire property.

As an example of such a division of a single asset between co-owners, assume that Old and Young own a single wheat and cattle ranch as equal tenants in common. A dispute has arisen, and both parties desire partition. Each contributed $50,000 toward purchase of the ranch. At the time of division the grazing land has a value of $100,000 and the wheat land a value of $100,000. Upon partition, Old receives the entirety of the grazing land, for which he will have a basis of $50,000. Young receives the entirety of the wheat land, for which he will have a basis of $50,000. The transaction is not a sale or exchange, and neither Old nor Young realizes taxable gain on the transaction.

This result of course assumes that the property is divided exactly in accord with the respective property interests of the co-owners. If Young gratuitously permits Old to have more than half of the ranch (in terms of value), the division will be in part a gift. If Old receives more than half the ranch (in terms of value), and Young is compensated for this by a payment from Old in other than co-owned property, the division will be in part a sale or exchange. For instance, assume again that Old and Young own a single wheat and cattle ranch as equal tenants in common. However, in this case the grazing land has a value of $90,000 and the wheat land a value of $110,000. Allocation of all the grazing land and a small part of the wheat land to Old would be unwise, because the wheat acreage would be too small for Old to operate economically. The obvious solution is for Old to agree to take only the grazing land. Young will receive all the wheat land and will pay Old $10,000 for the extra wheat land allotted to Young. The tax result of this transaction is that Old and Young have effected a nontaxable division of the ranch, followed by a sale of $10,000 worth of wheat land by Old to Young. Old realizes gain to the extent that the $10,000 cash he receives exceeds the portion of his basis allocable to the extra wheat land. Young will add to his $50,000 basis for the wheat land the $10,000 he has paid to Young.

\textsuperscript{2}Henceforth in this article the term "sale or exchange" is used to denote a transaction ("sale or other disposition") giving rise to realization of gain or loss under Int. Rev. Code of 1954, § 1001(a).
2. Multiple Assets. If the co-owners hold two or more separate assets as tenants in common, the tax questions involved may become more difficult. The safest approach where multiple assets are involved is a pro-rata division of each separate asset between the co-owners, exactly in accord with the relative interests of the owners. The result of such a pro-rata division is that each asset is analyzed separately. Each asset is divided between its co-owners; no sale or exchange occurs as to any asset and no gain or loss is realized.

However, pro-rata division of each asset is often inconvenient or undesirable. For example, assume that Rich and Poor own as tenants in common two apartment houses of equal value (Wilmington Apartments and Manchester Apartments) located in widely separated parts of a city. A dispute arises and the co-owners decide that a division of the property is necessary. Partition of each apartment house on a pro-rata basis to each co-owner would be undesirable because that would merely create another form of co-ownership—the very thing Rich and Poor want to eliminate. The solution, of course, is for each co-owner to receive sole ownership of an entire apartment house: Rich takes the Wilmington Apartments and Poor takes the Manchester Apartments. This kind of transaction will be described in this article as a "non-pro-rata division" because the aggregate of co-owned property is divided (on the basis of value on the date of division) in accord with the property interests of the parties but each co-owned asset is not divided pro-rata between the co-owners.

The business purpose for such a non-pro-rata division is unimpeachable. Surely the tax treatment of this transaction should not be different from that applied to Old and Young upon an equal division of the grazing land and wheat land portions of their ranch in the first example described above. However, a number of authors—in fact the great majority of those who have considered the question—have suggested that that very result will or may obtain. If those writers argue that the presence of multiple assets and a non-pro-rata method of division makes the transaction between Rich and Poor a sale or exchange. This approach can be illustrated with an example, assuming these facts:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Total Basis to Rich and Poor as Co-owners</th>
<th>Fair Market Value on Date of Division</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wilmington Apartments</td>
<td>$40,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Manchester Apartments</td>
<td>80,000</td>
<td>100,000</td>
</tr>
</tbody>
</table>

If Rich takes the entire Wilmington Apartments and Poor the entire Manchester Apartments, the authors referred to above would analyze the transac-

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tion in this way: Rich has sold a half interest in the Manchester (basis to Rich $40,000) and has received in return Poor’s half interest in the Wilmington (fair market value $50,000). Rich’s realized gain is $10,000. After the transaction Rich has a basis of $70,000 for the Wilmington ($20,000 for his original half interest in the Wilmington, plus a $50,000 cost basis for the half purchased from Poor). Poor has sold a half interest in the Wilmington (basis to Poor $20,000) and has received in return Rich’s half interest in the Manchester (fair market value $50,000). Poor’s realized gain is $30,000. After the transaction Poor has a basis of $90,000 for the Manchester ($40,000 for his original half interest in the Manchester, plus a $50,000 cost basis for the half purchased from Rich).4

In this particular example the transaction would qualify for like-kind exchange treatment,5 resulting in nonrecognition of the gain except to the extent depreciation recapture might be involved.6 The availability of statutory nonrecognition in many such cases almost certainly accounts for the absence of extensive authority—other than the community property division and residuary estate distribution cases discussed below—on the question of whether such a non-pro-rata division of multiple assets constitutes a sale or exchange. Nevertheless, such an exchange could produce recognized gain or loss in many situations. An exchange involving other than like-kind property, such as realty exchanged for personalty, would not qualify for nonrecognition.7 Nor would an exchange of securities (other than stock in the same corporation)8 or evidences of indebtedness, or an exchange involving property not held for investment or productive use in a trade or business9 qualify for like-kind exchange treatment.

If the authors referred to above are correct that a non-pro-rata division of multiple properties between co-owners is taxable unless nonrecognition is achieved, that result could have highly unfortunate consequences. The situation involving Old and Young, equally dividing a wheat and cattle ranch, and that of Rich and Poor, equally dividing an apartment house operation, are identical in business purpose and economic effect. The only difference is one of physical contiguity. The division between Old and Young apparently escapes taxation merely because one contiguous ranch is involved, while the division between Rich and Poor, absent nonrecognition, is taxed because the two apartment houses are on separate, noncontiguous parcels. It would seem

4 There is some difference of opinion as to basis determination in a case of this kind. See text accompanying notes 44 and 45, infra. Assuming use of the basis computation described in the text, it may be argued that the parties would never consummate the transaction in this way, because it generates $20,000 more realized gain for Poor than for Rich. However, that disparity would be eliminated upon eventual sale of the properties to third parties by Rich and Poor, when Rich would realize $20,000 more gain than Poor. Rich has the advantage of deferring taxation on part of the gain for a longer period, and perhaps of eliminating it entirely through the step-up in basis at death. Poor, on the other hand, has the advantage of higher depreciation deductions.

5 INT. REV. CODE OF 1954, § 1031.

6 INT. REV. CODE OF 1954, §§ 1245(a) and (b)(4), 1250(a) and (d)(4).

7 TREAS. REG. § 1.1031(a)-1(c) (1956).

8 INT. REV. CODE OF 1954, § 1036(a).

9 INT. REV. CODE OF 1954, § 1031(a).
far better to treat the transaction as a division, rather than a sale or exchange, if the apartment houses have been operated together, regardless of whether they are on a single parcel of land. Such an approach would at least give proper weight to the business purpose underlying the transaction.

Other difficulties of distinguishing between the two cases are equally obvious. What if the wheat land and grazing land portions of the ranch are contiguous but were acquired at different times from different sellers? Would that make the transaction a sale or exchange? If not, would a slight physical separation of the two parcels, such as an intervening highway, do so? What if both the Wilmington and the Manchester were originally acquired by Rich and Poor in the same transaction from the same owner? Would that make the apartment house transaction a nontaxable division? These questions demonstrate that treating an exchange as taxable merely because multiple assets and a non-pro-rata method of division are involved creates serious problems of application that aggravate the highly discriminatory effects of such a rule.

B. Division Between Other Than Co-owners

The obverse of the division of property rule can be stated in this way: a division of property between other than co-owners is a sale or exchange and will ordinarily be taxable. This kind of division usually occurs when one person has full ownership of the property and another person has merely a claim against or charge upon that property. The claim or charge is treated as an “independent legal obligation,” i.e., independent of ownership rights in the property. Receipt of a part of the property in satisfaction of the obligation is not a division, but an exchange of one kind of property (the burden or charge) for another kind of property (outright ownership).

The most prominent example of a division of property between persons who are not co-owners is a divorce property settlement that does not involve community property. The husband’s transfer of a portion of his property to his wife in satisfaction of her marital property rights is in effect a division of the entirety of the husband’s property between persons who are not co-owners of that property. The husband is treated as the sole “owner” of his property, and the wife’s inchoate marital rights in her husband’s property are not considered to “reach the dignity of co-ownership.” The transaction is a sale or exchange, producing realized gain or loss. Such a division between persons who are not co-owners is treated as a sale or exchange primarily because each party to the transaction is viewed as having significantly changed the nature of his property rights. In a common-law divorce property settlement, for instance, the husband has exchanged a portion of his separate property for the wife’s surrender of her inchoate marital rights. The husband realizes gain to the extent of the difference between his basis for the property he transfers to his wife and the value of the marital rights surrendered by the wife. In United States

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11 Id. at 70.
v. Davis,\textsuperscript{12} for example, the husband transferred to his divorced wife stock having a basis to him of approximately $75,000 and a fair market value of approximately $82,000. The Supreme Court treated the wife's marital rights as having a value equal to the value of the property she received for surrender of those rights, \textit{i.e.}, $82,000. The result was realization of a $7,000 gain by the husband.\textsuperscript{18}

Theoretically the wife also consummates a taxable exchange in such a transaction. Her gain should be the difference between her basis for her inchoate marital property rights and the value of the property she receives in return for surrender of those rights. However, the Commissioner has rendered the question moot by ruling that the wife does not realize gain or loss in such a transaction,\textsuperscript{14} for reasons discussed below.\textsuperscript{18}

C. \textit{Summary of the Consequences of Co-ownership or Its Absence}

The rules discussed above show that the question whether co-ownership is present assumes crucial importance whenever a property division occurs. If co-ownership is present the parties can be certain that the transaction will not be treated as a sale or exchange unless either multiple assets are involved or the property is divided other than in proportion to the parties' respective ownership interests. On the other hand, if co-ownership is not present the result is entirely different. A transfer of a portion of the property to a non-owner in satisfaction of his claim is not treated as a division, but is considered a sale or exchange, and will be taxable unless nonrecognition is achieved.

III. Applications of the Property Division Rule

A. Marital Property Settlements

The rule that a division of property between co-owners is not a sale or exchange has received greatest attention in connection with marital property settlements incident to divorce or separation. Because the rule has great practical significance in this area, the nature and extent of its application to such transactions is now fairly well defined.

1. Community Property States. A line of Board of Tax Appeals and Tax Court decisions covering a period of over three decades clearly establishes that a division of community property between husband and wife upon divorce and in proportion to their respective interests in the community property is not a sale or exchange.\textsuperscript{18} The Board and the Tax Court have reached this conclusion

\textsuperscript{12}370 U.S. 65 (1962).
\textsuperscript{13}Id. at 67, 71-74.
\textsuperscript{15}See text accompanying notes 96-98, infra.
\textsuperscript{16}John H. Schacht, 47 T.C. 5526 (1967), \textit{acquiesced in}, 1968-1 CUM. BULL. 2; Clifford H. Wren, 24 T.C.M. 290 (1965); Osceola Heard Davenport, 12 T.C.M. 856 (1953); Ann Y. Oliver, 8 T.C.M. 403 (1949); Frances R. Walz, 32 B.T.A. 718 (1935). It should be noted that in \textit{Ann Y. Oliver}, the primary issue was not realization of gain or loss at the time of the division, but the basis of the property received to the wife upon a later sale by her. However, the basis question can be answered only by determining whether the division was a taxable event. Thus the courts have uniformly considered "basis" cases like \textit{Ann Y. Oliver} equally important with cases actually involving gain or loss on the division.
because they have viewed spouses’ respective rights in community property as genuine co-ownership interests. This approach reflects the customary view of community property interests—that the wife has a “present, vested interest” in the community property, and that husband and wife are “equal and present owners of the common property.”

The statutes of two of the community property states—California and Nevada—include an express statement of the principle that husband and wife are co-owners of community property. The statutes of both those states provide that the rights of husband and wife in community property are “present, existing and equal interests.” Court decisions in other community property states have included similar characterizations of the relationship. For example, the Supreme Court of New Mexico has described the wife’s interest in community property as “a present, existing, vested interest, equal in all respects to the interest of the husband.”

However, the generalization that the wife has a “present, existing and equal interest” is only that—a very generalized principle that can obscure the more important question of the precise distribution of the indicia of ownership. One of the most important of these is the right to manage the community property. Seven of the eight community property states give the husband the right to manage and control the entire community property, with the exception of certain assets, such as the wife’s own earnings. Another important limitation on the wife’s interest is the rule in most of the community property states that the entire community property is liable for the debts of the husband contracted after marriage, while the liability of the community property for debts of the wife is often limited. These limitations show that the wife’s “co-ownership” is importantly qualified. Even more important for our purposes are the qualifications imposed on the wife’s right to a portion of the community property upon divorce. Since it is the taxation of transfers involving that right that we are concerned with, this aspect of the community property relationship deserves the most careful attention.

Both the Board and the Tax Court have apparently entertained the traditional and widely held assumption that upon divorce the wife is entitled to exactly half the community property. However, an examination of the statutes

See II American Law of Property 169 (1952); See also Poe v. Seaborn, 282 U.S. 101, 111 (1930).


See, e.g., Jenkins v. Huffman, 46 N.M. 168, 125 P.2d 327 (1942); Bottorff v. Osborne, 155 Wash. 585, 285 P. 425, 427 (1930); La Tourette v. La Tourette, 15 Ariz. 208, 137 P. 426, 428 (1914); Kohny v. Dunbar, 21 Idaho 256, 546, 121 P. 544 (1912).


in the community property states shows that today the traditional view is more leged than fact. Only Louisiana still applies strictly the rule that the wife
receives half the community property upon divorce. Two of the community
property states have adopted important exceptions to the traditional rule. In
California if the divorce is granted for adultery, extreme cruelty, or insanity the
court has discretion to divide the community property as it deems “just,” and
New Mexico gives similar discretion to the court if the ground for divorce is
insanity. Most important, five of the eight community property states—
Arizona, Idaho, Nevada, Texas, and Washington—have abandoned the tradi-
tional rule entirely and direct the divorce court to divide the community prop-
erty as may seem “just,” “right,” or “necessary.” These five states grant the
divorce court extremely broad discretion in dividing the community property.
In Arizona, for instance, the court is to weigh the “rights of each party and
their children” in making the decision, and the Texas statute is almost identical.
Idaho courts are to consider “all the facts of the case and the condition of the
parties.” Under Washington and Nevada law the court is to have “regard to the
respective merits of the parties and to the condition in which they will be left
by such divorce, and to the party through whom property was acquired, and
to the burdens, if any, imposed on it, for the benefit of the children.

It is especially significant that in Arizona, Texas, and Washington—three
of the states that grant wide discretion to the divorce court in dividing com-
community property—a single statutory provision concerning division of property
upon divorce applies alike to community, separate, and jointly owned property,
with exactly the same considerations required as to each type of property.
Certainly as to these three states it is difficult to argue that a wife, in con-
nection with a divorce, has significantly greater rights in community property than
in other property.

Unfortunately, the Board and the Tax Court have neither examined state
law closely nor considered the significance of the differences among community
property states regarding the property rights of the wife on divorce. Typically
the Board and the Tax Court have merely relied on prior tax cases holding
community property divisions nontaxable, without mention of authority as to
the nature of the wife’s rights under state law. The two exceptions are Frances
R. Walz, which merely cited one United States Supreme Court case for the
proposition that “[i]n Texas a wife owns a vested one-half interest in the com-
community property,” and Osceola Heard Davenport, which relied on the same

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28 LA. CIV. CODE ANN. art. 2406 (West 1952).
30 N.M. STAT. ANN. § 22-7-11 (1953).
31 ARIZ. REV. STAT. § 25-318A (Supp. 1969); IDAHO CODE ANN. § 32-712 (Supp. 1969); NEV. REV.
STAT. § 125.150(1) (1966); TEX. FAMILY CODE § 3.63 (1969); WASH. REV. CODE ANN. § 26.08.110
(1961).
32 The preceding quotes have been taken from the appropriate state statutes cited in footnote 28.
33 ARIZ. REV. STAT. § 25-318A (Supp. 1969); TEX. FAMILY CODE § 3.63 (1969); WASH. REV. CODE
ANN. § 26.08.110 (1961).
34 32 B.T.A. 718, 719 (1935).
35 12 T.C.M. 856 (1953).
Supreme Court case and one other for the conclusion that “a husband and wife under Texas law have each a present vested one-half interest in the property of the marital community.”

Because of their reluctance to examine state law closely, the Board and the Tax Court have of course made no attempt to distinguish among community property states regarding the wife's property rights upon divorce. Instead, they have in effect adopted a strict community property rule. If the division is of “community property”—regardless of the actual extent of the wife’s divorce property rights under that particular state’s law—an equal division of the property will not be treated as a sale or exchange. This rule, while simple, easy to apply, and consistent with the traditional view of the community property relationship, ignores the important differences between the laws of the various community property states.

Given the very generalized conception of community property employed by the Board and the Tax Court in the divorce cases, it has been easy for them to conclude that a division of community property is not taxable if each piece of community property is divided pro rata between the spouses upon divorce. However, such property divisions on divorce are not usually pro-rata. Ordinarily one spouse takes the entirety of certain assets while the other receives the entirety of the remaining assets, the two portions being equal in total value. As explained above, it can be argued that such a non-pro-rata division constitutes a sale or exchange between the spouses. The husband can be viewed as having exchanged his half interest in certain assets in return for surrender by his wife of her interest in certain other assets, and vice versa. Because of the difficulty of this question, the Board and the Tax Court have given considerable attention to it.

The earliest case involving such a non-pro-rata division of community property was Frances R. Walz, a 1935 Board of Tax Appeals decision. In this case, the husband and wife agreed to an exactly equal division of their community property but allocated certain assets in their entirety to the wife and others in their entirety to the husband. The taxpayer wife contended that the transaction was an exchange and that she sustained a deductible loss. The Board concluded that, despite the use of a non-pro-rata method of division, the transaction was not taxable. The Board relied on the following reasoning in reaching that conclusion:

Can it be said that when two or more parties are the owners in common of a mixed aggregate of assets purchased for profit and decide to partition it, a gain or loss results from such partition? We think not. If, when the property owned in common is distributed in kind to the respective parties in accordance with their partition agreement, one of the parties is allowed a deductible loss because certain of the property has declined in value from the cost of its original purchase, it would mean by the same line of reasoning that, if the property had appreciated in value from the

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\(\text{id at 857.}\)

\(\text{See text at note 3, supra.}\)

\(32 \text{ B.T.A.} 718 \text{ (1935).}\)
time of its original purchase, there would be a taxable gain in the partition transaction. We know of no Board or court case which would be authority for such a proposition and we have been cited to none.38

In four cases since Frances R. Walz, the most recent in 1967, the Tax Court has likewise concluded that a non-pro-rata division of community property is not a sale or exchange.87 In two of these cases the Commissioner contended that such a transaction was not a sale or exchange. In one he argued that the division was a sale or exchange. In the fourth case the Commissioner and the taxpayer agreed with the court that no sale or exchange was involved. It is especially significant that the Tax Court did not require, as a condition for nontaxable division treatment, that the community property be divided equally between the spouses. In two of the cases it appears the division was equal,38 but in the other two there is no indication that an equal division was attempted, and the agreements involved speak only of a "fair division"39 or a "fair and equitable settlement and division."40 It appears clear that the Tax Court's sole concern is whether the spouses have made a good faith effort to divide their community property in accord with their respective property interests upon divorce, i.e., the portions of the community property that would be allotted to each spouse by the divorce court if a settlement were not reached by the parties.

The reasoning of the Board and the Tax Court in the community property cases involving non-pro-rata divisions is well illustrated by this passage from one of them—the 1965 Tax Court memorandum decision in Clifford H. Wren: "We do not feel an agreement of this nature was anything more than a division of property whereby instead of each spouse owning a one-half undivided interest in the whole, each owned a 100 per cent interest in one-half of the property."41 The court also emphasized that the spouses had "made every effort to divide their community property as nearly equally as possible."42 The reasoning applied in these cases is far from elegant, but nevertheless has a strong appeal. The Board and the Tax Court have quite properly looked to the substance of the transactions and not their form. The crucial test is whether each co-owner receives property having a value equivalent to the value of his co-ownership interest; it does not matter which property he receives from the pool of co-owned assets.

The five Board of Tax Appeals and Tax Court cases referred to above, without a single holding to the contrary, now clearly establish that a non-pro-rata method of distribution does not transform a division of community property into a sale or exchange. If this rule applies to community property divisions, it should apply as well to other divisions between co-owners. If Rich and Poor,

38 Id. at 719.
35 Clifford H. Wren, 24 T.C.M. 290 (1965); Oscola Heard Davenport, 12 T.C.M. 856, 857-58 (1953).
40 Ann Y. Oliver, 8 T.C.M. 403, 430 (1949).
41 24 T.C.M. 290, 293 (1965).
42 Id. at 293.
the co-owners of two apartment houses described above, divide the houses in non-pro-rata fashion, this transaction should likewise be treated as a division and not an exchange. Unless there is a relevant difference between tenancy in common and community ownership for purposes of such divisions, the community property cases should negate any possibility that a non-pro-rata method of division can transform any division between co-owners into a sale or exchange, as has been suggested by the authors referred to above.\textsuperscript{43}

None of the community property division cases has provided an adequate discussion of determination of basis after such a nontaxable division. However, in \textit{Ann Y. Oliver} the Tax Court used figures suggesting a carryover basis theory, \textit{i.e.}, the spouse who receives a piece of community property takes as his basis for that property its basis as community property.\textsuperscript{44} This approach seems questionable and has been criticized because it may result in discrimination between the spouses. Even though the spouses divide the property equally as to value, the husband may find that he has a far lower basis for the property he receives than does his former wife for the property she receives.\textsuperscript{45} Of course, this problem will arise only if a non-pro-rata division is present. The danger of discrimination is entirely foreseeable at the time of divorce and can be prevented by judicious distribution of properties, giving appropriate consideration to both value and basis.

In all the community property division cases referred to above, the spouses made a bona fide attempt to divide the community property between themselves, so that nontaxable division treatment seemed quite appropriate. Although all the cases did not involve exactly equal divisions, in each instance the division was intended to reflect the relative rights of the parties to the community assets. Often, however, the community property consists largely of a single economically indivisible asset (such as real estate or stock in a closely held corporation) which cannot feasibly be split between the spouses. This requires that the indivisible asset be transferred to one spouse, usually the husband, in exchange for a transfer by the husband of noncommunity cash to the wife as compensation for relinquishment of her right to a portion of the indivisible asset. Such a transaction is, of course, not a true division, but a sale by the wife to her husband of her interest in the community property. As a result, the courts have consistently denied nontaxable division treatment to such transactions.

The earliest case of this kind was \textit{Johnson v. United States},\textsuperscript{46} decided by the Ninth Circuit Court of Appeals in 1943. In this case, the husband and wife, prior to their divorce, agreed to a division of their community property on a non-pro-rata basis. However, in return for the wife's transfer to the husband of her interest in one particularly important community asset, an account receiv-

\textsuperscript{43} See note 3, \textit{supra}.

\textsuperscript{44} Ann Y. Oliver, 8 T.C.M. 403 (1949).

\textsuperscript{45} See Brickner, \textit{Basis: Considerations in Planning a Nontaxable Division of Community Property}, 42 \textit{Taxes} 560 (1964).

\textsuperscript{46} 135 F.2d 125 (9th Cir. 1943).
able, the husband agreed to pay all the wife's income taxes for two years. The wife's share of the account receivable so acquired by the husband proved to be worth approximately $2,000 more than the amount of taxes the husband had to pay under the agreement. The district court treated the transaction as a nontaxable division, but the Ninth Circuit held the transaction taxable because the promise of payment of taxes did not involve community property. The opinion is unclear concerning exactly how the marital exchange produced taxable gain, for it appears that the husband's gain was not realized until he collected the account receivable from a third party. Nevertheless, the opinion is significant because of its statement that the promised payment of taxes by the husband made the transaction "something more than a mere division of property," therefore rendering it taxable.

In Long v. Commissioner the Fifth Circuit likewise held that a similar transaction constituted a sale or exchange. In this case, the divorce settlement agreement allocated certain community property to the wife, but provided that she was required to transfer certain portions of that property to her divorced husband if he obtained designated insurance policies for the wife's benefit. The husband obtained the policies, and the wife transferred the designated community property to him. Upon the husband's later sale of that property, the Fifth Circuit held that his basis for the property received from his wife was his cost—the cost of purchasing the insurance with which he "bought" the property from his wife—and not the basis of the assets when held as community property. This means that the Fifth Circuit viewed the property settlement as a two part transaction: an equal division between the parties followed by a sale by the wife of part of her portion of the community property.

In some cases, the husband and wife have gone even further than those in Johnson and Long and have allocated substantially all the community property to one spouse, such allocation being accompanied by an obligation of that spouse to transfer to the other spouse noncommunity property (often borrowed) having a value equal to half the value of the entirety of the community property. Both the Tax Court and the Fifth Circuit have held that such a "division" is in fact a taxable sale of one spouse's interest in the community property to the other spouse.

As a result of the community property decisions discussed above, the rules for taxation of divisions of community property upon divorce are now rather well established and may be summarized as follows:

1. If the husband and wife make a good faith attempt to divide their community property in accord with their respective property interests in it, the division will not be treated as a sale or exchange and therefore will not be taxable. This rule applies

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48 135 F.2d at 130.
49 Id.
50 173 F.2d 471 (5th Cir. 1949), cert. denied, 338 U.S. 518 (1949).
52 Rouse v. Commissioner, 159 F.2d 706 (5th Cir. 1947), aff'd 6 T.C. 908 (1946).
even though the property is not divided equally, so long as the division is in accord with the respective property rights of the spouses upon divorce. The division will not be treated as a sale or exchange regardless of the method of division, i.e., the spouses may either divide each asset pro rata or allocate the entirety of certain assets to one spouse and the entirety of the remaining assets to the other spouse.

2. If the division of community property is not in accord with the respective interests of the spouses, either of two results will follow. If the spouse receiving less than his share of the community property does not receive a compensating payment in non-community property from the other spouse, a gift may have occurred and gift tax may be payable. If the spouse receiving less than his share of the community property does receive a compensating payment in non-community property from the other spouse, the spouse receiving less than his share will be treated as having exchanged his interest in the community property for the non-community property received. This will be a sale or exchange giving rise to realized gain or loss.

Although these rules for taxation of community property divisions seem firmly established at this date, there have been several reports that the Internal Revenue Service may be reconsidering its position on community property divisions. Specifically, the Service is reported to have instructed certain of its agents to treat a division of community property upon divorce as nontaxable only if each asset is divided pro rata. For several reasons, it seems highly unlikely that the Service will in fact adhere to this position. First, such an approach squarely repudiates the decisions in the five cases discussed above that establish that a non-pro-rata division will be treated as nontaxable so long as a good faith division of the community property is sought. Second, in United States v. Davis, the Supreme Court appears to have accepted and tacitly approved the prevailing treatment of community property divisions. In fact, the Court took pains to distinguish community property divisions from those involving other than community property. Finally, the Commissioner's concession in a 1967 Tax Court case that a non-pro-rata division of community property was nontaxable for purposes of that case may indicate that the matter has been resolved in favor of continued nontaxability of non-pro-rata divisions.

2. Common-law States. Strangely, the treatment of marital property divisions involving other than community property remained unsettled until 1962. A split among the circuits existed prior to that time, and this was not resolved until the Supreme Court decision in United States v. Davis.

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54 John H. Schacht, 47 T.C. 552 (1967), acqulised in, 1968-1 Cum. Bull. 2; Clifford H. Wren, 24 T.C.M. 290 (1965); Osceola Hurd Davenport, 12 T.C.M. 856 (1953); Ann Y. Oliver, 8 T.C.M. 403 (1949); Frances R. Waltz, 32 B.T.A. 718 (1935).
55 370 U.S. 65 (1962), See text at note 12, supra.
58 The Sixth Circuit Court of Appeals and the Court of Claims had held that a husband's transfer of appreciated or depreciated property pursuant to a divorce in a common-law state was not a taxable event. Commissioner v. Marshman, 279 F.2d 27 (6th Cir. 1960); Davis v. United States, 287 F.2d 168 (Ct. Cl. 1961). The Second and Third Circuits had held to the contrary. Commissioner v. Hallwell, 131 F.2d 642 (2nd Cir. 1942); Commissioner v. Mesta, 123 F.2d 986 (3d Cir. 1941).
In *Davis*, the husband, pursuant to a property settlement agreement incorporated in a divorce decree, transferred appreciated securities to his divorced wife. In return, the wife surrendered all her marital rights with respect to her husband’s property. Under the applicable law—that of Delaware—the wife’s rights consisted of dower (as to real estate), a right to intestate succession, and a right to a portion of the husband’s property upon divorce. The agreement between husband and wife characterized the transfer as a “division in settlement of their property.”

The Supreme Court concluded that the wife’s rights in her husband’s property in this situation “do not even remotely reach the dignity of co-ownership.” Therefore the transaction was not a division of property between co-owners but was a “taxable transfer of property in exchange for the release of an independent legal obligation.” The husband was treated as realizing gain to the extent that the fair market value of the marital rights surrendered by his wife exceeded his basis for the property transferred to his wife. During the taxable year in question, the husband transferred to his divorced wife stock with a fair market value of approximately $82,000 and a basis to the husband of approximately $75,000. Because the Supreme Court treated the wife’s marital rights as having a value equal to the value of the property received in exchange for their surrender ($82,000), the husband was taxable on $7,000 of gain.

The crucial aspect of the Supreme Court’s reasoning in reaching this result lies in its characterization of the issue to be decided: “The taxpayer asserts that the present disposition is comparable to a nontaxable division of property between two co-owners, while the Government contends it more resembles a taxable transfer of property in exchange for the release of an independent legal obligation.” This method of stating the issue makes it clear that to the Court the central question was whether the right surrendered by the wife was a right of “ownership” with respect to the property involved, or merely an “independent legal obligation.” The Court, having framed the issue in this manner, concluded that “Delaware seems only to place a burden on the husband’s property rather than to make the wife a part owner thereof.” Similarly, it decided that the wife’s rights “partake more of a personal liability of the husband than a property interest of the wife.”

In reaching this result the Supreme Court used three tests to determine whether the wife’s rights constituted ownership interests or merely a personal liability of the husband. It viewed these three tests as the most significant in distinguishing between the rights of a wife in common-law and community property states. First, in *Davis* the wife had “no interest—passive or active—over the management or disposition of her husband’s personal property”.

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60 Id. at 66.
61 Id. at 70.
62 Id. at 69.
63 Id. at 69.
64 Id. at 70.
65 Id.
66 Id.
second, the wife’s rights were not descendable—she would not be entitled to share in her husband’s estate unless she survived him; and third, the share of the husband’s property to be allocated to his wife upon divorce was not fixed by statute, but was only what the divorce court might consider “reasonable.” The Court emphasized that the question of what constitutes a “reasonable” amount of property under Delaware law depends on many factors entirely apart from the extent of the husband’s property, including such matters as the needs of the wife and children.\(^{67}\) It was these three factors that resolved the issue as characterized by the Court and led to the conclusion that the wife’s marital rights under Delaware law constituted merely a burden on the husband’s property—not an actual ownership interest therein.\(^{68}\)

The Court’s conclusion has a good deal of appeal. We are accustomed to thinking of the wife’s rights in a community property system as greatly different, in both nature and extent, from those of a wife under a common-law system. Nevertheless, a close examination of the three factors considered most significant by the Court in differentiating a wife’s rights under the community property and common-law systems casts some doubt on the validity of the Court’s conclusion.

The first factor considered by the Court was its conclusion that Delaware law gave the wife in *Davis* “no interest—passive or active—over the management or disposition of her husband’s personal property.”\(^{69}\) Actually this is little different from the situation that prevails in a community property state. In seven of the eight community property states the husband has the right to control and manage the entire community property, with the exception of certain assets, such as the wife’s earnings.\(^{70}\) Furthermore, statutes in most community property states requiring joinder of the wife in conveyances of designated community property assets (usually real estate) are identical in effect to requirements in common-law states effectively requiring the wife to join in conveyances of dower property.\(^{71}\)

Second, the court found it significant that under Delaware law the wife’s rights are not descendable. The wife does not share in her husband’s estate—either upon intestacy or through right of dower—unless she survives him.\(^{72}\) Here there is a real difference between the two systems. Under most of the community property systems, half the community property goes to the legatees or descendants of each, regardless of order of deaths.\(^{72}\) However, the importance of this factor is greatly diminished because it is a divorce transfer—not a disposition at death—that *Davis* was concerned with.

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\(^{67}\) Id. at 70, 71.

\(^{68}\) Id. at 70.

\(^{69}\) See note 22, supra.

\(^{70}\) See II American Law of Property 203-09; I W. de Funiak, Principles of Community Property 562-63 (1943).
Third, the Supreme Court emphasized that under Delaware law the portion of the husband's property the wife receives upon divorce is merely what the court considers "reasonable," and that the determination of what is reasonable depends as much on the needs of the spouses as on the amount of the property involved.\textsuperscript{74} As is demonstrated above, this sort of direction to the court regarding division of property is quite similar to that provided in most of the community property states. In five of the eight community property states, the court has complete discretion in dividing community property as may seem "just" or "necessary" to it, and it may consider such matters as relative guilt of the parties and their respective needs in making the division.\textsuperscript{75} In two other community property states the court has such discretion if the divorce is granted for certain causes.\textsuperscript{76} Only in Louisiana is the strict rule of equal division followed.\textsuperscript{77}

One more factor should be added to the three considered by the Supreme Court in \textit{Davis} in comparing the wife's rights under the community property and common-law systems. Under both systems the wife, upon divorce, has a right to only a portion of a designated pool of assets. She has no enforceable right to demand an interest in any specific piece of property. Under both systems the divorce court has broad discretion to allocate assets between the spouses as it see fit.\textsuperscript{78} As to community property a California court has stated this principle very clearly:

In adjusting the property rights of the parties the court may consider all the common property as one asset or fund, composed of separate units, and can often more equitably settle and adjust matters by giving all of designated and described pieces of property to one party than by awarding to each an undivided interest in all. We know of no principle of law or practice that would forbid such a course of action. The court is no more bound to award to each spouse an undivided interest in each piece of land than it is to award to each an undivided interest in each cow or horse.\textsuperscript{79}

The foregoing comparison of marital rights upon divorce under the community property and common-law systems suggests that \textit{Davis} may be based on a rather tenuous premise. Although the interest of a wife in community property is commonly described as "present, existing, and equal," that generalization tells only part of the story, for there are several important similarities between the common-law and community property rights of a wife. Most important of all, in most community property states the wife's right to part of the community property \textit{upon divorce} is subject to the same sort of discretion of

\textsuperscript{74} 13 Del. Code Ann. \textsection{} 1531(a) (1953): "When a divorce shall be decreed for the aggression of the husband, the complainant shall be restored to all her real estate, and allowed, out of her husband's real and personal estate, such share as the court thinks reasonable; but if the divorce be for the wife's aggression, the court may restore the whole or a part of her real estate, and also such share of her husband's personal property as seems reasonable."

\textsuperscript{75} See note 28, supra.

\textsuperscript{76} See notes 26 and 27, supra.


\textsuperscript{78} 2 W. Nelson, \textit{Divorce and Annulment} 174-77, 179-87 (2d ed. 1961).

the divorce court as is exercised in common-law states. This means that the right of the wife in Davis to a share of her husband's property upon divorce under Delaware law would be similar to the right of an Arizona or Washington wife to a share of community property upon divorce. The fact that for other purposes there are differences between the wife's rights under the two systems has much less significance, for Davis was concerned solely with a divorce property transfer. Thus, to the extent that the Davis holding was based on the premise that a wife in a community property state has a much greater right to property upon divorce than does a wife in a common-law state, the Davis conclusion is open to some doubt. Unfortunately, the rather tenuous premise relied on in the Davis case has led to the creation of a significant difference in tax treatment between the two systems—the very sort of discrimination both Congress and the courts have sought to avoid.\footnote{See Helvering v. Hallock, 309 U.S. 106, 117-18 (1940); S. Rep. No. 1013, 80th Cong., 2d Sess., U.S. Code Cong. Serv. 1163, 1184-91 (1948).} That discrimination is not merely theoretical, for the Davis rule can have a drastic effect on a husband whose assets consist largely of highly appreciated property. Division of the property upon divorce can create a huge taxable gain, although the transaction will produce no cash with which to pay the tax. This can greatly complicate divorce negotiations if substantial property is involved.\footnote{It should be noted that the Davis rule raises a number of other troublesome questions relating to recognition and treatment of gain or loss, all of which are beyond the scope of this article. One particularly important problem is whether Int. Rev. Code of 1954, \S\ 267 prevents recognition of a loss on a transfer of property because, at the time of transfer, the parties may still legally be husband and wife. It has been suggested that a divorce property transfer is within the letter but not the spirit of \S\ 267. Barton, Tax Aspects of Divorce and Property Settlement Agreements—The Davis, Gilmore, and Patrick Cases, 16 So. Cal. Tax Inst. 421, 435 (1964). A similar problem is presented by Int. Rev. Code of 1954, \S\ 1239, which requires ordinary income treatment for gain on the sale or exchange of depreciable property between spouses.} Husbands in common-law states must wrestle with these matters, while their counterparts in community property states can ignore the problem. For this reason, among others, there has been considerable criticism of the Davis decision, and legislative reversal of the Davis rule has been urged.\footnote{19 Bulletin of the Section of Taxation, American Bar Ass'n 64-65 (1966); Taxation Resolution VI adopted by House of Delegates, American Bar Association, February 14, 1957, 53 A.B.A.J. 382-83 (1967). See also A.L.I., Fed. Income Tax Stat., X257 (Feb. 1954 Draft).}

Despite its unfortunate effects, the Davis rule seems firmly enshrined in our tax law and necessarily plays an important part in any divorce or separation in which significant assets other than community property are involved. Already the Davis rule has been applied in several reported cases. In Harry L. Swaim\footnote{50 T.C. 302 (1968).} and Mildred F. Swaim,\footnote{50 T.C. 336 (1968).} for instance, the Tax Court applied the Davis rule to a divorce involving Kentucky law. The court apparently did not think it significant that the divorce court, in ordering a property division, stated that under Kentucky law the wife was entitled to at least one-third of the husband's property, despite the fact that the Davis Court considered a wife's interest in a specific share of community assets an important distinction between common-law and community property states. In another Tax Court
case, both the Commissioner and the taxpayers agreed that the Davis rule applied to a New York divorce.\footnote{Dorothy L. Huckle, 27 T.C.M. 209 (1968).}

In Pulliam \textit{v.} Commissioner,\footnote{329 F.2d 97 (10th Cir. 1964), \textit{cert. denied}, 379 U.S. 836 (1964), \textit{aff’d} 39 T.C. 883 (1963).} the Tenth Circuit Court of Appeals extended the Davis rule by applying it to a case in which the property division was ordered by a decree of a Colorado divorce court, without a separate agreement between the spouses. The court found that the wife’s inchoate rights in her husband’s property under Colorado law were substantially the same as those under Delaware law and therefore it applied the Davis rule. The court held that the husband realized income from the transfer regardless of whether the transfer was pursuant to an agreement or a court decree. The husband’s obligation, described by the court as a “personal obligation,” was satisfied by the transfer of property in either case.

The most severe test of the Davis rule to date occurred in Collins \textit{v.} Commissioner, a 1968 Tenth Circuit case.\footnote{388 F.2d 353 (10th Cir. 1968), \textit{aff’d} 46 T.C. 461 (1966).} Collins involved marriage partners who had lived in Oklahoma throughout their married lives. The wife had contributed importantly to the success of the husband’s business, thus rendering the stock in the business, which was held in the husband’s name alone, “jointly acquired property” under Oklahoma law.\footnote{12 Okla Stat. Ann. \textsection 1278 (1961). The relevant statutory material is as follows: “As to such property, whether real or personal, as shall have been acquired by the parties jointly during their marriage, whether the title thereto be in either or both of said parties, the court shall make such division between the parties respectively as may appear just and reasonable, by a division of the property in kind, or by setting the same apart to one of the parties, and requiring the other thereof to pay such sum as may be just and proper to effect a fair and just division thereof.”} A significant feature of such jointly acquired property is that the spouse not having title nevertheless has important rights in the property—principally the right to receive some portion of the property upon divorce. The statute directs the divorce court to make such division as it considers “just and reasonable.” As the Tenth Circuit interpreted Oklahoma law, the portion allotted to the wife (assuming the husband has title to the property) depends primarily on her contribution to the couple’s earnings, although consideration is sometimes given to the needs of the parties. The wife has no vested interest in any particular part of the jointly acquired property, and the divorce court may choose any portion of the jointly acquired property for distribution to the wife. In addition, under Oklahoma law as interpreted by the Tenth Circuit, the wife has no right to control disposition of it or to exercise management over it. If the marriage produces no issue, the surviving spouse takes all the jointly acquired property for life in case of intestacy, followed by distribution of half to the heirs of each spouse upon the surviving spouse’s death.\footnote{388 F.2d at 356.}

The transaction involved in Collins was the taxpayer husband’s transfer of a portion of the jointly acquired stock to his wife pursuant to a property settlement agreement approved by the divorce court. The Commissioner, relying on Davis, claimed that the husband realized gain on this transfer. The husband
contended that the rights of his wife under Oklahoma law were significantly different from those of the wife in *Davis*. He argued that the wife in *Davis* had only an inchoate dower interest and a possible right to property upon divorce, whereas Oklahoma law granted a much more specific interest in a designated pool of jointly acquired property. He relied on Oklahoma and Kansas decisions which describe the distribution of jointly acquired property on divorce as a "division" of such property.

However, both the Tax Court and the Tenth Circuit held that *Davis* controlled and that the transfer was taxable to the husband. The Tenth Circuit concluded that the wife's interest under Oklahoma law did not meet the three crucial *Davis* tests: right to control and management, descendability, and entitlement to a fixed share upon divorce. The court viewed these as the "traditional elements of co-ownership" and found them lacking under Oklahoma law. The decision reached by the Tenth Circuit in *Pulliam v. Commissioner*,\textsuperscript{90} decided shortly before the *Collins* case, seems to have influenced its decision in *Collins* that the wife's interest in jointly acquired property is not co-ownership. As discussed above, the court had concluded in *Pulliam* that under Colorado law a wife's interest in her husband's property did not constitute co-ownership, and therefore *Davis* applied. In *Collins*, the Tenth Circuit found it difficult to distinguish between the rights of a wife under Colorado law and those of a wife under Oklahoma law. All that could be said was that the wife's rights were somewhat more specific in Oklahoma. Therefore the result in *Collins* was that, although an Oklahoma divorce court would call the transaction a "division" of property, it was not to be so for federal tax purposes.

The *Collins* decision is particularly interesting because it is directly contrary to the holding in *Swanson v. Wiseman*, a 1961 Oklahoma United States District Court decision.\textsuperscript{91} *Swanson v. Wiseman* concerned a divorce involving Oklahoma domiciliaries, all of whose assets were jointly acquired property under Oklahoma law. The divorce court ordered an equal division of the property. The property included certain stock, half of which the husband conveyed to his divorced wife. Later, on sale of the stock, the wife contended that the divorce conveyance was a sale, so that she would have a cost basis for the stock ($4.80 per share). The Commissioner argued that the conveyance was a nontaxable division of property, so that the wife's basis for the stock would be the same as its basis to her husband ($1 per share). The court held that the transaction was a nontaxable division and not a sale or exchange, emphasizing the clear and specific right of the wife under Oklahoma law to a part of the jointly acquired property. In its decision in *Collins*, which involved the same Oklahoma law, the Tax Court gave little attention to *Swanson v. Wiseman*. Instead the Tax Court, under what it viewed as the requirements of *Davis*, undertook a thorough examination of Oklahoma law and concluded that a wife's interest in Oklahoma is more like that of the wife in *Davis* than like that of a wife in

\textsuperscript{90} 329 F.2d 97 (10th Cir. 1964), cert. denied, 379 U.S. 836 (1964), aff'd 39 T.C. 883 (1963).
\textsuperscript{91} 61-1 U.S.T.C. ¶ 9264 (W.D. Okla. 1961).
a community property state. Affirming the decision by the Tax Court in Collins, the Tenth Circuit did not even consider Swanson v. Wiseman and its holding on the jointly acquired property question.

The Tenth Circuit's failure to consider Swanson v. Wiseman in deciding the Collins case was to prove unfortunate, as a result of further developments involving the Collins divorce. Oklahoma has an income tax law which for purposes of the Collins transaction is identical to the federal law. The Oklahoma Tax Commission sought to impose Oklahoma income tax on the Collins transfer, based on the Tenth Circuit's conclusion. Litigation resulted, and the case was appealed to the Oklahoma Supreme Court for final determination of the state income tax question. In a carefully reasoned opinion, the court upheld the taxpayer's position as to Oklahoma income tax and rejected the Tenth Circuit decision in Collins. The Oklahoma Supreme Court stated that the Tenth Circuit had misinterpreted the nature of a wife’s interest in jointly acquired property under Oklahoma law. The court argued that the wife’s interest in Collins was more than the mere “burden” on the husband’s estate found in Davis. It emphasized that the wife's interest under Oklahoma law is “fixed and vested.” Further, the Oklahoma Supreme Court considered descendibility of the interest irrelevant, for the transaction at issue was a divorce, not a death transfer. Finally, the court carefully distinguished the wife’s rights under Colorado law (involved in Pulliam), which the Oklahoma court viewed as merely a burden on the husband’s estate, from the vested interest granted under Oklahoma law. The court emphasized that under Colorado law a part of the husband’s property is conveyed to the wife to assure her support, while under Oklahoma law, as viewed by its supreme court, need is irrelevant, and the wife's rights are based solely on her contribution to the joint acquisition of the property. Thus the court concluded that the transfer in Collins was a division of property between co-owners and not a taxable event for purposes of the Oklahoma income tax.

After this decision by the Oklahoma Supreme Court in the Oklahoma income tax litigation, the Supreme Court of the United States granted certiorari as to the Tenth Circuit decision in Collins. In a per curiam decision the Supreme Court vacated the judgment of the Tenth Circuit, remanding the case “for further consideration in light of the opinion of the Supreme Court of Oklahoma in Collins v. Oklahoma Tax Commission.” On remand, the Tenth Circuit considered itself bound by the Oklahoma Supreme Court decision in the state income tax litigation and held that the transfer of the stock was a “nontaxable division of property between co-owners.” This result brings Collins into line with Swanson v. Wiseman. However, the United States Supreme Court's remand probably should not be interpreted as an outright repudiation of the Tenth Circuit's original reasoning in Collins. More

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likely it should be viewed as an exercise of deference by the United States Supreme Court to the interpretation by a state court of its own state’s law in a very complicated area.

Nevertheless, the Collins remand may prove very significant for developments regarding divorce property divisions. The Tenth Circuit had undertaken a careful application of the three Davis tests (right to management, descedability, and entitlement to a fixed share on divorce) and had concluded that a wife’s rights under Oklahoma law did not meet any of them. The Oklahoma Supreme Court, whose reasoning received at least the tacit approval of the United States Supreme Court, applied a quite different test. First, it rejected entirely the relevance of descedability because the transaction involved had occurred upon divorce—not death. Second, it concluded that the test of “entitlement to a fixed interest” was satisfied, even though an Oklahoma wife does not receive an automatic one-half, because the share of a wife in Oklahoma is, in the view of its supreme court, based not on the wife’s need, but on the extent of her contribution to the jointly acquired property.

The Collins litigation should certainly encourage taxpayers seeking to avoid taxation of divorce transfers to examine closely the state law governing the property aspects of the divorce. Significantly, the Tenth Circuit pointed out in Collins that the jointly acquired property concept is not unique to Oklahoma. Taxpayers (or the Commissioner) may find it possible to argue that in other states the wife’s interest is more like that of a wife under Oklahoma law than under Delaware law. Like the Oklahoma Supreme Court in Collins, other courts may well reject the relevance of the descedability test in determining the taxability of a divorce property transfer. In many states it may prove possible to argue that the rights of the wife to property upon divorce are as specific as they are in Oklahoma. In Arkansas, for instance, the wife has an absolute right upon divorce to one-third of the husband’s personality and one-third of certain of the husband’s realty. Even where this is not the case, Collins suggests that specificity can be shown if the divorce court emphasizes the contribution of the wife to acquisition of the property—rather than need—as the primary element in determining the share of property she receives.

The Davis case has established that a transfer of assets by a husband to his wife pursuant to a divorce property settlement in a common-law state produces taxable gain or loss to him, unless the Collins exception applies. Theoretically, the same rule should apply to the wife: she should be treated as realizing gain to the extent that the value of the property she receives from her husband exceeds her basis for her marital rights. However, the Internal Revenue Service has ruled that the wife does not realize gain or loss on such a transfer, even though she takes as her basis for the property received its fair market value on the date of transfer. This ruling confirms the Service’s prior administrative practice. The ruling states no rationale for the Service’s action, but the

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97 United States v. Davis, 370 U.S. 65, 73 n.7 (1962).
obvious reason for the position is the great difficulty of establishing a basis for the wife's inchoate marital rights in her husband's property. An additional argument for the position that the wife has not realized gain or loss is that taxation of the wife might subject to tax an amount greater than the total gain actually embodied in the property transferred.  

The Davis holding is somewhat limited because it concerned only property owned outright by the husband. No joint tenancy, tenancy by the entirety, or tenancy in common property was involved. Similarly, none of the post-Davis cases discussed above involved an attempt to divide property held in any of these forms. Thus there remains the question whether Davis would be applied to a division of property owned in joint tenancy, tenancy by the entirety, or tenancy in common upon a divorce involving the husband and wife co-owners.

In considering divisions of such property, it should first be noted that a termination of a joint tenancy or tenancy by the entirety resulting in a division of the property between the tenants may be treated as a gift rather than a sale or exchange. If the spouses have taken advantage of Int. Rev. Code of 1954, § 2515(a) to treat the creation of such a tenancy as other than a transfer for purposes of federal gift tax, the termination of the tenancy and division of the property between the spouses will be considered a gift to the extent that one spouse receives a portion of the property greater than the portion of the consideration for the original purchase furnished by that spouse.

The first case dealing with the question of dispositions of joint tenancy property not involving gift aspects was Cofield v. Koehler, decided just before Davis. The husband and wife involved in this case lived in Kansas and obtained a divorce there. All their property, which was jointly acquired property under Kansas law, was divided equally between the spouses upon divorce. The various assets were not divided in pro-rata fashion, and the wife received the entirety of certain Series E United States Savings Bonds held in a true joint tenancy, upon which interest had accrued. The Commissioner claimed that upon transfer of the entirety of the bonds to the wife the husband realized as income half the accrued interest on the bonds. The Commissioner's theory was that the husband had exchanged his right to half the accrued interest for other property of equal value. However, the United States District Court for Kansas held that the division was not a sale or exchange, and that the husband realized no gain on the transfer. The court stated its conclusion in this way: "He exchanged these bonds in which each had an undivided one-half interest, including the accrued interest for other property of equal value, also jointly owned by them. The effect of the divorce decree did no more than set apart to each in severalty the interest they owned in their community property. They gained nothing and they lost nothing." Cofield v. Koehler tells us little about the application of the division of property rule to divorce

98 Schwartz, supra note 53, at 181.
101 Id. at 74.
divisions of jointly held property. It is simply an example of the principle applied in *Swanson v. Wiseman* and in the Oklahoma Supreme Court's *Collins* opinion. However, the *Cofield v. Koehler* opinion does make a very important contribution to the law concerning non-pro-rata divisions, for it suggests that if a true division between co-owners is involved, the co-owners may exercise complete latitude in dividing the property in any way they wish, regardless of whether two or more forms of co-ownership are involved.

A more important case concerning co-owned property is *Robert K. Stephens*,102 a 1962 Tax Court decision rendered after *Davis*. In this case, an Ohio divorce court had directed the husband to transfer to his wife his half interest in their residence, held by tenancy in common. The Tax Court held that *Davis* applied, and that the husband realized gain on the transfer of his half interest in the residence because it had appreciated since its purchase by the spouses. It made no difference that the house was held by tenancy in common, for no attempt was made to divide the house. The Tax Court did not undertake an examination of Ohio law regarding the wife's marital rights, but merely stated, "There is no suggestion here that the law of real property with respect to husband and wife is any different in Ohio than in Delaware which was the State involved in the *Davis* case."103 The *Stephens* decision appears to establish that the *Davis* rule will apply to any transfer of the husband's interest in property, regardless of whether that interest is his full ownership of his separate property or his partial interest in property held in joint tenancy or tenancy in common. However, gain will be realized only upon transfer of the husband's interest. The wife's receipt of a portion representing her own interest in the jointly owned property is not a transfer of the husband's interest.

The recent case of *Hornback v. United States*104 includes a thorough discussion of the principles applicable where the property involved is held in joint tenancy or tenancy by the entirety. In this case, the property accumulated by the husband and wife during their years of marriage was held in tenancy by the entirety under Missouri law. Upon divorce the husband and wife agreed to divide the property equally. However, this was effected by a transaction in which the husband received almost all the entirety property, and promised to pay $36,000 in non-entirety cash to the wife. It was understood that the cash would be obtained by a loan to the husband from a third party, to be secured by a mortgage on the property involved. The court concluded that this was not a genuine property division, because money never a part of the entirety property was used to satisfy the claims of the wife. This is of course the same principle as that applied to community property "divisions" in which one spouse in effect buys out the other.106 By way of dictum the *Hornback* court stated that the transaction would have been nontaxable

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102 38 T.C. 345 (1962).
103 Id. at 348.
106 See text accompanying notes 46-52, supra.
even if the property had not been divided pro rata, so long as only entirety property was involved. The court relied on Clifford H. Wren, a non-pro-rata community property division case, for this conclusion.

Cofield v. Koehler, Robert K. Stephens, and Hornback permit the establishment of some general principles regarding the application of the Davis rule when a part of the spouses' property is held in joint tenancy, tenancy in common, or tenancy by the entirety. First, it is clear that such property is considered co-owned by the spouses. If it is divided between them in accord with their co-ownership interests, the transaction is a nontaxable division of property between co-owners. That this occurs incident to divorce and as part of a property settlement makes no difference. However, if the property is divided other than in proportion to the spouses' respective ownership interests, the transaction will be treated as in part a transfer of property from one spouse to the other, as in Stephens. Such a transfer, if in consideration of release of marital rights, is a sale or exchange and produces realization of gain or loss.

Although it is easy to reach these conclusions regarding the application of Davis to co-owned property, it is much more difficult to determine the precise boundaries of the Davis rule itself. Davis appears to stand for the proposition that any transfer of property by the husband to his wife upon divorce and in satisfaction of the wife's marital property rights is a sale or exchange, resulting in realization of gain or loss. This result has been reached as to divorces under the laws of Colorado, Delaware, Kentucky, New York, and Ohio. However, the Collins litigation shows that the Davis rule is somewhat vulnerable. It now appears certain that jointly accumulated property under Oklahoma law will be treated like community property, and the Davis rule will not be applied. It is entirely possible that the same result may be reached in other states. In any state that gives to the wife a more specific right in her husband's property than did Delaware, the husband may escape the Davis rule. This is particularly likely now that Collins will encourage counsel to take a closer look at local law regarding divorce transfers.

B. Distributions by Estates and Trusts

Another common transaction to which division of property principles apply is a liquidation or corpus distribution to two or more beneficiaries of an estate or trust. We are not accustomed to thinking of such an estate or trust distribution as a division of property. However, that is exactly what occurs when the assets of an estate or trust are divided and distributed to two or more legatees or beneficiaries. Distribution of a residuary estate or the corpus of a trust constitutes a division of such assets among the legatees or beneficiaries, and such a transaction may bring the division of property rules into play. This section considers these questions as they relate to estates and trusts other

\footnote{23 A.F.T.R.2d 69-1401 at 69-1404, -1405 (W.D. Mo. 1969).} \footnote{24 T.C.M. 290 (1965).}
than investment or business trusts. Investment or business trusts are considered in section C below.

It must be emphasized that the questions discussed here do not involve realization of gain or loss by the estate or trust upon a distribution of property. Realization of gain by the estate or trust is a matter entirely apart from realization of gain by the legatees or beneficiaries; the former concerns distributions in satisfaction of pecuniary interests, while the latter concerns distributions in satisfaction of fractional share interests. An estate or trust realizes gain or loss when the executor or trustee distributes appreciated or depreciated property in satisfaction of a pecuniary legacy. For example, assume a legatee is entitled to a pecuniary legacy of $10,000. The executor satisfies that legacy by transferring to the legatee estate property with a fair market value at the date of distribution of $10,000, and a basis to the estate (value on date of death or alternate valuation date) of $8,000. The estate realizes a $2,000 gain. This is not a division of property, but merely satisfaction of a debt, which produces taxable gain or loss to the estate.¹⁰⁸

In contrast, division of property questions arise when fractional share interests in an estate or trust are present. The distribution to a legatee of a fractional share of a residuary estate does not give rise to gain or loss to the estate, because the testator is taken to have intended the legatee to share in appreciation or depreciation of the assets between the date of death and the date of distribution.¹⁰⁹ The same is true of distribution of a fractional share of the corpus of a trust to a beneficiary.¹¹⁰ These rules make it clear that the residuary legatees of an estate are considered co-owners of the residuary estate, and that the beneficiaries entitled to the corpus of a trust (other than an investment or business trust) are considered co-owners of the trust corpus. The property division rule applies and it is therefore clear that a distribution of fractional share interests is nontaxable if made in pro-rata fashion. However, difficulty arises when a non-pro-rata method of distribution is used, and this problem is the subject of the discussion in this section.

The following example will serve to illustrate the questions involved in a non-pro-rata fractional share distribution. Assume that George Jones dies testate with a residuary estate consisting primarily of two apartment houses—the Dorchester Apartments and the Abington Apartments. George’s executor uses date of death values for federal estate tax purposes. A lengthy period of probate is involved, with the result that inflationary factors and market conditions cause the apartment houses to appreciate substantially in value during probate. The date of death values and the values on the proposed date of distribution to the legatees are shown below:


The will devises the residuary estate “in equal shares” to George’s two sons, James and Mark. The executor plans to distribute to James and Mark each an undivided half interest in each apartment house. However, James and Mark are not on good terms and fear that co-ownership of either apartment house would lead to further conflict. They suggest that the Dorchester be transferred to James, and that the Abington be transferred to Mark. The executor agrees and obtains written consents to this plan from both James and Mark.111

Such a non-pro-rata distribution is highly desirable, and doubtless best accomplishes the purposes of all involved—including the testator. Yet there is a danger that a tax problem has been created. Have James and Mark entered into a sale or exchange? Must James be treated as having transferred his one-half interest in the Abington (basis $15,000) to Mark in exchange for Mark’s one-half interest in the Dorchester (value $25,000), producing realized gain to James of $10,000? Must Mark be treated as having transferred his one-half interest in the Dorchester (basis $20,000) to James in exchange for James’ one-half interest in the Abington (value $25,000), producing $5,000 in realized gain?

It is readily seen that the problem raised by this example is exactly the same as that presented when tenants in common divide two or more properties between themselves. As explained above,112 a number of authors—the great majority of those who have considered the issue—have suggested that this sort of transaction may create taxable gain for both James and Mark unless non-recognition treatment can be achieved.113 One such writer is A. James Casner, who, in commenting on this sort of situation in the 1961 edition of his estate planning treatise, stated that “gain or loss may be realized on such exchange,” but added by footnote that he used the word “may” designately because the only authorities on the point hold that such an exchange is not taxable. The authorities he cites are the M. L. Long case and O.D. 667, both discussed below. Casner questioned “whether these authorities are still healthy in light of their age.”114 However, in Casner’s 1969 supplement he comments at length on the Clifford H. Wren case115 in this connection. The Wren case, it will be recalled, is a 1965 Tax Court decision involving a division of community property between husband and wife upon divorce. The property was divided in non-pro-rata fashion, but the Tax Court con-

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111 Obviously the distribution is not exactly equal, for Mark, taking an apartment house with $10,000 lower basis than James’ apartment house, will have to recognize greater gain upon a subsequent sale and will have lower depreciation deductions while he owns the property. Therefore Mark will demand additional cash or other assets from the estate to compensate for the inequality of basis.

112 See text accompanying note 3, supra.

113 See note 3, supra, and note 118, infra. The transaction in the above example would appear to qualify for nonrecognition under Int. Rev. Code of 1954, § 1031.


115 24 T.C.M. 290 (1965).
cluded that the transaction was not a taxable exchange. Casner states that such a division of community property between husband and wife is "similar to the division of a residuary estate into specified shares, so far as the right of each party to his or her fractional share of each item in the mass of property that is to be divided is concerned."\textsuperscript{118} The inference is that the caution expressed in the 1961 edition may have been outmoded by the \textit{Wren} case. This, of course, assumes that the same property division rules would apply to both transactions. It should be remembered, however, that the \textit{Wren} holding is not new, for the Board and Tax Court had reached the same result in three cases prior to \textit{Wren}, one as early as 1935.\textsuperscript{117}

Virtually all authors who have written on the subject agree with the caution expressed in the 1961 Casner edition that a non-pro-rata distribution of estate or trust assets in satisfaction of fractional share legacies may give rise to taxable gain or loss, at least if done at the request of or with the consent of the legatees.\textsuperscript{119} However, the few cases and rulings on the subject suggest the contrary.

The earliest case dealing with such a division of property among legatees was \textit{Henry J. Faulkin},\textsuperscript{118} a 1928 Board of Tax Appeals decision. In this case seven children held undivided one-seventh interests each in a residuary estate consisting of real property devised to them by their mother and father. While the land was still in the estates of their parents, the children agreed to a "sale" of the land. They agreed that portions of the land should be sold to four of the children, who would pay the entire group of seven a stipulated price. Each child would receive one-seventh of the total sale price. The parties treated the transaction as a "sale," and appropriate deeds were drawn and executed. Although the Board believed that the children intended the transaction to be essentially a settlement of rights to estate property, it concluded that the sales were taxable exchanges, and that for tax purposes the transaction was not a mere division of property among the children. Interestingly, the Board based its holding to a great extent on its conclusion that, under the applicable state law, the children took title to the land immediately upon the death of the parents. However, even if personality had been involved, the result would very likely have been the same.

The Board's holding in \textit{Faulkin} can also be supported on other grounds,

\textsuperscript{118} I A. J. \textsc{Casner}, \textsc{Estate Planning} 892-93 (Supp. 1969).

\textsuperscript{117} Osceola \textsc{Heard Davenport}, 12 T.C.M. 856 (1953); Ann Y. \textsc{Oliver}, 8 T.C.M. 403 (1949); Frances R. \textsc{Walc}, 32 B.T.A. 718 (1935).


\textsuperscript{118} 13 B.T.A. 1200 (1928).
because the transaction clearly was not a bona fide division. It was instead a sale by some co-owners of their interests in the estate property to other co-owners for cash. The Faulkin situation was exactly like the community property "divisions" discussed above in which one spouse took substantially all the community property and paid the other spouse in non-community cash. Sale or exchange treatment is inevitable in this kind of case, so Faulkin tells us little, even by way of dictum, about the question of whether a genuine division of estate property among the beneficiaries would constitute a sale or exchange if made in non-pro-rata fashion.

The most important case on the problem of non-pro-rata divisions between legatees in *M. L. Long*, a 1936 Board of Tax Appeals decision.\(^\text{120}\) The Long case concerned distribution of the estate of Flora T. Long, who devised one-third of her residuary estate to each of her two sons, M. L. Long and L. E. Long. She devised a life estate in the remaining one-third to her daughter, Alice P. Greer, with remainder over at Alice’s death to the issue of Alice, or to M. L. Long and L. E. Long if Alice should have no issue. The residuary estate consisted of several different assets, including at least two pieces of real estate. The Board made no mention of state law either permitting or requiring pro-rata distribution to residuary legatees. The will specifically directed the executor to divide the residuary estate equally among the three beneficiaries. However, all three of Flora’s children considered a pro-rata division undesirable. As a result they executed a "partition deed" designed to fix their interests in the residuary estate. Alice Greer took a life estate in certain real estate in Fort Worth, with remainder over to her issue, or to M. L. Long and L. E. Long if Alice should have no issue. The sons took the rest of the estate, which included a property known as the Borden County Ranch.

The tax controversy arose as a result of the later sale of the Borden County Ranch by the sons. The issue before the Board of Tax Appeals was whether the value of the remainder interest in the Fort Worth property deeded to Alice should have been included in the brothers’ cost basis for the ranch. This reflected the fact that both the Commissioner and the brothers treated the partition deed as a sale or exchange, so that cost rather than the date of death value was to be used as the brothers’ basis for the Borden County Ranch.

The Board concluded that both the Commissioner and the sons were wrong, and that the partition deed transaction was not a sale or exchange. The Board viewed the division of property among the legatees as merely a means of accomplishing an equitable distribution of the estate. Its conclusion was stated in this fashion:

> It can not be reasonably questioned, had the parties submitted the partition of the estate to the court and agreed to a decree setting aside to each party certain of the assets of the estate as constituting a fair and equitable division in accordance with the general devise of the will, that each of the heirs would have then taken the property assigned, set aside, and conveyed by decree of court, as property received.

\(^{120}\) 35 B.T.A. 95 (1936).
under the will and, consequently, with bases for purposes of computing gain on resale, in the amounts at which these several items of property were appraised for Federal estate tax purposes. The partition deed, executed by the three beneficiaries under the will, did nothing more than effect a similar partition of the property. It was manifestly not a transaction entered into for profit. It was not a purchase and sale of property in the ordinary sense, but was simply a transaction carried out to effect a partition of the estate and vest title to the partitioned properties in the several beneficiaries in a manner that would cause an absolutely equal division, without loss or gain, and thus effect the disposition of the property made by the will. As such it was no more than an incident in the administration of the estate. We are not concerned here with the technical question of deraignment of title but merely the actual source from which the petitioners acquired the Borden County Ranch. In our view this property, of which they stood possessed after the administration of their mother’s estate through the execution of the partition deed, was acquired by them under her will and their basis for gain or loss on its disposition was the same as if it had been set aside and conveyed to them by decree of court in a formal administration of the estate.\textsuperscript{121}

This seems to be a clear holding that the transaction was merely an equitable division of property among co-owners, and not a taxable sale or exchange. However, in a later part of the opinion the Board appears to have treated the transaction as a sale or exchange, at least hypothetically. This would of course require a basis for the Borden County Ranch in the amount of its cost to the brothers, \textit{i.e.}, the value of their interest in the property allotted to Alice Greer, rather than the date of death value of the ranch. In this connection the Board observed that the value of each asset in the residuary estate was the same on the date of the partition deed as on the date of death, resulting in no gain (and therefore no basis change) even if a taxable exchange had occurred:

It is evident to us that these computations of both respondent and the petitioners are incorrect. \textit{Even though we consider the execution of the partition deed as affecting such dispositions of property as to give rise to gain or loss, the result is a cost basis for the Borden Ranch in the hands of petitioners in the amount of its net value as appraised for estate tax purposes. The record shows that at the time of the execution of the partition deed the values of the various properties of the estate had not changed from the date of their appraisement for estate tax purposes, so that we are concerned here with cost bases constituting appraised values, as of the date of death of petitioners’ mother. Further, the execution of the partition deed was with the purpose of reaching a definite result. That was an exactly equal partition which would leave the beneficiaries possessed of the interest devised to each under the will, or, in other words, a division without gain or loss. In the absence of evidence to the contrary we assume that this object was effected and the division made without gain or loss to any one concerned, and for that which each party to the transaction gave up he or she received an equal value in return. Under such conditions the basis for gain or loss of each item of property would be exactly offset by property conveyed at an equal basis, since cost and value were the same, and the several transfers would result in no change of base as to the properties of which the several parties stood possessed after the execution of the partition deed.}\textsuperscript{122}

\textsuperscript{121} \textit{Id.} at 97-98.
\textsuperscript{122} \textit{Id.} at 98-99 (emphasis added).
The italicized portion of the court's opinion may have been intended as merely hypothetical, but it could be viewed as an alternative holding. This possibility deprives the Long case of some of the weight it would otherwise have, for without this ambiguity Long would appear to be a clear and unequivocal holding that a non-pro-rata division of fractional shares in an estate is not a sale or exchange.

The Board's 1942 decision in *Esther M. Findlay*\(^{128}\) also sheds some light on the question of non-pro-rata distributions. In this case the taxpayer was a legatee entitled to a fractional share of a residuary estate. Upon liquidation of the estate and distribution of its assets to the legatees, the taxpayer received property having less value than the value of her share of the residuary estate on the date of death. She claimed a loss, which the Board of Tax Appeals denied, holding that the transaction was not a "disposition" and therefore not a taxable event. The Board made these comments:

The estate was not distributed in undivided shares but was partitioned between the distributees in proportion to their respective undivided shares on the basis of the fair market value at the time of distribution. The value of the property distributed to each of the distributees was therefore equivalent to the value of his undivided share. No loss recognizable for tax purposes was sustained by petitioner in respect of such property prior to its partitioning and distribution. We do not believe that the distribution of divided shares of the property instead of undivided shares thereof constituted a "sale or other disposition" of the latter within the meaning of the statute. Such operation amounted merely to the segregation of the undivided share of petitioner in the property and the distribution to it of such share so segregated.\(^{124}\)

Although the *Findlay* opinion does not provide a convincing rationale for its result, it is nevertheless a square holding that a legatee realizes neither gain nor loss upon a non-pro-rata distribution of a fractional share of a residuary estate.

The most recent case concerning distribution of a fractional share of an estate is *Sam F. McIntosh*,\(^{125}\) a 1967 Tax Court memorandum decision. The *McIntosh* litigation resulted from the distribution of the estate of William McIntosh, Sr., who left a will giving a life estate in the residuary assets to a former wife, with the remainder to be divided equally between his two sons. His widow apparently elected to take against the will under Florida law, and this would ordinarily have resulted in a pro-rata distribution of the residuary estate, one-third each to the widow and two sons. However, the sons were anxious to acquire all the estate's stock in the family corporation, McIntosh Co. A "stipulation" regarding distribution of the residuary estate was agreed to by the widow and the two sons. The sons were to receive all the estate's shares of McIntosh Co. stock, plus certain other assets. The widow was to receive from the estate, in return for her interest in the property allocated to

\(^{127}\) 46 B.T.A. 1214 (1942).
\(^{128}\) Id. at 1215-16.
the sons, $26,472 in cash plus an automobile. This stipulation was approved by the probate court and the property was distributed accordingly.

The issue in the case was the basis the sons had for their McIntosh Co. stock. If the distribution pursuant to the stipulation was a sale or exchange, the sons would have a cost basis for the stock, i.e., the value of the property surrendered by them to acquire the stock. On the other hand, if the distribution was merely a division of the residuary property between co-owners and not a sale or exchange, the sons’ basis for the stock would be its date of death or alternate valuation date value.

The significant aspect of the case is that both the taxpayers and Commissioner agreed that the stock held by the sons was “acquired from their father’s estate” and that therefore their basis for the stock was the value of the stock on the date of William McIntosh’s death. The Tax Court agreed with this conclusion and cited the M. L. Long case to support it. It then proceeded to discuss other matters affecting the basis of the stock, which did not relate to the sale or exchange question.

Although the McIntosh settlement resulted in a non-pro-rata distribution, the case is not really a holding on the issue. Nevertheless, the taxpayer and the Commissioner concurred that the division of estate assets, although non-pro-rata, was not a sale or exchange, and the Tax Court agreed. It is also important that the Tax Court viewed M. L. Long as both controlling and good law despite its age. This application of M. L. Long in a 1967 case does much to eliminate the doubts that might otherwise be cast on it by its 30-year age.

The only government pronouncement on the subject of exchanges between legatees or beneficiaries is O.D. 667, published in 1920. O.D. 667 concerned a bequest of a testator’s residuary estate in equal thirds to his three sons. By “mutual agreement” the assets of the estate were distributed on a non-pro-rata basis, based on values at the date of distribution, which exceeded the date of death values. As to this situation the Bureau of Internal Revenue stated two conclusions: the estate realizes no gain from such a distribution, and the basis of each son for the assets he holds is the date of death value of those assets, and not the value at the time of distribution. O.D. 667 does not include an express discussion of whether the sons realize gain on the non-pro-rata distribution of the assets. However, the conclusion stated as to basis necessarily implies that the distribution is not a taxable event. If that were not the case, a cost basis would be required. Significantly, O.D. 667, despite its age, has not been included in the Internal Revenue Service’s recent listings of obsolete rulings.

Long, Findlay, McIntosh, and O.D. 667 seem to provide a rather conclusive answer to the question whether a non-pro-rata distribution of assets in satisfaction of a fractional share bequest is a sale or exchange. Although

126 Id. at 1289.
127 35 B.T.A. 95 (1936).
128 Digest of Income Tax Rulings, No. 19, 47 (1920).
each of these four authorities has a defect that somewhat impairs its persuasiveness on this particular issue, the combination of the four, spanning a period of almost 50 years, seems a sound basis on which to conclude that a non-pro-rata method of distribution does not present significant tax dangers. Nevertheless, many authors have not been satisfied with Long, Findlay, McIntosh and O.D. 667 as a final statement of the rules applicable to estate and trust distributions. For this reason several writers have looked to state law regarding such distributions for the final answer. It has been suggested that the residuary legatees will have consummated a taxable exchange in a non-pro-rata distribution only if each legatee has the power under state law to compel a pro-rata distribution to him of each asset in the residuary estate. The theory is that if the legatee can compel a pro-rata distribution his acceptance of anything else in lieu of a portion of each asset in the estate constitutes a voluntary act of exchanging one piece of property for another. This approach to the question, while emphasizing the voluntariness of the action of the legatees, has another and equally important aspect. It is based on the premise that an exchange is involved only if each legatee has a right to demand specific assets. The effort to determine whether the legatee has power to compel a pro-rata distribution is in fact an attempt to establish whether the beneficiary has a specific interest in each piece of residuary property.

Approaching the problem in this way, the Committee on Tax Aspects of Decedents' Estates of the Real Property, Trusts and Estates Section of the American Bar Association recently examined state law on this question and reached the following conclusions:

"Where the right of the distributee is simply to receive one-half of the residue of the estate, he would not normally be considered as equitably the owner of one-half of each item of property available for distribution; rather, distribution can technically be made in any manner that will fairly give each party his due proportion of that estate. Therefore, a sale by either the estate or the distributees, under these circumstances, would not be deemed to have taken place. However, it must be considered whether under local law each beneficiary has the right to receive either cash or an interest in each piece of property available for distribution." 180

... Unless the executor is required by the terms of the governing instrument or applicable state law to make a pro rata distribution, a non pro rata distribution does not result in a taxable exchange between the residuary beneficiaries. Further, such a requirement does not exist absent a specific provision to that effect in the governing instrument. 181

The first sentence of the second paragraph of the quoted material is especially significant, for it is very difficult to determine whether under state law a legatee

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129 Buell and Schmidt, supra note 118, at 273; Committee on Tax Aspects of Decedents' Estates, supra note 118, at 365.
can demand a portion of each asset in the estate, except in the rare instances in which a state statute settles the question. This very basic point is the subject of few reported cases, and even these are rather inconclusive. In a 1956 case, the Surrogate's Court for New York County, New York, impliedly authorized a non-pro-rata distribution where the will expressly permitted payment of legacies in kind and pro-rata distribution was not feasible.\textsuperscript{132} On the other hand, in a 1949 case, the Westchester County, New York, Surrogate Court required pro-rata distribution where the will permitted distribution in kind but required use of date of death values for this purpose, thus making equality of treatment of beneficiaries impossible unless exact pro-rata distributions were made.\textsuperscript{133} In a 1959 case, the Appellate Division of the Superior Court of New Jersey decided a case in which the will expressly permitted distributions in kind in satisfaction of residuary bequests. The executor, who was also a legatee, sought to make distribution on a non-pro-rata basis. The court upheld this method of distribution, provided fair and equitable valuations were made. However, the will itself provided for appraisal of all properties to be distributed in kind, which necessarily implied that the testator expected non-pro-rata distribution.\textsuperscript{134} Another case bearing on this question is \textit{Stayton v. Delaware Trust Company}, a 1965 Delaware Chancery Court decision.\textsuperscript{135} This case concerned the estate of Leon Stayton, who died on December 18, 1961, bequeathing to a trust all stocks “owned by me at my death.” Leon’s mother had died less than a month before, and Leon was entitled to one-half of her residuary estate, which included a considerable amount of stock that was ultimately distributed to Leon’s executor. The trust beneficiaries of course claimed that Leon “owned” the stock held by his mother’s estate when he died, but the court held to the contrary. It concluded that prior to distribution Leon had no right to any specific assets, since the executor had power to sell the stock, and arguably was under a duty to convert the assets to cash. Therefore Leon did not “own” any of the stock on December 18, 1961, and the stock did not enter the trust. The same result was reached by the Supreme Court of Delaware in a similar case in 1967.\textsuperscript{136} These Delaware cases may be of assistance in establishing that a residuary beneficiary does not have an interest in specific assets, but only an interest in a pool of residuary assets.

Despite these state court cases, most authors have concluded that unless the will or a statute settles the question, there is no clear answer as to whether a residuary beneficiary has a right to compel pro-rata distribution.\textsuperscript{137} Nevertheless, it is clear that the state cases provide at least some support for the proposition that a fractional share legatee does not have a right to specific assets.

\textsuperscript{132} \textit{In re Mann’s Estate, ... Misc. 2d ...}, 152 N.Y.S.2d 348 (Surr. Ct. 1956).
\textsuperscript{133} \textit{In re Burnett’s Will, 89 N.Y.S.2d 152} (Surr. Ct. 1949).
\textsuperscript{134} \textit{In re Estate of Fiedler, 55 N.J. Super. 500, 151 A.2d 201} (Super. Ct. 1959).
\textsuperscript{135} 206 A.2d 509 (1965).
\textsuperscript{137} Committee on Tax Aspects of Decedents’ Estates, \textit{supra} note 118, at 367.
Professor Casner has used another approach in an attempt to determine whether a residuary legatee can demand specific assets, at least as to personality. Casner relies on the generally acknowledged rule that it is the duty of the executor to convert the estate's personality to cash as quickly as possible, unless the will includes provisions allowing the executor to retain assets and distribute in kind, and argues from this that all a beneficiary can expect is cash or its equivalent value in property. Such a conclusion necessarily denies the legatee any interest in specific assets in the estate.

As a matter of planning, it has been suggested that the sale or exchange problem can be entirely avoided if the executor or trustee is given express authority to distribute residuary assets in other than pro-rata fashion. This is said to eliminate the possibility of gain or loss to the beneficiaries upon a non-pro-rata distribution. The possibility of exchange treatment as between the legatees is thus avoided, but other problems may be created. It has been suggested that granting such a power to the executor changes what would otherwise be a fractional share bequest to a pecuniary bequest. The theory is that the executor's exercise of such a power creates an intermediate step in the distribution process—one in which the legatee's rights are necessarily translated into a fixed dollar value, i.e., a pecuniary bequest. Thus the executor would realize gain or loss upon distribution of assets in satisfaction of the bequest. Furthermore, there could be a danger of disqualification of such a bequest for the federal estate tax marital deduction under Rev. Proc. 64-19.

Because steps taken to avoid the problem of a possible sale or exchange between legatees might produce undesirable side effects, many executors and trustees will hope to find assurance that a non-pro-rata distribution can be made, even without express authority in the instrument, without creation of taxable gain to the beneficiaries. The author believes that executors and trustees should proceed on this assumption and that the possibility of sale or exchange treatment is quite remote. All the case and ruling authority on the issue—scant though it may be—holds that a distribution of fractional share interests is not transformed into a sale or exchange by use of a non-pro-rata method of distribution. In addition, the state law cases, which probably tend to establish that no fractional share legatee has a right to specific assets, add support to this conclusion. Finally, the analogy to non-pro-rata divisions of community property upon divorce, as to which nontaxability has long been established, is very persuasive. At this time, therefore, it appears very unlikely that a non-pro-rata distribution could be treated as a taxable sale or exchange.

The conclusion that there is little danger of sale or exchange treatment is

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139 See Committee on Tax Aspects of Decedents' Estates, supra note 118, at 367; Rodman, Executor's Power to Allocate Property to Qualify for the Marital Deduction, 94 TRUSTS AND ESTATES 801 (1955).
140 See also Villard v. Villard, 219 N.Y. 482, 114 N.E. 789 (1916).
141 Buell and Schmidt, supra note 118, at 276; Polasky, supra note 118, at 864.
142 1964-1 CUM. BULL. 682.
143 See text accompanying notes 35-37, supra.
further supported by an examination of the policy aspects of the question, for the courts would undoubtedly give considerable weight to this in deciding the question. In a time when inflation and other factors often cause rapid appreciation of estate assets, the possibility of creation of taxable gain for the legatees through distribution of assets is an important matter. If the estate assets are liquid and readily divisible, such as widely traded securities, imposition of tax will impose little hardship beyond the tax liability itself, because a legatee can sell a portion of the stock to obtain funds with which to pay the tax. However, this is the very situation—when the estate consists primarily of widely held stock or similar liquid assets—in which pro-rata division of the assets among the legatees is feasible. Exactly the opposite is true if the estate assets are nonliquid or indivisible, such as stock in a closely held corporation or real estate. Creation of tax liability on the part of the legatees in this situation can have serious effects. The transaction may well not provide funds with which to pay the taxes imposed. Sale of a small portion of the real estate would bring a price per acre far below that obtainable if the entire tract were sold at one time. Sale of a portion of the closely held stock to obtain funds with which to pay taxes is usually out of the question, both because of lack of a market for such minority stock, and because the sale might endanger control by the family. Yet this situation, in which the assets are nonliquid or indivisible, is precisely when pro-rata division is not feasible. Distribution to several residuary legatees of pro-rata undivided interests in the real estate or stock may be the surest route to later problems. Co-ownership of each asset may lead directly to dissension, and fragmented ownership of closely held stock always poses serious dangers in case of controversy.

The hardship that would be caused by taxation of non-pro-rata divisions of estate assets is quite evident. The policy basis for non-recognition of gain in this context is surely just as strong as in the case of like kind exchanges, involuntary conversions, and residence sales.\footnote{\textit{Int. Rev. Code of 1954}, §§ 1031, 1033, 1034.} If such a non-pro-rata division were not treated as a sale or exchange, the legatee would take the date of death or alternate valuation date value as his basis for the property received. Upon later disposition of the property the entire gain or loss would be recognized. The effect, like that of any nonrecognition provision, would be merely one of postponing gain or loss. Since both gains and losses would be postponed, the revenue effect would be neutral except to the extent that the historical inflationary trend continues, producing in the aggregate more gains than losses. Of course, some taxpayers would take advantage of nonrecognition to postpone recognition of gain, and perhaps ultimately to eliminate it entirely through the step-up in basis at death,\footnote{\textit{Int. Rev. Code of 1954}, § 1014(a).} while selling loss items to obtain the tax benefits of losses. Although some danger of revenue loss is present, it seems to be far more than outweighed by the non-tax advantages to both estates and legatees.
C. Other Property Divisions

1. Conversion from Joint Tenancy to Tenancy in Common or Separate Ownership. The Service has ruled that a conversion of a joint tenancy in corporation stock to a tenancy in common, for the purpose of eliminating a survivorship feature, is not a taxable transaction, and that the same rule applies to a partition action resulting in severance of a joint tenancy in corporation stock and issuance of two separate stock certificates in the names of each of the former joint tenants. The Service does not regard either of these transactions as a sale or exchange; thus no gain or loss is realized. The authorities cited in the ruling suggest that the rationale is quite simple: each party has merely changed the form of his ownership, not its substance. The proposition that severance of a joint tenancy is not a sale or exchange receives some further support from Cofield v. Koehler, discussed above. Although that case involved a division upon divorce, there is no reason to think that a divorce division would be treated differently from any other. Hornback v. United States, also discussed above, provides additional support by dictum. On the basis of these authorities it now seems clear that the conversion of a joint tenancy into a tenancy in common or separate ownership will not receive sale or exchange treatment.

2. Distribution or Division of Investment Trust Assets. Division of property questions are also presented when a beneficiary of an investment trust exchanges his beneficial interest in the trust for a pro-rata portion of each asset held by the trust, pursuant to provisions in the governing instrument. Originally the Bureau of Internal Revenue took the position in G.C.M. 10235 that such a transaction is not a sale or exchange; thus the trust beneficiary takes the trust's basis for the assets he receives. This conclusion was based largely on inclusion in the trust instrument of a specific right of the beneficiary to claim a pro-rata share of the trust's assets at any time. The General Counsel concluded from this that the exchange of a trust interest for specific securities merely merges the legal and equitable titles, and is not a taxable sale or exchange.

However, in DuBois Young, the Board of Tax Appeals repudiated G.C.M. 10235. In this case, the taxpayer had exchanged shares in an investment trust for a pro-rata portion of the trust's securities, pursuant to a provision in the trust instrument. The taxpayer wished to treat the transaction as a taxable sale or exchange, since it would produce a loss to him. The Board of Tax Appeals agreed with the taxpayer, and was "not persuaded" by G.C.M. 10235. The Board emphasized the separate existence of the trust, particularly as a taxing entity, and concluded that direct ownership of the assets by the taxpayer after the transaction was very different from the taxpayer's owner-
ship of a portion of the beneficial interests in the trust. The Bureau entered a nonacquiescence.\footnote{181}

In *Commissioner v. Tew*,\footnote{182} the Sixth Circuit Court of Appeals reviewed a decision of the Board of Tax Appeals identical to *DuBois Young*. Like *DuBois Young*, *Tew* involved the surrender by an investment trust beneficiary of her beneficial interest in the trust in return for receipt of a pro-rata portion of the assets of the trust. The Commissioner argued both that the transaction constituted merely a merger of legal and equitable titles and that the taxpayer had merely reduced to possession something to which she had always had a right under the trust instrument. The Sixth Circuit disagreed and held that the transaction constituted a sale or exchange, permitting the taxpayer to realize a loss. The Sixth Circuit thought it significant that the trust was a separate taxable entity. However, it gave greater emphasis to the fact that the taxpayer’s equitable ownership interest in a pool of securities that the trustee might alter at any time was “totally different” from the taxpayer’s complete ownership and control of certain securities after withdrawal.

In G.C.M. 21915,\footnote{183} issued in 1940, the Bureau surrendered and accepted the holding in *Tew*, revoking G.C.M. 10235 and entering an acquiescence regarding *DuBois Young*.\footnote{184} In this memorandum the Chief Counsel acknowledged that the beneficiary taxpayer’s ownership of individual stocks after withdrawal was “essentially different” from ownership of an interest in the trust. In Rev. Rul. 68-633,\footnote{185} which supersedes G.C.M. 21915, the Service has restated its position on such transactions. The ruling concerns the surrender by an investment trust beneficiary of her beneficial interest in the trust in exchange for a pro-rata portion of each of the securities held by the trust, all pursuant to a provision in the trust instrument. The Service, citing *DuBois Young* and *Tew*, states that the beneficiary realizes gain or loss on this transaction, which is a taxable sale or exchange. Its reasoning is as follows:

In this case A [the beneficiary] received something different from the property right surrendered. While A had an equitable interest in all stock owned by the trust, she did not have an exclusive beneficial interest therein. When she terminated the trust relationship, she surrendered her interest in the shares remaining in the trust. The transaction effected a substantial change in her property interest and represents an exchange within the meaning of section 1002 of the Code.\footnote{186}

In a 1931 Second Circuit decision, *Allen v. Commissioner*,\footnote{187} the court reached the same result in a case somewhat similar to *Tew* and *DuBois Young*. The taxpayer in this case was a shareholder in a bank which was a party to a merger. In connection with the merger, certain assets of the bank were placed in trust to satisfy unknown claims. Stockholders in the bank received interests
in the trust proportionate to their stock holdings. The holders of the trust interests had no right to redeem their interests for assets of the trust, but the trustee had power to distribute the trust assets in kind at any time. On several occasions assets of the trust were distributed pro-rata to the trust beneficiaries. The Commissioner claimed the distributions were taxable as exchanges of trust assets for the beneficial interests in trusts, while the beneficiaries claimed that the distributions merely changed their form of ownership, and were not taxable. The court upheld the Commissioner, finding that the distribution accomplished a substantial change in property rights of the distributees—a change from an undivided equitable interest in the whole to the total ownership of a part.

The holding in the DuBois Young, Tew, and Allen cases was codified, as to common trust funds qualifying under Int. Rev. Code of 1954, § 584(a), in section 169(d) of the Revenue Act of 1936,108 now embodied in Int. Rev. Code of 1954, § 584(e). Section 584(e) provides: "The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of such interest by the participant."

As a result of these cases and rulings, and of section 584(e) in the case of common trust funds, it is now well established that the surrender by an investment or business trust beneficiary of his interest in the trust in exchange for a pro-rata share of the trust assets is a taxable sale or exchange. Obviously, this principle contrasts sharply with the nontaxable treatment of community property divisions and particularly with that the nontaxable treatment given fractional share distributions by a residuary estate or non-business trust. It would seem that liquidation of an investment trust interest could readily be viewed as a nontaxable division of property similar to a community property division or an estate or non-business trust distribution.

However, there are some important differences that could support the disparity in treatment. As to common trust funds qualifying under Int. Rev. Code of 1954, § 584(a), the taxability of withdrawals is the price that must be paid for the privilege of avoiding taxation of the trust fund as a separate entity, which would occur if section 584 were not present. As to investment and business trusts not qualifying under section 584(a), the distinction is of another kind. If the trust does not qualify as a common trust fund under section 584 it usually will be taxed as a corporation—not a trust.109 Thus withdrawal of a beneficiary's share of the assets of a business or investment trust is more like redemption of a shareholder's stock than distribution of a legatee's fractional share interest in a trust. Another distinction is also present. An investment or business trust is ordinarily established voluntarily by the beneficiary. He creates a separate taxable entity and intends to benefit from management by the trustees. By contrast, the co-ownership relationships considered above, such as those arising from marriage, death, or the creation of a donative trust, are

ordinarily not created voluntarily by the taxpayers who receive the assets. For instance, the husband and wife are involuntary holders under the community property rules; their sharing of ownership interests is forced upon them by their marriage relationship. Similarly, the estate beneficiary receives his interest in the estate or trust through the donative act of a third person. The fact that his interests are merged with those of other persons in the estate or trust is not of his doing. Because subjection of the taxpayer’s assets to the co-ownership arrangement was involuntary in the first place, it seems proper to permit unwinding of that relationship without realization of gain or loss.

Two recent rulings complete the picture regarding division of common trust funds. The first is Rev. Rul. 68-77, which concerns the division of a common trust fund governed by section 584—consisting of common and preferred stock, bonds and cash—into two separate common trust funds, one of which included all the common stocks and a portion of the cash, and the other of which contained all the remaining assets. Each common trust fund beneficiary received an equivalent interest in each of the two funds in return for his interest in the original fund. The Service ruled that this transaction did not result in taxable gain or loss to the beneficiaries or the fund, “because neither the fund nor its participants acquired any new property rights as a result of the division.”

However, the Service reached a somewhat contrary result in Rev. Rul. 68-456. This ruling likewise concerned a common trust fund taxed under section 584. Some of the participants in the trust were tax-exempt employee benefit trusts, and the trustee bank apparently wished to establish a separate common trust fund in which all the participants would be exempt trusts. This was accomplished by withdrawal of all the exempt trusts and their admission to a new and separate trust. The assets of the new trust consisted of a pro-rata share of each block of common stock held by the original trust. The ultimate result was therefore a pro-rata division of the property in the original trust. The Service treated the transaction as a “withdrawal of a participating interest” by the exempt trusts, constituting a sale or exchange under section 584(c).

These two rulings are difficult to distinguish. In both cases each beneficiary of the original trust retained after the division a beneficial interest in exactly the same assets as before the division. In one case the assets were divided; in the other the beneficiaries were divided. Perhaps the difference between the two results can be explained on the ground that in the second case all beneficiaries of the new trust would be tax exempt employee benefit trusts. This would doubtless give a new and different direction to the policies regarding management of the assets. To this extent each exempt trust could be viewed as gaining somewhat different rights as a result of the transfer. Thus the transfer could be treated as more than a mere division.

3. Other Modifications of Form of Ownership. Several rulings have dealt
with modifications of the form of ownership. They demonstrate that if merely
the form of ownership—and not its substance—is changed, there will be no
taxable sale or exchange. In Rev. Rul. 55-142,\textsuperscript{102} for example, various pieces
of real estate owned by a corporation were conveyed to a straw man, and then
reconveyed by him to the corporation so as to consolidate the pieces in one deed.
The Service ruled that this was a nontaxable transaction. The same rule is
applied when owners repurchase at a sale the same interests they had before
the sale.\textsuperscript{103} Another ruling involved ownership of a single piece of real property
by six persons as tenants in common.\textsuperscript{104} One of the six wished to sell his in-
terest to the others, but a sale price could not be agreed upon. As a result, the
property was sold at a partition sale, and the proceeds were distributed to the
six owners. The buyers at the sale were the remaining five owners, who
took title as tenants in common. The Service ruled that this was a nontaxable
transaction. It viewed each of the five buyers as having bought back the same
interest he had before, plus a portion of the selling party's undivided interest.

These rulings add further support to the broad principle that a mere change
in form of ownership does not constitute a sale or exchange. If the substance
and value of the taxpayer's interest is the same, the change in form of owner-
ship is not a taxable event. This approach is important because it is precisely
the idea that underlies the crucial aspect of the property division rule: a divi-
sion of property between co-owners changes only the form of ownership and
not its substance.

IV. Conclusion

Property divisions occur in a wide variety of contexts. The tax treatment of
some of these transactions, such as community property divisions upon divorce,
is now rather well established. The treatment of others, such as estate and
trust fractional share distributions, remains somewhat unsettled. Considered
together, however, the above discussions of the various types of property divi-
sions, permit the establishment of certain conclusions regarding the tax treat-
ment of property divisions generally.

These conclusions are stated below, and are divided into two areas: First,
what legal relationships constitute co-ownership such that a division of the
property subject to the relationship among the co-owners may be treated as
other than a sale or exchange? Second, assuming such co-ownership is present,
what methods of dividing the property may be treated as other than a sale or
exchange?

A. What Constitutes Co-ownership?

Regardless of the method used to divide the property, the transaction will
be a sale or exchange and gain or loss will be realized on the transaction un-

less the parties involved are considered co-owners. On the basis of the above material, the following rules can be established as to when co-ownership is present:

1. *Marital rights in community property.* The interests of husband and wife in community property are co-ownership interests. A division of the community property in accord with the respective interests of the spouses is not a sale or exchange.

2. *Marital rights in other than community property.*
   a. The general rule is that the inchoate marital rights of a wife with respect to her husband's property (other than community property) do not constitute a co-ownership interest. A distribution of the husband's separate property to the wife in settlement and discharge of her rights is not a division between co-owners, but is merely a discharge of a personal obligation of the husband and therefore a taxable sale or exchange. The husband realizes gain or loss on the transaction, but the wife does not. In cases in which the wife transfers a portion of her separate property to the husband in satisfaction of his marital property rights the same results follow but the roles of husband and wife are reversed.
   b. The general rule does not apply to jointly acquired property under Oklahoma law. Such property is treated like community property for this purpose.

3. *Residuary estates.* Legatees entitled to fractional shares of a residuary estate are considered co-owners for the pool of estate assets to which they are entitled. A legatee realizes neither gain nor loss on the distribution to him of a fractional share of the residuary estate.

4. *Trusts (other than business or investment trusts).* Beneficiaries entitled to fractional shares of the corpus of a trust, other than a business or investment trust, are considered co-owners of the assets in the trust corpus. Distribution of a fractional share of the trust assets to such a beneficiary is not a sale or exchange.

5. *Joint tenancy, tenancy in common, or tenancy by the entirety.* These forms of ownership, involving concurrent and mutual interest of two or more parties, constitute co-ownership. Division of the property between the co-owners or modification of the form of ownership is not a sale or exchange.

6. *Business or investment trusts and common trust funds.* Beneficiaries of a business or investment trust or common trust fund are not considered co-owners of the assets of the trust. Distribution of assets of such a trust to a beneficiary in liquidation of his interest is a sale or exchange.

7. *Modification of form of ownership.* Most modifications of the form of co-ownership, which do not affect the substance of the ownership interests, are not considered sales or exchanges.

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B. What Methods of Division are Nontaxable?

Assuming that two or more persons qualify as co-owners of property under the above rules, the question remains as to what method of division of the property among the owners must be used to assure that the division will not be treated as a sale or exchange. The rules as to method of division are described below. These rules come into play only if the transaction has already achieved the classification, under the above rules, as a division of property between co-owners.

1. **Single asset.** If a single asset is involved, and it is divided between the co-owners in accord with their respective ownership interests, the transaction will be a nontaxable division, and not a sale or exchange. If the division produces shares having respective values proportionately different from the ownership interests that existed before the division, either a gift or a sale or exchange will have occurred. If the party receiving a portion greater than his ownership interest gives no consideration to the other owner, the division is nontaxable but a gift may have occurred. If the party receiving a portion greater than his ownership interest transfers consideration (consisting of other than co-owned property) to the other owner, the transaction will be treated as having two steps: a nontaxable division followed by a taxable sale of a part of the property by one party to the other.

2. **Multiple assets.**
   a. **Proportionality to property interests.** The rule stated in the preceding paragraph applies as well to multiple assets: even if the transaction qualifies as a nontaxable division, any division not in accord with the relative property interests will be treated as a gift or as a sale or exchange to the extent of the disparity.
   b. **Pro-rata divisions.** If each co-owned asset is divided pro-rata between the owners in proportion to property interests, the division will not be a sale or exchange.
   c. **Non-pro-rata divisions.** The most serious difficulties in the area are presented by divisions of multiple properties in other than pro-rata fashion. Several authors have suggested that such a transaction constitutes an exchange of properties among the co-owners, resulting in gain or loss to each co-owner.\(^{106}\) However, examination of the cases and rulings involving all the various types of property divisions shows that in fact there is virtually no case or ruling authority for this proposition, save the reports that the Internal Revenue Service may have recently instructed some local agents to take this position.\(^{107}\) On the contrary, the Board of Tax Appeals and the Tax Court have treated non-pro-rata community property divisions as nontaxable in five successive decisions.\(^{108}\)

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\(^{106}\) See notes 3 and 118, supra.

\(^{107}\) See note 53, supra.

\(^{108}\) John H. Schacht, 47 T.C. 552 (1967), acquiesced in, 1968-1 CUM. BULL. 2; Clifford H. Wren, 24 T.C.M. 290 (1965); Osceola Heard Davenport, 12 T.C.M. 856 (1953); Ann Y. Oliver, 8 T.C.M. 403 (1949); Francis R. Walz, 32 B.T.A. 718 (1935).
and trust distributions, the *Long, Findlay, and McIntosh* cases and O.D. 667 support the rule of nontaxability of non-pro-rata divisions. A close examination of all those cases in which a division between co-owners was held taxable shows the presence of a payment in non-co-owned property by one party to the other as compensation for a disproportionate allocation of the aggregate of co-owned property. This was true in *Johnson* and *Long* (community property divisions) and in *Cofield v. Koehler* and *Hornback* (joint tenancy and tenancy by the entirety). The conclusion seems inescapable that neither the Commissioner nor taxpayers will find much success in attempting to treat a division of property between co-owners as taxable merely because a non-pro-rata method of distribution is used.

C. **Deficiencies in the Taxation of Property Divisions**

A study of the property division area reveals two major deficiencies in the law relating to these transactions.

First, the rule of the *Davis* case will undoubtedly continue to cause difficulty. There is little legitimate basis for creating in this way another unfortunate dichotomy between community property and common-law states. As is pointed out above, the traditional view that a great disparity exists between the systems as to the property rights of the wife upon divorce yields on close examination to the conclusion that in many instances the wife's rights upon divorce are quite similar under the two systems. The *Collins* litigation is dramatic evidence of this, and suggests that there will be more cases in which a party claims that the law of a common-law state as to property rights of the wife upon divorce is more like that in community property states than that in Delaware. This continuing source of litigation, together with the highly unfortunate effect of the *Davis* rule on divorce negotiations, suggests that legislative reversal of *Davis* through adoption of a nonrecognition provision should receive serious consideration.

Second, the problem of non-pro-rata divisions of multiple properties needs further clarification. As stated in the conclusions above, a close examination reveals that the chances are quite small that a division between co-owners will be treated as taxable merely because a non-pro-rata method of distribution of multiple properties is involved. However, the number of writers who have suggested otherwise will doubtless cause many taxpayers, especially executors and trustees, to continue to exercise caution in this area. This may unfortunately continue to produce somewhat artificial distribution methods caused by a possibly unjustified fear of tax dangers. If the nontaxability of non-pro-rata divisions were firmly established, there would be little danger of revenue loss, and the Treasury might avoid considerable litigation in this way. Much could be gained for all concerned if the Treasury were to issue a ruling redrafting, clarifying, and hopefully expanding the position taken in O.D. 667.

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\(^{180}\) *See text accompanying notes 74-77, supra.*