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THE PENNSYLVANIA COMMUNITY PROPERTY STATUTE: ITS FEDERAL INCOME, GIFT AND ESTATE TAX IMPLICATIONS

By

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With the approval by Governor Duff on July 7, 1947 of Senate Bill No. 615, effective September 1, 1947, Pennsylvania joined the fast-growing ranks of the community property states. The Bureau of Internal Revenue has recently indicated that it will recognize Pennsylvania's statute for income tax purposes: Letter from Commissioner of Internal Revenue, August 25, 1947; Legal Intelligencer, August 28, 1947. The legislatures of Oregon, Michigan and Nebraska enacted community property laws during their 1947 sessions, so that the system now obtains in fourteen jurisdictions.¹ Four states have rejected community property bills, while legislation is pending in four others.²

Under the community property system, property of each spouse acquired

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¹Arizona Code Annotated, Sec. 63-301 et seq. (R. S. 1901, Sec. 3104, as amended), California Civil Code (1941), Sec. 161 et seq.; Idaho Code Annotated, Sec. 31-907; Louisiana Civil Code, Art. 2332 et seq.; New Mexico Statutes Annotated (1941), Sec. 65-301 et seq.; Nevada Compiled Laws (1929), Sec. 3355 et seq., based on California Civil Code; Vernon's Texas Revised Civil Statutes, Art. 4619 et seq.; Remington's Revised Statutes of Washington, Sec. 6890 et seq.; Oklahoma Statutes Annotated, Title 32, Sec. 66 et seq.; Oregon Laws, 1947, S. B. 210, effective July 5, 1947; Pennsylvania, Act of 1947, P. L. 384; Michigan: L. 1947, Pub. Act 317, effective July 1, 1947; Nebraska: L. 1947, Bill No. 410, effective Sept. 7, 1947; Hawaii Laws, 1945, Series D-201: Act 273

²Rejected in Florida, Missouri, Wyoming and Indiana; pending in Alabama, New Hampshire, Wisconsin and Illinois: Report of Research Institute of America. Legislative leaders of New York State are also considering such legislation.

after marriage, otherwise than by gift, descent or devise, is jointly owned by them. Its origins which antedate the common law have been traced back to the rule of the Goths in Spain in the fifth century A. D. when the women of the tribes fought side by side with their husbands and it was felt that they were entitled to share equally in the spoils of battle.⁸

The Spaniards who settled the southwestern part of the United States brought the community property system with them. Eight states formed from this territory continued the system when they were admitted into the union. These states are Arizona, California, Idaho, Louisiana, New Mexico, Nevada, Texas and Washington.

The basic historical difference between the common law and community property systems is the vesting in the wife of a one-half interest in community property equal to that possessed by her husband. Furthermore, except in Nevada and New Mexico, she has full power of testamentary disposition over her interest. Thus, the adoption of the community property system by a common law state such as Pennsylvania is in a sense a logical extension of the gradual, economic emancipation of women from their position of complete subservience under the common law. See, for example, the Act of May 17, 1945, P. L. 625, (48 P S 31, 32), giving to married women the same rights to acquire and dispose of their property as possessed by married men. That is, a married woman can contract without restriction except that she still must have the joinder of her husband to convey real property.

Although the adoption of the community property system might be justified on the social philosophy, its extension into six common law jurisdictions (Oklahoma, Oregon, Nebraska, Michigan, Pennsylvania, and the Territory of Hawaii) within the past eight years was motivated by the desire to save Federal taxes, an effort which has been but partially successful.

The increased burden of Federal income surtax rates has stimulated efforts on the part of taxpayers and their advisors to develop devices by which the weight of such taxation could be reduced. In the forefront of such mechanisms has been the trend towards the adoption of systems of community property in states whose basic concept of property ownership stemmed from the common law. Recognizing the distinct income tax advantage which the residents of community property states enjoy by reason of the fact that spouses are permitted to divide between them the income of the community, these common law states have enacted community property statutes to make available to their residents similar income tax advantages.

Poe vs. Seaborn, 282 U. S. 101 (1930, Washington) decided that where the wife had under the appropriate state law a present, vested interest in the community property, each spouse could report one-half of the family income for Fed-

⁸See De Funiak, *Principles of Community Property*, Sec. 2; McKay, *Community Property*, Sec. 9

eral income tax, notwithstanding the statutory rights of the husband with respect to the management, control and disposition of the property. This was so because he was regarded only as the "agent of the community" in exercising such rights.

Until now, the device has been effective for income tax-saving purposes because of a line of Supreme Court decisions holding that the ownership of property is determined by state law. See, for example, *Helvering vs. Stuart*, 317 U. S. 154 (1942); and *Blair vs. Commissioner*, 300 U. S. 5 (1937). It may be noted here that this rationale conflicts with an equally recent and more realistic succession of decisions taxing income to the one who earns it, or controls it or has the actual enjoyment of it: *Lucas vs. Earl*, 281 U. S. 111 (1930); *Helvering vs. Clifford*, 309 U. S. 331 (1940); and *Helvering vs. Horst*, 311 U. S. 112 (1940). These two doctrines cannot be reconciled and their coexistence in tax law provides incongruous tax consequences.

THE PENNSYLVANIA COMMUNITY PROPERTY ACT

The basic provisions of the Pennsylvania Act may be summarized briefly:

1. Before September 1, 1947, the effective date of the Act, there was no community property in Pennsylvania. Everything owned by spouses before that date remains their separate property.

After September 1, 1947, any property acquired by either spouse other than by gift, descent or devise or received as compensation for personal injuries is community property. See Sections 1-3 of Community Property Act.

2. Each spouse is to have the management, control and power of disposition of his or her separate property except real estate, as to which prior statutory provisions with respect to joinder are still applicable (Act of June 8, 1893, P. L. 344, Sec. 1, 2, as amended by Act of May 17, 1945, P. L. 625, Sec. 1, 2, (48 P S 31, 32)). In addition, the wife is to have the management, control and right of disposition of community property economically attributable to her and community property standing in her name. All other community property is subject to the management, control and power of disposition of the husband: Sections 4 and 5 of Community Property Act.

Although the wife has certain statutory rights in the community property economically attributable to the husband, she cannot obtain her interest in the community until the dissolution of the community, either by death or divorce. But the husband, though his power of disposition over the community not under his wife's control is unrestricted on paper, will probably be held subject to the limitation obtaining in Texas, where a husband cannot dispose of community property in fraud of the wife: *Locke vs. Locke*, 143 S. W. 2d 637 (1940 - Texas). The

payment of taxes on his separate property out of community funds by the husband has been held not to constitute a fraud against the wife: *Ames vs. Ames*, 188 S. W. 2d 689, (Texas, 1945); but where a husband purchased a death benefit certificate with community funds, naming the wife as beneficiary, and then changed the beneficiary, the attempt was held to be a fraud on the wife, so that the second beneficiary named could recover only one-half of the proceeds of the certificate: *Allen vs. Brewster*, 172 S. W. 2d 192 (Texas, 1943). Similarly, where a husband makes gifts to his mistress: *Johnson vs. United States*, 135 F. 2d 125 (CCA-9, 1943, California).

In California, the husband is prohibited by statute (Sec. 172 of the California Civil Code) from making a gift of the community personal property without the written consent of the wife, who can set aside such a gift with respect to her undivided half interest after the death of the husband: *Trimble vs. Trimble*, 26 P. 2d 477 (California, 1933); and in its entirety during the lifetime of the husband: *Britton vs. Hammell*, 52 P. 2d 221 (California, 1935).

3. Under Section 9 of the Community Property Act, spouses are given the right to deal between themselves with community property *in esse*, a conveyance of community property to one of the spouses making it the separate property of such spouse.

4. Upon the dissolution of the marriage by divorce, i.e., a decree *a.v.m.*, since Pennsylvania does not regard a decree *a.m.e.t.* as dissolving the marriage (see Freedman, Law of Marriage and Divorce in Pennsylvania, Sec. 705) each spouse, is vested with an undivided one-half interest in the community property as tenants in common: Section 10 of Community Property Act.

5. On the dissolution of the community by the death of either spouse, the surviving spouse is to administer all the community property, paying the debts of the community and then conveying one-half of the remainder to the executor or administrator of the deceased spouse to be administered and distributed as other property of the estate of the deceased spouse, either by will or under the laws of descent and distribution. The surviving spouse may also act as the executor or administrator of the deceased's estate: Section 15 of Community Property Act.

6. Sections 7 and 8 of the Community Property Act protect the rights of the creditors of each spouse against community property if debts are contracted or torts committed in the management of such property.

7. The Community Property Act also sets up certain presumptions:

a. Section 3: all property possessed by husband and wife at the time of the dissolution of the marriage is presumed to be community property.

b. Section 6: funds on deposit in a bank in the name of one spouse are presumed to be the separate property of that spouse.

c. Section 7: all debts created by the husband or wife after marriage or after the effective date of the Act are presumed to be community debts.

COMPARISON WITH OTHER COMMUNITY PROPERTY STATUTES

Since Pennsylvania's Community Property Act is copied from the Oklahoma Community Property Act, which in turn was modelled on the Texas statute, decisions from those states should be helpful as guides in construing the Pennsylvania Statute. There have been but few decisions under the Oklahoma Act, which was re-enacted in 1945 after its first statute, allowing spouses to elect to become subject to its terms, was held invalid for Federal income tax purposes: *Commissioner vs. Harmon*, 323 U. S. 44 (1944). Therefore, a study of the numerous cases decided under the Texas statute will be illuminating, always bearing in mind the differences between the Texas and Pennsylvania Acts.

Under the Texas community property statute, increase of lands acquired after marriage by gift, devise or bequest remains the separate property of the spouse acquiring the land: *Fleming vs. Commissioner*, 153 F. 2d 301 (CCA-5, 1946); *Evans vs. Purinton*, 34 S. W. 350, Texas Court of Civil Appeals, 1896 (profits from sale of separate property of married women was separate property). Royalties from oil and gas leases which are the separate property of a Texas spouse also remain separate property: *Turbeville vs. Commissioner*, 84 F. 2d 307 (CCA-5, 1936); *Commissioner vs. Wilson*, 76 F. 2d 766 (CCA-5, 1934). Rent from separate property is community property, however: *Commissioner vs. Wilson*, supra. In Pennsylvania, profits realized from the disposition of separate property should similarly be held to be separate property of such spouse.

Texas, unlike Pennsylvania, requires the joinder of husband and wife to dispose of stocks and bonds, in addition to real estate.

The Pennsylvania Community Property Act differs in other particulars from some provisions found in the several community property statutes. For instance, income from separate property of either spouse is designated community property under Section 4 of the Pennsylvania Act. It is also community property in Idaho (Sec. 31-907 of Idaho Code Annotated); Louisiana (Sec. 2402 of Dart's Louisiana Civil Code); Nebraska (L. 1947, L. B. 410, Sec. 4); Oklahoma (L. 1945, H. 218, Sec. 4); Oregon (L. 1947, Ch. 525, Sec. 4); and Texas (Vernon's Texas Civil Statutes, Art. 4619). In the other community property jurisdictions, notably California (Sec. 162, 163 of California Civil Code), income from the separate property of a spouse remains separate property.

Although in general, the wife has full power of disposition over her separate property, her rights in the management, control and disposition of the community property vary widely in the different jurisdictions. These rights range from the liberal ones in the "Oklahoma group", i.e., Pennsylvania, Nebraska and Oregon, which adopted the 1945 Oklahoma statute, to the narrowly restrictive provisions of Louisiana and Texas.

Under Section 4 of the Oklahoma, Pennsylvania, Nebraska, and Oregon statutes, the wife may freely dispose of the community property economically attributable to her, and of all community property standing in her name, subject to joinder provisions in the sale or encumbrance of real estate. In the other community property jurisdictions, more control has been vested in the husband, as the "agent of the community", such powers not being sufficient, however, to divest the interest of the wife for Federal income tax purposes. See *Poe vs. Seaborn*, 282 U. S. 101 (1930, Washington).

In Arizona, New Mexico, Texas and Washington, the husband has the sole and complete power of disposition over community personal property.⁴ This right is subject to the statutory restriction under Sec. 2404 of the Louisiana Civil Code that the husband may not make gifts of community personal property in fraud of the wife, a restriction which has been read into the appropriate statute by judicial construction. See *Locke vs. Locke*, 143 S. W. 2d 637 (1940, Texas), a result which would probably be reached in Pennsylvania also under similar facts. In California, the husband must have the written consent of the wife to make a valid gift of community personal property: Sec. 172 of California Civil Code; *Britton vs. Hammell*, 52 P. 2d 221 (California, 1935).

In Nevada and New Mexico, the wife has no power of testamentary disposition over her half of the community property. Although no express provision as to testamentary disposition appears in the Pennsylvania Community Property Act, provision is made in Section 15 for the transfer by the surviving spouse to the executor or administrator of the deceased spouse's estate of one-half the community property remaining after payment of the debts of the community, such half to be distributed as part of the estate of the deceased spouse or under the intestate laws.

The wife must join in the conveyance of community real property or its encumbrance in California, New Mexico, Nevada, Idaho, Washington and Pennsylvania.⁵

⁴Arizona Code Annotated, Sec. 63-301; New Mexico Statutes Annotated, Sec. 68-403; Vernon's Texas Civil Statutes, Art. 4619; Remington's Washington Statutes, Sec. 6892

⁵California Civil Code, Sec. 172a; New Mexico Statutes Annotated, Sec. 68-403; Remington's Washington Statutes, Sec. 6893; Nevada Compiled Laws, Sec. 3360 (homestead only); Idaho Code Annotated, Sec. 31-913; Pennsylvania Community Property Act, Sec. 5

DOMICILE

Since only the residents of a community property state may take advantage of its laws, a determination of the domicile of a taxpayer must be made in some cases to determine the applicable law. The taxpayer must be an actual resident of the community property state at the time when the income was earned, and must intend to remain there. See *Rogers Hornsby*, 26 BTA 591 (Texas, 1932); *Kastel vs. Commissioner*, 136 F. 2d 530 (CCA-5, Texas, 1943). For a discussion of the elements entering into a determination of domicile, see Mertens, *Law of Federal Income Taxation*, Vol. 3, Sec. 19.31.

In *Skilkret vs. Helvering*, 138 F. 2d 925 (Ct. of App., D. C., 1943) it was held that money earned in California by a taxpayer domiciled in another state was not community income; while in *Eddy R. McDuff*, 3 TCM 882 (1944, Texas) the taxpayer was found to have retained his domicile in a community property state although he had been working for five years in another state because the job was supposed to be a temporary one and there was clear evidence of intent to retain the Texas domicile.

The question of domicile in connection with community property has arisen most frequently with respect to two factual situations: the holding of property in a non-community property state by spouses domiciled in a community property state; and change of domicile to or from a non-community property jurisdiction.

General principles of conflict of laws are applicable in both instances, namely, that the community property law of a state operates with respect to land situated within its bounds, even though held by non-residents; and to all personal property owned by spouses domiciled within the state. Thus, the earnings of a spouse domiciled in Pennsylvania and working in New Jersey are community property, whereas the Pennsylvania Community Property Act would not apply to the earnings of a New Jersey resident employed in Pennsylvania. See I. T. 1268, C. B. June 1922, p. 234; 2 Beale, *Conflict of Laws*, pp. 952-953; *Black vs. Commissioner*, 114 F. 2d 355 (CCA-9, 1940, Washington), where a husband and wife domiciled in a non-community property state agreed to hold real estate in a community property state in community, each reporting one-half of the income, and the agreement was held effective for purposes of the Federal income tax.

When spouses change their domicile, whether from a community property state to a non-community property state or vice versa, the income is prorated. That earned in the community property state is reportable half by each spouse, while that earned in the non-community property state must be reported by its earner: *Wrightsmen vs. Commissioner*, 111 F. 2d 227 (CCA-5, 1940, Texas); O. D. 810, C. B. June 1921, p. 235.

In *David L. Loew*, 7 TC 363 (1946, California), income earned by a taxpayer domiciled in a non-community property state prior to his change of domicile to a community property state was not community income; while in *Fooshe vs.*

Commissioner, 132 F. 2d 686 (CCA-9, California, 1942), it was held that income earned in a community property state but not paid until after the taxpayer had moved to a non-community property state was still community income divisible between the spouses.

The law of the situs of real property determines the character of income derived from it as community or non-community. Thus, spouses domiciled in a non-community property state who received income from property situated in a community property state could each report one-half of the income, such income being community property: *Hammonds vs. Commissioner*, 106 F. 2d 420 (CCA-10, 1939, Oklahoma; Texas property); *Commissioner vs. Skaggs*, 122 F. 2d 721 (CCA-5, 1941, Texas): income from California property acquired by a Texas resident was not community property, the law of the situs controlling as to whether income from separate property was separate or community and it was separate under the law of California. See also *W. D. Johnson*, 1 TC 1041 (1943, Mo.).

In *Estate of Angus P. Malloy*, 28 BTA 716 (1933, Washington), the husband purchased property in a community property state with capital earned in a common law state before acquiring domicile in the community property state. The property itself was held to have remained his separate property.

NECESSITY FOR VALID MARRIAGE

The existence of a valid marriage is essential before spouses can take advantage of the tax benefits of the community property system. Since common law marriages are recognized in Pennsylvania, parties to such a marriage would be entitled to file separate returns on community income.

Where spouses are not living together but the marriage has not been dissolved, the domicile of the husband determines that of the wife for the applicability of the community property acts. Thus, income from community property in Texas was still community income where the husband, who was *non compos mentis*, resided in Texas and the wife in Virginia: O. D. 1023, C. B. Dec. 1921, p. 196; S. M. 4297, C. B. Dec. 1925, p. 130.

Where the wife was a non-resident alien living separate from her husband but the marriage had not been dissolved, income earned by him in a community property state was held to be community income, reportable one-half by each spouse: *Commissioner vs. Cavanagh*, 125 F. 2d 366 (CCA-9, 1942, California); *Herbert Marshall*, 41 BTA 1064 (1940, California).

Conversely, where the wife was resident in a community property state (Texas), and the husband was not, Ohio being his and the matrimonial domicile, her income was not community income: *Payne vs. Commissioner*, 141 F. 2d 398 (CCA-5, 1944, Texas).

Since only a divorce *a.v.m.* terminates a marriage in Pennsylvania (see Freedman, *Law of Marriage and Divorce in Pennsylvania*, Sec. 705), income earned following a divorce *a.m.e.t.* would be reportable by both spouses as community income.

Where the husband's right to compensation arose during the marriage but was not paid until after his death, it was community property: *Commissioner vs. King*, 69 F. 2d 639 (CCA-5, 1934, Texas); but fees earned by a surviving spouse as executrix of her husband's estate were not community property because the death of the husband terminated the community: S. M. 4623, IV-2, C. B. 40.

GENERAL INCOME TAX IMPLICATIONS

a. — Returns

If spouses file on the long form 1040, each will report income from his separate property plus one-half the sum of the community income. Should the taxable income of either or both be less than \$5,000, the short form 1040 may be used. Spouses may use Form W-2 only if their combined gross income is less than \$5,000 and their combined income not subject to withholding is less than \$100. Declarations of estimated tax are still required under the appropriate circumstances (income from wages subject to withholding in excess of \$5,000 a year, or gross income of \$500 or more and more than \$100 income not subject to withholding).

b. — Gross Income

The gross income which may be divided equally between the spouses will consist of the income from the separate property and personal services of each spouse, and the income from community property: Section 4 of the Pennsylvania Community Property Act. It is thus unnecessary to consider the problem in Pennsylvania of the ownership of income from separate property. See, for example, *Shea vs. Commissioner*, 81 F. 2d 937 (CCA-9, California, 1936); *W. D. Johnson*, 1 TC 1041 (1943) (Missouri, property in Texas).

The following items have been held to constitute community property in Texas and should be similarly treated in Pennsylvania:

Interest on the husband's separate bank account: *Oscar Chesson*, 22 BTA 818, affirmed 57 F. 2d 141 (CCA-5, 1932).

Income from property devised to spouse during marriage: *Commissioner vs. Terry*, 69 F. 2d 969 (CCA-5, 1934).

Income from an *inter vivos* trust: *Commissioner vs. Wilson*, 76 F. 2d 766 (CCA-5, 1935).

c. — Capital Gains and Losses

The treatment of this item depends upon whether the property sold is community property or the separate property of one of the spouses.

If it is community property, that is, acquired after September 1, 1947 with community income, the gain or loss is to be divided equally between the spouses: *Bishop vs. Commissioner*, 152 F. 2d 389 (CCA-9, California, 1945).

If the property is separate property, purchased with separate funds, the spouse must report the entire gain or deduct the entire loss in his or her separate return: *Fleming vs. Commissioner*, 153 F. 2d 361 (CCA-5, Texas, 1946).

Where capital stock was the separate property of the husband and its increase in value was not due in any way to the efforts of the community, the increase in value did not fall into the community even though the corporation was controlled by the husband and his family: *Beals vs. Fontenot*, 111 F. 2d 956 (CCA-5, Louisiana, 1940); *Commissioner vs. Skaggs*, 122 F. 2d 721 (CCA-5, 1941, Texas). The profit from the sale of war bonds was similarly treated in *O'Connor vs. Commissioner*, 110 F. 2d 652 (CCA-5, 1940, Texas).

In *W. T. Carter, Jr.*, 36 BTA 853 (1937, Texas), the increase in the value of stock was found to have been due to the efforts of the husband, so that the increase was community property. Similarly, where it was found that the decedent was adequately compensated for his services, increment in the value of corporate stock was held to be community property: *Gump vs. Commissioner*, 124 F. 2d 540 (CCA-9, 1941, California); cert. den., 316 U. S. 697 (1942).

d. — Income from Trust Estates

Pennsylvania comes under the rule that in the community property states in which income from separate property is community property, income from a trust is community income where the beneficiary resided in a community property state, even though the trust was not created in that state and the trust corpus was not located there: *Commissioner vs. Porter*, 148 F. 2d 566 (CCA-5, 1945, Texas); *Commissioner vs. Sims*, 148 F. 2d 574 (CCA-5, 1945, Texas); *Commissioner vs. Snowden*, 148 F. 2d 569 (CCA-5, Texas, 1945).

e. — Income From Partnerships

In Pennsylvania, the income from a partnership is community income whether the property invested in the partnership is separate or community. Thus, cases dealing with the ownership of income from separate property or with the allocation of income between capital and services to separate and community property do not arise under the Pennsylvania Community Property Act, regardless of whether the business of the husband is a partnership or sole proprietorship. This is so because income from the capital will be community property, even though it was the separate property of one spouse.

ALLOCATION OF INCOME TO PERIODS BEFORE AND AFTER EFFECTIVE DATE OF COMMUNITY PROPERTY STATUTE

A problem which will arise under the Pennsylvania Community Property Act, however, is that of the allocation of both income from sole proprietorships and partnerships before and after September 1, 1947. See, I. T. 3792, C. B. 1946-1 dealing with this question under the Hawaiian Community Property Law, which is similar to Pennsylvania's in that income from separate property is community property which requires allocation of income before and after the effective date of the Statute.

The test is, when the income was earned, not when it was paid. Thus, income earned before September 1, 1947 must be reported by the spouse actually earning it, regardless of the date when the compensation was received. See *Wrightsmen vs. Commissioner*, 111 F. 2d 227 (CCA-5, 1940, Texas).

In a partnership on a cash basis, income representing partnership net earnings for the period after the effective date of the act is community income; for the period before September 1, 1947, the income would be the separate income of the spouse receiving it. Where the partnership is on an accrual basis, it would seem that income earned before the effective date of the Act, no matter when paid or distributed, would be separate income. See *Albin Johnson*, TC Memo. Op., CCH Dec. 15, 666 (M) (1947) (Washington).

In California and the other jurisdictions, in which income from separate property remains the separate property of the spouse earning it, an allocation must be made in the case of partnership income between that attributable to the personal services of the spouse, which is community income, and that attributable to the separate capital of the spouse, which remains the separate income of that spouse. See G. C. M. 9825, C. B. X-2, p. 146, giving the formula for allocation and apportionment in the case of a California partnership in which the husband was a partner and the wife was not; also *Shea vs. Commissioner*, 81 F. 2d 937 (CCA-9, California, 1936); and *W. D. Johnson*, 1 TC 1041 (1943 Mo., Texas property); *George W. Van Vorst*, 7 TC 826 (1947, California).

INCOME DURING ADMINISTRATION OF ESTATE

There are two lines of decisions on the question of whether community income is divisible between the surviving spouse and the estate of the deceased spouse while the estate is being administered. The rule in Washington is that such income is taxable entirely to the estate, the reason being that the executor takes title to all of the community property on the death of the husband, all of it being subject to administration: *Commissioner vs. Larson*, 131 F. 2d 85 (CCA-9, 1942).

The opposite result was reached in California in *Bishop vs. Commissioner*, 152 F. 2d 389 (CCA-9, 1945). There, the income was held divisible between

the surviving spouse and the estate of the deceased spouse because the personal representative does not take title to the community property. The same result has been reached under Louisiana Law in *Henderson's Estate vs. Commissioner*, 155 F. 2d 310 (CCA-5, 1946); and will be followed with respect to Idaho spouses, under which law the wife on the death of the husband takes one-half of the community property as a matter of right, not by descent: I. T. 3861 (1947). It seems probable that Pennsylvania will also follow the *Bishop* case, since the surviving spouse has only the power to administer the community property until the payment of debts, after which one-half is to be transferred to the estate of the deceased spouse: Section 15 of Pennsylvania Community Property Act.

BASIS OF PROPERTY

I. T. 3862 (1947) deals with the basis of community property where it is sold by the executor or administrator of the estate of a deceased spouse. With respect to the widow's half interest, the adjusted basis is to be the cost or other basis of such share to the community, while the basis of the half interest of the deceased spouse is to be the fair market value at the date of the death of the spouse.

DEDUCTIONS

If the deduction is incident to the production of community income, it may be divided equally between the spouses: *Stewart vs. Commissioner*, 95 F. 2d 821 (CCA-5, 1938, Texas).

If the deduction is not attributable to community property or to the production of community income, it is to be taken separately by each spouse: *Irma Jones Hunt*, 47 BTA 829 (1942, Texas). In this case, it was held that taxes, attorneys' fees and interest paid by a Texas wife with respect to her separate property were deductible by her alone when the property had produced no income during the taxable year, even though the income, had there been any, would have been community property. Since the Commissioner has not acquiesced in this decision (N. A. 1943-1-C. B. 33), the rule may be limited to the particular facts in the case.

Where the community incurred an obligation which was paid by the taxpayer and the estate of her deceased husband, she was entitled to deduct from her income one-half of the amount paid as a bad debt: *Alice G. K. Kleberg*, 43 BTA 277 (1941, Texas).

But the wife was not entitled to deduct as her share in a community debt one-half of the settlement of a lawsuit by her husband where the misfeasance occurred before the husband and wife had acquired their domicile in a community property state: *Lottie Zukor*, 43 BTA 825 (1941, California).

State sales and excise taxes are deductible half by each spouse only if paid out of community funds: see *Bishop vs. Commissioner*, 152 F. 2d 389 (CCA-9, 1945, California).

The same rule applies to the deduction for medical expenses, which are deductible by the spouse paying them. Thus, if paid out of separate funds, the deduction could be taken only by the spouse paying the expenses, but the deduction may be divided if paid out of community funds: *Ernest W. Clemens*, 8 TC 121 (1947, Texas).

Charitable contributions are deductible by each spouse only if it can be shown that the payment was made with community funds and with the approval of both spouses: *Stewart vs. Commissioner*, 95 F. 2d 821, (CCA-5, 1938, Texas); *Ernest W. Clemens*, supra.

DEPENDENTS

The credit for dependents cannot be divided between the spouses but must be taken in its entirety for each dependent by either one or the other: I. T. 1275, I-1, C. B. 201. If there is more than one, however, it would appear that each spouse could claim one or more if the dependent were supported entirely from community funds.

AGREEMENTS BETWEEN SPOUSES AFFECTING OWNERSHIP OF PROPERTY

Several community property states permit spouses to enter into agreements which change the character of the ownership of property during the marital status. The agreement may either provide for the transmutation of the separate property of either spouse into community property and vice versa; or it may be prospective in its operation providing, in effect, that the income of each spouse shall continue to remain his or her separate property, as though the community property statute was non-existent. An agreement of this type permits the parties to "elect out" of the community property statutes.

Where local law permits such agreements between spouses, they will be recognized for income tax purposes, provided they do not constitute assignments of future income under the prohibition of *Lucas vs. Earl*, 281 U. S. 111 (1930). See *Johnson vs. United States*, 135 F. 2d 125 (CCA-9, 1943, California); *Boland vs. Commissioner*, 118 F. 2d 622 (CCA-9, 1941, California); I. T. 3792, 1946-1 C. B. 86. Thus, it has been held where spouses agreed that their individual earnings should remain their separate property, each spouse was taxable on his or her earnings in their entirety: *Van Dyke vs. Commissioner*, 120 F. 2d 945 (CCA-9, 1941, California); *Helvering vs. Hickman*, 70 F. 2d 985 (CCA-9, 1934, California); *Claire vs. United States*, 34 F. Supp. 1009 (Ct. Cl., 1940, California).

California is a notable example of a community property state where parties may by agreements, either oral or written, change the character of the ownership of property. Thus, it has been held that parties may agree that the earnings of either spouse shall remain the separate property of such spouse: *Helvering vs. Hickman*, supra; *Claire vs. United States*, supra. Similarly, agreements may provide that the separate property of either spouse shall become community property: *Yoakum vs. Kingery*, 58 Pac. 324 (1899, California); *Samuel S. Berger*, BTA Memo. op. 11, 290-E (1940, California). Conversely, community property may be transmuted into separate property. Other states which permit agreements to the extent recognized in California are Idaho (*Ahlstrom vs. Tager*, 174 Pac. 605 (1918, Idaho)); Nevada (*Stockgrowers and Ranchers Bank vs. Milisich*, 283 Pac. 913 (1930, Nevada)); Arizona (*Martha Locke Shoenhair*, 45 BTA 576 (1941, Arizona)); Washington (*Gage vs. Gage*, 138 Pac. 886 (1914, Washington)), *Black vs. Commissioner*, 114 F. 2d 355 (CCA-9, 1940, Washington)); Hawaii (I. T. 3792, 1946-1 C. B. 86).

The states of Louisiana and New Mexico, however, hold that the husband and wife cannot change the character of the ownership of property by agreement during marriage: *Guillot vs. Guillot*, 74 So. 704 (1917, Louisiana); *McDonald vs. Lambert*, 85 P. 2d 78 (1938, New Mexico).

Texas has adopted a position somewhat in between these two extremes. It permits agreements between spouses transmuting the character of their ownership of property *in existence*. Thus, community property *in existence* may, by agreement, be converted into separate property and vice versa: *Marrs McLean*, 41 BTA 565 (1940, Texas); *Stewart vs. Commissioner*, 95 F. 2d 821 (CCA-5, 1938, Texas). However, agreements may not be entered into with respect to property not presently in existence. Thus, future earnings of either spouse or future income from the separate property of either spouse may not, by agreement, be changed into the separate property of the earning spouse: *Stewart vs. Commissioner*, supra.

There are no decisions on these questions with respect to the community property statutes operative in Oklahoma and Pennsylvania. Both statutes, as has been previously indicated, are modeled to a large extent after the Texas statute.

The community property statutes of Oklahoma and Pennsylvania provide "the husband may give, grant, bargain, sell, or convey directly to his wife, and a wife may give, grant, bargain, sell, or convey directly to her husband his or her community property *in esse*. Every deed and conveyance made from the husband to the wife or from the wife to the husband shall operate to divest the property therein described of every claim or demand as community property to the extent herein provided and shall vest the same in the grantee as the separate property of the grantee, provided, however, that the deeds, conveyances, or trans-

fers hereby authorized shall not affect any existing equity in favor of creditors of the grantor at the time of such transfer, gift, or encumbrance.”: Section 9, Pennsylvania Community Property Act; Oklahoma Community Property Act.

The reference in this provision to property “in esse” would seem to preclude agreements affecting the future earnings or income of the parties. Thus, it may well be held that in Pennsylvania, as in Texas, parties may not, by agreement, change the character of the ownership of property not in existence.

The question may be raised as to the effect of this provision on ante-nuptial agreements. Can ante-nuptial agreements hereafter provide that property acquired by spouses after marriage, which would normally be community property, shall continue to remain the separate property of the earning spouse, as it was prior to the effective date of the community property statute? It may be argued that, since Section 9 of the Pennsylvania Statute permits transactions between spouses only with respect to property “in esse”, ante-nuptial agreements cannot alter the rights of the parties in community property arising thereafter. On the other hand, the policy of the law, certainly in Pennsylvania, which has regarded with favor ante-nuptial agreements entered into under certain circumstances may be construed to be of such compelling force that this provision will be held not to affect such agreements entered into between the parties before the marital status has been established. Moreover, it is to be noted that Section 9 deals specifically with transactions between *husband and wife* and does not by its terms cover pre-nuptial agreements.

SEPARATION AGREEMENTS

The rules applicable with respect to agreements generally would be equally applicable in respect of separation agreements. Thus, California and the other states (see above), which have liberal rules concerning agreements, permit parties to enter into separation agreements, dividing the community property between them and providing that the future earnings of each spouse shall remain separate. *Boland vs. Commissioner*, 118 F. 2d 622 (CCA-9, 1941, California); *Beard vs. Beard*, 24 P. 2d 47 (1933, Idaho); *Parsons vs. Tracy*, 220 P. 813 (1923, Washington). Louisiana, on the other hand, does not allow the dissolution of the community by a separation agreement: *Guillot vs. Guillot*, 74 So. 704 (Louisiana, 1917).

Texas, although it recognizes separation agreements which deal with existing community property, does not permit the division of community property not in existence. Thus, despite the fact that the spouses have separated and have divided the community property between them, future earnings of either spouse, as well as the income from the separate property of either, will continue to remain community property. G. C. M. 10941 X1-2 C. B. 223.

As for Oklahoma and Pennsylvania, the previous discussion with respect to agreements generally is equally applicable here.

FEDERAL ESTATE AND GIFT TAX IMPLICATIONS

Much emphasis has been placed upon the Federal income tax advantages to residents of Community Property States. Less attention has been directed to the Federal Estate and Gift tax implications which, in some instances, minimize or overcome the income tax advantages.

FEDERAL ESTATE TAX

Prior to the Revenue Act of 1942, effective as to decedents dying after October 21, 1942, recognition had been given to the vested interest of each spouse in one-half of the community property, so that only such half was included in the estate of the spouse who was the first to die. Thus, where the community property had been largely amassed through the efforts of one spouse and that spouse died first, the decedent's estate paid Federal estate tax only on the value of one-half of the community property. As a result, an Estate tax saving was enjoyed which became substantial in the higher brackets. See, Report of the House Committee on Ways and Means, H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 35-37; and of the Senate Committee on Finance, S. Rep. No. 1631, 77th Cong., 2d Sess., p. 231.

Legislative efforts to offset this estate tax advantage have met with greater success than in the income tax field.

The Revenue Act of 1942 added Sections 811 (e) (2), 811 (g) (4) and 811 (d) (5) to the Internal Revenue Code with the express purpose of eliminating the preferential treatment enjoyed by spouses residing in the community property states. These changes were made effective as to decedents dying after October 21, 1942.

The amendments made by Section 402 of the Revenue Act of 1942, which became section 811 (e) (2) of the Code, established a new test for the inclusion of community property in the gross estate of a decedent resident in a community property state. It provided that all community property shall be includible in the gross estate in its entirety except for such part ". . . as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse". The test of taxibility is—to whom is the property economically attributable? Property is considered to be economically attributable to a spouse if such spouse can show that it was derived from his or her personal services or separate property; or that it was originally his or her separate property which was transferred to the community; or that the property was purchased with income from such personal services or from separate property. The entire community property is presumed to belong to the spouse who is the first to die. The surviving spouse has the burden of proving that the community property was economically attributable to him or her before it will be excluded from the estate

of the deceased spouse. To the extent only that the surviving spouse successfully meets this burden will such community property escape Federal estate taxation.

In taxing the whole of the community property in the estate of the first spouse to die, to the extent that it is economically attributable to such spouse, the 1942 amendment disregards the vested interest in the community property given to each spouse under state law, which has been recognized for income tax purposes: *Poe vs. Seaborn*, 282 U. S. 101 (1930). State law is recognized, however, to the benefit of the Treasury, by the further provision that in no event shall there be included in the gross estate of the decedent "less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition": Section 811 (e) (2) I. R. C. This latter is half of the community property in every jurisdiction except Nevada and New Mexico, where the wife has no power of testamentary disposition over her interest in the community property. Logically, then, it would seem that in those states no estate tax should be assessed against the estate of a wife dying first with respect to her interest in community property which was not economically attributable to her.

The two factual situations which will arise under Section 811 (e) (2) of the Code are the prior death of (a) the earning spouse, and (b) the non-earning spouse. In the first case, all of the community property may be included in the estate of the spouse, the burden being on the surviving spouse to show any property economically attributable to him or her. In the second case, at least one-half of the community property will be included in the estate of the deceased spouse regardless of who earned it.

The use of the double barreled test — that of economic source where the earning spouse is the first to die, and power of testamentary disposition where the non-earning spouse dies first, has been criticized as discriminatory and inequitable. 45 Michigan Law Review 409 (February, 1947); Application of Federal Income, Estate and Gift Tax Laws to Community Property — Willard S. Pederson. Actually, it is a realistic attempt to equalize the tax burden between residents of community and non-community states. Otherwise, as has been previously indicated, residents of community property states would enjoy a distinct estate tax advantage.

The taxation of the whole community property in the estate of a decedent to whom it is economically attributable is justifiable on the ground that he is the economic source of the property. A similar test has been applied with respect to the taxation of tenancies by the entireties and joint tenancies. *United States vs. Jacobs*, 306 U. S. 363 (1939). Furthermore, death brings about important changes in the rights of the parties in community property. It terminates the control which the decedent, assuming he is the husband, exercised over the entire property during his lifetime and for the first time brings the wife's share of the property into her full and exclusive possession, control and enjoyment. "The cessation of these extensive powers of the husband, even though they were

powers over property which he never 'owned', and the establishment in the wife of new powers of control over her share, though it was always hers, furnish appropriate occasions for the imposition of an excise tax." *Fernandez vs. Wiener*, 326 U. S. 340 (1945).

It is equally just to tax one-half of the community property in the estate of the non-earning spouse (assuming it is the wife) in the event she should die first. The power to dispose of property at death has always been regarded as one of the important criteria for determining the includibility of property in the gross estate of a decedent. See Section 811 (c), (d) and (f) of the Internal Revenue Code, dealing generally with powers held or retained under inter vivos transfers to affect the disposition of property at death. To persons of wealth, power to dispose of property is often more important than the power to consume.

Furthermore, if the test for taxability were economic source alone, so that nothing would be taxable in the estate of the non-earning wife should she die first, residents in community property states would continue to enjoy a substantial tax advantage. Assuming the non-earning wife were the first to die, leaving her half of the community property to her children, this half would pass to them untaxed. Thereafter, when the husband, the earning spouse, would die, only one-half of the community property would be taxable in his estate, since that is all that would remain in his possession and control. Such a result would be even more advantageous to residents of community property states than the former method of Federal estate taxation, under which half was taxable in the estate of each spouse, so that eventually the whole estate was subjected to the tax.

The constitutionality of Section 811 (e) (2) of the Code has been sustained by the Supreme Court in the cases of *Fernandez vs. Wiener*, 326 U. S. 340 (1945, Louisiana); and *United States vs. Rompel*, 326 U. S. 367 (1945, Texas), in both of which cases the husband had died first and the entire community property was held includible in his gross estate because none was economically attributable to the surviving spouse.

In *Fernandez vs. Wiener*, supra, the deceased spouse was a resident of Louisiana. It was sought to exclude from his gross estate one-half of the community property, none of which was economically attributable to the surviving spouse. The Court held that all of the property was properly includible in his gross estate under Section 811 (e) (2) of the Internal Revenue Code; that the death of the husband operated to transfer to the wife under Louisiana law the control which he had exercised over her interest in the community during his lifetime. The Federal estate tax being an excise tax, the termination of the husband's control and its establishment in the surviving spouse were held to create a proper occasion for the imposition of such a tax. In this situation, the estate tax incidence is the same as in the non-community property states. By way of dicta, the Court also pointed out that the death of the wife effected a taxable transfer to the husband by releasing certain restrictions over his right to

dispose of the community property. Even though the interests of the spouses were vested, the changed relationship brought about by the death of either spouse was held sufficient to justify the imposition of an estate tax.

In *United States vs. Rompel*, supra, the application of the same statute to the estate of a Texas spouse was upheld. The following extract from the opinion gives the rationale for the decisions in both cases: "The death of either the husband or the wife of the Texas community thus effects sufficient alteration in the spouses' possession and enjoyment and reciprocal powers of control and disposition of the community property as to warrant the imposition of an excise tax measured by the value of the entire community." (326 U. S. at p. 370). Of course, under the statute, any portion of the community economically attributable to the surviving spouse would be excluded from the gross estate of the deceased spouse, with the limitation that in no event would there be included in the decedent's estate less than one-half.

STATUTORY PRESUMPTIONS

There is a presumption that the entire community property in a decedent's estate originated with the decedent, and it is the burden of the executor or administrator to prove by convincing evidence what portion thereof was economically attributable to the survivor. For this reason, it is advisable for the spouses to keep clear records, segregating separate property and indicating the origin of community property. In the absence of adequate proof, it may result that the community property would be included in the decedent's estate, although it actually was economically attributable to the survivor.

LIFE INSURANCE PROCEEDS

Under Section 811 (g) of the Internal Revenue Code, life insurance proceeds are includible in the gross estate of a decedent for Federal estate tax purposes where the decedent paid the premiums directly or indirectly or possessed at the date of death any incident of ownership in the policy.

Section 811 (g) (4), added by Section 404 of the Revenue Act of 1942, provides that premiums paid out of community funds shall be deemed to have been paid by the insured, except for that portion which may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse.

The section further provides that the term "incidents of ownership" includes incidents of ownership possessed by the decedent at his death as manager of the community.

The constitutionality of this provision has recently been upheld: *Fernandez vs. Wiener*, 326 U. S. 340 (1945). Thus, it becomes obvious that the source of premium payments should be clearly indicated and records to establish it carefully preserved.

TRANSFER OF COMMUNITY PROPERTY IN CONTEMPLATION OF DEATH

Under Sections 811 (c) and (d) of the Internal Revenue Code, there is includible in the decedent's gross estate for Federal estate tax purposes property which the decedent has transferred in contemplation of or to take effect at death, and property which the decedent transferred in trust but over which he retained a power to amend, alter, revoke or terminate. With respect to such transfers, Section 811 (d) (5), added by Section 402 (d) of the Revenue Act of 1942 and which is applicable to Sections 811 (c) and (d), provides that ". . . a transfer of property held as community property by the decedent and surviving spouse . . . shall be considered to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse."

This provision was apparently designed to meet the situation where spouses resident in community property states make such transfers to third parties. However, it may have inadvertently resulted in a loophole whereby a non-earning spouse may release her interest in the community property, in contemplation of death, thus avoiding the taxation of her one-half interest therein at death. Section 811 (d) (5) in effect states that a transfer of community property in contemplation of death shall be considered a transfer by a decedent only to the extent that it is economically attributable to him. If the wife is the non-earning spouse and she releases her interest, it would seem that such a transfer would be excluded from the operation of section 811 (c) or (d). It may well be held, however, that such a literal interpretation of the statute violates the spirit of section 811 (c) and such transfer will nevertheless be taxable.

Furthermore, a release by a non-earning spouse might be construed as a release of a power over property sufficiently similar in its legal attributes to a power of appointment so as to bring it within the purview of Section 811 (f) of the Code which provides for the taxation of powers of appointment released in contemplation of death.

PENNSYLVANIA STATE INHERITANCE TAX

Where husband and wife hold property jointly with rights of survivorship, or as tenants by the entireties, such property is exempt from the Pennsylvania Transfer Inheritance Tax. Article 1, Section 1 (e), Act of June 20, 1919 P. L. 521 as amended by Act of June 22, 1931, P. L. 690 and July 14, 1936, P. L. 44, (72 P S 2301). Would community property fall within this provision to exclude it entirely from such taxation? The primary difference between property held by the community and property held by the entireties is that community property does not entail rights of survivorship. Thus, it would seem that the interest of the decedent in community property would not be exempt from the Pennsylvania Transfer Inheritance Tax.

THE FEDERAL GIFT TAX

Section 453 of the Revenue Act of 1942, effective January 1, 1943, added Section 1000 (d) to the Internal Revenue Code, dealing with gifts of community property. Previously, gifts of community property were taxed one-half to each spouse, enabling them to take advantage of lower tax brackets: Letter of Deputy Commissioner, November 22, 1935, CCH Federal Estate and Gift Tax Reporter, Paragraph 3935.21. Beginning with the calendar year of 1943, such gifts were presumed to be the gifts of the husband except insofar as the wife could prove that they were economically attributable to her or, in the words of the statute, were ". . . shown to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from separate property of the wife. . .". To that extent only was it a gift by the wife, enabling the spouses to reduce the gift tax applicable to the transfer.

Section 86.2 of Regulations 108 provides examples of donative transfers by and between spouses which will be subject to a gift tax:

1. A gift of community property to a third party or parties.
2. A division of community property between a husband and wife into the separate property of either.
3. A transfer by a husband and wife of community property into the separate property of either or into a joint estate with rights of survivorship or a tenancy by the entirety of both spouses. In all of these cases, however, it would seem that property economically attributable to the donee would be excluded so as to avoid the *reductio ad absurdum* of paying a gift tax on a transfer of one's own property to oneself. A gift is commonly defined as the transfer of one's property to another, so that where the donee retains the beneficial interest, there can be no gift of that interest.

The Supreme Court has not as yet passed upon the constitutionality of this amendment, but in view of the rationale of the decisions in *Fernandez vs. Wiener*, 326 U. S. 340 (1945, Louisiana) and *United States vs. Rompel*, 326 U. S. 367 (1945, Texas), in which the incidents of ownership released on the death of a spouse were held to effect a transfer of property sufficient to justify the imposition of an estate tax on all community property economically attributable to the deceased spouse, it would seem highly probable that its validity will be upheld when and if it reaches the Supreme Court. An additional factor is the expressed Congressional intent to eliminate the favorable position enjoyed by spouses resident in community property states, which was approved as to the Federal estate tax in the *Wiener* and *Rompel* cases.

The Tax Court, in *Charles I. Francis*, 8 TC 822 (1947, Texas) recently relied upon the philosophy of the Supreme Court in the *Wiener* case in upholding the constitutionality of Section 1000 (d) in the case of a gift of war bonds eco-

nomically attributable to the husband but held as community property by Texas spouses. The vested interest of the wife was not considered to be a sufficient factor to prevent the imposition of a gift tax against the husband on the full value of the bonds. Rather, the decision went on the sole power of the husband, during coverture, to dispose of community property, the exercise of this power being regarded by the Tax Court as the proper subject of an excise tax. *G. H. Beavers*, TC Memo. CCH Dec. 15, 756 (M) (1947, Texas) also followed the *Francis* case in upholding the constitutionality of Section 1000 (d).

CONFLICT BETWEEN INCOME, ESTATE AND GIFT TAXATION OF COMMUNITY PROPERTY

As will be noted from the above discussion, the Supreme Court has followed two diametrically opposed lines of reasoning with respect to the taxation of community property. In *Poe vs. Seaborn*, 282 U. S. 101 (1930, Washington), the vested interest which each spouse held in the community property was the determining factor in permitting each to report one-half of the community income. Hence, the test used was the "ownership" of the community interest by each spouse. That the husband had extensive powers of control over the community property was held not to be decisive.

In the case of the gift and estate taxes, the economic source of the community property is the test regardless of the vested interest which both spouses possess in the property, the incidence of tax will depend on its economic source except in the situation where the non-earning spouse is the first to die.

SITUATIONS WHICH MAY ARISE FROM 1942 AMENDMENT

Some rather anomalous results may follow from the 1942 amendment to the gift tax, bearing in mind the provisions of the Regulations as summarized above.

Thus, if the husband makes a gift of community property to the wife, it is taxable entirely to him if none is economically attributable to her, even though she has a vested interest in one-half of it.

On the other hand, if the wife transfers community property to the husband, none of which is economically attributable to her, there is no resultant gift tax liability, even though she has a vested interest in one-half of the property so transferred.

If the husband makes a gift which is voidable by the wife, either because she has not consented (see Sec. 172a of California Civil Code) or because it was made in fraud of her interest, the gift would appear to be incomplete by reason of her power to revoke or have it set aside, so that no gift tax could be assessed. See *Sanford vs. Commissioner*, 308 U. S. 39 (1939).

No taxable gift results from a transfer of separate into community property: Regulations 108, Section 86.2.

A taxable gift results from a transfer by the husband of separate or community property, economically attributable to him, to a third person to be conveyed to the spouses as joint tenants.

It is evident from the above situations which may result from the application of Section 1000 (d) that the tracing of the economic origins of community property will become an increasingly important and complex problem in all aspects of tax law. The 1942 amendments to the Federal estate and gift tax statutes also show an increasing tendency to look to the economic realities of the community property system, rather than to its technical refinements of title and ownership under state law, by levying the excise tax on the spouse to whom the property is economically attributable.

CONCLUSION

The present treatment of income of husband and wife for Federal income tax purposes creates a patent, geographical inequality between residents of community and non-community property states. This condition is unsupportable under any theory of taxation. The recent trend of common law states towards the adoption of the community property system is motivated solely by the desire to give its citizens the benefit of income tax savings. The proper solution, in order to remove this discrimination, is national legislation which would provide the same tax benefits available to husband and wife in community property states to residents of all states. Several such plans have been proposed and although Congress thus far has defeated all efforts in this direction, it is highly probable that the next session of the Congress will see the adoption of a solution. The plan that has received the most favorable comment and which is apparently acceptable to the Treasury Department is to allow husband and wife in all states to total their income, divide this total between them and permit each to report one-half. See, *Family, Income and Federal Taxation* by Stanley S. Surrey, Tax Legislative Counsel to the Treasury Department, 24 *Taxes* 980 October 1946.

We venture to predict that when this type of legislation is enacted by the Congress, many of the common law states, including Pennsylvania, which adopted community property statutes with such haste will just as speedily repeal them.