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Federal Estate Taxation - Inter Vivos Gift Between Co-Owners of United States Savings Bonds Requires Surrender And Reissue

RECENT DECISION

Federal Estate Taxation—INTER VIVOS GIFT BETWEEN CO-OWNERS OF UNITED STATES SAVINGS BONDS REQUIRES SURRENDER AND REISSUE— *United States v. Chandler*, 410 U.S. 257 (1973).

At the present time there are approximately 500 million Series E United States Savings Bonds outstanding about 75% of which are registered in the names of co-owners.[1] Until recently there had been no consensus in the federal courts as to whether a registered co-owner of such a bond could remove it from his gross estate by making an *inter vivos* gift to the other co-owner without having the bond reissued according to Treasury Regulation procedures.[2] This conflict in case law and its attendant confusion has had the effect of preventing uniform application of federal estate tax law concerning savings bonds. The issue was recently resolved in the United States Supreme Court decision of *United States v. Chandler*, which held the bonds includable in the gross estate for purposes of the federal estate tax.[3]

In *Chandler* the decedent had purchased numerous Series E bonds which she registered in co-ownership form in the name of herself and one of her granddaughters. In 1961, the decedent made an irrevocable *inter vivos* gift of the bonds to each of her two granddaughters by delivering the bonds to them with donative intent. However, the decedent did not have the bonds reissued in the granddaughters' names.[4] At the donor's death in

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1. Estate of Elliot v. Commissioner, 57 T.C. 152 n.8 (1971), *aff'd mem.*, 474 F.2d 1008 (5th Cir. 1973).

2. For a detailed discussion of the divergent pre-*Chandler* decisions on the issue see notes 8-12 *infra*.

3. 410 U.S. 257 (1973). A federal district court in California originally heard this matter and held for the estate. Chandler v. United States, 312 F. Supp. 1263 (N.D. Cal. 1970). In a *per curiam* opinion, the Ninth Circuit affirmed this decision and also adopted the district court's reasoning. United States v. Chandler, 460 F.2d 1281 (9th Cir. 1972). On appeal the United States Supreme Court reversed the circuit court's decision.

4. The factual situation in *Chandler* typifies the situation in the various cases that have dealt with this issue. A benevolent individual will purchase Series E government bonds registered jointly as payable to himself or one or more of his children, or payable to himself or his wife. Sometime during his life the individual will attempt to make an outright gift of the bonds to the co-owner by actual or constructive delivery. However, the donor will fail to surrender the bonds and have them reissued in the name of the donee pursuant to the Treasury Regulations. On the donor's death, the government claims that the full value of the bonds is includable in the decedent's gross estate. The estate argues that the *inter vivos* gift was complete under the state's personal property laws and that therefore the bonds have been eliminated from the decedent's estate prior to his death. *See, e.g.*, Estate of Curry v. United

1962, an audit of her estate tax return was conducted by the Internal Revenue Service and it was determined that the value of the bonds should have been included in the gross estate under the broad joint tenancy provisions of § 2040 of the Internal Revenue Code of 1954.[5] The Ninth Circuit Court of Appeals, in affirming the district court's decision, ruled that the decedent had completely divested herself of any interest in the bonds prior to her death.[6]

Both the Third and Ninth Circuits had interpreted the Treasury Regulations as not requiring a reissuance of a bond in order for a co-owner donor to transfer his interest in the bond to the other registered co-owner. The Third Circuit case of *Silverman v. McGinnes*[7] had ruled that the regulations were only applicable to questions relating to the contract obligation of the debtor government to pay the bond.[8] According to *Silverman*, an *inter vivos* gift of a bond to a co-owner would not jeopardize the federal government's obligation to pay a bond pursuant to its contract. This approach recognizes a gift to another co-owner as a completed gift for federal estate tax purposes by applying the equitable principles of state property law.[9] In *Silverman*, the court thought it unnecessary to apply the Treasury

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States, 409 F.2d 671 (6th Cir. 1969); Silverman v. McGinnes, 259 F.2d 731 (3rd Cir. 1958); Estate of Elliot v. Commissioner, 57 T.C. 152 (1971), *aff'd mem.*, 474 F.2d 1008 (5th Cir. 1973).

None of the above cases, including *Chandler*, were concerned with deliveries made in contemplation of death, therefore, Internal Revenue Code of 1954, § 2035 which covers this subject is not relevant to the situation in *Chandler*.

5. INT. REV. CODE OF 1954, § 2040 provides:

> The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth.

The purpose of this section is to prevent a decedent from avoiding the estate tax by simply putting his property in the form of a joint interest with a right of survivorship. The law therefore requires the decedent to be taxed on all property subject to the joint interest to the extent that he supplied the consideration for the property. United States v. Jacobs, 306 U.S. 363 (1939). The characteristic feature of a joint interest which causes it to be included in the decedent's gross estate is the right of survivorship. Estate of Boogher, 22 T.C. 1167 (1954).

6. United States v. Chandler, 460 F.2d 1281 (9th Cir. 1972).

7. 259 F.2d 731 (3rd Cir. 1958).

8. *Id.* at 733. It should be noted that the court in *Silverman* does not doubt that the Treasury Regulations have the full force of law. However, it concludes that the scope of their application does not include determinations of the rights of individual citizens arising out of transactions between themselves.

9. In *Silverman*, the court states that it is "impressed with the results and the reasoning" reached in various state cases which have dealt with this same question with respect to state

Regulations to an *inter vivos* transfer between registered co-owners, since there was no risk of possible payment to unregistered adverse claimants.[10] Presumably, such a risk would only arise upon a transfer from a registered owner to a stranger without a reisssuance of the bond.

When this issue came before the Sixth Circuit Court of Appeals the *Silverman* rationale was not followed.[11] That court felt that the Treasury Regulations required that the bonds be includable in the donor's estate. However, the opinion failed to offer any supportive reasoning concerning the applicability of the regulations to the issue.[12]

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inheritance or estate taxes. The cases cited by the court stress the equitable rights of the donees of the bonds. 259 F.2d at 733-34. *See, e.g., In re* Hendricksen's Estate, 156 Neb. 463, 56 N.W.2d 711 (1953); *see also* Annot., 40 A.L.R.2d 788 (1955).

10. Cases representative of this position regard the primary purpose of the Treasury Regulation's prohibition against unregistered transfers as the prevention of the government's involvement in disputes that may arise between adverse claimants. 259 F.2d at 734. *See In re* Hendricksen's Estate, 156 Neb. 463, 56 N.W.2d 711 (1953); Littlejohn v. County Judge, 79 N.D. 550, 58 N.W.2d 278 (1953).

In its *Chandler* opinion, the district court held adverse to the government because the evidence in the case was sufficient to show that the donor intended to release her survivorship interest. In this opinion, later adopted by the Ninth Circuit, the interest that the government had in the *inter vivos* transfer betwen co-owners was seen to be so slight that it did not justify application of federal laws. Chandler v. United States, 312 F. Supp. 1263, 1268 (N.D. Cal. 1970).

11. Estate of Curry v. United States, 409 F.2d 671 (6th Cir. 1969). *Curry* held that the regulations required a surrender and registration in the name of the donee in order to be effective, but the opinion evades any direct explanation of the Treasury Regulations themselves. The court was content to rely on a 1953 federal case, Guldager v. United States, 204 F.2d 487 (6th Cir. 1953). The case involved a Michigan law under which all bonds payable simply to husband or wife created an estate by the entireties. However, the Sixth Circuit held that even if the Series E bonds had been registered to joint tenants by the entireties, the rights of creditors as prescribed in the regulations would not be affected. The court concluded that the estate created by these bonds was controlled by federal laws and not by Michigan law. 204 F.2d at 489.

12. In 1971, the Tax Court offered a detailed explanation on how the Treasury Regulations required a reissuance by the co-owner. Estate of Elliot v. Commissioner, 57 T.C. 152 (1971) *aff'd mem.*, 474 F.2d 1008 (1973). The Tax Court in *Elliot* recognized and appreciated the sharp conflict that existed between *Curry* and *Silverman*. However, the court felt *Curry* represented the sounder view. The opinion offers an explanation of how the Treasury Regulations applicable at the time of the gift should be interpreted. Paramount in the court's reasoning was its conclusion that the Treasury Regulations are clear as to ownership and transferability of the bonds. In fact, the reverse side of a Series E bond itself states that it is non-transferable except pursuant to the Treasury Regulations. On the face of the bond is stamped "NON TRANSFERABLE." 57 T.C. at 160.

Probably the most logical argument in favor of the *Elliot* decision deals with the survivorship rights of the donor if the putative donee dies first. The regulations clearly provided that if a registered co-owner dies, the other registered co-owner becomes the sole and absolute owner. Therefore, if a putative donee dies before his donor dies, the federal contract would not recognize the donee's administrator or executor as the successor to the bonds, but they

The irreconcilable positions that had been taken by the lower Federal courts on the applicability of the Treasury Regulations were noted by the Supreme Court in its decision of *United States v. Chandler.*[13] In *Chandler,* the Court ruled that the Treasury Regulations were controlling and that the value of the bonds given to the co-owner must be included in the donor decedent's gross estate for tax purposes unless the bonds had been properly reissued.

The applicable Treasury Regulations[14] provide that the "form of registration used must express the actual ownership of and interest in the bond and . . . will be considered as conclusive of such ownership and interest."[15] Furthermore, it is provided that no judicial proceeding can give effect to an attempted voluntary *inter vivos* transfer.[16] Another section provides that during the joint lives of the co-owners payment will be made at either's separate request, or that it can be reissued during the co-owners' lives in the "name of either, alone, or with a new co-owner. . ."[17] Upon the death of a co-owner, the other will be recognized as the "sole and absolute owner" for all purposes of reissue.[18]

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would still belong to the living co-owner who ostensibly gave the bonds away in the first place. *Id.* at 160, 161.

After the United States Supreme Court rendered the *Chandler* decision in January of 1973, the Fifth Circuit affirmed the Tax Court's decision and reasoning in *Elliot* in a memorandum opinion. Reference was also made to *Chandler* as the final rule with regard to any future disputes. 474 F.2d 1008 (5th Cir. 1973).

13. 410 U.S. 257 (1973).

14. The Secretary of the Treasury is authorized to issue United States Savings Bonds and to promulgate regulations concerning their transfer. 31 U.S.C. § 757c(a) (1970). These Treasury Regulations have the force of law. Silverman v. McGinnes, 259 F.2d 731, 733 (3rd Cir. 1958). *See* Free v. Bland, 369 U.S. 663 (1962).

The Federal Regulations are continually being revised by the issuing agencies. The individual volumes of the Code of Federal Regulations are revised yearly to keep pace with the changes. The Treasury Regulations that are in effect during the year of an alleged transfer of Series E bonds are the controlling law regardless of when the case is heard. Therefore, the Treasury Regulations that were in effect in 1961 when the decedent in *Chandler* allegedly made an *inter vivos* gift to her co-owner are controlling in this case. The substantive portions of the Code that are applicable here have not experienced any major changes up to the present time. However, some shuffling of the various provisions has occurred between the applicable sections which makes a reference to a numbered Code section confusing if a volume for that particular year is not available for reference.

15. 31 C.F.R. § 315.5 (1961).

16. 31 C.F.R. § 315.20(a) (1961).

17. 31 C.F.R. § 315.60 (1961). This 1961 version also described the procedure for reissuance during the lives of both co-owners. This portion of the provision is presently a separate section numbered 31 C.F.R. § 315.61 (1972).

18. 31 C.F.R. § 315.61 (1961). This section related to payment or reissue after the death of a co-owner. The substance of this provision is presently contained in 31 C.F.R. § 315.62 (1972).

The Court noted that, according to the Treasury Regulations, a co-owner who transfers his interest without reissuance retains a right to have the bond redeemed during his lifetime,[19] in addition to a right of survivorship if the putative donee dies first.[20] Accordingly, in *Chandler* the Court held these interests were retained by the decedent at the time of her death despite her apparent intent to relinquish all possession and control of the bonds. Application of Section 2040 was therefore required, and the value of the bonds was included in her gross estate.[21] That section of the Internal Revenue Code requires the value of any interest held jointly to be included in the gross estate to the extent that the decedent supplied the consideration.[22]

Despite the presence of some convincing arguments for adopting the *Silverman* rationale,[23] the Court in *Chandler* wisely viewed the need for uniformity in tax treatment and recordkeeping by the government as paramount to the need for free transferability of co-owned savings bonds.[24] The need for uniform application of laws in this area should not be subjugated to the imposition of inconsistent state property laws.[25] Series E bonds are

19. 410 U.S. at 261. A literal reading of 31 C.F.R. § 315.60 (1961) requires the government to pay the bond to whichever registered owner requests payment first, thereby extinguishing the other co-owner's interest in the bond. If one co-owner attempted to make a gift of the bond to the other co-owner, but failed to have it reissued solely in the donee's name, it is entirely possible under the regulations for the putative donor to still obtain payment of the bond if he can obtain possession of it in some way. *Chandler* has now offered a procedure to avoid this equivocal result. A potential donee is now on notice that without a surrender and reissue his donor remains a full and equal co-owner.

20. 410 U.S. at 261. An attempted gift without reissue from one co-owner to another would not cut off the putative donor's right to become the absolute owner should the donee die first. Because the donor retains this survivorship right given by the Treasury Regulations, he cannot avoid § 2040 if he dies with this right. See note 5 *supra* for further discussion of the Internal Revenue Code of 1954, § 2040.

21. *See* note 20 *supra*.

22. *See* note 5 *supra*.

23. Two arguments in *Silverman* are particularly impressive. The first is that the proceeds of the bonds should equitably belong to the donee in accordance with the standards of state property laws which focus on intent and delivery. The second argument concerns the frequently repeated statement that the only purpose of the Treasury Regulations is to prevent government involvement between adverse claimants to the bonds. If this is true, then the regulations are inapplicable to this tax problem because the government has already protected itself from liability as long as it pays any registered co-owner. 259 F.2d 731 (3rd Cir. 1958).

24. 410 U.S. at 262.

25. The government's intention to prevent absolute freedom of transferability is possibly best evidenced by the language of 31 C.F.R. § 315.20(a) (1972):

> No judicial determination will be recognized which would give effect to an attempted voluntary transfer inter vivos of a bond or would defeat or impair the rights of survivorship conferred by these regulations upon a surviving coowner or beneficiary.

federally issued and necessitate the uniform treatment prescribed in *Chandler*. Now that an invariable standard has been clearly established for estate tax purposes, co-owners will know exactly what procedures must be followed in transfers of their savings bonds. Despite the formality required by the *Chandler* rule, it nevertheless appears to be a welcome relief to a previously uncertain area of estate planning.

R.C.B.

While the final results in *Chandler* and *Elliot* are the same, the opinions differ as to the applicability of Free v. Bland, 369 U.S. 663 (1962). That case involved a provision of Texas community property law which in effect prevented a married couple from taking advantage of the survivorship clause in the Treasury Regulations in cases where the purchase price was paid out of community funds. When Mrs. Free passed away, the other co-owner of the bonds, her husband, claimed exclusive ownership because of the survivorship clause (now contained in section 315.62), while the beneficiary in the will claimed an interest because of the community property law. The Court held that the inconsistent Texas community property law must yield to the Treasury Regulations which clearly confer a full right of survivorship on the remaining co-owner. The *Chandler* Court was in complete agreement with *Free* and proclaimed that their decision in *Chandler* was required by it. 410 U.S. at 262.

The Tax Court in *Elliot* did not feel *Free* applied to this particular question because none of the co-owner's rights as survivors were at issue as in *Free*. However, the Tax Court intimates that some of the broad language in *Free* may be applicable. 57 T.C. at 157.