Volume 34 | Number 4 Article 20

6-1-1956

Gift and Inheritance Taxation of Community Property by Common Law States

J. Thomas Mann

Unless the transactions are taxed in the donors' estates, the use of reciprocal trusts allows a taxpayer to rid his estate of assets at gift tax rates and at the same time receive valuable lifetime economic powers in return.[31] This coupled with the fact that he has, at the same time, given identical economic benefits to a member of his family, who also escapes estate taxation, should justify remedial legislation.[32]

The Third Circuit has recognized that the *actual* consideration test applied in that court is substantially different from the so-called *inferred* consideration test. It has suggested that the situation could be cured by legislation which would treat these transfers as a single joint transaction and thereby regard each of the settlors as a pro tanto transferor of the res over which he has control.[33] It is submitted that this statutory solution would be an equitable one in that the inherent nature of the normal family relationship is one of interdependence and concert of action.[34]

HERBERT S. FALK, JR.

Gift and Inheritance Taxation of Community Property by Common Law States

Generally, when a transfer of property occurs by gift or upon the death of an individual, its taxability depends upon the policy within the taxing jurisdiction and upon the extent of the interest transferred. Granting that the problem of determining the extent of the interest transferred is often a difficult one, it becomes more complex when community property is transferred by a husband to his wife due to the prior interest of the wife which must be taken into account. It is a novel situation when this problem arises within a common law jurisdiction, and several recent decisions merit analysis.

The problem, as it relates to gift taxation, recently confronted the Virginia Supreme Court of Appeals in *Commonwealth v. Terjen.*[1] A

[31] See Phillips v. Gnichtel, 27 F. 2d 662 (3d Cir. 1928), *cert. denied* 278 U. S. 636 (1929), where the taxpayer argued that reciprocal trusts which were in contemplation of death should be treated as a bona fide sale. See also Estate of Scholler v. Commissioner, 44 B. T. A. 235 (1940).

[32] See Technical Changes Act of 1949, 63 STAT. 893 § 6 (1949), where Congress impliedly approved the "judicial fiction" of the *Lehman* case by allowing, for a limited time, a tax free rescission of reciprocal trusts.

[33] Newberry's Estate v. Commissioner, 201 F. 2d 874, 878 (3d Cir. 1953). It would seem that the legislation would be more equitable if it established a conclusive presumption of consideration when the trusts with crossed powers are created by members of one family within two years of each other. If the second trust is established more than two years after the first, the commissioner should be required to prove that each trust was in consideration of the other. Thus, the taxpayers would have a certain amount of freedom in disposing of their property.

[34] See in general Notes, 42 CALIF. L. REV. 151 (1954) and 38 A. L. R. 2d 522 (1954).

[1] — Va. —, 90 S. E. 2d 801 (1956).

husband and wife, while domiciled in California, acquired a substantial amount of community personal property under the laws of California.[2] After moving to Virginia, they used a portion of the community funds to pay for a home located in Virginia, title to which was taken in the name of the wife. The Virginia Department of Taxation assessed the husband with a gift tax based upon the full value of the property.[3] The husband contested this assessment on the theory that his wife had a one-half vested interest in the community funds; that this interest was not divested by their change of domicile; and that therefore he should be assessed only for the transfer of his one-half interest in the property. It was held that the husband was taxable for the full value of the property. While the court agreed that the character of community property is not affected by a change of domicile,[4] it took the position that a wife does not have a vested interest in community property under the laws of California, and that this transfer of community funds from the husband to his wife constituted a gift of the full value of the property.[5]

In contrast to this Virginia decision is a 1954 opinion of the Attorney General of North Carolina,[6] in which an opposite conclusion was reached upon identical facts. A husband and wife moved from California to North Carolina, purchased a home in North Carolina with community funds, and placed the title in the name of the wife. The Attorney General stated that the husband thereby made a gift of one-half of the purchase price of the home and thus was liable for a gift tax[7] only on that one-half value. This result was founded on the theory that in California the interests of the husband and wife in community property are "pres-

[2] Sections 162 and 163 of the California Civil Code define separate property of each sponse as "All property owned by the [spouse] before marriage, and that acquired afterwards by gift, bequest, devise or descent, with the rents, issues, and profits thereof. . . ." CAL. CIVIL CODE ANN. (West 1954). Section 164 then defines community property as "All other property acquired after marriage by either husband or wife, or both, including real property situated in this State and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in this state. . . ." *Ibid.*

[3] For applicable gift tax statutes, see VA. CODE ANN. §§ 58-218, 58-219, and 58-223 (1950).

[4] The general rule is that "a change of domicile from a state where the community property law prevails to a common law state does not affect the community character of property previously acquired. The law of the state to which the parties remove will regulate their future conduct and acquisitions, but the removal will not alter the rights of either to property then in possession, the title to which had vested under the community property law." 11 AM. JUR., *Community Property* § 16 (1937). See also 92 A. L. R. 1352 (1934).

[5] See the discussion of the court, Commonwealth v. Terjen, — Va. —, 90 S. E. 2d 801, 802-804 (1956).

[6] Op. N. C. Atty. Gen., C C H INH., EST. & GIFT TAX REP. ¶ 18,156 (February 23, 1954).

[7] For applicable gift tax statutes, see N. C. GEN. STAT. §§ 105-188 through 105-191 (1950).

ent, existing and equal,"[8] and that the wife's interest is a "present vested right."[9]

As it relates to inheritance taxation, this problem was recently considered in an opinion of the Attorney General of Maryland[10] and in a decision of the Supreme Court of Montana.[11]

The Maryland opinion involved community property acquired by the husband and wife while domiciled in Texas.[12] They moved to Maryland, where the husband later died leaving all his property (after a few specific bequests) to his surviving wife. Based on the conclusion that the wife has a present vested interest in one-half of Texas community property,[13] the Attorney General was of the opinion that (1) community property acquired in Texas, the character of which had never changed, should be taxed[14] only on the one-half interest of the husband passing to the wife; (2) property acquired in Maryland with community funds, title to which was in the husband alone, should be taxed at its full value;[15] and (3) property acquired in Maryland, to which there is no evidence of record title, should be taxed at one-half value if purchased with community funds.[16]

In the Montana case, *In re Hunter's Estate*,[17] the husband and wife acquired community property while domiciled in California. Although they never left that state, the husband purchased in his name with community funds both personal and real property located in Montana. The

[8] Op. N. C. Atty. Gen., *supra* note 6, at 90,209.

[9] *Ibid.* The Attorney General also states: "Had the title been taken in the name of the hubsand the transaction would have been a gift of one-half the original price by the wife to the husband, unless the circumstances were such as to give rise to a presumption that the property was to be held in trust for the wife." *Ibid.* As an example of such a resulting trust, see Depas v. Mayo, 11 Mo. 314 (1848), where, after a divorce, the wife had the court impose a trust as to one-half of property which had ben purchased in the husband's name with community funds.

[10] Op. Md. Atty. Gen., C C H INH. EST. & GIFT TAX REP. ¶ 18,385 (May 27, 1955).

[11] *In re* Hunter's Estate 125 Mont. 315, 236 P. 2d 94 (1951).

[12] Community property in Texas is defined as "All property acquired by either the husband or wife during marriage, except that which is the separate property of either. . . ." TEX. CIVIL STAT. ANN. art. 4619, § 1 (Vernon 1951).

[13] In Texas the rights of the husband and wife are considered equal, and each is considered as having a vested beneficial interest in the community. When legal title is in the husband, the wife's interest is equitable but vested. Davis v. Davis, 186 S. W. 775 (Tex. Civ. App. 1916); Burnham v. Hardy Oil Co., 108 Tex. 555, 195 S. W. 1139 (1917).

[14] For the applicable inheritance tax statutes, see MD. CODE ANN. art. 81, §§ 148, 150 (1951).

[15] The Attorney General thought that, as a practical matter, the Register of Wills should not be required to look beyond record title to determine the ownership of such property. Op. Md. Atty. Gen., C C H INH. EST. & GIFT TAX REP. ¶ 18,385 at 90,728-90,729 (May 27, 1955).

[16] "This conclusion is supported by those opinions in which an implied exemption from the inheritance tax was allowed by reason of the fact that an adequate consideration was paid by the recipient of the property for his interest." *Id.* at 90,729.

[17] 125 Mont. 315, 236 P. 2d 94 (1951).

husband died in California, leaving all the Montana property to his wife. The Montana court imposed an inheritance tax[18] on the full value of the property on the theory that the privileges of the wife in California community property were not yet those of ownership as to give the wife a vested interest sufficient "to overcome the presumption that title is where the record puts it."[19]

Thus, it is seen from a discussion of decisions in four states that their determination of the extent of interest transferred depended primarily upon whether the wife had a "vested interest" in one-half of the community property. Each decision assumed that if the wife had such an interest only the husband's half could be made the subject of a "transfer," and in order to determine the nature of her interest each looked to the laws of the state where the property was originally acquired. Furthermore, each decision seems to have hinged its tax results on whether the mere *label* of "vested" had been affixed, without analyzing the property rights of the wife to determine whether, regardless of the label, a sufficient interest nevertheless did pass beneficially to her as a result of the transfer.[20] And in determining whether or not such label had been attached to the interest of the wife in California North Carolina differed from Virginia and Montana.

The first question arises in connection with the dispute whether or not the wife's interest in California has been labeled as "vested." To determine which decision or decisions stated the correct view it will be necessary to look at California law.

Prior to 1927, it was clearly established that the wife's interest had never been regarded as a "vested" interest.[21] Because of this, in 1926

[18] For the applicable inheritance tax statute, see MONT. REV. CODE § 91-4401 (1947).

[19] *In re* Hunter's Estate, 125 Mont. 315, 324, 236 P. 2d 94, 99 (1951).

[20] This is not to say that the decisions ignored the rights of the wife in their discussions. Actually, the Virginia, Maryland and Montana decisions discussed many aspects of the rights of the wife in community property. But due to their concern over whether the community property state had merely designated the wife's interest as "vested," the decisions left the impression that what was important in determining the extent of the wife's interest was not the extent of her substantive rights but whether such rights had ever been labeled as "vested." From the nature of their discussions, it is very likely that, even if the wife had no property rights whatsoever in California community property, Virginia and Montana would nevertheless have taxed the transfers only at one-half value, if they could have determined that California courts had ever labeled the interest of the wife as "vested."

[21] As early as 1860, it was established that the wife's interest in California community property was a "mere expectancy, like the interest which an heir may possess in the property of his ancestor." Van Maren v. Johnson, 15 Cal. 308, 312 (1860). In 1896, the Supreme Court of California said that the wife had no right or title of any kind in the property, and had at most a "possible interest in whatever remains upon dissolution of the community otherwise than by her own death." *In re* Burdick, 112 Cal. 387, 393, 44 Pac. 734, 735 (1896). Twelve years later, in 1908, the court held that since the wife, upon the death of the husband, takes a one-half interest as heir, her interest is subject to inheritance taxes. Estate of

the United States Supreme Court ruled that the husband and wife in California could not submit separate returns in reporting income from community property for federal income tax purposes.[22] At the next session of the California legislature, in 1927, a statute was passed defining the interests of the husband and wife as "present, existing and equal . . . under the management and control of the husband. . . .";[23] and in 1931, the United States Supreme Court interpreted this statute to indicate that the wife now had a "vested" interest in the community property, and could file a separate return for her interest in community income.[24]

The fact remains, however, that the California legislature did not use the label "vested" in defining the wife's interest in the 1927 statute. The question of whether that result was intended by implication has never been presented to the Supreme Court of California, though in 1941 that court, by way of *dictum,* stated that "section 161a of the Civil Code does not change the nature of the wife's interest to a vested one. . . ."[25] And

---

Moffitt, 153 Cal. 359, 95 Pac. 653 (1908). This decision was overturned by the legislature, however, in 1917, when a statute was passed exempting the wife's interest from such taxation. CAL. STAT. 1917, p. 881. The statute today is CAL. REVENUE AND TAXATION CODE ANN. § 13551(b) (Deering 1952). This latter statute reads: "Upon the death of the husband: . . . (b) The one-half of the community property which belongs and goes to the surviving wife pursuant to Section 201 of the Probate Code is not subject to this part." Interpreting this statute in 1926, the court stated that it did not operate to create a "vested" interest in the wife, but that nevertheless she did now possess more interest than an ordinary heir. Stewart v. Stewart, 199 Cal. 318, 340, 342, 249 Pac. 197, 206, 207 (1926). Other rights which the wife had acquired at the time of this decision were the right to join in conveyances of real property for periods longer than one year, the right to secure a division of the community property without dissolving the marital relation when she had cause for divorce, and the right to dispose of one-half of the community property by will. However, the California courts had not labeled her bundle of rights as "vested." See Simmons, *The Interest of a Wife in California Community Property,* 22 CALIF. L. REV. 404, 407, 409-410 (1934).

[22] United States v. Robbins, 269 U. S. 315 (1926).

[23] CAL. CIVIL CODE ANN. § 161a (West 1954). This section further states: "This section shall be construed as defining the respective interests and rights of husband and wife in community property."

[24] United States v. Malcolm, 282 U. S. 792 (1931). This privilege had already been extended to the community property states of Washington, Arizona, Texas and Louisiana. Poe v. Seaborn, 282 U. S. 101 (1930); Goodall v. Kock, 282 U. S. 118 (1930); Hopkins v. Bacon, 282 U. S. 122 (1930); Bender v. Pfaff, 282 U. S. 127 (1930). It should be noted that the federal courts also recognized the wife's interest as "vested" after the 1927 California statute in the field of estate taxation. As to property acquired prior to 1927, the entire value of the community property was includible in the estate of the decedent who acquired the property. Rule v. United States, 63 F. Supp. 351 (Ct. Cl. 1945); Sampson v. Welch, 23 F. Supp. 271 (S. D. Cal. 1938). But as to property acquired after 1927, community property was includible in the estate of the decedent only to the extent of one-half of its value, if under the law of the state the wife had a vested interest in her half. Lang v. Commissioner, 304 U. S. 264 (1938); Rickenberg v. Commissioner, 177 F. 2d 114 (9th Cir. 1949).

[25] Grolemund v. Cafferata, 17 Cal. 2d 679, 686, 111 P. 2d 641, 644 (1941). This statement was important to the decision, however, since the court actually held that the community property was liable for the husband's debts. *Id.* at 689, 111 P. 2d at 646.

intermediate appellate courts in California have interpreted the statute in the same manner.[26]

Thus, it appears that the Virginia and Montana decisions arrived at the correct conclusion as to the nature of the wife's interest in California, as interpreted by the California legislature and courts.[27]

Therefore, putting the North Carolina decision aside, the other decisions (Virginia, Montana and Maryland) show this distinction: since the wife's interest in California has not been labeled as "vested," the full value of the property transferred to the wife was taxed by Virginia and Montana, but since the wife's interest in Texas has been so labeled,[28] only the value of the husband's one-half interest passing to the wife was taxed by Maryland. In view of the differing tax consequences in those decisions, the second and more important question arises: Is the label "vested" a valid criterion for determining the extent of the interest transferred? To answer this question it is necessary to compare the substantive rights of the wife in each state involved in the decisions, California and Texas.

For purposes of clarification, in comparing the substantive rights of the wife in each state, it will be helpful to consider first their similarities. In each state the wife has the right to dispose of her one-half interest by will,[29] the right to take one-half of the community property free of inheritance taxes when the husband predeceases her,[30] and the right to a distribution of the community property upon divorce.[31] She does not

[26] The intermediate appellate court interpretations were made incident to holdings that community property cannot be attached by a trustee in bankruptcy for the benefit of the wife's judgment creditors, Smedberg v. Bevilockway, 10 Cal. App. 2d 578, 46 P. 2d 820 (1935), nor applied by a judgment of the court to satisfy a married daughter's liability for support of her mother, Grace v. Carpenter, 42 Cal. App. 2d 301, 108 P. 2d 701 (1941).

[27] There is a division of opinion among law review writers as to the intention of the legislature in passing the 1927 statute. One has significantly pointed out that her local rights and remedies remain the same, Cahn, *Federal Taxation and Private Law*, 44 COLUM. L. REV. 669, 676 (1944), and the most recent writer is of the opinion that perhaps the legislature intended only to permit the husband and wife to file separate federal income tax returns without overturning previous statements of the courts as to the nature of her interest, Marsh, *California Family Law—A Review*, 42 CALIF. L. REV. 368, 373-374 (1954). See also: Hooker, *Nature of Wife's Interest in Community Property in California*, 15 CALIF. L. REV. 302 (1927); Horne, *Community Property—A Functional Approach*, 24 So. CALIF. L. REV. 42 (1950); Kirkwood, *The Ownership of Community Property in California*, 7 So. CALIF. L. REV. 1 (1933); Simmons, *The Interest of a Wife in California Community Property*, 22 CALIF. L. REV. 404 (1934); Recent Legislation, 16 CALIF. L. REV. 63, 68 (1927); 23 So. CALIF. L. REV. 237 (1950).

[28] See note 13 *supra*.

[29] CAL. PROBATE CODE ANN. § 201 (1956); Cook v. Spivey, 174 S. W. 2d 634 (Tex. Civ. App. 1943).

[30] CAL. REVENUE AND TAXATION CODE ANN. § 15301 (Deering 1952); Jones v. State, 5 S. W. 2d 973 (Tex. Comm. App. 1928).

[31] CAL. CIVIL CODE ANN. § 146 (West 1954); TEX. CIVIL STAT. ANN. art. 4638 (Vernon 1951).

have the right to alienate, to encumber, or to manage or control her interest during coverture.[32] Only the husband has these rights.[33]

On the other hand, the interest of the wife in each state are slightly dissimilar in several respects. In California the wife must join in conveyances of community property for a period of more than one year.[34] In Texas the wife is not required to join in conveyances, and the husband may convey in fraud of her interest, but his separate estate may become liable to the community for her loss.[35] In California the wife's interest is not liable for tort judgments against the wife, whereas in Texas it has been held to be so liable.[36] In Texas if the husband disappears for more than one year, the wife by petition to the courts can obtain all the rights which her husband exercised over the community property.[37] This privilege does not seem to exist in California, though perhaps somewhat the same result is reached in the latter state when the wife obtains a division of the property upon legal separation from the husband.[38] Lastly, by recent constitutional amendment, the husband and wife in Texas may voluntarily partition the community property and hold their interests separately thereafter.[39] There is no express constitutional or statutory authority for such a partion in California, but the husband and wife may contract between themselves to hold their property separately.[40]

Thus, it is seen that though Texas and California differ in labeling the wife's interest, the rights of the wife in both states are substantially the same, and that the variance in labeling could not be founded upon any substantial differences between basic substantive rights of the wife in each state. Furthermore, the reliance in the decisions upon the label of "vested" does not seem to justify the differing consequences, and it would therefore seem reasonable to conclude that the label is meaningless

[32] CAL. CIVIL CODE ANN. §§ 172 and 172a (West 1954); TEX. CIVIL STAT. ANN. arts. 4619 and 4621 (Vernon 1951). Under article 4619, it would seem that the Texas wife cannot sell her interest, since only the husband is given a power of disposal during coverture, and under article 4621 the community property is not liable for debts or damage resulting from contracts of the wife; however, such property is stated to be liable for necessaries furnished the wife or children. In California, under section 174 of the Civil Code, the husband is liable for necessaries furnished the wife or children.

[33] *Ibid.*

[34] CAL. CIVIL CODE ANN. §§ 172 and 172a (West 1954).

[35] Graves v. Guaranty Bond State Bank, 161 S. W. 2d 118 (Tex. Civ. App. 1942); Rudasill v. Rudasill, 219 S. W. 843 (Tex. Civ. App. 1920).

[36] CAL. CIVIL CODE ANN. § 167 (West 1954); Patterson v. Frazer, 93 S. W. 146 (Tex. Civ. App. 1906).

[37] TEX. CIVIL STAT. ANN. art. 4619 (Vernon 1951).

[38] CAL. CIVIL CODE ANN. § 146 (West 1954).

[39] TEX. CONST. art. 16, § 15 (Vernon 1955). See also TEX. CIVIL STAT. ANN. art. 4624a (Vernon 1951).

[40] See CAL. CIVIL CODE ANN. § 159 (West 1954): "A husband and wife cannot, by any contract with each other, alter their legal relations, *except as to property.* . . ." (Emphasis added.) See Essick v. United States, 88 F. Supp. 23 (S. D. Cal. 1949), where the husband and wife agreed to hold community property as tenants in common.

as a criterion for determining the extent of the interest transferred when community property passes from a husband to his wife by gift or upon his death.

It is evident from the rights of the wife detailed above that when a husband transfers community property to his wife, she then for the first time receives certain important property rights in her one-half interest. Whether the transfer of those rights is so insignificant as not to warrant taxation of course depends largely upon individual state taxing policy.[41] However, before the tax consequences are resolved, the extent of the interest transferred should be determined and brought into a proper perspective with the taxing policy. It is submitted that common law states, when confronted with the problem of taxing transfers of community property from a husband to his wife, can more realistically accomplish this determination by analyzing the actual substantive rights possessed by the wife before and after the transfer—and not by relying upon the sometimes vague and meaningless label of "vested."

J. THOMAS MANN.

Real Property—Conveyances between Spouses—Creation and Dissolution of Estates by the Entirety

In North Carolina, a married woman can make a valid conveyance to her husband of her real property[1] only if the instrument of conveyance contains a certificate by the certifying officer of his findings of facts and conclusions as to whether the deed is unreasonable or injurious to her.[2] The certificate is based on a private examination of the wife.[3]

[41] New York, for example, has a specific estate tax statute (similar to the federal statute in effect from 1942 to 1948) in regard to community property. It states that the gross estate of a decedent shall include property "held as community property by the decedent and surviving spouse under the law of any state . . . or any foreign country, except such part thereof as may be shown to have been received as compensation for personal services rendered by the surviving spouse or derived originally from such compensation or from the separate property of the surviving spouse. In no case shall such interest included . . . be less than the value of the community property as was subject to the decendent's power of testamentary disposition." N. Y. TAX LAW § 249-r (5-a). Where all the community property passes to the wife upon the husband's death, it has been held, under this statute, that the entire amount of property was includible in the husband's gross estate. *In re* Walk's Estate, 192 N. Y. Misc. 237, 79 N. Y. S. 2d 645 (Surr. Ct. 1948).

[1] N. C. CONST. art. X, § 6. "The real and personal property of any female in this State . . . may be devised and bequeathed, and, with the written consent of her husband, conveyed by her as if she were unmarried." See also Perry v. Stancil, 237 N. C. 442, 75 S. E. 2d 512 (1953) (The wife conveyed her separate estate to her husband without his written consent. The court held that art. X, § 6 of the Constitution did not apply to the conveyance to the husband. The provision applies only to conveyances to third parties.)

[2] N. C. GEN. STAT. § 52-12(b) (1955).

[3] N. C. GEN. STAT. § 52-12(a) (1955).