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Inequity & Economics: Federal Income, Gift and Estate Tax Treatment of De Facto Families

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INEQUITY & ECONOMICS: FEDERAL INCOME, GIFT AND ESTATE TAX TREATMENT OF DE FACTO FAMILIES

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The last decade has seen two trends suggesting the decline of the lifetime marital family unit: Both the divorce rate[1] and the number of couples living outside of marriage are increasing.[2]

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1. As of March 1978, there were 90 divorced persons for every 1,000 married persons living as husband and wife in the United States, a 157% increase over 1960 (35/1,000). The ratio is higher for persons under 45 than for those over 45. Ratios for persons under 30 years increased by 296% between 1960 and 1978 (from 28/1,000 to 91/1,000) while the increase for the 45-64 year-old age group was 83% (from 53/1,000 to 84/1,000) in that period. U.S. DEPT. OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, POPULATION CHARACTERISTICS, MARITAL STATUS AND LIVING ARRANGEMENTS, SERIES P-20, No. 338, at 2-3 (May 1979) [hereinafter cited as MARITAL STATUS].

The increasing divorce rate is no longer accompanied by a parallel trend in the rate of remarriage. Since 1965, the ratio of divorces to first marriages has risen sharply while the ratio of remarriages to divorces has begun to drop. In 1965 there were 20 divorces and 150 remarriages for every 110 first marriages of women ages 14-44. By 1974 the number of divorces had risen to 32 for every 99 first marriages; the number of remarriages declined to 164 for every 32 divorces. U.S. DEPT. OF COMMERCE, OFFICE OF FEDERAL STATISTICAL POLICY AND STANDARDS, BUREAU OF THE CENSUS, SOCIAL INDICATORS 1976, at 66 (1977) [hereinafter cited as SOCIAL INDICATORS].

2. The number of households with two unrelated adults of the opposite sex is increasing. In 1978, there were 1.1 million "unmarried couple" households, a 117% increase over 1970 when there were 523,000 such households. MARITAL STATUS, *supra* note 1, at 3. The author found no statistics on the number of homosexual family units in the U.S. However, this Comment concerns all women who live in households headed by an unmarried woman. In March 1978, there were 437,000 households consisting exclusively of two females. MARITAL STATUS, *supra* note 1, at 42. An additional 8,037,000 families have a female householder with no husband present. *Id.* at 5. These figures include lodgers, partners, guests, and resident employees with no relatives in the household. *Id.* at 57.

Census Bureau demographers predict an increase in the number of non-family (non-husband-wife) households. In 1978, 25% of all households were non-family households. The Census Bureau projects that by 1995, 30% of all households will be non-family households, accounting for 32-53% of the total increase in households between 1978-1995. U.S. DEPT. OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, POPULATION ESTIMATES AND PROJECTIONS, PROJECTIONS OF THE NUMBER OF HOUSEHOLDS

Choice of lifestyle has an obvious impact on the legal status of a living arrangement. However, courts interested in protecting the interests of parties to legitimate, serious (albeit unmarried) relationships are not necessarily limited to outdated notions of the "meretricious"[3] nature of a couple's living arrangement.[4] The tax system should keep pace. Equal treatment of taxpayers in similar situations and their abilities to pay are the proper concerns of a tax scheme. Alternative households are basically family situations; their limited duration appears less significant as the divorce rate rises. Yet, when men and women seek alternative relationships—primarily as unmarried heterosexual or homosexual couples—they face a federal tax program which refuses to recognize the de facto (if not de jure) family structure of their household.[5]

Disparate tax treatment of married couples in common law

AND FAMILIES: 1979 TO 1995, SERIES P-25, No. 805, at 2 (May 1979).

3. Historically, courts were reluctant to grant relief to couples who chose to forego marriage. They branded such relationships meretricious, and took the view that those who live outside the law may not avail themselves of the law's aid in settling property disputes arising from such living arrangements. Public policy considerations and the clean hands doctrine were common rationales. The parties were left in their relative positions and property belonged to the holder of the title—generally the man. *See, e.g.,* Hewitt v. Hewitt, 77 Ill. 2d 49, 394 N.E.2d 1204 (1979), *rev'g* 62 Ill. App. 3d 861, 380 N.E.2d 454 (1978).

4. Marvin v. Marvin, 18 Cal. 3d 660, 557 P.2d 106, 134 Cal. Rptr. 815 (1976) is the leading case. Existing California case law already provided property rights for a cohabitant who had an express contract, where sex was not the express or entire consideration. Vallera v. Vallera, 21 Cal. 2d 681, 134 P.2d 761 (1943). *See* 1 CALIF. FAM. L. REP. 1002 (1977). *Marvin* expanded the possibilities of implied contracts, implied agreements, and other tacit understandings between the parties such as resultant trust, constructive trust, quantum meruit, or other equitable remedies to protect the expectations of unmarried couples. *Marvin* is said to have inspired at least 1,000 suits as well as a flurry of restrictive legislation. I. BAXTER, MARITAL PROPERTY 11 (Supp. 1980). For cases annotated according to the points stressed in *Marvin,* see *id.,* at 94.

5. The Census Bureau defines a family as a group of two or more persons residing together who are related by blood, marriage, or adoption. SOCIAL INDICATORS, *supra* note 1, at 71. The common law concept of family is somewhat broader. *See, e.g.,* Hartley v. Bohrer, 52 Idaho 72, 77-78, 11 P.2d 616, 618 (1932) (a collective body of persons forming one household under one head and domestic government, having reciprocal, natural, or moral duties to support or care for one another); State *ex rel.* Kemp v. Arnold, 234 Mo. App. 154, 158, 113 S.W.2d 143, 145 (1938) (a collective body of persons living together in one home, in a permanent and domestic character, under one head or management). *But see* Village of Belle Terre v. Boraas, 416 U.S. 1 (1973), upholding on other grounds a zoning ordinance which excluded from the definition of "family" three or more persons "living and cooking together as a single housekeeping unit [who are] not related by blood, adoption, or marriage . . . ." *Id.* at 2.

vis-a-vis community property states led to remedial congressional action a generation ago.[6] The current inequity lies between married and unmarried couples. Correcting that imbalance will again require congressional action. Nevertheless, this Comment argues that precedent exists for judicial remedy of some of the inequitable tax burdens of the unmarried couple. Tax planning is beyond the scope of this Comment, but suggestions will be offered. Property rights and contract formation are treated only to the extent of their tax ramifications.[7]

I. MARRIAGE UNDER THE INTERNAL REVENUE CODE

The Internal Revenue Code[8] (Code) does not define marriage; it looks to state law for definitions of marriage, separation, and divorce.[9] Although the Code treats each individual as a separate person for tax purposes,[10] there are some significant tax advantages (and disadvantages)[11] for married persons[12] as hus-

6. *See* note 32 *infra. See also* I.R.C. §§ 1(a), 2, 6013 (income splitting provisions); 2513 (gift splitting provision); 2056 (estate tax marital deduction); and 2523 (gift tax marital deduction).

7. For discussions of property rights and contract formation by unmarried couples, *see generally* I. BAXTER, note 4 *supra;* Bruch, *Property Rights of De Facto Spouses Including Thoughts on the Value of Homemakers' Services,* 10 FAM. L.Q. 101 (1976); Havighurst, *Services in the Home—A Study of Contract Concepts in Domestic Relations,* 41 YALE L.J. 386 (1932); Kay & Amyx, Marvin v. Marvin: *Preserving the Options,* 65 CALIF. L. REV. 937 (1977); Pfaff, *Death Is Not the Great Equalizer: Division of Non-Marital Property,* 14 U.S.F.L. REV. 157 (1980); Note, *Beyond Marvin: A Proposal for Quasi-Spousal Support,* 30 STAN. L. REV. 359 (1978) [hereinafter cited as *Beyond Marvin*]; Note, *Property Rights of Same-Sex Couple: The Outlook After Marvin,* 12 LOY. L.A.L. REV. 409 (1979) [hereinafter cited as *Property Rights of a Same-Sex Couple*]; 1 CALIF. FAM. L. REP. 1002 (1977).

8. All references are to the Internal Revenue Code of 1954.

9. I.R.C. § 143 sets out criteria for the determination of marital status; it does not define marriage. The Internal Revenue Service (IRS) generally follows state law and recognizes common law marriages which are recognized by the state of the parties' residence. Rev. Rul. 58-66, 1958-1 C.B. 60. State characterizations are not always determinative, however, particularly where those characterizations may result in uneven treatment of taxpayers in different states. *Id.* Conflict between federal and state characterizations arises most frequently over property settlements and alimony payments. *See* note 160 *infra.*

10. M. CHIRELSTEIN, FEDERAL INCOME TAXATION: A LAW STUDENT'S GUIDE TO THE LEADING CASES AND CONCEPTS 156 (2d ed. 1979).

11. For a discussion of the "marriage tax penalty," see note 32 *infra.*

12. Legal marriage in California is created by a formal ceremony solemnizing the relationship. CAL. CIV. CODE § 4100 (West 1970). This has been required since common law marriage was formally abolished in California in 1895. Kay & Amyx, *supra* note 7, at 939. Marital duties in California include mutual obligations of marital support, CAL. CIV. CODE § 5100 (West 1970), and child support, CAL. CIV. CODE § 196 (West Supp. 1981).

band[13] and wife[14] which are not available to unmarried couples.

Unmarried opposite-sex couples have some acknowledged property rights,[15] but the Code ignores the family nature of their living arrangement and treats these couples as individual unmarried persons. The Code takes more notice of the marital contract than it does of the "family" nature of a marriage.[16] Unmarried opposite-sex couples who reject ceremonial marriage[17] at least retain the option to elect it. Same-sex couples are denied that choice.[18] No state recognizes homosexual marriages—same-sex couples who choose to achieve the equivalent must create their own rights and duties by contract.[19]

II. CONTRACTS IN LIEU OF MARRIAGE

Couples who plan to marry sometimes enter into antenuptial agreements,[20] setting forth their respective property rights

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13. Husband is a generic term with a definite and precise meaning identical with the common or colloquial meaning. It signifies a man who has a wife. 41 C.J.S. *Husband and Wife* § 2 (1944).

14. Wife defines a woman who has a husband and generally implies a lawful marriage. *Id.* § 3. However, gender classifications can be reassigned. *See* M.T. v. J.T., 140 N.J. Super. 77, 355 A.2d 204 (1976), *cert. denied,* 71 N.J. 345, 364 A.2d 1076 (1976), holding that a transsexual who through successful sex reassignment surgery harmonizes her gender and genitalia so that she becomes physically and psychologically a woman is a member of the female sex for marital purposes.

15. *See* materials cited note 7 *supra.*

16. For example, a husband and wife have a duty at common law to cohabit, 41 C.J.S. *Husband and Wife* § 11 (1941); but not under the Code. It provides that married persons may file income tax returns separately, recognizing that they may live apart. I.R.C. § 1(d).

17. There were 1,137,000 unmarried couple households in the United States in 1978. MARITAL STATUS, *supra* note 1, at 3.

18. *See, e.g.,* Jones v. Hallahan, 501 S.W.2d 588 (Ky. Ct. App. 1973) (lesbian couple not entitled to a marriage license because what they proposed was not a marriage); Baker v. Nelson, 291 Minn. 310, 191 N.W. 2d 185 (1971), *appeal dismissed,* 409 U.S. 810 (1972) (marriage means state of union between persons of opposite sex).

19. At least one pre-*Marvin* case, Garcia v. Venega, 106 Cal. App. 2d 364, 368, 235 P.2d 89, 92 (1951), recognized the enforceability of property sharing agreements between "any two persons (two women or two men, for example) . . . ." *See generally Property Rights of a Same-Sex Couple, supra* note 7.

20. An antenuptial contract is a contract made before marriage or an agreement in contemplation of marriage. Hewitt v. Gott, 132 Kan. 168, 294 P. 897 (1931). An antenuptial settlement is a contract or agreement before marriage, but in contemplation of and generally in consideration of marriage. The main provision is that the property rights and interests of either the prospective husband or wife or both of them, are determined or property is secured to either or both of them, or their children. *In re* Carnevale's Will, 248 A.D. 62, 65, 289 N.Y.S. 185, 188 (1936). *See generally* 2 A. SINDEY, SEPARATION

after marriage. Couples who choose to live outside marriage may formulate contracts in lieu of marriage.[21] Federal tax statutes in this area primarily concern transfers of wealth by individuals, so policies favoring traditional marriage are not evident.

Generally, property transferred in exchange for the promise of marriage is subject to gift tax,[22] as is any transfer of property without full consideration in money or money's worth.[23] According to the Treasury Regulations, "[a] consideration not reducible to a value in money or money's worth as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift."[24]

Although detriment to the donee is generally sufficient con-

AGREEMENTS AND ANTE-NUPTIAL CONTRACTS § 90 (1980).

21. *See* 2 A. SINDEY, SEPARATION AGREEMENTS AND ANTENUPTIAL CONTRACTS § 100 (Supp. 1980); P. ASHLEY, OH PROMISE ME BUT PUT IT IN WRITING (1978) (discussing homosexual as well as heterosexual cohabitation).

22. The gift tax applies to a transfer by gift whether the property is real or personal, tangible or intangible, and whether the transfer is direct or indirect. I.R.C. § 2511(a). Transfers made for a valuable consideration in money or money's worth are not subject to the tax. The gift tax is an excise tax on transfers of wealth. Bradford v. Commissioner, 34 T.C. 1059, 1063 (1960). Treas. Reg. § 25.2511-2(a) (1958), further states the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. The tax is measured by the value of the property passing from the donor. The gift tax is primarily concerned with depletion of a taxpayer's estate through lifetime transfers of wealth.

The estate tax, a single assessment levied on the value of a person's estate, could be defeated if inter vivos gifts went untaxed. Accordingly, the estate and gift taxes are construed together. Merrill v. Fahs, 324 U.S. 308, 311 (1945); Estate of Sanford v. Commissioner, 308 U.S. 39, 44 (1939); Estate of R.R. Glenn v. Commissioner, 45 T.C. 323 (1966). One of the basic changes of the 1976 Tax Reform Act, Pub. L. No. 94-455, § 2001, 90 Stat. 1521 (codified at I.R.C. § 2001(c)), was to repeal the dual system of tax rates (the gift tax had been ¾ of the estate rates) and replace it with a single unified rate schedule for use in computing both. Flanagan, *Overview of Estate and Gift Tax Reform,* 82 COM. L.J. 220 (1977).

23. Transfers taxed as gifts are not confined to those lacking a valuable consideration according to the common law concept of gifts, but "embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given" in exchange. Treas. Reg. § 25.2512-8 (1958). "Money's worth" requires more consideration than is necessary to support a contract. Commissioner v. Wemyss, 324 U.S. 303, 306 (1945) (Congress intended "gifts" in its broadest, most comprehensive sense with the evident desire to "hit all the protean arrangements which the wit of man can devise that are not business transactions . . . .").

24. Treas. Reg. § 25.2512-8 (1954).

sideration to support a contract,[25] it is inadequate to avoid gift tax liability. For example, in *Commissioner v. Wemyss*,[26] a widow and her child received trust income from her former husband. The woman stood to forfeit her trust income upon remarriage. To offset her unwillingness to lose the income and induce her to marry him, her fiancé transferred stock worth $149,000 to her. Affirming the Tax Court's holding that the transfer was a taxable gift, the Supreme Court noted that "[t]o allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open the door for evasion of the gift tax."[27]

Under the same principle, any transfer of property as part of a contract in lieu of marriage will result in a taxable gift.[28] The gift is complete, hence taxable, when the donor so parts "with dominion or control as to leave . . . no power to change its disposition . . . ."[29] Beneficial use of the property must be transferred; mere legal title is not enough.[30]

III. INCOME SPLITTING POSSIBILITIES

Once a household is established, the inequities are clearer. The most visible tax advantage of the married couple is the opportunity to file a single joint return.[31] Congress enacted the joint return in 1948 to remedy the imbalance between commu-

25. Detriment to the promissee is generally adequate consideration, whether or not any benefit accrues to the promisor. 1 CORBIN ON CONTRACTS § 122 (1963).

26. 324 U.S. 303 (1945).

27. *Id.* at 308. This case was decided the same day as Merrill v. Fahs, 324 U.S. 308 (1945), which held that estate taxes and gift taxes are construed in *pari materia*. In *Wemyss*, the Court reasoned the gift tax "aims to reach those transfers which are withdrawn from the donor's estate." 324 U.S. at 307.

28. *See* I.R.C. §§ 2501, 2502(d). If the donor does not pay the tax, the donee may be required to discharge the liability to the extent of the value of the property received. I.R.C. § 6324(b). For other potential tax consequences to the recipient, see discussion of sexual services cases, notes 56-64 *infra* and accompanying text.

29. Treas. Reg. § 25.2511-2(b) (1958).

30. The gift tax is "applicable only to a transfer of a beneficial interest in property. It is not applicable to a transfer of bare legal title to a trustee." Treas. Reg. § 25.2511-1(g)(1) (1958).

31. IRC § 6013(a) states that: "[a] husband and wife may make a single return jointly of their income taxes . . . even though one of the spouses had neither gross income nor deductions . . . ." Husband and wife are taxed as if each were an unmarried person who earned one-half their combined income. I.R.C. § 1(a). The lower rates applicable to each half generally result in a lower combined tax.

nity property and common law jurisdictions.[32] Previously, married couples in common law states often attempted to achieve the benefits of community property for tax purposes by assigning the rights to income to whichever spouse was in the lower tax bracket—generally without success. De facto families who attempt the tax savings of the joint return through private income-splitting agreements will encounter the same resistance from the Internal Revenue Service (IRS) and the courts, as did their predecessors.

The general principle for married and unmarried families is that income from personal services is taxable to the person who earns it. Both the assignment of rights to future income from services to be performed[33] and the assignment of rights to in-

32. The Revenue Act of 1948, Pub. L. No. 471, § 301, 62 Stat. 114 (1948) (amending Int. Rev. Code of 1939, ch. 1, § 12, 53 Stat. 5 (now I.R.C. § 1(a)) introduced the joint return to equalize the opportunities for income splitting in the common law states with those of the eight community property jurisdictions (Arizona, California, Idaho, Louisiana, Nebraska, New Mexico, Texas, and Washington). M. Chirelstein, *supra* note 10, at 193. *See, e.g.,* Poe v. Seaborne, 282 U.S. 101 (1930) (state law controls). The advent of the joint return made marital status important in federal income taxes for the first time because income splitting reduced taxes, making it advantageous to be married. B. Bittker & L. Stone, Federal Income Estate and Gift Taxation 348 (4th ed. 1972); Mess, *For Richer, For Poorer: Federal Taxation and Marriage,* 28 Cath. U.L. Rev. 87, 104 (1978).

Because of the progressive nature of the tax schedule (the higher the income, the higher rate at which increments are taxed) allowing a married couple to split the income means the couple is effectively taxed at a lower rate than if all the income were attributable to the person who earned it. Before the Tax Reform Act of 1969, Pub. L. No. 91-172, § 803, 83 Stat. 487 (codified at I.R.C. § 1), the difference between single and married couples' rates was as great as 42% at some income levels. When single persons complained that they were discriminated against for choosing to remain unmarried, the 1969 Act retained the married taxpayer as the basic unit and reduced the single taxpayer's rate schedule. Now the rate structure discriminates against some married couples. If, for example, one partner of the marriage produces all or most of the income, he or she pays less tax than if single. If both spouses work, however, the second income is added to the first and is thus placed in a higher marginal tax bracket than if it stood alone. For couples filing jointly who earn comparable salaries, the higher tax bracket more than offsets the lower rate schedule for joint returns—the so-called "marriage tax penalty." *See* Mess, *supra,* at 96.

A married couple's scheme to avoid the "marriage penalty" failed when the Tax Court decided their foreign year-end divorces, designed to give them the status of single taxpayers, were invalid. Boyter v. Commissioner, 74 T.C. 989 (1980). The taxpayers relied on I.R.C. §§ 143(a), 6013(d)(1)(A), providing that marital status is determined at year's end. IRS argued the divorces were sham transactions, relying on Rev. Rul. 76-255, 1976-2 C.B. 40. The court avoided that determination, ruling only that the foreign courts lacked subject matter jurisdiction over the divorce proceedings, and that state law was binding.

33. Lucas v. Earl, 281 U.S. 111 (1930) (assignment of future earnings to spouse inef-

come already earned but not yet received[34] are ineffective to divert the tax. The income is taxed back to the party who performs the services.

Income from property is treated differently. Obviously, property can be given away and the future income will be shifted to the donee.[35] Consequently, even the value of personal services which went into creating property (a patent or copyright, for example) will not be taxed back to the source, provided that more than the bare right to collect income is transferred. For example, if *A* gives a bond coupon to *B* so that *B* becomes the owner of the coupon and entitled to receive the income, but *A* retains the underlying bond, the income from the coupon will be taxed to *A*.[36] Here, *A* has retained too much control—in this case, the ability to determine future income flow from the underlying property. A gift of the bond itself, on the other hand, would permanently vest the income in the new owner.[37]

On this same principle, a fractional interest of the underlying property can be given away and a portion of the income thereby shifted.[38] Thus, if one person purchases income-producing real estate, taking title jointly with another person, one-half the income is taxable to each of the co-owners.[39]

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fective to divert tax). *Accord,* Rev. Rul. 79-132, 1979-1 C.B. 62 (military chaplain under vow of poverty is taxed on income he turns over to his religious order). *But cf.* Rev. Rul. 76-479, 1976-2 C.B. 20 (rule does not apply to payments received by agent on behalf of principal and turned over to principal).

34. Helvering v. Eubank, 311 U.S. 122 (1940) (rights to renewal commissions previously earned but assigned to a family trust were taxable to the person who earned them).

35. For gift tax consequences, see text accompanying notes 110-117 *infra.*

36. Helvering v. Horst, 311 U.S. 112 (1940) (interest coupons detached and given to son did not transfer the income to the son).

37. *See id.,* at 115.

38. Heim v. Fitzpatrick, 262 F.2d 887 (2d Cir. 1959). In *Heim,* the taxpayer assigned rights to his invention to a company, retaining the option to cancel. He then assigned 75% of that contract to his wife and two children. The court held the future income was not taxable to him because more than collection rights were assigned—these were gifts of income-producing property.

39. *See* Finney v. Commissioner, 35 T.C.M. (CCH) 1504 (1976), *appeal dismissed, nolle pros.;* Treas. Reg. § 25.2511-1(h)(5) (1958). For example, if *A* with her own funds purchases property and has the title conveyed to herself and *B* as joint owners, with rights of survivorship which may be defeated by either party severing her interest, there is a completed gift of one-half the value of the property. *Id.*

Joint bank accounts are treated differently than other forms of jointly owned property.[40] If only one person deposits funds in an account from which either party may withdraw, all interest income is includable in the income of the depositor.[41] No taxable gift occurs so long as the contributor retains the power to take possession of the entire contribution, even though the contributor may be a co-owner under state law.[42] Only when the noncontributor withdraws funds does a completed gift occur, and then only to the extent it exceeds his or her contribution.[43] Therefore, splitting interest income from savings accounts requires a partition unless the funds are so commingled that the sources are unascertainable. In that case, interest income is divided equally among the co-owners.[44]

IV. INTERNAL ECONOMICS: INCOME AND GIFT TAXES

A. Support as Income to the Housekeeper

Day-to-day economic exchanges of money, property, and services within the marital household go largely untaxed because of policy decisions to exclude them from the tax base.[45] They are potentially taxable to members of the non-marital household. The primary reason the value of support received by a housekeeping spouse is not included in his or her income is the marital support duty,[46] although administrative convenience un-

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40. *See* Treas. Reg. § 25.2511-1(h)(4) (1958); Rev. Rul. 54-143, 1954-1 C.B. 12.

41. Treas. Reg. § 2511-1(h)(4) (1958).

42. *See id.;* L. Thomas, Tax Consequences of Marriage, Separation and Divorce 64 (2d ed. 1976).

43. Treas. Reg. § 25.2511-1(h)(4) (1958). The $3,000 annual gift exclusion, provided by I.R.C. § 2503(b), was intended to make it unnecessary to report small transfers. S. Rep. No. 665, 72nd Cong., 1st Sess., *reprinted in* 1939-1 C.B. (Part 2) 496, 525.

44. Finney v. Commissioner, 35 T.C.M. (CCH) 1504 (1976), *appeal dismissed, nolle pros.*. In *Finney*, one-half of separated spouses' jointly held funds was taxable to each. It was immaterial that the husband received no part because he nonetheless had an unrestricted right to it.

45. *See* notes 77-81 and accompanying text, *infra.*

46. At common law, the husband is legally obligated to support his wife and children. 41 Am. Jur. 2d *Husband and Wife* § 329 (1968). The wife has no corresponding common law obligation. *Id.* § 334. In California, the support obligation is mutual. Cal. Civ. Code § 5100 (West 1970). Payments in discharge of this obligation are neither deductible by the payor nor income or gift to the recipient. *See* Crittenden v. United States, [52-2] U.S. Tax Cas. (CCH) ¶ 10,870 (E.D. Wis. 1952).

One commentator has criticized these marital duty classifications as possibly unconstitutional, overbroad generalizations based on sex. Note, *Estate Tax Section 2040: Homemaker's Contribution to Jointly Owned Property,* 29 Tax Law 623, 629 (1976) [hereinafter cited as *Homemaker's Contributions*]. Thus, even if the common law recogdoubtedly plays its part. Thus, a housewife's allowance is normally considered neither income[47] nor gift[48] to her; similarly, a joint bank account used to defray household and living expenses is ordinarily not a gift.[49]

Unmarried household members have neither common law nor statutory obligations to support one another. Exchanges of money, property, or services within the de facto family raise questions of income tax liability.[50] The Code specifically excludes gifts from gross income,[51] but does not define "gift." The Supreme Court has declined to formulate a definitive test.[52] The determination of when a payment is to be treated as a gift, depends "ultimately on the application of the fact finding tribunal's experience with the mainsprings of human conduct [and] the totality of the facts of each case."[53] It has held (albeit in a

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nizes the wife's duty to render domestic services, basing application of a federal statute on such a gender-based classification may violate the fifth amendment. The Supreme Court has held a statute which provides unequal treatment for men and women similarly situated, where the difference in treatment bears no rational relationship to the purpose of the statute, violates the equal protection clause of the fourteenth amendment and the due process clauses of the fifth and fourteenth amendments. The concept of a wife's duty to provide domestic services to her husband is clearly a classification based on sex and one arising from archaic and overbroad generalizations about gender-based roles. *Id.* at 629-30.

47. Burkhart v. Commissioner, 11 B.T.A. 275, 278 (1928) (allowance as compensation for acting as housewife represented merely a personal expense to husband, not taxable income to wife).

48. Support is relative to the family's standard of living. Hill v. Commissioner, 88 F.2d 941 (8th Cir. 1937). One commentator would find a presumption of a gift for any excess amount a wife accumulates if retained with the husband's consent. L. THOMAS, *supra* note 42, at 88. If the allowance is a reasonable amount, it is doubtful Congress intended it to be subject to gift tax. If the allowance were substantially increased for no apparent reason, it would be a prima facie case for gift taxation.

49. *See* Crittenden v. United States, [52-2] U.S. Tax Cas. (CCH) ¶ 10,870 (E.D. Wis. 1952) (trust payments made to maintain taxpayer's home and to support and educate his children did not exceed the actual expenses incurred and therefore were not taxable gifts).

50. I.R.C. § 61. Gross income includes income received in any form, be it money, property, or services, and from whatever source derived. Treas. Reg. § 1.61-1(a) (1957). Similarly, payment of an obligation or liability on behalf of a third person is income to that person. *E.g.*, Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929).

51. I.R.C. § 102.

52. Duberstein v. Commissioner, 363 U.S. 278, 284-89 (1960).

53. *Id.* at 289. While not determinative, the donor's intent is critical. *Id.* at 285-86. With business associates, part of the examination of the total facts includes scrutinizing how the donor treated the transation for his or her own tax purposes. A deduction claimed for a business expense suggests it was not meant as a gratuity. This test is not useful with most non-business-related expenditures because personal expenses are gener-

commercial context) that a payment in return for services rendered or arising from the "constraining force of any moral or legal duty" is income to the recipient regardless of how the parties characterize the payment.[54] Courts have applied statutory language[55] broadly in determining whether payments supporting a nonfamily member should be taxed as income. In two leading cases involving true meretricious relationships, the results were inconsistent.

Margaret Brizendine was convicted of prostitution five times before 1945.[56] She met a man who promised to buy her a house and support her if she gave up prostitution. She then married another man. The first kept his promise: He furnished a $2,000 down payment for a house, arranged financing, provided mortgage payments, and gave her at least an additional $25 per week.[57] The court held her promise to relinquish prostitution and grant him companionship was sufficient consideration to make the payments includable in her gross income.[58]

In contrast, a man provided Greta Starks a substantial amount of cash and property, including a house, automobile, and living expenses over a five-year period.[59] She claimed a "very personal relationship"[60] with the man and the court classified the payments as gifts.[61] The *Starks* court relied on more than testimony as to the warmth of the relationship—it looked also to the fact that the woman received $41,000 in 1955 and only $5,000 or $6,000 in other years.[62] The payments to Brizen-

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ally not deductible. I.R.C. § 262 (no deduction for personal, living, or family expenses).

54. Duberstein v. Commissioner, 363 U.S. 278, 285 (1960) (citing Bogardus v. Commissioner, 302 U.S. 34, 41 (1937)).

55. I.R.C. § 61 (gross income includes income received in any form, from any source).

56. Brizendine v. Commissioner, 16 T.C.M. (CCH) 149 (1957).

57. *Id.* at 150.

58. *Id.* at 151.

59. Starks v. Commissioner, 25 T.C.M. (CCH) 676 (1966).

60. *Id.* at 677.

61. The Tax Court found it noteworthy that the government's attorney failed to ask the man involved whether *he* considered the payments gifts. Two writers view this concern with the donor's motive as reflecting "the importance of the human element in the taxing process." R. SOMMERFELD & G. STREULING, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, TAX RESEARCH TECHNIQUES 32 (1976). While this seems a flimsy basis on which to distinguish the cases, it suggests the importance of the donor's intent under the general guidelines of Duberstein v. Commissioner, 363 U.S. 278 (1960).

62. Starks v. Commissioner, 25 T.C.M. (CCH) at 677.

dine were more uniform in amount and regularity, but Brizendine's record as a prostitute, and her husband's avocation as a gambler, suggested the presence of unreported, illegal income. Because the IRS had reconstructed Brizendine's income based on known expenditures,[63] the Tax Court did little more than recognize the obvious: She and her husband had significantly underreported their income. The "agreement" merely furnished a ready rationalization to sustain the agency's findings.[64]

Some courts view meals, lodging, and other support received by a de facto family homemaker as compensation for services rendered rather than as support,[65] even though basic contract law generally does not view a housekeeper's services as an exchange for compensation.[66] Income is taxable in whatever form received, including cash, property, and the free use of property.[67] The value of support received appears to fall within the definition of gross income. Two cases seem to support this proposition.

For example, W.T. Hamilton felt obligated, but was incapable of caring for his 81-year old mother.[68] He arranged for an old family friend in need of a home to care for his mother and perform light housekeeping chores. Hamilton provided the housekeeper a place to live and paid her cash to care for his mother.

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63. She filed no income tax returns for the taxable years ending 1945-1949. Brizendine v. Commissioner, 16 T.C.M. (CCH) at 149.

64. *See* R. SOMMERFELD & G. STREULING, *supra* note 61, at 31.

65. *See* text accompanying notes 68-71 *infra*.

66. Many of the early cases on compensation for services rendered in the household are claims against the estate. Generally, there was no expectation of wages. Rather, plaintiff often hoped for and was encouraged to expect a legacy. Havighurst, *supra* note 7, at 392. *See generally* sources cited note 7 *supra*.

67. Treas. Reg. § 1.61-1(a) (1957) explains that income may be realized in the form of services, meals, accommodations, stock, or other property as well as in cash. Most cases dealing with tax treatment of free lodging have involved the employer-employee relationship. Chandler v. Commissioner, 41 B.T.A. 165 (1949), *aff'd*, 119 F.2d 623 (3d Cir. 1941) (rent-free use of a house owned by a corporation wholly controlled by the taxpayer was given not as a gratuity but as compensation for services rendered and was properly includable in income); Dean v. Commissioner, 9 T.C. 256 (1947), *appeal dismissed*, 187 F.2d 1019 (3d Cir. 1951); Roberts v. Commissioner, 7 T.C.M. (CCH) 599 (1948). *But see* Richards v. Commissioner, 111 F.2d 376 (5th Cir. 1941) (absent evidence that the rental value was compensation for services, it was a gift from the corporation to its stockholders, not taxable income); Peacock v. Commissioner, 256 F.2d 160 (5th Cir. 1958), *rev'g* 15 T.C.M. (CCH) 1252 (1956).

68. Hamilton v. Commissioner, 34 T.C. 927 (1960).

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The Tax Court determined that the payment of essential living expenses was compensation for services.[68.1]

D.L. Angstadt met and began dating an acquaintance.[69] Both were employed, but he suggested that if she served as a housekeeper and generally cared for their day-to-day needs, she and her daughter could live with him. Angstadt, in return, offered to furnish food, shelter, and all their living needs. The parties understood that they were not entering into a common law marriage and that neither was obligated to continue the arrangement.[70] Again, the Tax Court held that, because the arrangements were economically beneficial to the parties, payment of essential living expenses was compensation for services rendered.[71] Both cases arose in the context of a claimed personal exemption for the housekeeper, not on whether any support received was taxable income. The pronouncements on compensation justified disallowing the claimed dependency exemption;[72] they are dictum on the issue of income tax liability for the value of support received.[73]

B. The Value of Housekeeper's Services as Income to the Householder

Domestic services have value.[74] A housewife's services to her

68.1. 34 T.C. at 929.

69. Angstadt v. Commissioner, 27 T.C.M. (CCH) 693 (1964).

70. *Id.* at 693.

71. *Id.* at 695. *Accord,* Massey v. Commissioner, 51 F.2d 76 (6th Cir. 1931) (single man maintained a home for his mother and sister; contributions to the sister's support were in return for the performance of duties as a housekeeper).

72. For a discussion of dependency exemptions for household members see § V *infra.*

73. Both *Hamilton* and *Angstadt* involved the individual income tax returns of the primary householders. The courts did not discuss whether the housekeepers included in income on their own returns the value of support received.

74. The Social Security Administration fixed the annual value at $4,705 in 1972. Office of Research and Statistics, Social Security Administration, Note No. 9, Economic Value of a Housewife (DHEW Pub. No. 75-11701)(1975), *noted in* Bruch, *supra* note 7, at 113. One commentator placed that value at $13,364. Galbraith, *A New Economic Role for Women?,* 155 Current 41 (1973). The total value of homemakers' services has been calculated to be roughly one-fourth the Gross National Product. *Id.*

One commentator states that the most significant contribution the women's movement has made to the problem of economic justice at divorce is calling attention to the value of homemaker's services. As of 1979, 22 states had by statute or court decision authorized divorce courts to consider the homemaker's contribution in determining property distribution or setting the amount of alimony or separate maintenance. I. Baxter, *supra* note 4, at 8. Along with this recognition has developed an accompanying trend family are a major source of imputed income,[75] even though these services go untaxed. They are considered imputed income, and not an exchange of labor because of a tacit recognition by the Treasury that the services are self-generated and totally consumed within the family.[76] The IRS has never attempted to draw imputed income from domestic services into the tax base,[77] probably because of a lack of authority in the Code for taxing imputed income,[78] doubts of its constitutionality,[79] a concern

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toward decreasing the amount and duration of alimony so that, on balance, the egalitarian principles of the women's movement have been used to remove prior advantages without compensating advances. *Id.* at 9. *See generally* Comment, *Equity and Economics: A Case for Spousal Support,* 8 GOLDEN GATE U.L. REV. 443 (1979).

With nonmarital partners, an implied agreement may lead to the presumption the services were rendered gratuitously, particularly in states other than California. *See, e.g.,* York v. Place, 273 Or. 947, 949, 544 P.2d 572, 574 (1975) (presumption that the services were rendered as a gratuity extended to nonmarital partners because their domestic union was essentially a family relationship).

I.R.C. § 2040(c), added by the Revenue Act of 1978, Pub. L. No. 95-600, § 511, 92 Stat. 2881, recognizes the value of services contributed by a surviving spouse and joint owner of property, provided the property is used in a business or farm in which she or he materially participated. The surviving spouse's participation affects the extent to which jointly owned property is taxed in the decedent's estate. Even this recognition ignores services in the home.

75. Imputed income is defined as a "flow of satisfactions from durable goods owned and used by the taxpayer, or from goods and services arising out of the personal exertions of the taxpayer on his own behalf." Note, *The Constitutionality of the Taxation of Imputed Income,* 9 VAL. L. REV. 221, 221 (1974) [hereinafter cited as *Taxing Imputed Income*] (citing Marsh, *Taxation of Imputed Income,* 58 POL. SCI. Q. 514, 514 (1943)).

For example, if a housekeeper hires someone to prepare meals, clean, and perform domestic services she will have to work to produce additional income (which will be taxed) to pay the other person. But if she stays home and does her own work, no taxable income is generated even though the net benefit to the family is the same. B. BITTKER & L. STONE, *supra* note 32, at 64.

76. *See* M. CHIRELSTEIN, *supra* note 10, at 21.

77. *Id.* A 1947 Treasury study determined that, because of the housewife's substantial contributions, a married couple does not need twice the money income of a single person to maintain the same standard of living. Comparison of the standard deductions (now Zero Bracket Amounts) allowed single persons and married couples in subsequent years suggests that the housewife's contribution is actually indirectly taxed through a relatively lower standard deduction. B. BITTKER & L. STONE, *supra* note 32, at 356. In a commercial context, the IRS has taxed what verges on imputed income. *See* Commissioner v. Minzer, 279 F.2d 338 (5th Cir. 1960) (commissions received by a life insurance broker on policies upon his own life are income to the broker); Commissioner v. Daehler, 281 F.2d 823 (5th Cir. 1960). In *Daehler* a real estate salesman purchased for himself real estate listed with a second broker who split the commission with the first broker's employer. The employer gave his portion of the commission to the employee. The court held the amount was compensation for services and not a discount in sale price.

78. M. CHIRELSTEIN, *supra* note 10, at 21.

79. *Id. See also Taxing Imputed Income, supra* note 75.

over valuation,[80] and a sense that the concept is vague and theoretical to the general public.[81] Enforcing such provisions under our self-reporting income tax system could prove an administrative nightmare,[82] although there are no guarantees the IRS will never attempt to or cannot tax such services.[83]

Treasury regulations argue that the value of domestic services performed by the de facto family housekeeper are income to the beneficiary,[84] but there is no case law taxing as income the value of these services.[85] Valuation poses a problem. The value of services might readily be determined in the case of barter clubs[86] where all members are professionals exchanging professional services.[87] It is far more difficult to accurately value the de facto housekeeper's domestic services because of the presence of an element of gift in those services. Like the marital unit, the de facto family's services are imputed income to that living unit.

80. In most cases the real value is less than the fair market value of services because the individual might choose to do without the service if he or she had to pay for it. M. CHIRELSTEIN, *supra* note 10, at 21.

81. *Id.*

82. The American income tax system relies heavily on wage withholding to collect most of the personal income tax. *See* E. GRISWOLD & M. GRAETZ, *supra* note 75, at 115. Wage withholding was enacted because most taxpayers are unable to save enough money to pay their taxes in one installment at year's end. The United States government's reliance on a self-executing system to assess and collect most income tax further argues against taxing imputed income. *Id.*

83. It would probably take specific congressional action to do so. *See* M. CHIRELSTEIN, *supra* note 10, at 20.

84. *See* Treas. Reg. § 1.61-2(d)(1) (1957) (if services are paid for in exchange for other services, the fair market value of such other services taken in payment must be included in income as compensation).

85. The Tax Court has found an implied agreement that the value of the housekeeper's services equals the value of food, lodging, and other support. *See, e.g.,* Massey v. Commissioner, 51 F.2d 76 (6th Cir. 1931); Hamilton v. Commissioner, 34 T.C. 927 (1960); Provita v. Commissioner, 29 T.C.M. (CCH) 1318 (1970); Angstadt v. Commissioner, 27 T.C.M. (CCH) 693 (1968). This reasoning has been used to deny the householder a personal exemption for the housekeeper, not to tax the services as income to the householder. *See* notes 68-71 *supra* and accompanying text.

86. More than $13 billion in goods and services are bartered annually in the United States. Mutual Credit Buying Systems, Inc., of Los Angeles, Calif., transacts $1 million annually among its 3,500 members. Useful Exchange in Reston, Va., offers a communitywide pool of 100 personal services exchanged on an hour-for-hour basis. C. STAPLETON & P. RICHMAN, BARTER: HOW TO GET ALMOST ANYTHING WITHOUT MONEY 37-40 (1978).

87. Rev. Rul. 79-24, 1979-1 C.B. 60, offers this example: "In return for personal legal services by a lawyer for a housepainter, the housepainter painted the lawyer's [home]. Both the lawyer and the housepainter are members of a barter club. . . . All the members of the club are professional or trades persons." Both must include in income the fair market value of services received.

Because they are not part of an arm's length, bargained for exchange of labor, as envisioned in the statutory definition of gross income,[88] the value of such services does not belong in the tax base. De facto families, like their married counterparts, view housekeeping services as an obligation of ordinary family life, not as a wage earning position.[89]

There are some additional arguments for excluding from the income of the homemaker the value of support received, even if it appears to fit within the tax base. The Code excludes from income the value of "meals and lodging furnished on the premises for the convenience of the employer."[90] Meals and lodging are excludable when received by a live-in maid.[91] This reasoning can be extended to both the housewife and the de facto family housekeeper. Alternately, the situation can be viewed as simply a sharing of personal expenses. There is some authority for this view because reimbursements for car pooling are not income.[92] Under this theory, the income producing partner pays the housekeeper's share of personal living expenses and is reimbursed through services.

C. Reciprocal Gifts and the Gift Tax

Household services rendered by an unmarried cohabitant have traditionally been considered gifts under contract law.[93] Household services are not subject to gift tax.[94] Free lodging might be, because the permissive use of property involves the

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88. *See* Treas. Reg. § 1.61 (1957).

89. *See* M. Chirelstein, *supra* note 10, at 162-63.

90. I.R.C. § 119(a) states that the value of meals and lodging furnished to an employee, the employee's spouse, or dependents is excluded from the gross income of the employee, provided the meals are furnished on the premises and acceptance of the lodging on the business premises is a condition of employment. The exclusion is a tacit recognition that in-kind payments are worth considerably less than retail or fair market value. *See* M. Chirelstein, *supra* note 10, at 18; Benaglia v. Commissioner, 36 B.T.A. 838 (1937).

91. According to Treas. Reg. § 1.119-1(c) (1956) the term "business premises of the employer" generally means the place where the employee is employed. Consequently, meals and lodging furnished in the employer's home to a domestic servant are treated as meals and lodging furnished on the business premises of the employer.

92. Rev. Rul. 55-555, 1955-2 C.B. 20.

93. *Beyond Marvin, supra* note 7, at 384.

94. The gift tax is imposed only on "the transfer of property." I.R.C. § 2501. No tax is payable on donated services. R. Stephens, G. Maxfield & S. Lind, Federal Estate and Gift Taxation ¶ 1.03[2] (4th ed. 1978).

transfer of a property right. However, given the gift tax concern with depletion of a taxpayer's estate through inter vivos transfers, sharing property cannot be said to diminish a taxpayer's accumulated wealth within the purpose of that law.

There is little case law on the gift tax liability of shared property. Rent-free lodging is similar to the use of interest-free loans and may be profitably compared. The courts have uniformly rejected attempts by the IRS to tax such loans,[95] a refusal predicated in part on the absence of any realization of cash income and in part on the freedom not to make a profit.[96]

There is a distinction, after all, between (1) permitting a friend to share your residence, and either (2) paying that person's rent elsewhere, or (3) making a gift of money with which to rent or purchase housing.[97] The distinction rests on the completeness of the gift.[98] Because control and dominion have not passed in the case of mere permissive use, no gift has been made.[99] The gift tax is concerned with depletion of an estate

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95. *E.g.*, Crown v. Commissioner, 67 T.C. 1060 (1977), *aff'd*, 585 F.2d 234 (7th Cir. 1978); Johnson v. United States, 254 F. Supp. 73 (N.D. Tex. 1966); Dean v. Commissioner, 35 T.C. 1083 (1961). In *Crown*, the taxpayer was a one-third partner in Areljay Co.. Areljay made approximately $18,000,000 in non-interest-bearing and demand notes on open account to 24 trusts established for various relatives. The court followed *Johnson*, which held that because the loan principal remains in the lender's estate at death, nothing about the transfers permitted the lender to avoid future estate tax by reducing the current estate via inter vivos gifts of principal. 67 T.C. at 1063. The IRS, however, refuses to follow *Johnson*. Rev. Rul. 73-61, 1973-1 C.B. 408.

96. Crown v. Commissioner, 67 T.C. at 1063.

97. That distinction—the sharing of property among relatives or family members—was discussed in *Crown*:

> [T]here are policy considerations which militate against viewing the value use of money or property as a taxable event for gift tax purposes . . . . [The IRS position] could be extended to a multitude of situations involving gratuitous use or sharing of real or personal property among relatives. The application of the gift tax to common intra-family sharing or use of property seems administratively unmanageable and such situations point up the difficulty with the concept of gift taxation attaching to mere permissive use.

67 T.C. at 1065.

98. "As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him *no power* to change its disposition, whether for his own benefit or the benefit of another, the gift is complete." Treas. Reg. § 25.2511-2(b) (1958) (emphasis added). Rev. Rul. 73-61, 1973-1 C.B. 408.

99. Free use of real estate may be taxable when the donee has exclusive use of it, but the reasoning of Rev. Rul. 73-61, 1973-1 C.B. 408, does not apply to either the shar-

through lifetime transfers.[100] Logically, then, all transfer-for-consumption exchanges as well as the shared use of property should be exempt from gift tax, provided the transfers do not result in the donee acquiring power of disposition over property of significant value.[101]

D. Income Tax and Gift Tax Liability Under Share Expenses Agreements

Often, both partners in the de facto family have outside income. For the family that rents its living quarters, the tax treatment of contributions to rent are quite simple. The parties are merely splitting personal rental expenses under the rationale of the car pooling doctrine.[102] If one of them owns the real estate, however, cash contributions by the nontitle holder may be rental income[103] unless a gift can be shown.[104] The presence of an income pooling or expense sharing agreement undercuts any argument that the money is intended as a gift.

Nothing is gained by treating the arrangement as a rental transaction. Rental income can be offset by income-related expenses,[105] but the largest of these (state and local property taxes,[106] and mortgage interest[107]) are already deductible by every property owner. When a transaction is not profit moti-

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ing of property or to services because neither constitutes a transfer of property.

100. Commissioner v. Wemyss, 324 U.S. 303 (1945); Merrill v. Fahs, 324 U.S. 308 (1945). Some courts hold that protection of the income tax is another purpose of the gift tax. Crown v. Commissioner, 585 F.2d at 235 n.2. *See* IRS Letter Ruling 7921017 (Feb. 16, 1979) (transfer taxed as both income and a gift).

101. *See* ALI Estate and Gift Tax Project 17 (1968) [hereinafter cited as Gift Tax Project]. The American Law Institute proposal exempts transfers for the benefit of any person residing in the transferor's household, so long as the expenditure does not provide the donee with property that will retain significant value after one year from the date of expenditure. *Id.* at 19.

102. Rev. Rul. 55-555, 1955-2 C.B. 20. *See* text accompanying note 92 *supra.*

103. I.R.C. § 61(a)(5). Treas. Reg. § 1.61-8 (1957) (gross income includes rents received from the occupancy of real estate).

104. I.R.C. § 102(a) states the general rule that gross income does not include the value of property acquired by gift.

105. I.R.C. § 162(a). Depreciation (I.R.C. § 167(a)(2)) is a mandatory deduction for income producing property. Treas. Reg. § 1.167(a)-10(a) (1956). Failure to take the proper deduction attributable to income in the taxable years it is allowed does not preclude a later accounting for that depreciation deduction, and an increase in taxable gain when the property is sold.

106. I.R.C. § 164(a).

107. I.R.C. § 163(a).

vated, deductions may not exceed income and a loss may not be shown for tax purposes.[108] If the parties' agreement sets a value on the lodging which is less than the fair market rental value of the housing, the transaction may be scrutinized as not profit motivated.[109]

One response to the problem of unintended taxable income is joint ownership, where contributions by both parties go to their respective equities in the property. Placing property in joint ownership, however, is irrevocable. It can also give rise to gift tax liability.

The undivided interest and survivorship features of joint tenancy[110] may make this form of co-ownership attractive to de facto families who seek to emulate either marital joint tenancy or community property. However, creating any form of co-ownership where the interests of the contenants do not correspond with actual contributions results in a taxable gift.[111] If title is conveyed, a gift has been made.[112] The fact that the donor re-

108. I.R.C. § 183(b)(2).

109. The IRS view is valid where separate quarters (a flat, separate apartment, or distinct housing unit) are involved. It is generally inapposite where the parties share the same living space, because of the difficulty in valuing permissive use. A separate housing unit which is not offered at a bargain rate to a relative or friend would be available to the public at its fair market value; the personal quarters of the householder normally would not.

110. For the estate tax consequences of a gift of property in joint tenancy, see notes 193-197 and accompanying text, *infra*.

111. For example, *A* purchases real property with personal funds and has title conveyed to himself or herself and another party *B* as joint owners, with rights of survivorship which may be defeated by either party severing his or her interest. *A* has made a gift of half the value of the property to *B*. Treas. Reg. § 25.2511-1(h)(5) (1958).

The exact form a cotenancy takes is governed by local law. Generally, property acquired by cohabitants belongs to the holder of legal title. Common law emphasizes fortuitous or calculated taking of title so that even if the parties previously entered into a 50-50 agreement, some courts impose a tenancy in common. *See generally* I. BAXTER, *supra* note 7, at 560-76 and cases therein.

112. There are several important statutory provisions which limit the taxation of marital intra-family transfers of wealth which are not available to de facto families. The most significant allows one-half the value of a gift between spouses to escape tax. I.R.C. § 2523. The splitting provision equalizes gift tax treatment between community property and common law states. R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 94, at ¶ 11.03.

The second relates to purchase of a home. Despite the general rule on taxation of disproportionate interests, creation of a tenancy by the entirety or a joint tenancy in real property between husband and wife is not considered a gift unless the owner intends a gift. I.R.C. § 2515. Why any donor would choose to treat a transfer as a taxable gift when not necessary is answered partly by the difference in gift tax treatment of the terminatains the ability to receive all the property upon the death of the donee does not preclude a taxable gift.[113]

In general, when two persons assume a mortgage upon which both are individually liable, each is a purchaser to the extent of one-half the debt assumed. If one cotenant contributes disproportionately toward the purchase price, however, the excess contribution is a taxable gift.[114] Subsequent unequal contributions are also gifts in the year made.[115]

Payments on a residential mortgage in the early years go mostly to interest. If both parties are jointly and severally liable, payments on behalf of the non-contributor are neither income nor gift;[116] only the portion of the mortgage payment applied toward the donee's share of the principal is a taxable gift. So long as principal payments remain under $6,000 annually, gift tax can be avoided.[117]

A revocable trust,[118] on the other hand, would both retain

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tions of cotenancies involving jointly held marital real property. That, in turn, depends on whether the property was previously subject to gift tax. For a discussion of the tax consequences of non-election, *see* H. Dubroff & D. Kahn, Federal Taxation of Estates, Gifts and Trusts 352-59 (3d ed. 1980). The election covers subsequent improvements and other additions in value to the property, such as mortgage payments. *See* I.R.C. § 2515(c)(2).

113. *See* note 111 *supra.*

114. R. Stephens, G. Maxfield & S. Lind, *supra* note 94, at ¶ 10.05[1].

115. Examples are mortgage payments and capital improvements. *See id.*

116. Nicodemus v. Commissioner, 26 B.T.A. 25 (1932) (despite the general rule on apportionment according to interests, when parties share a joint and several obligation, the deduction for real estate taxes and interest is allowed to the party who makes the payment out of his or her separate funds). *Accord,* Blackburn v. Commissioner, 38 T.C.M. (CCH) 1048 (1978); Finney v. Commissioner, 35 T.C.M. (CCH) 1504 (1976).

117. With two joint tenants, only half the principal amount constitutes a gift; $3,000 falls within the annual exclusion. I.R.C. § 2503(b). When the property is later sold, income tax rules take effect. In computing gain for income tax purposes, the basis of a donee's interest at the time of sale is the same as it would have been in the hands of the donor. For purposes of computing a loss, it is the lesser of the donor's basis or the fair market value at the time of the gift. I.R.C. §1015(a). In either case, the basis is increased by the amount of the gift tax paid, but not to exceed the fair market value of the property at the time of the gift. I.R.C. § 1015(d). For gifts made after 1976, only that portion of the gift tax paid which is attributable to the appreciation in value of the property while in the hands of the donor may be added. I.R.C. § 1015(d)(6).

118. The settlor has power to revoke the trust if and to the extent he or she reserves such a power. Restatement (Second) of Trusts § 330 (1959). Historically, property transferred in trust to a person in consideration of an agreement to cohabit illegally with the settlor was invalid as against public policy. *Id.* § 64. Cohabitation is no longer illegal

title and avoid gift tax.[119] An agreement allocating payments by the non-title holder to that person's interest in the property would seem to preclude having to treat those payments as rent. Alternatively, the IRS might argue that periodic contributions received by the title holder are gain from the sale of the property on an installment basis. This also would not be true under an express or even an implied trust theory. And in California at least, prior or contemporaneous payment is not a prerequisite to a resulting trust, so that an implied trust can arise even when payments are made after the conveyance.[120]

Intrafamily exchanges are generally marked by a sense of personal obligation and donative intent. Where sharing of property is involved—even when there is a reciprocal exchange of services—the situation lacks the free exchange and self-interest characteristic of the open market, arm's length transaction. Because support concerns personal living expenses rather than accretions in wealth, in the absence of a clear profit motive, all intrafamily exchanges of services, transfers for consumption, and sharing of property should be exempted from income, gift, and estate taxes.[121]

V. PERSONAL EXEMPTIONS

A married taxpayer who files a separate income tax return is entitled to a dependency exemption for his or her spouse.[122] An exemption is also provided for both the taxpayer and spouse on a joint return.[123] There is no exemption for a common law spouse if the state of their domicile does not recognize common law marriage.[124]

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in California. *See generally* materials cited notes 3 & 4 *supra.*

119. *See* note 98 *supra. See also* R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 94, at ¶ 10.01[5].

120. Viner v. Untrecht, 26 Cal. 2d 261, 158 P.2d 3 (1945); Stone v. Lobsien, 112 Cal. App. 2d 750, 247 P.2d 357 (1952). In *Stone,* circumstances showed an implied promise to make the installment payments. That was sufficient to find a resulting trust. *Id.* at 756, 247 P.2d at 360.

121. *See* GIFT TAX PROJECT, *supra* note 101, at 19.

122. I.R.C. § 151(b) allows an exemption of $1,000 for the taxpayer. An additional exemption of $1,000 is allowed for the taxpayer's spouse if the taxpayer does not file a joint return and the spouse has no gross income and is not the dependent of another taxpayer.

123. I.R.C. § 6013 allows a married couple to file a single joint return.

124. I.R.C. § 152(b)(5). H.R. REP. No. 775, 85th Cong., 1st Sess. § 5 (1957), *reprinted in* 1958-3 C.B. 811, 817-18. *Accord,* Peacock v. Commissioner, 37 T.C.M. (CCH)

The Code does allow an exemption for an "individual . . . who . . . has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household."[125] There are, however, three major obstacles to gaining a dependency exemption for a de facto family member under this definition: (1) the dependent's gross income must be less than $1,000;[126] (2) the relationship may be held in violation of local law;[127] and (3) the relationship may be characterized by the courts as an exchange of services, not support.[128]

In the leading case, *Turnipseed v. Commissioner*,[129] the taxpayer violated the criminal laws of Alabama[130] by living with a woman who was married to another man. Turnipseed claimed her as a dependent. The Tax Court was unable to find any legislative guidance, but reasoned that "Congress never intended the specific paragraph in question [Code section 152(a)(9)] to be construed so literally as to permit a dependency exemption for an individual whom the taxpayer is maintaining in an illicit relationship in conscious violation of the criminal laws of the jurisdiction of his abode."[131] The House Report to the Technical Amendments Act of 1958[132] confirmed the holding in *Turnipseed* that persons in an illicit relationship cannot constitute a household.[133] That report was issued in 1957 when nonmarital cohabitation was generally illegal,[134] but it still shapes the

177 (1978), *appeal dismissed nolle pros. by taxpayer.*

125. I.R.C. § 151(e) allows a $1,000 exemption for each dependent as defined in I.R.C. § 152.

126. I.R.C. § 151(e)(1)(A).

127. *See* text accompanying notes 129-133 *infra.*

128. *See* text accompanying notes 135-143 *infra.*

129. 27 T.C. 758 (1957).

130. ALA. CODE tit. 14, § 16 (1940) (currently at § 13-8-1 (1975)).

131. 27 T.C. at 760.

132. Pub. L. No. 85-866, § 4, 72 Stat. 1606 (1958) (codified at I.R.C. § 152(b)(5)).

133. H.R. REP. No. 775, 85th Cong., 1st Sess. § 5 (1957) *reprinted in* 1958-3 C.B. 811, 817-18.

134. Bruch, *supra* note 7, at 132 n.115. California has since repealed criminal sanctions for sexual activity between consenting adults. 1975 Cal. Stats., ch. 71, §§ 5-12. *Compare* California's neutral standard formulated in Marvin v. Marvin, 18 Cal. 3d 660, 557 P.2d 106, 134 Cal. Rptr. 815 (1976) (mores have changed so radically that a standard based on moral considerations cannot be imposed) *with* Doe v. Commonwealth's Atty., 403 F. Supp. 1199 (E.D. Va. 1975), *aff'd mem.*, 425 U.S. 901 (1976) (citing biblical quotes in upholding a Virginia sodomy statute).

The possible unconstitutionality of such statutes may not be used to attack I.R.C. § 152(b)(5). Ensminger v. Commissioner, 610 F.2d 189 (4th Cir. 1979), *aff'g* 36 T.C.M. 934

courts' thinking. Even if a state has no statute proscribing a particular living arrangement, the court can refuse to allow the exemption on the grounds that meals, lodging, and other amenities furnished a cohabitant are remuneration for services, not support.[135]

In *Bombarger v. Commissioner*,[136] the taxpayer and her son moved in with Winnie Stewart and her husband. The Bombargers remained after Stewart's husband died. Bombarger had an outside job, Stewart did the housework; the women considered themselves "just like mother and daughter."[137] Because she viewed herself as having furnished the support of the household, Bombarger requested a finding that Stewart resided in *her* "home" for purposes of the dependency exemption,[138] but was denied the exemption because Stewart owned the house.[139] The court found other grounds as well on which to deny the exemption: "These parties are mutually dependent upon one another. Each contributes something the other needs and each receives a benefit from a mutually satisfactory arrangement."[140] The determination of mutual dependency was dictum. Furthermore, the court ignored the fundamental principle that the law should tax those who are best able to pay. When applied consistently to cases of mutual dependency between de facto spouses, that principle supports a personal exemption for a non-wage earning housekeeper.

An example of the Tax Court's undue emphasis on the element of gift involved in support is *Hamilton v. Commissioner*.[141] In *Hamilton*, the Tax Court analyzed a similar situation under

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(CCH) (1977) (the Commissioner cannot be required to determine the constitutionality of such a law). *Contra, In re* M.M. Shackelford, 45 Am. Fed. Tax Rep. 2d (P-H) ¶ 80-529 (D.C. Mo. 1980) (dictum) (Missouri statute prescribing criminal sanctions for unmarried cohabitation was unconstitutional).

135. *See* Massey v. Commissioner, 51 F.2d 76 (6th Cir. 1931); Hamilton v. Commissioner, 34 T.C. 927 (1960); Provita v. Commissioner, 29 T.C.M. (CCH) 1318 (1970); Angstadt v. Commissioner, 27 T.C.M. (CCH) 693 (1968).

136. 31 T.C. 473 (1957).

137. *Id.* at 474.

138. I.R.C. § 152(a)(9) includes in the definition of a dependent "an individual . . . who for the taxable year of the taxpayer, has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household."

139. 31 T.C. at 475.

140. *Id.* at 476.

141. 34 T.C. 927 (1960).

the history of the household member exemption and decided that Code section 152(a)(9) was intended for foster children, not unmarried adult housekeepers.[142] Explaining the nature of support, the court said that, in the case of foster children, "support would be gratuitous and given to the recipient from motives of charity, affection, or moral obligation without thought of receiving in return a *quid pro quo*."[143]

The court did not face the realities of foster care. Whatever the foster parents' motive in caring for foster children, they do receive an inducement in the form of foster care payments.[144] The dependency exemption is simply one more incentive to encourage foster care. The family with foster children is in fact a de facto family, one sanctioned by both Congress[145] and the states.[146] The Tax Court itself already allows exemptions for a cohabitant's children,[147] not because of the absence of any "quid

142. *Id.* at 929.

143. *Id.*

144. In California, monthly rates for foster care are set by the county and (as of 1972) vary from $72 to $160. R. MNOOKIN, CHILD, FAMILY AND STATE 521 n.36 (1978). Most foster parents are middle to lower middle class and over age 40. *Id.* at 521. There are an estimated 243,600 children in foster homes. *Id.* at 514 n.2.

145. The federal government, under the Social Security Act, reimburses states for a portion of foster care costs for children meeting financial eligibility requirements. 42 U.S.C. § 608(a) (1976).

146. In California, the state is primarily concerned with financing foster care although it is also concerned with supervising and licensing the program. *See* CAL. WELF. & INST. CODE §§ 16510-16511 (West 1980); 22 CAL. ADMIN. CODE ch. 6, §§ 85015-85175 (1980).

147. *See* Peacock v. Commissioner, 37 T.C.M. (CCH) 177 (1978), *appeal dismissed, nolle pros. by taxpayer* (exemption allowed for cohabitant's child, but not for cohabitant). Illanovsky v. Commissioner, 24 T.C.M. (CCH) 225, 226 (1965) (dictum) (marital status of the couple does not affect their right to claim children as dependents). In distinguishing Turnipseed v. Commissioner, 27 T.C. 758 (1957), Estate of Daniel Buckley v. Commissioner, 37 T.C. 664 (1962) and Unterman v. Commissioner, 38 T.C. 93 (1963), the *Illanovsky* court stated in dictum:

> In each of these cases the taxpayer was not entitled to an exemption for the woman with whom he lived because their relationship violated local law. But none of these cases concern children living with the taxpayer. Even if we assume that the . . . [couple was] not legally married, that alone would not affect their right to claim the children as dependents.

Id. at 226. *See also* Rev. Rul. 54-498, 1954-2 C.B. 107 (exemption allowed for illegitimate child).

Where more than one person provides support for the children in the household, there may be some proof problems in establishing the precise amounts contributed. There is some case authority that a person who supplies more than half the aggregate support for a group of persons has supplied more than half for each of them, and that pro quo," but more likely due to the children's ignorance of parental lifestyle. Denying personal exemptions to de facto spouses on the grounds that the relationship is "illicit," or that support and services are bargained for compensation, is anachronistic. An encouraging sign is *In re M.M. Shackelford,*[148] a recent bankruptcy case. In *Shackelford,* the taxpayer was a single woman who lived with her three children and a single man. Their living arrangement violated a Missouri statute that made any open and notorious adulterous situation or lewd cohabitation a misdemeanor. The IRS denied the exemption for the man. The bankruptcy court allowed the exemption and held the living arrangement lawful based on a modern reading of state statute, legislative history, and existing case law.[149] The court noted that although, in the past, the mere act of living together was construed as lewd and lascivious behavior, it was not so today.[150] One case does not necessarily herald a trend, but the decision does significantly expand the parameters of qualified dependents, and may open the courts to further challenges of the strict IRS view.

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the cost of maintaining the household generally inures equally to each dependent. Fisher v. Commissioner, 16 T.C. 1144 (1951); Dunn v. Commissioner, 32 T.C.M. (P-H) ¶ 63,189 (1963).

Alternatively, when two or more persons each furnish more than 10% of the child's support, together they provide at least 50%, and none individually furnishes more than 50% of each child's support, they may sign a "multiple support agreement." I.R.C. § 152(c). Under this arrangement, any one of the supporters (the highest income partner, for example) may claim all the exemptions, thereby reducing that person's marginal tax rate, and lessening the overall household tax bill.

148. 45 Am. Fed. Tax Rep. 2d (P-H) ¶ 80-529 (D.C. Mo. 1980).

149. The court explained:

> It is not for this Court to say that two unmarried persons living together is a step ahead or behind two unmarrieds holding themselves out as husband and wife. . . . It is not within the jurisdiction of this Court to establish a code of morals for taxpayers.

Id. at 80-1076.

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> If one goes far enough back in case law, perhaps such conduct [unmarried cohabitation] could be said to be in violation of . . . state law . . . . [B]ut in this day and age, can it be said that merely living together is open, gross lewdness or lascivious behavior? Does this conduct openly outrage decency? Is it injurious to public morals? . . . I think not.

Id. (Barker, C.J.).

VI. DISSOLUTION OF THE FAMILY: GIFT AND INCOME TAX CONSIDERATIONS

A. SEPARATE MAINTENANCE PAYMENTS

During marriage, payments to support a spouse or children are not taxable income to the recipient, and generally do not comprise taxable gifts.[151] Voluntary payments made after the dissolution of a marriage similarly remain outside the ambit of the income tax.[152] The Code does, however, tax as income certain mandatory spousal support payments incident to dissolution of a marriage.[153]

Dissolution of a de facto family may be accompanied by similar separate maintenance payments.[154] De facto family members have no reasonable expectations of support based on status, but they can create their own support rights and duties through

151. Burkhart v. Commissioner, 11 B.T.A. 275 (1928); Crittenden v. United States, [52-2] U.S. Tax Cas. (CCH) ¶ 10,870 (E.D. Wis. 1952). Support is relative to the family's station in life. For a discussion of some thorny problems which can arise in determining the extent or value of this support obligation, see R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 94, at ¶ 10.02[5][a].

152. *See* Treas. Reg. § 1.75-1(b) (1957).

153. The major sections governing these separate maintenance payments are I.R.C. §§ 61(a)(8), 71 (inclusion in gross income of amounts received); 215 (deduction of payments); and 7701(a)(17) (defining "husband" and "wife"). I.R.C. § 71(a) defines three types of alimony and separate maintenance payments which are includable in the recipient's gross income. Those are payments arising under (1) a decree of divorce or separate maintenance; (2) a written separation agreement; or (3) a decree for support.

I.R.C. § 71(a) includes in the recipient's gross income periodic payments received "in discharge of a legal obligation, which because of the marital *or family* relationship is imposed on or incurred by" a payor under a written agreement. (Emphasis added.) Payments can be "periodic" even though not made at regular intervals; a lump-sum amount specified in the written agreement would not be includable in the recipient's income even if paid in installments. Distinguishing periodic payments from installment payments is not always easy, but § 71(c) provides guidelines. In general, payments continuing for more than 10 years are considered periodic payments even if a lump-sum is specified in the decree. I.R.C. § 71(c)(2). Prince v. Commissioner, 66 T.C. 1058 (1976) (property settlement payments over 121 months are alimony); Ryker v. Commissioner, 33 T.C. 924 (1960) (language that 121 payments were part of property division was not controlling. The payments were taxable to the recipient as income). I.R.C. § 215 excludes from the gross income of the payor amounts includable in the income of the recipient.

Oral agreements do not qualify. Alexander v. Commissioner, 38 T.C.M. (CCH) 969 (1979) (fact that recipient included payments in income was irrelevant). *Accord,* Kievler v. Commissioner, 28 T.C.M. (CCH) 1042 (1969).

154. *See Property Rights of a Same-Sex Couple, supra* note 7, at 419 (citing Richardson v. Conley, No. 416547 (San Diego County Super. Ct., May 17, 1978)) (temporary support awarded upon the dissolution of a lesbian household).

contract. One provision might allow for the separate maintenance of one of the parties following the break up of the living unit. Unless these payments are viewed as equivalent to marital alimony and separate maintenance payments, they will be subjected to *double* taxation: initially when earned by the obligor, and again when paid over to the recipient.[155]

Non-marital support payments can be treated the same as marital alimony and separate maintenance payments without severely distorting statutory language or contravening congressional intent. The Revenue Act of 1942[156] evinced a dual intent regarding such support payments. Congress promulgated the Act to (1) tax only the party beneficially receiving the income, and (2) produce "uniformity" in the treatment of amounts paid in the nature of or in lieu of alimony, regardless of variance in different states concerning the existence and continuance of an obligation to pay alimony.[157] The pertinent Code sections[158] treat alimony and separate maintenance payments as income to the wife and allow a corresponding deduction to the husband for such amounts. When the flow of payments is reversed so that the wife pays, "husband" means wife and "wife" means husband.[159] Thus, "wife" and "husband" are interchangeable terms, serving only to identify the recipient and payor in order to avoid double taxation. It is not so great a step to extend these provisions to putative spouses and, logically, to de facto spouses as well.[160]

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155. *See* I.R.C. § 61.

156. Pub. L. No. 753, § 120, 56 Stat. 798 (amending Int. Rev. Code of 1939, Ch. 1, § 22, 53 Stat. 9 (now I.R.C. § 71)).

157. H.R. REP. No. 2333, 77th Cong., 1st Sess. 72 (1942), *reprinted in* 1942-2 C.B. 372, 427. Lack of a state support obligation is no bar. *See, e.g.*, Brown v. Commissioner, 16 T.C. 623 (1951) (treatment of payments is not determined by state law characterization); Harris v. Commissioner, 11 T.C.M. (CCH) 895 (1952) (payments taxed as alimony even though Louisiana imposes no duty of support on a divorced husband).

158. *See* note 153 *supra*.

159. I.R.C. § 7701(a)(17).

160. Although courts consistently hold that determination of the parties' marital status is governed by the law of their domicile, *e.g.*, Boyter v. Commissioner, 74 T.C. 989 (1980), the characterization of a dissolution is not binding for federal tax purposes.

State characterizations notwithstanding, certain payments under a written agreement incident to an annulment of a void or voidable marriage (like those under divorce or separation) may be deductible by the payor and includable in gross income by the recipient. Reisman v. Commissioner, 49 T.C. 570 (1968), *acq.* 1971-2 C.B. 3. *See also* Estate of Borax v. Commissioner, 349 F.2d 666 (2d Cir. 1965), *cert. denied*, 383 U.S. 935 (1966) (payments were deductible by payor and income to recipient even though divorce

For example, *Newburger v. Commissioner*[161] illustrates the Tax Court's flexible interpretation of the Revenue Act of 1942. Newburger's wife sued for separation. He counterclaimed and obtained an annulment based on the invalidity of the wife's earlier ex parte divorce.[162] The court ordered him to pay $150 per week support.[163] The IRS argued the payments were not deductible because Newburger had no legal obligation under New York law, but the Tax Court held the putative marriage created a legal obligation and allowed him the deduction.[164]

The deductibility of payments is a relief measure which—by taxing only the party who beneficially receives the income—encourages obligors to make support payments. It applies to those payments made because of the "family or marital relationship in recognition of the general obligation to support which is made specific by the decree, instrument or agreement."[165] Because of increasing societal and judicial acceptance of de facto families, the "general obligation to support" should be predicated on the mutual expectations and needs of the parties.[166] *Newburger* is an important step toward recognizing de facto family life and is consistent with the express congressional intent to treat spousal support payments uniformly.[167]

Temporary support or rehabilitation payments received by one of the partners following dissolution of a de facto family are probably income in any event.[168] The IRS will likely take the position that court ordered payments incident to the dissolution of a de facto family are the discharge of a contractual obligation, hence a nondeductible personal expense to the obligor.[169] Failure of the courts to extend *Newburger* will, therefore, result in the

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was invalid in New York). *But see* Rev. Rul. 67-442, 1967-2 C.B. 65 (IRS will not follow these Second Circuit decisions). *Compare* Lee v. Commissioner, 64 T.C. 552 (1974) (rejecting *Borax*) *with* Newburger v. Commissioner, 61 T.C. 457 (1974) (following *Borax*).

161. 61 T.C. 457 (1974).

162. *Id.*

163. *Id.* at 458.

164. *Id.* at 460.

165. Treas. Reg. § 1.71-1(b)(4) (1957).

166. *See* notes 1-4 *supra*.

167. *See* note 157 *supra*.

168. *See* I.R.C. § 61.

169. *See* Newburger v. Commissioner, 61 T.C. 457 (1974). I.R.C. § 262 makes personal expenses nondeductible.

inequity of *double* taxation.

B. Property Divisions

Marital dissolution actions commonly provide for the division of property. A property settlement is not income to the recipient because courts find an implied agreement that the marital rights surrendered equal the amount received,[170] and such a settlement is generally not subject to gift tax.[171]

De facto family property settlements do not fall squarely within any statutory provision. They must be analyzed under the general rules governing transfers of property. Severance of joint tenancy property does not result in gain or loss for income tax purposes and the partition of jointly owned property according to contributions does not create a taxable gift.[172] When property held in one name is partitioned disproportionately upon the dissolution of a de facto family, the tax consequences may depend upon the cause of action vindicated, although state characterizations of the form of recovery are not necessarily binding for federal tax purposes.[173]

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170. United States v. Davis, 370 U.S. 65 (1962). The *Davis* Court assumed the parties negotiated at arm's length and judged the marital rights to be equal in value to the property for which they were exchanged. Because there are generally no income tax consequences to the recipient of a property distribution incident to a divorce, does not necessarily mean there are none to the transferor. *See* note 188 *infra* and accompanying text.

171. I.R.C. § 2516 (transfer of property or interests in property made under a qualified written agreement in settlement of marital or property rights is considered to be made for full and adequate compensation). *But see* Rev. Rul. 68-379, 1968-2 C.B. 414 (distinguishing settlement of support rights from inheritance rights). A transfer to satisfy the support obligation which normally lasts as long as both spouses live, or until the recipient remarries, does not diminish the transferor's estate any more than any other personal obligation. But a settlement of inheritance rights is a present transfer of what would otherwise be a major portion of the payor's estate on death. Consequently, a transfer of property under a divorce decree is a gift to the extent the value of the property exceeds the value of the support rights surrendered. *Id. See also* R. Stephens, G. Maxfield & A. Lind, *supra* note 94, at ¶ 10.02[5][a] (discussing the difficulties of valuing support rights).

172. It must first be determined whether the creation of the joint tenancy involved a completed gift. If not, each party must withdraw her respective contribution plus the net income attributable to it, or a taxable gift occurs. *See* Stinehart, *Tax Implications of the Forms of Spousal Co-ownership,* 6 Comm. Prop. J. 25, 41 (1979).

173. Bruch, *supra* note 7, at 129.

Gift Tax

An unmarried cohabitant may be granted relief under a variety of equitable theories,[174] the resulting trust,[175] constructive trust,[176] or implied domestic partnership.[177] These remedies focus on real or imagined economic contributions to property and can result in gift tax liability to the extent the recipient's recovery exceeds consideration given.[178] Here, the absence of a marital relationship may prove advantageous to the unmarried couple—at least to the extent the property distribution is court-ordered. Not all exchanges lacking full consideration in money

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174. *See* note 4 *supra*.

175. A resulting trust arises when a person makes or causes to be made a disposition of property under circumstances which raise the inference that she does not intend the person taking or holding the property to have the beneficial interest in the property, where the inference is not rebutted, and the beneficial interest is not otherwise effectively disposed of. RESTATEMENT (SECOND) OF TRUSTS § 404 (1959). It may arise where property is purchased and the purchase price is paid by one person and at her direction the vendor transfers the property to another person. *Id.* §§ 440-460. A resulting trust is appropriate where one partner contributed to the purchase price of property, but title stands in the name of the other. Pfaff, *supra* note 7, at 189. *Compare* McDonald v. Carr, 150 Ill. 204, 37 N.E. 225 (1895) (resulting trust permitted for a non-family relationship of 20 years duration; one party purchased the land and placed title in cohabitant's name), *with* Creasman v. Boyle, 31 Wash. 2d 345, 196 P.2d 835 (1948) (trust recovery denied). In *Creasman*, one party purchased property, made additions, and put it in cohabitant's name. The court held that, absent evidence to the contrary, it was presumed the parties disposed of the property as they intended because they deliberately made disposition between themselves. *But see In re* Estate of Thornton, 81 Wash. 2d 72, 499 P.2d 864 (1972) (recovery allowed on other grounds). The court said: "Arguably, *Creasman* should be over-ruled and its archaic presumption invalidated." *Id.* at 75, 499 P.2d at 867.

The resulting trust theory works best where both parties have incomes and contribute their earnings to a common fund to purchase property. Pfaff, *supra* note 7, at 192. The theory is inapplicable where one partner works at a salaried position and the other is a homemaker. *Id.*

176. A constructive trust is a relationship concerning property subjecting the person by whom title to the property is held to an equitable duty to convey it to another on the grounds that retention of the property is wrongful and would result in unjust enrichment. It arises not from intention but as an equitable remedy. RESTATEMENT (SECOND) OF TRUSTS § 1(e) (1959). Fraud is the essential element, but the inherent flexibility in the doctrine makes it a useful last resort for de facto families without a remedy. Pfaff, *supra* note 7, at 193.

177. Domestic partnership claims provide the best avenue in those courts which are willing to view the relationship as an economic arrangement in which one party provides capital, the other services. This claim still seems to require some type of business arrangement. *E.g., In re* Estate of Thornton, 81 Wash. 2d 72, 499 P.2d 864 (1972) (implied partnership found in the operation of cattle ranch). The better view finds the very existence of a non-marital relationship a joint economic venture. *See generally* Pfaff, *supra* note 7, at 185-89.

178. *See generally* notes 22-23 *supra*.

or money's worth are taxable gifts.[179] Treasury Regulations exclude sales, exchanges, and *transfers of property* "made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent) . . . ."[180] Court-imposed property settlements probably qualify as exempt exchanges.[181] The key is the involuntariness of the transfer. Absent an intention by the donor to circumvent the estate tax by voluntarily depleting the estate, there is no reason to subject the transaction to gift tax.[182]

Income Tax

A more difficult situation arises when a money or property division is tailored to compensate the plaintiff for the value of services rendered, or to restore the value of benefits received by the defendant. Any amount received under a breach of contract[183] or quantum meruit[184] claim has generally been includable in gross income as compensation for services.

In *Cotnam v. Commissioner*,[185] for example, a woman quit

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179. Treas. Reg. § 25.2512-8 (1958).

180. *Id.*

181. The gift tax applies only to voluntary transfers. Harris v. Commissioner, 340 U.S. 106 (1950). In *Harris*, the Court explained:

> This [divorce settlement] transaction is not "in the ordinary course of business" in any conventional sense. . . . But if two partners on dissolution of a firm entered into a transaction of this character or if Chancery did it for them, there would seem to be no doubt that the [settlement would be tax free]. . . . No reason is apparent why husband and wife should be under a heavier handicap . . . .

Id. at 112.

182. *See id.* Accordingly, the reasoning of Rev. Rul. 68-379, 1968-2 C.B. 414, discussed in note 171 *supra*, does not apply, even if the de facto spouse's support rights are valued at zero. That ruling distinguished settlement of marital support rights from settlement of inheritance rights and found gift tax liability in the latter. De facto spouses have no inheritance rights. For income tax consequences to the de facto spouse whose support and inheritance rights are valued at zero, see notes 189-191 *infra* and accompanying text.

183. Cohabitation alone does not give rise to rights in the property of the other partner, but express agreements between the cohabitants are enforceable if illicit sex is not the sole consideration. *See generally* materials cited note 7 *supra*. An implied agreement may lead only to a presumption that the services were rendered gratuitously. York v. Place, 273 Or. 947, 949, 544 P.2d 572, 574 (1975).

184. Quantum meruit is a legal action brought on an existing but unenforceable contract. It requires evidence of specific services and is subject to attack on the basis of illegal consideration. Pfaff, *supra* note 7, at 187.

185. 28 T.C. 947 (1957), *aff'd in part, rev'd in part*, 263 F.2d 119 (5th Cir. 1959).

her job and moved into a man's residence to "render services and attention as an attendant or friend,"[186] in exchange for one-fifth his estate. The man died intestate in 1945 but Cotnam received judgment for $120,000, less attorney's fees of $50,366. The Tax Court classified the recovery as delayed compensation for services rather than a tax-free bequest. The entire $120,000 was included in her income, spread over the four-and-a-half year period during which it was "earned."[187] Cotnam was allowed a deduction for attorney's fees, but only in the year in which they were paid. Because the attorney's fees in the year paid far exceeded her other income for that year, much of the deduction was useless.

Property Division

A final consideration is the income tax consequences of a property division. Even the transfer of property in exchange for the release of marital rights results in taxable gain to the payor if the value of the property at the time of the transfer exceeds the transferor's basis in that property.[188]

The other side of the transaction concerns the recipient. Neither marital nor de facto spouses have a financial basis in their support rights, having paid nothing for them in the first place. The difference between the value of property received and the basis in the rights surrendered (zero) is logically all taxable

186. 263 F.2d at 120 n.1.

187. The Fifth Circuit reversed the Tax Court and accepted Cotnam's position that the attorney's fees were not includable in income. The court of appeals relied on an Alabama statute which provided that an attorney has "the same right and power over said suits, judgments and decrees, to enforce their liens as their clients had or may have for the amount due thereon to them." *Id.* at 125 (citing ALA. CODE tit. 46, § 64 (1940)).

Absent a specific statute like Alabama's, courts have consistently refused to follow the Fifth Circuit, reaffirming the Tax Court holding in *Cotnam* and the general rule that a lien is not a right or title in the recovery. Accordingly, the entire recovery is taxable income to the litigant even though she never receives that portion which goes to the attorney. *E.g.*, Estate of Gadlow v. Commissioner, 50 T.C. 975 (1968).

188. In United States v. Davis, 370 U.S. 65 (1962), a Delaware taxpayer, under a property settlement agreement incorporated in a divorce decree, transferred to his former wife appreciated shares of stock in return for the release of her marital rights. The court found the transfer not a nontaxable division of property between co-owners but rather a taxable transfer of property in satisfaction of a legal obligation. Accordingly, he was taxed on the difference between his adjusted basis in the property and its fair market value on the date of transfer.

gain.[189] Even under community property rules, where a divorce settlement is viewed as a division of property belonging to the marital partnership, the use of any separate property to satisfy the settlement gives rise to a taxable event.[190]

There is room here for improvement in the treatment of both marital and de facto families. What is really being transferred in most property settlements is title, possession, and use of tangible property the couple previously shared. It would be more sensible to treat the dissolution property transfer as a nontaxable event, carry the old basis of the property over to the new owner, and defer taxation until the new owner sells it. The courts, however, have not accepted this view.[191]

VII. ESTATE TAX

A. Marital Deduction; Joint Tenancy Property

Except for the marital deduction and a different treatment of joint tenancy property, estate tax laws treat married and unmarried households basically alike. The marital deduction is a major benefit because it allows the greater of $250,000 or fifty percent of the value of property passing to the surviving spouse to be deducted from the decedent's gross estate.[192]

The survivorship feature of joint tenancy allows property to pass to the surviving cotenant outside the decedent's estate and free of claims by the decedent's creditors.[193] Despite the popular misconception, it does not exclude the value of the property for

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189. *See* I.R.C. § 1001. The IRS has ruled—without really explaining why—that a wife in this situation has no taxable gain. Rev. Rul. 67-221, 1967-2 C.B. 63. The de facto spouse is in a more tenuous position. The IRS ruling, however, leaves open the possibility that a future ruling will extend equivalent treatment to de facto spouses, even in the absence of congressional action.

190. Carrieres v. Commissioner, 64 T.C. 959 (1975), *aff'd per curiam*, 552 F.2d 1350 (9th Cir. 1977). In the Carrieres' California divorce decree, community property was unevenly distributed. The husband was required to equalize the division by transferring separate property. The Tax Court held that, to the extent separate property was used to acquire a share of the wife's community property, there was a taxable sale on which the wife's gain must be recognized.

191. *See* United States v. Davis, 370 U.S. 65, 68-71 (1962).

192. I.R.C. § 2056. This is another form of equalization of treatment between community property and common law states. R. Stephens, G. Maxfield & S. Lind, *supra* note 94, at ¶ 5.06[1]. *See also* notes 6 and 32 *supra*.

193. R. Powell & P. Rohan, Powell On Real Property 615 (abr. ed. 1968).

estate tax purposes.[194] The entire value of jointly owned property (except to the extent that the surviving tenant contributed to the cost of the acquisition of the property), including appreciation in value, is included in the estate of the first cotenant to die.[195] The burden is on the survivors to prove their contributions if they hope to exclude them from the estate tax base.[196] If the decedent's interest was acquired gratuitously from another co-owner, the value of that interest is not included in the estate.[197]

B. Claims Against the Estate

De facto families intent on preserving the property rights and interests of survivors need to draft contracts capable of withstanding a court test.[198] Contract claims require recitation of consideration to support the contract. Thus, a cause of action under breach of contract or quantum meruit is a claim for compensation for services performed, and any amount received is includable in income.[199] Framing the claim in testamentary language does not necessarily convert the recovery into a tax-free legacy or bequest.[200] The issue of whether any amount is taxable to the beneficiary generally arises when the recipient maintains

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194. R. Stephens, G. Maxfield, & S. Lind, *supra* note 94, at ¶ 4.12[4].

195. I.R.C. § 2040(a). R. Stephens, G. Maxfield & S. Lind, *supra* note 94, at ¶ 4.12[4].

196. *Id.* at ¶ 4.12[7][a]. I.R.C. § 2040(c), added by the Revenue Act of 1978, Pub. L. No. 95-600, § 511(a), 92 Stat. 2881, recognizes the value of services contributed by a surviving spouse/joint owner of property, provided the property is used in a business or farm in which he or she materially participated. Sugar, *How New § 2040(c) Alters the Estate Tax Burden on Jointly-Owned Property,* 50 J. Tax. 270, 272 (1979). The value of homemaker's contributions are excluded.

197. I.R.C. § 2040(a).

198. *See generally* Pfaff, *supra* note 7. Written contracts are more likely to survive than oral contracts, which face Statute of Frauds challenges and evidentiary problems. Services rendered furnish adequate consideration to support a contract, even if the services are minimal. *See generally* Pfaff, *supra* note 7.

199. *See* Cohen v. United States, 241 F. Supp. 740 (E.D. Mich. 1965) (amounts received were income because the property was promised to the taxpayer by the decedent in exchange for services); Davies v. Commissioner, 23 T.C. 524 (1954) (Taxpayer could not and did not rely on a mere promise of the decedent unsupported by any consideration, but in each count of her claim mentioned some valuable consideration moving from her to him. The Tax Court included the settlement in income.). Rev. Rul. 67-375, 1967-2 C.B. 60 (distribution of property under the terms of a will in satisfaction of a written agreement requiring the taxpayer to perform services for the testator is compensation for services, and includable in gross income in the taxable year of receipt).

200. *E.g.,* Cohen v. United States, 241 F. Supp. 740 (E.D. Mich. 1965) (federal tax liability is based on the underlying nature and not the form of the claim).

the recovery is a gift or bequest,[201] while the estate argues the amounts constitute settlement of a claim and, therefore, are deductible by the estate.[202] Federal tax liability is based on the underlying nature of the claim, not its form.[203] The court must determine the value of personal services rendered to the decedent.

Gertrude Davies, for example, worked for a physician for $25 per week from 1941 until her death in 1946.[204] In addition, she and her husband performed miscellaneous personal services for the doctor. To retain her services, the physician orally promised to bequeath to her one-third of his estate so she would "never have to work again."[205] He died intestate. She sued for one-third of his $180,000 estate, and settled for $8,500. Davies alleged that reasonable compensation for her services from 1941-1946 would have been $75 to $100 per week. The Tax Court held the $8,500 settlement (when added to the $25 per week she had formerly received) did not exceed reasonable compensation and was, therefore, gross income.[206]

Even a close family relationship is not enough to exclude the recovery from gross income where business related services are rendered. In *Cohen v. United States*,[207] the taxpayer agreed to assist his ailing brother in operating a corporation. As an inducement, his brother promised to bequeath corporate stock to him, but died without naming Cohen as a legatee. Cohen sued for specific performance of the will contract. His entire recovery was taxed as income. The district court explained that "love and affection combined with the business aspects of the agreement, did not change the ordinary contractual obligations which ensued . . . ."[208]

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201. I.R.C. § 102 excludes from income amounts received by gift, bequest, devise, or inheritance.

202. *See, e.g.*, Cohen v. United States, 241 F. Supp. 740 (E.D. Mich. 1965); Davies v. Commissioner, 23 T.C. 524 (1954).

203. Cohen v. United States, 241 F. Supp. 740 (E.D. Mich. 1965).

204. Davies v. Commissioner, 23 T.C. 524 (1954).

205. *Id.* at 525.

206. The court found she "failed to show any part of the $8,500 was received as a testamentary gift. . . ." *Id.* The language of the court leaves open the possibility that, had she recovered more than the reasonable value of the services, the excess would have been treated as a tax-free bequest.

207. 241 F. Supp. 740 (E.D. Mich. 1965).

208. *Id.* at 742.

In *First National Bank v. United States*,[209] a woman sought to enforce an oral agreement to make a will in return for managing the decedent's household, assisting in the operation of the ranch, and attending to his personal needs. She released her claim in exchange for $65,000 and a ranch in Mexico. The government sought to prevent the reduction of the gross estate by the contract claim, and argued that the woman failed to show adequate consideration. The court disagreed, found adequate consideration, and allowed the deduction to the estate.[210] Obviously, the settlement was income to her.

The services rendered in all these cases are distinguishable from those performed in the household. Because courts and the IRS hold domestic services have no value in "money or money's worth" as contributions to property acquisitions,[211] consistency requires the same services not be adjudged "valuable" when settling a claim against the estate. That consistency was lacking in *Hansen v. Commissioner*,[212] where the plaintiff received $150,000 in settlement of a claim for compensation for services rendered from 1946-1964. The court made no attempt to value the services. Because the taxpayer "was not an heir . . . and not a legatee under an earlier will,"[213] and because she *alleged* the amount was for compensation, the $150,000 was includable in income.[214] Had she recovered instead under a trust or implied domestic partnership theory,[215] an argument that domestic services lack commercial value might have withstood the IRS challenge that the recovery was compensation for services, without actually jeopardizing the claim itself. It would be unwise to forfeit a cause of action due to an inaccurately phrased claim, but *Hansen* demonstrates that effective tax planning begins with the drafting of the complaint.

VIII. CONCLUSION

It is commonly said that federal tax liability is based on the

209. 422 F.2d 1385 (10th Cir. 1970).
210. *Id.* at 1388.
211. I.R.C. §§ 2043(a) (estate tax); 2512(b)(gift tax).
212. 33 T.C.M. (CCH) 43 (1974).
213. *Id.* at 45.
214. *Id.*
215. *See generally* Pfaff, *supra* note 7.

underlying nature of the claim, not its form. It is apparent, however, that many of the tax provisions governing the economics of de facto family life were developed in a commercial context. De facto families are on the rise,[216] and tax policies favoring ceremonial marriage are anachronistic. Courts will increasingly face tax questions concerning de facto families.[217] In order to further the general tax policy of equivalent treatment of taxpayers in similar situations, courts will be called upon to evaluate the family nature of a household. Some suggested factors to consider are:

(1) intermingling of funds;
(2) sharing of expenses;
(3) shared use of personal property;
(4) shared use of housing (as opposed to clearly segregated rooms or living areas);
(5) dependency of one or more household members on another for support;
(6) duration of the living arrangement;
(7) extent of gift giving within the household;
(8) moral obligation to care for another person; and
(9) intent of the parties.

The presence of a significant number of these factors indicates that the household constitutes a de facto family. The presence of a clear profit motive (receiving rental income, for example) would help distinguish the more loosely structured roommate or non-family situation where incomes, expenses, and assets are clearly segregated. The factual determination required is no more difficult than that which the courts customarily engage in whenever an agreement is implied or an equitable solution imposed. Certainly the analysis will be easiest where it will also be most prevalent—in the case of couples. Unfortunately, parties who enter non-marital living arrangements often do not know their existing property rights and are unaware of the tax consequences of their decisions. Unless Congress rectifies the present tax inequities, parties to a self-defined relationship will require effective tax counseling if they are to minimize their disproportionate tax burden.

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216. *See* note 2 *supra.*

217. *See* note 4 *supra.*