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## II

## Avoiding Undesirable Results When Terminating Joint Ownership

*W. Dean Hopkins*

**B**ANK TRUST departments occasionally publish pamphlets warning against possible undesirable results from the joint and survivorship form of ownership. Despite such warnings, this form continues to be frequently employed.

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This article discusses only incidentally whether property should be placed in joint ownership. If the lawyer has found that joint ownership exists and is not desirable, he will wish

to know the results of various methods of terminating the arrangement. This article attempts to outline those results.

Unless otherwise stated, it will be assumed in the examples discussed that a husband (*H*) has contributed all of the funds deposited in an account or used to acquire an asset, and that the account or asset is in the names of *H* and his wife (*W*) as joint owners with a right of survivorship.

Four different types of property will be considered: (1) bank accounts; (2) treasury bonds; (3) real estate; and (4) securities. In each instance, emphasis will be placed primarily upon rights of termination, gift tax consequences, federal estate tax consequences, and Ohio inheritance tax consequences. In addition, special problems, such as contemplation of death situations, will be considered.

### I. BANK ACCOUNTS

#### *A. Right of Termination*

Under Ohio law, the right of survivorship in a deposit arises by contract between the depositor and the bank or savings association. There is no true common law joint tenancy.<sup>1</sup> It would appear,

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<sup>1</sup> See *In re Moore*, 188 N.E.2d 221 (Ohio P. Ct. 1962) and cases cited therein.

therefore, that either of the "joint" parties has the right to terminate unless the contract expresses or implies a different intent of the parties.

### B. *Gift Tax Consequences*

The creation of a joint account does not constitute a gift because the party creating the account can withdraw the full amount the next day. It follows, therefore, that a gift results when part or all of the account is transferred to *W* for her own benefit.<sup>2</sup> If there has been a disagreement between *H* and *W*, and the latter withdraws the whole account, there may be a question concerning the donative intent of *H* to make a gift. Neither the Internal Revenue Code nor the regulations make an exception for such a situation; apparently it is assumed that *H*'s original intention when setting up the account, that *W* may possibly withdraw all of the account, carries forward to the time when she actually does withdraw it.

### C. *Federal Estate Tax Consequences*

If the account is not changed, or is closed by transferring all of the funds to *H*, the entire amount is taxable in *H*'s estate upon his death.<sup>3</sup> If the account is not changed and if *W* pre-deceases *H*, the entire amount is taxable to her estate except to the extent that it can be traced and shown to have originally belonged to *H* and never to have been received by *H* from *W* for less than full consideration.<sup>4</sup> If any part or all of the account is transferred to *W*, the part so transferred will not be taxable in *H*'s estate, unless the transfer is found to have been made by *H* within three years prior to his death.<sup>5</sup>

### D. *Ohio Inheritance Tax Consequences*

If the account is not changed, one-half of the account is taxable to *W* as survivor if *H* dies first, and one-half is taxable to *H* as survivor if *W* dies first. This is the result of a recent addition to the section of the Ohio law regarding inheritance tax on joint property.<sup>6</sup>

<sup>2</sup> Treas. Reg. § 25.2511-1(h) (4) (1958), as amended, T.D. 6542, 1961-1 CUM. BULL. 420 [hereinafter cited as Reg. §].

<sup>3</sup> INT. REV. CODE OF 1954, § 2040 [hereinafter cited as CODE §].

<sup>4</sup> *Ibid.*

<sup>5</sup> CODE § 2035(b).

<sup>6</sup> OHIO REV. CODE § 5731.02(E) (Supp. 1964). The addition reads: "Provided when the persons holding said property jointly are a husband and wife, the survivor shall be deemed to have a succession taxable to the extent of one-half the total value of the property without regard to enhancement."

It should be noted that this provision of the Ohio statute does not provide an election or an option. Thus, if *W* dies first, one-half of the account is taxed to the survivor even though *W* never supplied any of the funds. In addition, because this provision applies only to husband and wife, the same tracing problem mentioned under federal estate tax may arise if the joint tenants are not husband and wife.

## II. TREASURY BONDS

### A. *Right of Termination*

The right to terminate a joint tenancy in treasury bonds is determined completely by treasury regulations.<sup>7</sup> These regulations provide that the proceeds of such joint and survivorship bonds "will be paid to either upon his separate request, and upon payment to him the other shall cease to have any interest in the bond."<sup>8</sup> The regulations also state that "a bond registered in co-ownership form may be reissued upon its presentation and surrender during the lifetime and competency of both co-owners, upon the request of both . . ."<sup>9</sup> This provision is applicable to the joint ownership of husband and wife.

### B. *Gift and Income Tax Consequences*

The gift tax consequences of treasury bonds are no different from those with reference to joint and survivorship bank accounts.<sup>10</sup> The termination of joint ownership of Series E bonds may, however, result in undesirable income tax consequences, if income tax has not been paid annually on the increment in value. If *H* receives the full amount upon redemption, he will have taxable income equal to the difference between the redemption amount and the purchase price. If, however, *H* has the bonds reissued in his name, no gift or income results at that time. If *W* receives the proceeds by redemption, or even if all of the bonds are merely reissued in the name of *W*, there is a gift of the whole value at that time. In addition, there is also taxable income to *H* at that time which is measured by the current increase in value over the purchase price.<sup>11</sup>

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<sup>7</sup> *In re Sachs*, 173 Ohio St. 270, 181 N.E.2d 464 (1962).

<sup>8</sup> Treasury Department Circular No. 530, § 315.60 (December 23, 1964).

<sup>9</sup> *Id.* at § 315.61.

<sup>10</sup> Reg. § 25.2511-1(h) (4) (1958).

<sup>11</sup> Rev. Rul. 278, 1955-1 CUM. BULL. 471. See also 2 P-H 1965 FED. TAXES § 8316-17.

### C. *Death Tax Consequences*

The termination of joint ownership in bonds leads to the same estate tax and inheritance tax consequences as the termination of joint and survivorship bank accounts.<sup>12</sup>

## III. REAL ESTATE

### A. *Right of Termination*

The Ohio courts have consistently held that although there is no common law joint tenancy in Ohio, a survivorship tenancy in real estate can be created by proper language in a deed.<sup>13</sup> The language of a deed creating survivorship might permit an argument that the tenancy is not subject to termination without the consent of both parties. It is submitted, however, that in the usual situation, either party can terminate the tenancy by partition or conveyance.<sup>14</sup> If real estate in another state is held in tenancy by entirety, severance requires consent of both parties.<sup>15</sup>

### B. *Gift Tax Consequences*

The gift tax consequences upon termination of a joint tenancy in real estate arise from the fact that after such tenancy has been created, neither joint tenant can convey the whole of the property, but either joint owner can demand partition and receive one-half of the proceeds. For this reason, *H*'s action in placing property in joint and survivorship form with *W* is a gift of one-half interest to *W*. Such gift is, however, no longer subject to a gift tax in all situations. Under the Internal Revenue Code of 1954, the gift is not taxable unless *H* elects to treat it as such by inclusion of the gift in a gift tax return.<sup>16</sup> This election feature applies only to husband and wife, and only to real estate, although it is not limited to a residence.

The gift tax results, upon termination of a joint tenancy in real estate, depend upon whether there was a taxable gift upon acquisition.<sup>17</sup> Suppose the joint tenancy is terminated by transferring one-

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<sup>12</sup> CODE § 2040; OHIO REV. CODE § 5731.02(B).

<sup>13</sup> *Lewis v. Baldwin*, 11 Ohio 352 (1842).

<sup>14</sup> OHIO REV. CODE § 5307.01; *Shafer v. Shafer*, 30 Ohio App. 298, 163 N.E. 507 (1928); see 14 OHIO JUR. 2D *Cotenancy* § 3 (1955).

<sup>15</sup> 26 AM. JUR. *Husband and Wife* § 81 (1940).

<sup>16</sup> CODE § 2515.

<sup>17</sup> CODE § 2515(b).

half of the title to *H* and one-half to *W*. If the gift of the one-half interest was taxable upon acquisition, that one-half is not again taxable upon termination. If the gift was not taxable upon acquisition, transfer of a one-half interest to *W* upon termination will constitute a taxable gift.

### C. Federal Estate Tax Consequences

If *H* dies without having changed the ownership of the real estate, or if all of the real estate has been transferred to *H*, its entire value at the date of *H*'s death is taxable to his estate.<sup>18</sup> If *W* dies first with no change in the ownership of the real estate, the entire value is taxable to her estate except to the extent that the property can be shown to have originally belonged to *H* and never to have been received by *H* from *W* for less than full consideration.<sup>19</sup> If the joint ownership arose before 1954 and has been terminated by equal division between *H* and *W*, only one-half of the value thereof is taxable upon *H*'s death, regardless of any question of contemplation of death at the time of termination.<sup>20</sup>

### D. Ohio Inheritance Tax Consequences

Joint ownership of real estate presents no Ohio inheritance tax problems different from those considered under joint and survivorship bank accounts.<sup>21</sup>

## IV. CORPORATE SECURITIES

### A. Right of Termination

Temporarily avoiding the conflict of laws questions, it will be assumed that (1) *H* and *W* hold a stock certificate in an Ohio corporation with title to the stock in their names "as joint tenants," (2) *H* and *W* are residents of Ohio, and (3) the certificate of stock is located in Ohio. The Ohio Revised Code provides that this stock ownership is a common law joint and survivorship tenancy.<sup>22</sup> Because it is a true joint and survivorship tenancy, either party has the right to terminate and receive half of the property.<sup>23</sup>

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<sup>18</sup> CODE § 2040.

<sup>19</sup> CODE § 2040.

<sup>20</sup> See text accompanying note 42 *supra*.

<sup>21</sup> OHIO REV. CODE § 5731.02(E).

<sup>22</sup> OHIO REV. CODE § 1701.24(D).

<sup>23</sup> 14 AM. JUR. *Cotenancy* § 14 (Supp. 1964).

### B. *Gift Tax Consequences*

Upon the acquisition of the stock, there was a gift from *H* to *W* amounting to one-half of the cost. It follows, therefore, that upon termination: (1) if *W* transfers her interest to *H*, so that all of the stock is owned by *H*, there is a gift of one-half of the value from *W* to *H*; (2) if *H* transfers his interest so that all of the stock is owned by *W*, there is a gift of one-half of the value from *H* to *W*; and (c) if there is an equal division between *H* and *W*, there is no gift. One possible danger should be noted with reference to division between *H* and *W*. If there are several different securities, there may be a temptation to be practical and to transfer all of one issue to *H* and all of another issue to *W*, and to balance the distribution with still another issue. In such a situation the Internal Revenue Service might argue either (1) that *H* and *W* made an exchange of securities and each has a capital gain equal to appreciation of the value of the stock, or (2) that *H* made a gift to *W*, and *W* made a gift to *H*. It is suggested that every stock should be split equally to avoid such problems.

The existence of a gift of one-half interest upon the creation of the joint tenancy is relevant to the subject of severance of joint estates. Normally, it has not occurred to a joint tenant that he made a gift at the time he bought the securities; part of the lawyer's task in such a case will be the preparation of delinquent gift tax returns. The lack of understanding on this point appeared to be so nearly universal at one time that the Internal Revenue Service was willing to accept late gift tax returns covering such gifts without imposing a penalty under section 6651(a).<sup>24</sup>

### C. *Federal Estate Tax Consequences*

If *H* dies without having changed the ownership of the securities, or if all of the securities have been transferred to *H*, the entire value of the securities at the date of *H*'s death is includable in his estate.<sup>25</sup> If *W* dies first with no change in the ownership of the securities, the entire value of the securities is taxable in her estate except to the extent that they can be shown to have originally belonged to *H* and never to have been received by *H* from *W* for less

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<sup>24</sup> The Senate Committee Report on CODE § 2515 found in 1 CCH FED. EST. & GIFT TAX REP. § 3454.15 could be helpful in arguing for this result. See also 5 RABKIN & JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 75.02 (1963).

<sup>25</sup> CODE § 2040.

than full consideration.<sup>26</sup> If the joint ownership has been terminated and the securities have been divided equally between *H* and *W*, only those in *H*'s name are taxable upon his death, regardless of contemplation of death at the time of termination.<sup>27</sup>

#### D. *Ohio Inheritance Tax Consequences*

Joint ownership of securities presents no Ohio inheritance tax problems different from those considered under joint and survivorship bank accounts.<sup>28</sup>

#### E. *Ownership of Securities as Affected by Conflict of Laws*

Section 1701.24(D) of the Ohio Revised Code creates a joint estate in certain securities. Because this statute is a part of the Ohio Corporation Code, it presumably has no application to corporations not incorporated in Ohio. The question then arises: What law controls with reference to the form of ownership of shares in a corporation incorporated in a state other than Ohio? The *Restatement of Conflicts* states that:

Shares in a corporation are subject to the jurisdiction of the state in which the corporation was incorporated.

The share certificate is subject to the jurisdiction of the state within whose territory it is.

To the extent to which the law of the state in which the corporation was incorporated embodies the share in the certificate, the share is subject to the jurisdiction of the state which has jurisdiction over the certificate.<sup>29</sup>

Thus, if the certificate is located in Ohio, and if the law of the state of incorporation is that the certificate embodies the share, the Ohio law is controlling. Even though this law would technically be the "general law of Ohio" rather than the particular provision of the Ohio Corporate Code, it seems unlikely that any Ohio court would find the two to be dissimilar on this point.

The Uniform Stock Transfer Act and the Uniform Commercial Code require that a security be an instrument which "evidences a share, participation, or other interest in property or in an enterprise . . ."<sup>30</sup> This has been held to mean that the certificate em-

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<sup>26</sup> *Ibid.*

<sup>27</sup> See text accompanying note 42 *supra*.

<sup>28</sup> OHIO REV. CODE § 5731.02(E).

<sup>29</sup> RESTATEMENT (SECOND), CONFLICT OF LAWS § 53 (1958).

<sup>30</sup> UNIFORM COMMERCIAL CODE § 8-102(1)(a)(iv); UNIFORM STOCK TRANSFER ACT § 13.



bodies the share.<sup>31</sup> Because of the widespread adoption of the Uniform Stock Transfer Act or the Uniform Commercial Code, it may be generally concluded that the form of ownership of securities located in Ohio will be determined by the law of Ohio. There is at least one important exception to this conclusion — the State of Delaware adopted the Uniform Stock Transfer Act in 1945, but left in effect another statute that specifically provides that the situs of the ownership of stock in Delaware corporations shall be Delaware.<sup>32</sup> It has been held that this provision has not been repealed by the adoption of the Uniform Act.<sup>33</sup>

Regardless of which state law is controlling, if stock is in two names, there are only three possible types of ownership: (1) tenancy in common; (2) joint tenancy; and (3) tenancy by the entirety.

If ownership is determined to be a tenancy in common rather than joint tenancy, there would be a gift of one-half interest at the creation of such a tenancy, and thus no gift would exist upon equal division of the property.

If there has been no change in the form of registration before the death of *H*, and if the designation of the certificate is ambiguous, such as merely naming *H* and *W*, it would be proper to claim that the ownership was a tenancy in common, so that only one-half of the value is includable in the estate. With the exception of stock incorporated in a state which follows the Delaware rule on situs of stock, it appears that for a stock certificate located in Ohio, the law of Ohio would control in determining whether joint ownership or tenancy in common is present in an ambiguous situation.

If the stock were found to be held by a tenancy by the entirety (under the law of a state other than Ohio), each owner has a life estate in one-half of the stock with a contingent remainder in the whole which is dependent upon the owner surviving the other tenant. In such a case the valuation of the share of each depends upon actuarial tables and the relative ages of *H* and *W*.<sup>34</sup> The termination of such a tenancy by agreement of *H* and *W* and the equal division of the shares between them could, therefore, result in a gift to *W* of the difference between one-half of the total value and the actuarial value of her interest.

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<sup>31</sup> *Mills v. Jacobs*, 333 Pa. 231, 4 A.2d 152 (1939).

<sup>32</sup> *Ibid.*

<sup>33</sup> *Krizanek v. Smith*, 32 Del. Ch. 513, 87 A.2d 871 (Sup. Ct. 1952).

<sup>34</sup> Reg. § 25.2515-2(b)(2) (1958); Reg. § 25.2515-4(b) (1958).

## V. COMMON PROBLEMS INVOLVING JOINT OWNERSHIP

### A. Disclaimer or Renunciation

Can a surviving joint tenant disclaim or renounce his rights to the account or property? In *In re Hershey*,<sup>35</sup> the Franklin County Court of Appeals permitted renunciation; however, the Probate Court of Fulton County refused to do so in *In re Bauer*.<sup>36</sup> The reasons for the attempts to renounce in these two cases illustrate possible weaknesses of joint ownership. In *Hershey*, the daughter disclaimed so that the account would be part of the probate estate, thereby qualifying for the marital deduction, and thus resulting in lower federal estate taxes.<sup>37</sup> In *Bauer*, the disclaimer was intended to place property in the probate estate so that claims against the estate could be set off against it, thereby decreasing Ohio inheritance taxes.<sup>38</sup>

### B. Reservation of the Right to Live in the Family Residence

Suppose that when *H* and *W* bought their first residence twenty years ago, *H* placed the title in *W*'s name, but furnished all of the funds for the purchase; in addition, assume that *H* died two years ago and is survived by *W*. The Internal Revenue Service may claim that the residence is part of *H*'s estate under section 2036 and that *H* has retained the right to possession or enjoyment of the property, because he intended to continue living with his wife. At least two decisions have held against the Internal Revenue Service on such claims,<sup>39</sup> but other cases are pending. An Ohio probate court, when faced with a similar problem in an inheritance tax case, concluded: "It is not unusual for a husband to live in the same house with his wife regardless of who has title to the real estate."<sup>40</sup>

### C. Contemplation of Death Problems and Opportunities

If *W* withdraws all of a joint bank account while *H* is unconscious on his death bed, a question arises as to whether this consti-

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<sup>35</sup> 1 Ohio App. 2d 511, 205 N.E.2d 590 (1965).

<sup>36</sup> 191 N.E.2d 859 (Ohio P. Ct. 1962).

<sup>37</sup> *In re Hershey*, 1 Ohio App. 2d 511, 513, 205 N.E.2d 590, 592 (1965).

<sup>38</sup> *In re Bauer*, 191 N.E.2d 859, 860 (Ohio P. Ct. 1962). It is suggested that this decision could have been on the sole ground that the claims against the estate were not bona fide.

<sup>39</sup> *Stephenson v. United States*, 238 F. Supp. 660 (W.D. Va. 1965); *Union Planters Nat'l. Bank v. United States*, 238 F. Supp. 883 (W.D. Tenn. 1964).

<sup>40</sup> *In re Middecker*, 29 OHIO OP. 2d 430 (Ohio P. Ct. 1964).

tutes a gift in contemplation of death by *H*. There are two cases involving this kind of situation, both of which were decided in favor of the government.<sup>41</sup> Both of these cases, however, were based on California law; the property was taxed as joint and survivorship property, not as a gift in contemplation of death. It is submitted that this question remains open in Ohio, and that it obviously would stretch the meaning of "contemplation" to apply it to a decedent who neither had knowledge nor was able to have knowledge of the transfer when it occurred.

Suppose securities and land have been acquired in survivorship form. *H*, in contemplation of death, terminates the joint tenancy by transferring his interest to *W*, and then dies within three years after the transfer. If *H* had not made the transfer, the whole value of the property would be taxable in his estate as joint and survivorship property under section 2040. However, *H* transferred only one-half interest in contemplation of death, because this is all that he owned. In such a case, only the one-half that he transferred is subject to tax.<sup>42</sup>

If a transfer of real estate into joint form was made before 1954, and if securities were placed in joint form at least three years ago, the attorney is in a position to render a valuable service, even though *H* is in his last illness. The separation of the property into two equal shares will remove one-half from *H*'s estate, despite *H*'s contemplation of death. Although there is a termination of joint tenancy in contemplation of death, there is no *gift* in contemplation of death, because the gift of one-half to *W* was made when the tenancy was created. The separation saves estate taxes and incurs no gift taxes.

It is unwise to terminate joint tenancy by conveying joint property to a trustee under a revocable trust. It has been held that the full value of such property is taxable in the estate of *H* as joint and survivorship property.<sup>43</sup>

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<sup>41</sup> Estate of Frank K. Sullivan, 10 T.C. 961 (1948); Estate of Harold W. Grant, 1 T.C. 43 (1943).

<sup>42</sup> Sullivan Estate v. Commissioner, 175 F.2d 657 (9th Cir. 1949). In United States v. Allen, 293 F.2d 916 (10th Cir. 1961), the court held for the government on a different set of facts, but followed a theory similar to that rejected in the *Sullivan* case. In Heasty v. United States, 239 F. Supp. 345 (D. Kan. 1965), the court refused to follow the theory of the *Allen* case.

<sup>43</sup> Estate of Frank N. Derby, 20 T.C. 164 (1954).

*D. Income Tax Basis*

If a joint owner died before January 1, 1954, the survivor did not get a stepped-up basis.<sup>44</sup> If death has occurred after December 31, 1953, to the extent that the joint property is includable in the gross estate of a deceased owner for federal estate tax purposes, it gains a new basis in the hands of the survivor.<sup>45</sup> This is true even though no federal estate tax return is required.<sup>46</sup> This should be kept in mind when termination of a joint tenancy is contemplated. If *H*'s estate is small and the cost basis of the asset in joint tenancy is much lower than its present value, there may be a distinct tax advantage in having the property in joint form at *H*'s death. Although the application of the Ohio inheritance tax is, in effect, limited to one-half<sup>47</sup> of the value of the joint property, at *H*'s death the survivor gains a new income tax basis for all of the property equal to the value of the property at *H*'s death.

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<sup>44</sup> INT. REV. CODE OF 1939, ch. 1, § 113(a)(5), 52 Stat. 490 (1938), as amended, 53 Stat. 872 (1939).

<sup>45</sup> CODE § 1014(b)(9).

<sup>46</sup> Reg. § 1.1014(b)(2) (1957).

<sup>47</sup> OHIO REV. CODE § 1701.24(D).