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COMMENTS

FEDERAL TAX CONSEQUENCES OF ANTENUPTIAL CONTRACTS

An antenuptial contract is an agreement entered into prior to marriage by which prospective spouses may alter the normal incidents of marital property rights. Such contracts are considered conducive to marital tranquility and are generally regarded favorably by the courts. A variety of provisions may be contained in antenuptial contracts. For example, the parties may relinquish rights in each other's property and estate which they would otherwise acquire by reason of the marriage; they may release their distributive shares in each other's property and estate which they would otherwise acquire by reason of the marriage; and the right of election to take against a deceased spouse's will. A. LINDEY, supra at 90-57.

Marital property rights can be altered by antenuptial contract (see discussion in notes 2-6 infra), but conjugal rights cannot. In re Marriage of Dawley, 17 Cal. 3d 342, 551 P.2d 323, 131 Cal. Rptr. 3 (1976); In re Marriage of Higgason, 10 Cal. 3d 476, 516 P.2d 289, 110 Cal. Rptr. 897 (1973); Eule v. Eule, 24 Ill. App. 3d 83, 320 N.E.2d 506 (1974); Norris v. Norris, 174 N.W.2d 368 (Iowa 1970); A. LINDEY, supra at 90-26.

Some of the basic rules to be considered in drafting antenuptial contracts are as follows: (1) the marriage itself is sufficient consideration to support the agreement; (2) the agreement must make a fair and reasonable provision for the spouse waiving his or her marital rights, or, alternatively, there must be a full and frank disclosure of the worth of the spouse benefiting from the agreement; (3) the spouse waiving his or her marital rights must sign the agreement freely and voluntarily, preferably with advice of independent counsel with full knowledge of his or her rights; (4) an engagement to marry creates a confidential relationship between the parties; therefore, if the contract makes inadequate provision for the spouse waiving his or her marital rights, the burden of proving the validity of the contract falls upon the party asserting it. Friedlander v. Friedlander, 80 Wn. 2d 293, 494 P.2d 208 (1972); A. LINDEY, supra note 1.

It should be noted that the antenuptial contract in Friedlander was denied enforcement because it failed to make a fair and reasonable provision for the wife, and because the husband failed to prove that he had made a full, frank disclosure of his property and his worth to his prospective wife before the antenuptial contract was signed. Friedlander v. Friedlander, 80 Wn. 2d 293, 494 P.2d 208 (1972); A. LINDEY, supra note 1.

An antenuptial contract can validly alter the rights each spouse will have in the property of the other due to the marriage. Hartz v. Hartz, 248 Md. 47, 234 A.2d 865 (1967); In re Strickland's Estate, 181 Neb. 478, 149 N.W.2d 344 (1967); In re Perlman's Estate, 438 Pa. 112, 263 A.2d 375 (1970); A. LINDEY, supra note 1, at 90-57 to 90-61.

1. See generally 2 A. LINDEY, SEPARATION AGREEMENTS AND ANTENUPTIAL CONTRACTS § 90 (rev. ed. 1967). Rights arising as a result of marriage include (a) conjugal rights such as consortium and support and (b) marital property rights such as dower, curtesy, community property, widow's allowance, homestead rights, rights in intestacy, and the right of election to take against a deceased spouse's will. A. LINDEY, supra at 90-57.

2. See, e.g., Friedlander v. Friedlander, 80 Wn. 2d 293, 301, 494 P.2d 208, 213 (1972); A. LINDEY, supra note 1, at 90-30. See also In re Marriage of Hadley, 88 Wn. 2d 649, 565 P.2d 790 (1977) (applying the Friedlander requirements to determine the validity of property status agreements entered into during marriage).
er's estate or surrender their rights to take against one another’s will, the wife may forego her dower, or the husband his curtesy; the agreement may alter the operation of the community property system, or possibly provide for a property settlement in the event of dissolution or divorce.  

Often such agreements will include provisions for one or both spouses to transfer property to the other either before or after the marriage. When such transfer provisions are included, there may be important federal tax consequences. As a result of the growing number of marriage dissolutions and the consequent increase in families in which spouses have remarried, both spouses work, and one or both have stepchildren, the use and significance of the antenuptial contract is increasing. As the number of antenuptial agreements involving transfers of property grows, it is essential that persons utilizing such contracts be aware of the tax consequences.

This comment will examine the federal gift, estate, and income tax consequences of antenuptial contracts. Each of these taxes will be discussed separately. Antenuptial contracts which provide for the transfer of property arise more frequently in common law property states, where spouses have inchoate rights in one another's property,


5. Dickason v. English, 272 Ill. 368, 112 N.E. 65 (1916); In re Moore's Estate, 210 Or. 23, 307 P.2d 483 (1957); A. LINDEY, supra note 1, at 90-60.


7. The status of such provisions is unclear. It is often stated that those antenuptial contracts which provide for an amount of alimony or a property settlement in the event of separation or divorce encourage divorce and are against public policy and unenforceable. See A. LINDEY, supra note 1, at 90-27; id. at 323 (Cum. Supp. 1977).

There are indications, however, that this general rule is under attack. See In re Marriage of Dawley, 17 Cal. 3d 342, 551 P.2d 323, 131 Cal. Rptr. 3 (1976). See generally A. LINDEY, supra note 1, at 325 (Cum. Supp. 1977). Antenuptial contracts providing for a waiver of alimony in the event of divorce have been upheld providing the wife has adequate means of her own. See Belcher v. Belcher, 271 So. 2d 7 (Fla. 1972); Unander v. Unander, 265 Or. 102, 506 P.2d 719 (1973). See also 10 WILLAMETTE L.J. 117 (1973) (discussing Unander). In addition, contracts providing for payments in lieu of alimony in the event of divorce have been upheld against a wife claiming that the contract was void. Void v. Void, 6 Ill. App. 3d 386, 286 N.E.2d 42 (1972).


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than in community property states, where the spouses share the community property equally.10 In the antenuptial contract setting, federal taxes are imposed upon the transfer of property; when an antenuptial contract provides for a transfer of property, there are no differences in the federal tax consequences between common law property and community property systems. There are, however, some provisions which are unique to community property jurisdictions, and the comment concludes with a brief discussion of the tax consequences of agreements altering community property rights.

I. GIFT TAX

A. Consideration Required to Avoid Tax

Federal gift taxes attach to transfers of property “for less than an adequate and full consideration in money or money’s worth.”11 An agreement to transfer property in consideration of either the marriage or the release of the prospective spouse’s marital rights involves gift tax consequences because neither a promise to marry nor a release of marital rights is considered adequate consideration in “money or money’s worth” for estate and gift tax purposes.12

10. For background material on common law and community property systems, see T. Atkinson, Law of Wills §§ 15, 29, 30 (2d ed. 1953); W. deFuniak & M. J. Vaughn, Principles of Community Property § 1 [hereinafter cited as deFuniak]; Cross, supra note 6.


I.R.C. § 2512(b) provides:

Where property is transferred for less than an adequate and full consideration in money or money’s worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar quarter.

Treas. Reg. § 25.2512–8 (1958) provides: “A consideration not reducible to a value in money or money’s worth, as . . . [a] promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift.”

The amount of a gift to a spouse which is actually taxed, however, is substantially reduced by the marital deduction. I.R.C. § 2523 (1954), as amended by Tax Reform Act of 1976, Pub. L. No. 94–455, § 2002(b), 90 Stat. 1806, 1854. This provision increases the marital deduction for transfers between spouses. The first $100,000 of such gifts is entirely deductible. Thereafter, the deduction allowed is 50% of lifetime transfers in excess of $200,000. The estate tax marital deduction is reduced by the amount of the marital deduction allowed for lifetime transfers in excess of 50% of the value of the transfers (i.e., where lifetime gifts eligible for the marital deduction are less than $200,000). H.R. REP. No. 1380, 94th Cong., 2d Sess. 18 (1976). For a discussion of the estate tax marital deduction, see note 32 infra.
A promise of marriage by the donee is not sufficient consideration to prevent a transfer of property from being taxed as a gift under section 2512(b). The test requiring receipt by the donor of "money or money's worth" was found controlling by the Supreme Court in Commissioner v. Wemyss, even though the donee prospective spouse stood to lose a substantial trust fund by marrying. The court also held that the existence vel non of donative intent was not the essential issue in determining whether or not there was a gift.

The release of marital rights also will not provide sufficient consideration to create a tax-free transfer under an antenuptial contract. The gift tax provision of the Internal Revenue Code makes no specific reference to relinquishment of dower or curtesy, but the estate tax provision explicitly provides that release of such rights is not consideration in "money or money's worth." The Supreme Court has reasoned that the two taxes are similar in purpose and should be construed alike in order to discourage tax avoidance and carry out the basic statutory purpose of the gift tax.

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13. See note 12 supra.
14. 324 U.S. 303 (1945). The taxpayer desired to marry a widow who had a child. The widow's deceased husband had set up two trusts, with the income going equally to the widow and child. Upon her remarriage, all the income from the trusts would go to the child. To induce the widow to marry him, the taxpayer executed an agreement transferring stock to her to replace her forfeited trust income.
15. Id.
16. Id. at 306. Treas. Reg. § 25.2511–1(g)(1) (1958), adopted after Wemyss, states: Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer, and the circumstances under which it is made, rather than on the subjective motives of the donor.
17. Merrill v. Fahs, 324 U.S. 308 (1945). The taxpayer in Merrill was extremely wealthy. An antenuptial agreement with his prospective wife provided that she release all rights in his property which she would otherwise acquire as a wife or widow in exchange for his establishing an irrevocable trust for her benefit and testamentary trusts for the benefit of their surviving children. The court found the wife's release insufficient consideration and taxed the trusts as gifts.
18. I.R.C. § 2512(b), quoted at note 12 supra.
19. I.R.C. § 2043(b) provides: For purposes of this chapter, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth."
20. Merrill v. Fahs, 324 U.S. 308, 312–13 (1945). An important purpose of the gift tax is to prevent the avoidance of estate taxes by taxing inter vivos transfers of property which, except for their gift quality, would be subject to the estate tax. Sanford's Estate v. Commissioner, 308 U.S. 39, 44 (1939). To hold that the release of dower by a wife during her husband's life constitutes consideration for any transfer by him defeats this purpose because it would permit an untaxed transfer by gift of property which otherwise would be subject to estate tax at the husband's death. Commissioner v. Bristol, 121 F.2d 129 (1st Cir. 1941).
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In short, in order to avoid gift tax liability, the donor must receive something which is deemed to be adequate consideration. The release of marital rights or promise of marriage by the donee does not satisfy this requirement.

B. Effective Date of the Gift

Once one has identified those types of transactions which will create gift tax liability, the additional problem arises of determining when such a gift will be effective. An antenuptial agreement becomes binding upon the marriage of the parties.21 Because the donor becomes contractually obligated to make the transfer at that time, the question is raised whether the donor is liable for the value of the gift tax at the time of the marriage, or when the property is ultimately transferred. Court decisions and IRS Revenue Rulings have established that the full value of the gift is subject to the gift tax at the time of marriage,22 provided the gift is susceptible of valuation.23 The full value of the gift is taxed even when it consists of a series of payments and is subject to contingencies.24 It should be noted, however, that the full value will be calculated according to recognized actuarial principles25 in determining a donor's taxable gift for a given tax period.26

22. See Estate of Copley v. Commissioner, 15 T.C. 17 (1950), aff'd, 194 F.2d 364 (7th Cir. 1952). In Copley, taxpayer and his intended wife entered into an antenuptial agreement in 1931. Copley agreed to give her a specified sum of money in consideration of the marriage and in lieu of all her marital rights in his property. No date was specified for the payments, which were actually made in 1936 and 1944. The tax court held that a gift tax would have been due in 1931 if there had been a gift tax law in effect at that time, because under state law, the agreement became legally enforceable on the date of the marriage.

See also Rev. Rul. 69–347, 1969–1 C.B. 227. The taxpayer and his prospective wife entered into an antenuptial contract which provided that in consideration of her release of marital property rights he would pay her a fixed amount per year after their marriage for a period of 20 years or until her death. Even though the gift was subject to the contingency of the wife's death, the Service ruled that, because the taxpayer became legally obligated to perform the contract upon marriage, the gift was complete at that time.


26. The total amount of annual gifts made minus the annual exclusion and allow-
II. ESTATE TAX

Antenuptial contracts can create estate tax problems in several situations. In each of these, the issue is whether or not the property transferred is deductible from the value of the gross estate. For example, one spouse may have agreed to leave the other a fixed sum at death;\(^{27}\) one spouse may have agreed to establish a testamentary trust to pay his or her surviving spouse periodic payments for life;\(^{28}\) or, the spouses may have agreed to leave to the surviving spouse a life estate in decedent spouse's property.\(^{29}\) In these and similar situations, the taxpayer wishes to establish that the payments made or property transferred by the antenuptial contract will be deductible, and thus not taxed as part of the decedent's estate.

Taxpayers have attempted to obtain deductions for such transfers of property under two sections of the estate tax provisions. The deductions have been allowed under section 2056,\(^{30}\) which allows a marital deduction for property passing from decedent to surviving spouse, but have not been allowed under section 2053,\(^{31}\) which allows a deduction for claims against the estate.

A. Marital Deduction: Section 2056

Section 2056 provides that the value of the taxable estate is determined by deducting from the gross estate the value of any property interest which passes from the decedent to his or her surviving spouse, subject to certain conditions and limitations.\(^{32}\) The specific question

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\(^{27}\) Empire Trust Co. v. Commissioner, 94 F.2d 307 (4th Cir. 1938), aff'g 35 B.T.A. 866 (1937) (testator made a bequest to his wife in fulfillment of an antenuptial agreement under which she was to be paid a certain sum if she survived him).

\(^{28}\) Estate of Rubin, 57 T.C. 817 (1972) (taxpayer agreed by terms of antenuptial contract to devise 50% of his residuary estate to a trust to pay his wife $100 a week for life with a remainder to his sons).

\(^{29}\) Estate of Pollard, 52 T.C. 741 (1969) (in an antenuptial agreement, husband and wife waived all claims of dower, curtesy, or other statutory right in the property of each other, and provided that the survivor would be entitled to a life estate in the property of the other).

\(^{30}\) I.R.C. § 2056, discussed at note 32 infra.

\(^{31}\) I.R.C. § 2053, discussed at note 37 infra.

\(^{32}\) For example, no deduction is allowed for most terminable property interests. I.R.C. § 2056(b). See note 36 infra for a discussion of deductible and nondeductible
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raised by antenuptial contracts is whether payment to a surviving spouse pursuant to such an agreement is an "interest in property which passes or has passed from the decedent to his surviving spouse" for purposes of this section. Subsection 2056(d)\textsuperscript{33} allows only a limited number of methods by which property may be considered as passing from decedent to another person. This subsection states that property bequeathed or devised by a decedent qualifies, but it does not specifically mention antenuptial contracts. It has been established, however, that the value of an interest transferred to a surviving spouse is deductible as long as the other statutory limitations are overcome,\textsuperscript{34} because a transfer of property pursuant to the terms of an antenuptial contract is no different from a devise or bequest of the same property.\textsuperscript{35}

B. Terminable Interests: No Deduction as a Claim Against the Estate Under Section 2053

No deduction is allowed under the marital deduction section of the Code for most terminable interests transferred to a surviving spouse.\textsuperscript{36}

\textsuperscript{33} I.R.C. § 2056(d).
\textsuperscript{34} See discussion at note 32 supra.
\textsuperscript{35} First Nat'l Bank v. Nelson, 355 F.2d 546 (7th Cir. 1966); Rev. Rul. 68-271, 1968-1 C.B. 409. In the IRS ruling, decedent and his wife had entered into an antenuptial agreement whereby she relinquished any marital rights she might acquire in her prospective husband's property. In return, he agreed to pay her a fixed sum from his estate, provided she survived him as his widow. After her husband's death, the estate paid the sum based on the antenuptial contract pursuant to a claim filed by his widow. She was not mentioned in her husband's will, nor was the will contested. The deduction was allowed as a marital deduction. See Rev. Rul. 54-446, 1954-2 C.B. 303, in which decedent and his wife entered into an antenuptial contract whereby she agreed to relinquish all her marital rights and he agreed to leave her specific property by will at his death. In his will, decedent left her different property of greater value. The value of the property was allowed as a marital deduction.

\textsuperscript{36} Estate of Krampf, 56 T.C. 293 (1971). A "terminable interest" in property is one which will end on the lapse of time or on the occurrence of some contingency.
As a result, some taxpayers have attempted to obtain a deduction for such interests under section 2053. This section provides that the value of the taxable estate is determined by deducting from the gross estate the amount of claims against the estate, provided they were contracted for adequate and full consideration. In addition, it explicitly provides that the relinquishment of marital rights is not adequate consideration. Taxpayers have argued, thus far unsuccessfully, that their antenuptial contracts are supported by consideration other than the release of marital rights, and that such consideration is adequate and full. The courts have not been persuaded, and deductions under this section for the value of property passing under the terms of antenuptial contracts have not been allowed.

Taxpayers have argued specifically that the mutual obligations assumed by a prospective husband and wife in an antenuptial contract are adequate and full consideration within the meaning of section 2053. This argument was rejected in Estate of Pollard. Decedent and her husband had executed an antenuptial agreement which provided that the survivor would be entitled to a life estate in the property of the first to die, and the taxpayer asserted that the value of the life estate qualified for a deduction as a claim against the estate. The taxpayer argued that the reciprocal obligations assumed by the contracting parties met the statutory requirement of adequate and full consideration in money or money's worth. Although noting that the

A life estate or an interest for a term of years are examples of terminable interests. Treas. Reg. § 20.2056(b)–1(b) (1958). A “nondeductible terminable interest” is one which passes from decedent to some other person for less than an adequate and full consideration in money or money’s worth after the termination of the spouse’s interest. Id. § 20.2056(b)–1(c). For example, if a prospective husband and wife enter into a valid antenuptial contract, and one agrees to leave the other a life estate in his or her property with a remainder to their children, this interest, although passing to the surviving spouse for purposes of § 2056(d), is a nondeductible terminable interest. See Jackson v. United States, 376 U.S. 503 (1964); Estate of Rubin, 57 T.C. 817 (1972); Estate of Myers, 27 Tax Ct. Mem. Dec. 975 (1968).

A property interest passing to a decedent’s surviving spouse may be deductible even though it is a terminable interest. I.R.C. § 2056(b). For example, if a surviving spouse receives a right to income for life with a general power of appointment, the interest is deductible. Gelb v. Commissioner, 298 F.2d 544 (2d Cir. 1962); Treas. Reg. § 20.2056(b)–1(d) (1958).

37. § 2053(c) states: “The deduction allowed by this section in the case of claims against the estate . . . shall, when founded on a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money’s worth.” I.R.C. § 2053(e) then refers to § 2043(b), which provides that a relinquishment of dower, curtesy, or other marital rights in decedent’s property is not to any extent a consideration in “money or money’s worth.”


39. Id. at 741.
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mutual promises constituted adequate consideration under the law of contracts, the court disagreed insofar as the tax consequences were concerned: "This is in substance merely a contractual arrangement for a testamentary disposition not within the intendment of the statute. Such reciprocal arrangement 'for the benefit of the natural object of each . . . [promisor's] bounty,' does not qualify as the kind of consideration required by the statute . . . ."\(^{40}\)

Another argument advanced is that a spouse releasing all of his or her marital rights is actually giving up support rights which have been accepted as adequate consideration.\(^{41}\) This theory was rejected in Estate of Rubin.\(^{42}\) In that case, the taxpayer and his wife entered into an antenuptial agreement in which the wife released all her rights in her husband's property, and the husband agreed to devise fifty percent of his residuary estate to a trust to pay her $100 a week for life with a remainder to his sons. The taxpayer contended that the claim was not disallowed by subsection 2053(e),\(^{43}\) because the wife had agreed to release her support rights rather than her marital rights. The court disagreed:

The "support rights," the relinquishment of which has been held to constitute consideration in money or money's worth, are the support rights to which a wife is entitled during marriage and which she may relinquish in a settlement agreement incident to a divorce . . . . They do not refer to any rights a widow may claim as a result of her husband's death.\(^{44}\)

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\(^{40}\) Id. at 745.

\(^{41}\) The distinction between support and marital rights has significant tax consequences. Generally, a husband has a duty to support his wife during their joint lives or until she remarries. E.g., Estate of Glen, 45 T.C. 323 (1966); Kinne v. Kinne, 82 Wn. 2d 360, 510 P.2d 814 (1973); Rev. Rul. 68–379, 1968–2 C.B. 414, 415. Transfers of property in return for the release of support rights most often occur pursuant to divorce, and the release of support rights constitutes a consideration in money or money's worth for both estate and gift tax purposes. Estate of Ellman, 59 T.C. 367 (1972); Estate of Keller, 44 T.C. 851 (1965); Rev. Rul. 60–160, 1960–1 C.B. 374, 375. In contrast, marital rights are those rights which a surviving spouse may acquire in decedent's property or estate by reason of the marriage. Estate of Glen, 45 T.C. 323 (1966); Rev. Rul. 60–160, supra, at 375. See note 1 supra.

Section 2056 of the Code and Treasury Regulation § 25.2512–8 state that the release of dower or curtesy or a statutory substitute for dower or curtesy (marital rights) is not a consideration in money or money's worth. See Rev. Rul. 75–395, 1975–2 C.B. 370, which states that the debt of a decedent founded upon the release of a spouse's marital rights in the property of the other spouse, rather than the release of the right to support, is not deductible under § 2053(a)(3).

\(^{42}\) 57 T.C. 817 (1972).

\(^{43}\) I.R.C. § 2053(e), discussed at note 37 supra.

\(^{44}\) 57 T.C. at 825. Accord, Estate of Ellman, 59 T.C. 367 (1972) (release of a
In short, if an interest cannot be taken as a marital deduction because of the terminable interest rule, its value will not be deductible as a claim against the estate, because the release of marital rights is not adequate consideration in "money or money's worth." Thus, section 2053 supplies no relief to parties executing an antenuptial contract.

To summarize briefly, property passing under the terms of an antenuptial contract, as long as it is not a terminable interest, is deductible under the marital deduction provision of the Code because it qualifies as an interest passing from the decedent to the surviving spouse. Such property is not deductible as a claim against the estate, because the antenuptial contract is based upon inadequate consideration.

III. INCOME TAX

For income taxation, unlike estate and gift taxation, property transferred pursuant to an antenuptial contract in consideration of the release of marital rights is considered to have been for adequate and full consideration. Therefore, the transferor of appreciated property will recognize gain and pay an income tax. The important ramifications of this rule are discussed below.

A. Transferee's Basis in Property Transferred

The transferee's basis of property transferred under an antenuptial agreement is the fair market value of the property at the time of the transfer. The transfer is not considered a gift under section 1015, which requires the transferee to take the transferor's basis with some adjustment for the gift taxes paid.
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This rule was established in Farid-Es-Sultaneh v. Commissioner.\textsuperscript{48} The court stated: "In our opinion the income tax provisions are not to be construed as though they were in pari materia with either the estate tax law or the gift tax statutes."\textsuperscript{49} In Farid-Es-Sultaneh, the taxpayer transferred stock to his wife pursuant to an antenuptial contract whereby she agreed to marry him and release all her marital rights in his property. She later sold some of the stock and reported a loss on the sale, arguing that the transfer was not a gift, but rather a transfer for adequate and full consideration. She had, accordingly, reported her basis as the fair market value of the stock at the time of the transfer, and not her husband's cost. The court found for the taxpayer:

Her inchoate interest in the property of her affianced husband greatly exceeded the value of the stock transferred to her. It was a fair consideration under ordinary legal concepts of that term for the transfers of the stock by him. . . . She performed the contract under the terms of which the stock was transferred to her and held the shares not as a donee but as a purchaser for a fair consideration.\textsuperscript{50}

Thus, the recipient of property under an antenuptial contract, in which one prospective spouse releases marital rights in the other prospective spouse's property, takes as a purchaser, and his or her basis is the fair market value of the property at the time of the transfer.\textsuperscript{51}

B. Taxable Gain to Transferor

While a transferor of appreciated property normally realizes a taxable gain,\textsuperscript{52} the issue of taxable gain to the transferor under an antenuptial agreement has not been directly addressed by the courts or by revenue rulings. Logically, the Supreme Court's reasoning in the leading case involving transfer of property pursuant to a separation

\textsuperscript{48} 160 F.2d 812 (2d Cir. 1947).
\textsuperscript{49} Id. at 814-15.
\textsuperscript{50} Id. at 815. The IRS had labeled the transaction a gift and given the taxpayer the donor's basis on the authority of Commissioner v. Wemyss, 324 U.S. 303 (1945), discussed at note 14 supra, and Merrill v. Fahs, 324 U.S. 308 (1945), discussed at note 17 supra. Both cases were distinguished in Farid-Es-Sultaneh.
\textsuperscript{51} Cf. Rev. Rul. 67-221, 1967-2 C.B. 63 (dealing with a case in which a husband transferred appreciated property to former wife in consideration of the release of her dower rights; the ruling stated there is no gain or loss to the wife, and the basis of the property to her is its fair market value on the date of the transfer).
\textsuperscript{52} I.R.C. § 1001.
agreement, *United States v. Davis*,\(^53\) should be applicable to transfers under antenuptial contracts.

In *Davis*, stock was transferred to the wife by the husband pursuant to a property settlement and separation agreement incident to divorce. The court stated that Congress clearly intended to tax the economic growth of the stock as "income from whatever source derived, including . . . [g]ains derived from dealings in property."\(^54\) The issue presented was *when* should the gain be taxed: at the time of the transfer of the property from the husband to the wife, or later, when and if the wife transferred the property? The court held that the gain on the transfer was taxable to the husband when he transferred the property to the wife because the transfer was in consideration of a "release of an independent legal obligation,"\(^55\)—his wife's inchoate marital rights in her husband's property, including, but not limited to, dower and all rights under the laws of testacy and intestacy.\(^56\)

A transfer of property pursuant to an antenuptial contract is frequently in exchange for the release of this same independent legal obligation: the prospective spouse's rights which would otherwise be acquired as a result of the marriage. The transfer, therefore, is a taxable event, and the gain, if it can be measured,\(^57\) must be taxed to

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\(^{53}\) 370 U.S. 65 (1962).

\(^{54}\) *Id.* at 68 (quoting I.R.C. § 61(a)).

\(^{55}\) *Id.* at 69. Taxpayers have tried, unsuccessfully, to avoid the impact of the *Davis* rule by arguing that the transferee spouse did not surrender an independent legal obligation. *See*, e.g., *Pulliam v. Commissioner*, 329 F.2d 97 (10th Cir. 1964) (husband realized a long-term capital gain on the transfer of appreciated property to former wife even though there was no express release of the wife's marital rights); *Matthews v. United States*, 425 F.2d 738 (Ct. Cl. 1970) (income tax imposed on wife's transfer of appreciated stock to former husband; there was no gift even though under Florida law the wife had no legal obligation to give the husband anything).


\(^{57}\) In order for a gain from the sale or exchange of property to be taxable, the amount realized must be susceptible of valuation; if there is no ascertainable value, the transaction is not a taxable event. *Burnet v. Logan*, 283 U.S. 404 (1931); *Commissioner v. Marshman*, 279 F.2d 27 (6th Cir. 1960); *Dorsey v. Commissioner*, 49 T.C. 606 (1968); Rev. Rul. 68–194, 1968–1 C.B. 87.

The property received by the taxpayer in *Davis* was the release of the wife's marital rights. The lower court had reasoned that there was no accurate method to determine their fair market value, and that therefore it was impossible to determine the taxable gain realized by the taxpayer. The Supreme Court rejected this reasoning and held that because the parties had acted at arm's length, the values of the properties ex-
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conform with congressional intent to tax as income "[g]ains derived from dealings in property." Under the rule of *Farid-Es-Sultaneh*, the gain is not taxable to the transferee,\(^58\) whose basis is the fair market value at the time of the transfer. Therefore, if the gain is to be taxed, the tax must be assessed against the transferor at the time of the transfer.\(^59\)

C. Loss Not Deductible

While gain realized by a transferor under an antenuptial agreement is subject to income tax, any loss is not deductible, whether the transfer takes place prior to or after the marriage. If the transfer takes place after the marriage, or prior to the marriage when the parties are married by the end of the taxable year, any deduction for the loss is explicitly prohibited by section 267,\(^60\) which disallows deductions for losses from sales or exchanges of property between members of a family.\(^61\) If the transfer takes place prior to the marriage and the parties are not married by the end of the taxable year, any deduction is prohibited by section 165(c).\(^62\) That section states that losses incurred

changed were presumed to be equal. Consequently, the taxpayer had a taxable gain measured by the fair market value of the property at the time of the transfer minus his cost.

In *Davis*, the Court assumed that the parties were acting at arm's length because they were seeking divorce. In contrast, one may presume that parties to an antenuptial contract do not deal at arm's length with one another; instead, their relationship is one of mutual confidence and trust. Friedlander v. Friedlander, 80 Wn. 2d 293, 494 P.2d 208 (1972); A. Lindley, *supra* note 1, at 90-41. *Contra*, *In re Marriage of Dawley*, 17 Cal. 3d 342, 551 P.2d 323, 131 Cal. Rptr. 3 (1976). The argument could therefore be made that, because of the confidential relationship, parties to an antenuptial contract do not necessarily judge the marital rights to be equal in value to the property for which they were exchanged. Consequently, there would be no way to compute the fair market value of the marital rights surrendered, and, therefore, no way to determine the taxable gain realized by the taxpayer.

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\(^58\) See text accompanying notes 46-51 *supra*.

\(^59\) The gain to the transferor spouse may be treated as ordinary income, and not capital gain. I.R.C. § 1239 provides that any gain realized on the sale or exchange of depreciable property between husband and wife is ordinary income.

\(^60\) I.R.C. § 267. The transferee's basis for loss purposes is his cost and not the transferor's basis, so the deduction is permanently lost. I.R.C. § 1012. However, if the transferee later sells or exchanges the property, he need recognize only so much of the gain as is in excess of the transferor's basis. I.R.C. § 267.

\(^61\) I.R.C. § 267; McWilliams v. Commissioner, 331 U.S. 694 (1947) (loss on sale of stock sold indirectly by husband to wife through a stock exchange specifically disallowed).

\(^62\) I.R.C. § 165(c) provides a limitation on losses allowed individuals. A loss is allowed only if it was (1) incurred in a trade or business, (2) incurred in any transaction entered into for profit, or (3) a casualty loss.
by an individual are deductible only if incurred in a transaction entered into for profit.\textsuperscript{63}

It is virtually inconceivable that a transfer pursuant to an antenuptial contract would be entered into for profit. The test to determine whether a transaction has been entered into for profit is whether the transaction is profit-motivated, either when the property is acquired or when it is sold or exchanged.\textsuperscript{64} If a transfer is made within the context of a family relationship, and there is no evidence that the transaction resembled a profit-motivated sale of property, (such as an effort to obtain the best price possible), no loss will be allowed on the sale or exchange.\textsuperscript{65} In an antenuptial transfer, the transferor is exchanging property in return for the release of marital rights by the prospective spouse; that he or she is making an effort to realize a profit on the transaction is extremely unlikely.

In summary, any deduction for loss on the exchange of property pursuant to the terms of an antenuptial contract will be disallowed by section 267 or section 165(c).

D. Loss of Exclusion of Proceeds of Life Insurance Policy

Section 101 states that gross income does not include amounts received under a life insurance contract, unless the life insurance policy is transferred for valuable consideration.\textsuperscript{66} In the latter situation, the

\begin{itemize}
  \item \textsuperscript{63} \textit{Id.}
  \item \textsuperscript{64} \textit{See} Evans v. Rothensies, 114 F.2d 958 (3d Cir. 1940). In Evans, the taxpayer sold stock to his son-in-law under an agreement that the son-in-law would pay an annuity to the taxpayer for his life, and on taxpayer's death to his wife for life. The court there stated:
    \begin{quote}
      But, as a transaction which originally is not entered into for profit may by later change become one for profit . . . and, hence, susceptible of producing gain or loss recognizable as such for income tax purposes, just so may a transaction which is entered into for profit become one not for profit when the owner's ultimate disposition of the property evidences a change in the nature of the transaction's intended purpose. The disposition of property as well as its acquisition is material to the question whether the transaction was entered into for profit within the contemplation of the income tax law. . . . Therefore, unless the [taxpayer] is able to show that the transaction for which a deduction for loss is claimed was throughout a transaction for profit, he is not entitled to claim the benefit of deduction for loss . . . .
    \end{quote}
    \textit{Id.} at 962.
  \item \textsuperscript{65} Estate of Miller, 27 Tax. Ct. Mem. Dec. 1140 (1968), \textit{aff'd}, 421 F.2d 1405 (4th Cir. 1970). In Miller, an estate's interest in a family partnership was sold to one of the children for less than half of its fair market value. The court held that the transaction was merely intended to equalize the family property holdings, and was not a transaction entered into for profit.
  \item \textsuperscript{66} I.R.C. § 101.
\end{itemize}
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exclusion does not exceed the actual value of the consideration plus premiums and other amounts subsequently paid by the transferee. Consequently, if an antenuptial contract provides that a life insurance policy upon the life of one spouse be transferred to the other, it is likely that the transfer will be held to be for valuable consideration, and therefore some of the proceeds will be included in gross income.

Under the reasoning of *Farid-Es-Sultaneh*, a spouse who surrenders his or her marital rights has paid valuable consideration and takes as a purchaser. The rights surrendered are presumed to be equal to the fair market value of the property transferred, which, in the case of a life insurance policy, is its cash surrender value. As a result, when policy proceeds are paid to a transferee spouse, only the value of the policy at the time of the transfer and any premiums and additional sums paid by the transferee are excluded from gross income.

In summary, a transferee's basis of property transferred pursuant to an antenuptial contract is the fair market value of the property; the transferor of appreciated property recognizes any taxable gain on the transfer of appreciated property, but losses are not deductible; and proceeds of a life insurance policy received by a transferee are only partially excluded from gross income.

IV. COMMUNITY PROPERTY JURISDICTIONS

Marital property rights in a community property jurisdiction are quite different from common law property rights, in that each spouse immediately has an equal interest in community property acquired during marriage, rather than the inchoate dower or curtesy rights.

67. Hacker v. Commissioner, 36 B.T.A. 659 (1937) (when taxpayer's father took out a life insurance policy on his life and subsequently assigned all of his right, title, and interest in it in return for payment to him of the cash surrender value of the policy, the excess of the proceeds received over the amount paid for the policy by the assignor constituted taxable income).

68. 160 F.2d 812 (2d Cir. 1947). See notes 46–51 and accompanying text supra.


70. James F. Waters, Inc., v. Commissioner, 160 F.2d 596 (9th Cir. 1947). In Waters, the insured had transferred policies on his life to a corporation of which he was president in return for their cash surrender value. On his death, a successor corporation holding the policies as a result of a merger was held liable for taxes on the proceeds minus the consideration and the premiums paid by the corporations. The case was decided prior to the adoption of § 101(a)(2)(B), which provides that if a transfer for valuable consideration is to a corporation in which the insured is a shareholder or officer, the proceeds are not included in gross income.

71. *In re Jolly's Estate*, 196 Cal. 547, 238 P. 353 (1925); Yesler v. Hochstattler,
which arise in a common law jurisdiction.72 Because each spouse acquires an equal share in the community property,73 transfers of property rarely are included in community property antenuptial contracts. Federal tax consequences ensue, however, as in a common law jurisdiction, if the agreement does include a provision to transfer property.

In most community property jurisdictions, it is permissible to alter community property consequences by agreement between the spouses.74 A common form of antenuptial property agreement is one whereby the spouses agree, without presently transferring any consideration, that all property and income acquired after the marriage will be the separate property of each, rather than community property.75 The IRS has ruled that, for purposes of the income tax, this type of agreement is effective to create separate rather than community income,76 which will be taxed as the separate income of the spouse who earns it.77

4 Wash. 349, 30 P. 398 (1892); deFUNIAK, supra note 10, § 66; Cross, supra note 6, at 734. Property owned before marriage and property acquired after marriage by gift, inheritance, bequest, or devise remain each spouse's separate property. Rico v. Brandenstein, 98 Cal. 463, 33 P. 480 (1893); Kohny v. Dunbar, 21 Idaho 258, 121 P. 544 (1912); In re Witte's Estate, 21 Wn. 2d 112, 150 P.2d 595 (1944); deFUNIAK, supra note 10, §§ 63, 69; Cross, supra note 6, at 746. The general rule is that fruits and profits of separate property are community property. Mire v. Sunray DX Oil Co., 285 F. Supp. 885 (D.C. La. 1968); Kohny v. Dunbar, 21 Idaho 258, 121 P. 544 (1912); Frame v. Frame, 120 Tex. 61, 36 S.W.2d 152 (1931); deFUNIAK, supra, § 71. This rule has been altered in a number of community property states, including Washington, where the rents, issues, and profits of separate property remain separate property. In re Pepper's Estate, 158 Cal. 619, 112 P. 62 (1910); In re Witte's Estate, 21 Wn. 2d 112, 150 P.2d 595 (1944); WASH. REV. CODE §§ 26.16.010 & .020 (1976); deFUNIAK, supra note 10, § 72; Cross, supra note 6, at 768.

72. See T. ATKINSON, LAW OF WILLS §§ 15, 29, 30 (2d ed. 1953).

73. In a community property jurisdiction, neither spouse has inchoate marital or inheritance rights in the property of the other which he or she can release. Poe v. Seaborn, 282 U.S. 101, 111 (1930); Togliatti v. Robertson, 29 Wn. 2d 844, 190 P.2d 575 (1948); Cross, supra note 6, at 734.

74. E.g., In re Marriage of Higgason, 10 Cal. 3d 476, 516 P.2d 289, 110 Cal. Rptr. 897 (1973); Hamlin v. Merlino, 44 Wn. 2d 851, 272 P.2d 125 (1954); WASH. REV. CODE § 26.16.120 (1976); deFUNIAK, supra note 10, § 136 at 337; Cross, supra note 6, at 798–802.

75. E.g., Hamlin v. Merlino, 44 Wn. 2d 851, 272 P.2d 125 (1954). Spouses are also permitted to agree that all separate property, either presently owned or subsequently acquired, will be community property. Rev. Rul. 77–359, 1977–42 I.R.B. 6; Cross, supra note 6, at 809.

76. Rev. Rul. 73–390, 1973–2 C.B. 12. Cf. Rev. Rul. 73–391, 1973–2 C.B. 12, which provides that, absent an agreement between a husband and wife to change characterization of separate and community property invested in a partnership, the partnership income derived from their separate property is treated as their separate income and that derived from their community property and from a partner's salary is community income.

77. An agreement that the property acquired by each spouse after marriage shall remain separate property theoretically involves gift tax consequences, but no case
V. CONCLUSION

Prospective spouses are increasingly resorting to antenuptial contracts, many of which operate to transfer the property of one spouse to another. Practitioners drafting antenuptial contracts should be aware that transfers of property provided for in such contracts can be taxable events under both the gift and income tax provisions of the Code. A transferor of appreciated property must pay an income tax because he or she "realizes" a gain on the transfer of such property in exchange for the release of an independent legal obligation, namely, the prospective spouse's marital property rights. Unfortunately, the IRS and the courts reach a different conclusion in imposing a gift tax on such a transfer. In this context, the surrender of marital property rights does not constitute adequate consideration; therefore, the transferor must pay the tax.

Under the estate tax provisions of the Code, a marital deduction will generally be allowed for property passing from a decedent to a surviving spouse pursuant to an antenuptial agreement, because the transfer is similar to a devise or bequest. However, a deduction will not be allowed as a claim against the estate under section 2053, because the claim must be based on a transfer for adequate consideration; here, as in the gift tax context, the surrender of marital rights does not meet the criterion.

has been found imposing gift tax liability. The gift tax possibilities are illustrated by the following example. Husband earns $30,000 annually and wife earns $10,000. Under the community property system each spouse owns a one-half interest in the total earned—$20,000 each. Husband and wife have agreed that their earnings will remain separate property; as a result, husband has acquired $30,000 rather than $20,000. In effect, wife has made a taxable gift to husband of $10,000. This theory rests on the proposition that the property earned is at the first instance community property, and then is transferred as a gift by force of the agreement. But see Cross, supra note 6, at 809.

Ordinarily, the gift tax would be due the year of the marriage. Rev. Rul. 69–347, 1969–1 C.B. 227. The gift, however, would be impossible to value until the income is actually earned, so the liability would be postponed until the end of each taxable year. Burnet v. Logan, 283 U.S. 404 (1931). If both spouses earned or acquired property of equal value which would have been community property during the course of the year, no gift tax would result. However, as discussed above, if one spouse earned substantially more than the other, the transfer would be subject to the gift tax. Cf. Rev. Rul. 77–359, 1977–42 I.R.B. 6 (dealing with the income and gift tax consequences of either oral or written agreements in Washington which provide that all presently owned and subsequently acquired real and personal property will be community property). The ruling stated that the gift tax is applicable to the conversion of separate property into community property, and that to the extent that the agreement affects income from separate real property and not the property itself, spouses may not split that income when they file separate returns.

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In community property states, prospective spouses may sign an antenuptial community property agreement which alters the normal community property rules. This agreement may provide that all property acquired after marriage by each spouse, including income, will be the separate property of each, or it could provide that all separate property will become community property. There are possible income and gift tax consequences, but beyond this unique type of agreement, the federal tax consequences of transfers by antenuptial agreements are the same in community property states as in common law states.

The antenuptial agreement is a valuable tool, providing flexibility for prospective spouses within the marital property systems. Awareness of the pitfalls and inconsistencies in the tax law governing the transfer of property under such agreements will enable practitioners to use this tool to best serve their clients' needs.

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