University of Cincinnati Law Review

Volume 89 | Issue 4 Article 3

October 2020

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Recommended Citation
Keeva Terry, *Divorce Without Marriage: Taxing Property Transfers Between Cohabiting Adults*, 89 U. Cin. L. Rev. 882 (2020)
Available at: https://scholarship.law.uc.edu/uclr/vol89/iss4/3

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DIVORCE WITHOUT MARRIAGE: TAXING PROPERTY TRANSFERS BETWEEN COHABITING ADULTS

Keeva Terry[1]

INTRODUCTION

Are you or someone you know living with another person in a long-term, committed relationship? The answer is probably yes, since one out of every ten couples in the United States has chosen to live together without marriage.[2] But what happens when a couple's relationship dissolves, and property is divided as part of the break-up? The answer is less than clear. Unlike marriage, there are no federal income tax provisions that deal directly with nonmarriage.[3]

Nonmarriage is undoubtedly on the rise in the United States.[4] Major news outlets continue to report that more and more couples are choosing to live together in exclusive, committed relationships without marriage.[5] Specifically, USA Today reported in a front-page story that the number of couples choosing not to marry increased by twenty-five percent in ten years.[6] Yet, despite this growing group of taxpayers,

1. Associate Professor of Law, Howard University School of Law. A.B., Harvard University; M.B.A., University of Michigan; J.D., Columbia University. I would like to express my profound gratitude and heartfelt appreciation to my student research assistants who have provided invaluable assistance over the years.

2. *See generally Families and Living Arrangements*, U.S. CENSUS BUREAU, https://www.census.gov/topics/families.html (last visited Nov. 25, 2020); s*ee also* Haya El Nasser & Paul Overberg, *Fewer Couples Embrace Marriage*, USA TODAY (McLean, Va.), May 26, 2011, at 1A ("Unmarried couples made up 12% of U.S. couples in 2010, a 25% increase in 10 years, according to Census data out today.").

3. Patricia A. Cain, *Taxing Families Fairly*, 48 SANTA CLARA L. REV. 805, 825 (2008) ("It is unclear, however, how unmarried couples will be treated when they dissolve their relationships and enter into agreements about the division of property...there is no direct authority dealing with unmarried couples, and so the outcome is less than clear.").

4. *See generally* Wendy Wang & Kim Parker, *Record Share of Americans Have Never Married: As Values, Economics and Gender Patterns Change*, PEW RES. CENTER (Sept. 24, 2014), https://www.pewresearch.org/social-trends/2014/09/24/record-share-of-americans-have-never-married/.

5. *See, e.g.*, Veronica Dagher, *How to Buy a Home Together When You're Not Married*, WALL ST. J. (Nov. 3, 2020), https://www.wsj.com/articles/how-to-buy-a-home-together-when-youre-not-married-11604399401 ("The number of unmarried partners living together nearly tripled in the past two decades...according to the U.S. Census Bureau."); Liam Stack, *Unmarried Couples Gain in Numbers, But Survey Finds Married Ones May Be Happier*, N.Y. TIMES (Nov. 7, 2019), https://www.nytimes.com/2019/11/07/us/pew-research-marriage-cohabitation.html ("[T]he share of American adults who live with an unmarried partner has more than doubled since 1993...."); Hannah Reed, *More Unmarried Partners are Living Together. These Couples Explained Why Cohabiting Works for Them*., CHI. TRIB. (Oct. 11, 2019), https://www.chicagotribune.com/suburbs/post-tribune/ct-ptb-couples-living-together-st-1013-20191011-arz7klkiozdgvfujl4j755lhzi-story.html ("[T]he number of unmarried partners living together has increased by more than 13 million since 1996....").

6. El Nasser & Overberg, *supra* note 2 ("Unmarried couples made up 12% of U.S. couples in

Published by University of Cincinnati College of Law Scholarship and Publications, 2020

University of Cincinnati Law Review, Vol. 89, Iss. 4 [2020], Art. 3

there is no direct authority providing federal income tax guidance to cohabiting adults.[7] As a result, scholars and practitioners differ in their analyses regarding the taxation of property transfers between cohabiting adults upon dissolution of their relationship.

Scholars and practitioners agree that a transfer of property between spouses, or a transfer between former spouses incident to divorce, is not a taxable event. There is no consensus, however, regarding the tax consequences of a property transfer between cohabiting adults upon dissolution of their relationship.[8] Currently, there are two contradictory approaches. The first approach treats property transfers between cohabiting adults as taxable events akin to a taxable sale or exchange.[9] This approach essentially disregards the personal relationship between the parties and treats the transfer like a transaction between strangers.[10] The second approach treats property transfers between cohabiting adults as nontaxable events similar to a nontaxable gift.[11] This approach accords great significance to the personal relationship between the parties and treats the transfer in a manner virtually identical to a property transfer between married persons, even though the parties have made the conscious choice *not* to marry. The consequences of this divergence in views impact millions of dollars in federal tax revenue and present a legal quandary for those involved.

Sadly, the Internal Revenue Service ("IRS") continues to remain silent and fails to provide clear guidance to cohabiting adults regarding the federal income tax consequences of property transfers upon dissolution

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2010, a 25% increase in 10 years, according to Census data out today.").

7. *See* Anthony C. Infanti, *Decentralizing Family: An Inclusive Proposal for Individual Tax Filing in the United States*, 2010 UTAH L. REV. 605, 644 ("For the nontraditional family, it is clear that the benefits of §§ 1041, 2056, and 2523 are off limits because, by their terms, these provisions apply only to transfers between husbands and wives.").

8. 26 U.S.C. § 1041. *See* BORIS I. BITTKER, MARTIN J. MCMAHON, JR. & LAWRENCE A. ZELENAK, FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 36.09[2] (3d ed. 2002) ("Section 1041...treats such transfers as nontaxable events."); J. MARTIN BURKE & MICHAEL K. FRIEL, UNDERSTANDING FEDERAL INCOME TAXATION §§ 35.01–35.06 (6th ed. 2019); MERTENS LAW OF FEDERAL INCOME TAXATION § 31A:63–67 (2021); MARVIN A. CHIRELSTEIN, FEDERAL INCOME TAXATION ¶ 5.04 (14th ed. 2018). These same tax treatises are silent with respect to the federal income tax treatment of property transfers between cohabiting adults.

9. *See, e.g.*, Patricia A. Cain, *Taxation of Property Divisions at Dissolution of Nonmarital Relationships*, LGBT BAR (Nov. 2015), http://lgbtbar.org/wp-content/uploads/2015/12/Taxation-of-Property-Divisions-at-Dissolution-of-Nonmarital-Relationships.pdf (stating that family lawyers report that they often treat all payments from one partner to the other as taxable transfers).

10. *See, e.g.*, LEON GABINET, TAX ASPECTS OF MARITAL DISSOLUTION § 15:5 (2d ed. 2020) ("[P]roperty divisions pursuant [to property settlement agreements in long standing cohabitations] should not be treated as gifts.").

11. *See, e.g.*, Cain, *Taxation of Property Divisions at Dissolution of Nonmarital Relationships*, *supra* note 9, *and* Cain, *Taxing Families Fairly*, *supra* note 3, at 805 (stating that similarly situated families and couples, whether they are married or unmarried, should be taxed similarly).

of their relationship.[12] Given the lack of direct authority, uncertainty persists regarding the appropriate tax treatment of property transfers for this growing group of taxpayers. The lack of IRS guidance perpetuates confusion on how these transfers should be treated. Therefore, the time has come for the IRS finally to disclose public guidance to this burgeoning group of taxpayers.

This Article proposes a theory for the taxation of nonmarriage and provides a framework to reconcile these two contradictory approaches. It advocates for the adoption of an interdisciplinary approach that incorporates family law principles which recognize more fully the changing landscape of the American family. This Article also embraces the idea that nonmarriage should be considered a distinct body of law on its own terms.[13] The rules applicable to cohabiting adults should not simply mirror marital provisions. Instead, laws regulating nonmarriage should attempt to respect the myriad of choices that cohabiting adults have made in their relationship and apply the tax consequences that flow naturally from such choices. One size does not fit all. Facts and circumstances do matter.[14] This theory of taxation is also consistent with a larger movement toward a substantive deregulatory model of nonmarriage that differs dramatically from the status-based regulation of marriage.[15]

This Article proceeds in three parts. Part I discusses the legal bases for the two current approaches to the taxation of property transfers between cohabiting adults upon dissolution of their relationship. This Part analyzes the seminal Supreme Court case *United States v. Davis*[16] and the legislative response to *Davis* embodied in Internal Revenue Code Section 1041[17] ("Section 1041"). Ironically, these authorities, which focus on married persons, form the legal bases for the two current approaches to the taxation of *un*married persons. Although the laws involving the

12. Notably, considering the demographics, this lack of guidance further marginalizes certain already marginalized groups. *See* Wang & Parker, *supra* note 4 ("This trend cuts across all major racial and ethnic groups but has been more pronounced among blacks.") *and* ("Today one-in-five never-married adults ages 25 and older are black....").

13. June Carbone and Naomi Cahn, *Nonmarriage*, 76 MD. L. REV. 55, 58 (2016), available at https://scholarship.law.umn.edu/faculty_articles/588 ("[T]he time has come to consider 'nonmarriage' as a distinct body of law on its own terms.").

14. *See id.* at 57 ("Indeed, relatively few states are willing to imply an agreement, impose a duty to share property, or provide continued support from the fact of cohabitation alone. Instead, the courts take their lead from the parties' formal agreements and their actions in commingling their assets. As though they were dealing with business partnerships, the courts unwind the parties' financial entanglements in accordance with express contract terms and the law of unjust enrichment.").

15. *See id.* at 58 ("[T]he laws governing financial obligations [between cohabiting adults] are moving toward a deregulatory model that differs radically from the status-based regulation of marriage....").

16. United States v. Davis, 370 U.S. 65 (1962).

17. 26 U.S.C. § 1041.

distribution of marital property do not apply directly to the division of property following a cohabiting relationship, scholars and practitioners have looked to these laws for guidance in the same way judges have sometimes done.

Part II provides a framework to resolve the conflict based on an interdisciplinary approach to the taxation of nonmarriage. Utilizing principles of family law, this Part encourages consideration of the individual facts and circumstances in a cohabiting relationship to determine the appropriate tax treatment of a property transfer upon dissolution of the relationship.[18] Consistent with a deregulatory model of nonmarriage, this proposed framework recognizes the plethora of possible choices made by cohabiting adults and accepts the reality that such choices may yield varying tax consequences.

Part III describes the benefits of adopting this proposed framework. First, this Part explains why an interdisciplinary approach is beneficial from a legal and a social perspective. Second, this Part discusses how this proposed framework reinforces long established principles in federal tax law which dictate that state law determines ownership and state law creates property rights.[19] Finally, this Part maintains that the economic realities present in a cohabiting relationship should determine the tax treatment of a property transfer upon dissolution of the relationship, and that this approach is consistent with federal income tax jurisprudence which states that the substance of a transaction, not its mere form, will control the tax treatment.

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18. *See* LYNN DENNIS WARDLE & LAURENCE C. NOLAN, FAMILY LAW IN THE USA §§ 700, 706 (2011) (Facts and circumstances to consider may include, inter alia, the length of the relationship; the age and physical and emotional health of the parties; the income or property brought to the relationship by each person; the standard of living established during the relationship; any written agreement made by the parties before or during the relationship concerning property distribution; the economic situation of each person at the time the division of property becomes effective; the income and earning potential of each person; the contribution by each person to the education, training or earning power of the other person; the contribution of each person as to the acquisition of any property as well as the contribution of a person as a homemaker; the tax consequences to each person; the market and emotional value of the assets; the need for the custodial parent to remain in the home and keep possession of household effects; the debts and liabilities of each person and the ability of each person to pay those debts.); *see also* ECONOMIC RIGHTS OF UNMARRIED COHABITANTS ACT, at 3 (Nat'l Conf. of Commissioners on Uniform State L., Discussion Draft 2021), *available at* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=8c8ca36d-9185-a9db-9fb4-5c53428a8e89&forceDialog=0.

19. *See* Keeva Terry, *Separate and Still Unequal? Taxing California Registered Domestic Partners*, 39 U. TOL. L. REV. 633, 641 (2008), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1267328.

I. *DAVIS* AND SECTION 1041: POLAR OPPOSITES SETTING THE STANDARD

Currently, the taxation of nonmarriage incorporates two contradictory approaches. The first approach treats a property transfer between cohabiting adults upon dissolution of their relationship like a taxable sale transaction.[20] Some scholars and practitioners believe such property transfers should be considered taxable events akin to arm's length transactions, and *United States v. Davis* is often cited as support for their position.[21] The *Davis* decision illustrates the well-established rule that, unless both parties have an ownership interest in the property, a transfer of property from one person to another generally constitutes a taxable exchange in which gain or loss must be recognized by the transferor of the property.[22]

Others contend, however, that a property transfer between cohabiting adults upon dissolution of their relationship should be treated as a nontaxable event and viewed as a nontaxable gift under the Internal Revenue Code.[23] Section 1041 is often cited as support for this position; it provides that any transfer between former spouses incident to the divorce shall be treated as a nontaxable gift.[24] The second approach advocates for the same tax treatment of property transfers between cohabiting adults upon dissolution of their relationship as the federal income tax treatment of property transfers between former spouses incident to their divorce. These advocates assert that the emotional and financial connections present in a cohabiting relationship are substantially similar to those present in a marriage. Therefore, the federal income tax treatment of property transfers upon dissolution of a cohabiting relationship should similarly be nontaxable as well.

A. United States v. Davis

Before the Supreme Court decided *United States v. Davis*,[25] the seminal case regarding the federal income taxation of property transfers

20. *See, e.g.*, LEON GABINET, TAX ASPECTS OF MARITAL DISSOLUTION § 15:5 (2d ed. 2020) ("[P]roperty divisions pursuant [to property settlement agreements in long standing cohabitations] should not be treated as gifts.").

21. United States v. Davis, 370 U.S. 65 (1962).

22. 26 U.S.C. § 1001(a); *Davis*, 370 U.S. at 71 (Having determined that the transaction was a taxable event....").

23. *See, e.g.*, Cain, *Taxation of Property Divisions at Dissolution of Nonmarital Relationships*, *supra* note 9, *and* Cain, *Taxing Families Fairly*, *supra* note 3, at 805 (stating that similarly situated families and couples, whether they are married or unmarried, should be taxed similarly).

24. 26 U.S.C. § 1041.

25. *Davis*, 370 U.S. at 65.

made incident to divorce, there was considerable confusion over how and whether such transfers should be taxed.[26] Federal Courts of Appeals disagreed whether such a transfer resulted in a taxable gain.[27] This confusion mirrors the confusion experienced by cohabiting adults today.[28] The Supreme Court ended all debate with *Davis* and clearly stated that a transfer of property between spouses incident to a divorce is a taxable event triggering potential income tax liability for the transferor of the property.[29]

In *Davis*, Mr. Thomas Davis brought suit against the IRS to recover federal income taxes erroneously assessed to him.[30] Mr. Davis and his former wife, Alice M. Davis, had entered into a property settlement agreement in connection with their divorce.[31] Pursuant to this agreement, Mr. Davis transferred to Mrs. Davis 500 shares of DuPont stock, which had been held solely in his name.[32] At the time of the transfer, the DuPont stock had appreciated in value from the time when Mr. Davis acquired it.[33] The IRS argued that the transfer of stock amounted to a taxable exchange because Mr. Davis had transferred the stock to Mrs. Davis in satisfaction of his legal obligations resulting from Mrs. Davis's statutory marital rights.[34]

Mr. Davis contended that the transfer of stock was a nontaxable division of property between co-owners.[35] He further argued that even if the transfer was a taxable event, it was too difficult to calculate the fair

26. *See* Karen B. Brown, *The Story of Davis: Transfers of Property Pursuant to Divorce*, *in* TAX STORIES 171 (Paul L. Caron ed., 2d ed., 2009).

27. *Compare* Comm'r v. Marshman, 279 F.2d 27 (6th Cir. 1960) (holding that the Commissioner's ruling that fair market value of property received during a property settlement due to divorce was an "insurmountable obstacle" to determine whether a realized tax gain occurred), *with* Comm'r v. Mesta, 123 F.2d 986 (3d Cir. 1941) (holding that the property transfer after divorce was a taxable gain because the property's fair market value was readily determinable), *and* Comm'r v. Halliwell, 131 F.2d 642 (2d Cir. 1942) (holding that securities transferred pursuant to a divorce created a gain realized).

28. Ordinary taxpayers have characterized cohabiting relationships as "the wild west where some exceptionally non-intuitive [and] unjust outcomes can happen." *See, e.g.*, *Can My Ex Boyfriend Sue Me for Money He Gave Me?*, AVVO (July 19, 2013), https://www.avvo.com/legal-answers/can-my-ex-boyfriend-sue-me-for-money-he-gave-me--1333371.html.

29. *Davis*, 370 U.S. at 71-73.

30. *Id.* at 66.

31. *Id.*

32. *Id.* at 66-67 ("Pursuant to the above agreement which had been incorporated into the divorce decree, one-half [500 shares] of this [E. I. du Pont de Nemours & Co.] stock was delivered in the tax year involved, 1955, and the balance thereafter.").

33. *Id.* at 67 ("Davis' cost basis for the 1955 transfer was $74,775.37, and the fair market value of the 500 shares there transferred was $82,250.").

34. *Id.* at 66-67 ("The then Mrs. Davis agreed to accept this [property] division 'in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy) ....'").

35. *Id.* at 69.

market value of the marital rights Mrs. Davis had surrendered.[36] As a result, it was impossible to determine the "amount realized" by Mr. Davis and any taxable gain resulting from the transaction.[37] In a taxable exchange, the amount realized by the transferor of the property equals the sum of any money received plus the fair market value of any property the transferor received in the exchange.[38] If Mrs. Davis's marital rights had an indeterminable value, then the amount realized by Mr. Davis was also indeterminable.[39] The Supreme Court rejected both of these arguments.[40]

The first question the Court addressed was whether the transfer of stock constituted a taxable event or a nontaxable division of property between co-owners.[41] The Court stated that the transfer of stock constituted a taxable event because Delaware law did not grant Mrs. Davis any ownership rights in her husband's property.[42] According to the Court, the statutory marital rights granted by Delaware law more closely resembled a personal liability of the husband instead of a property interest of the wife.[43] The Court reasoned that if Mrs. Davis had no ownership rights in the stock that was transferred, then she was not a co-owner of the stock.[44] And if she was not a co-owner of the stock, then the transfer did not constitute a division of property between co-owners.[45]

Once the Court determined that the transfer of stock was indeed a taxable event, it next addressed whether the amount realized by Mr. Davis could be calculated with any accuracy.[46] The Court reasoned that when two parties make an exchange, it is assumed that the properties exchanged are at least approximately equal in value.[47] Therefore, the Court declared that the fair market value of the marital rights surrendered by Mrs. Davis is presumed to equal the fair market value of the stock surrendered by Mr.

36. *Id.* at 67-68.

37. *Id.* ("[A]lthough such a transfer might be a taxable event, the gain realized thereby could not be determined because of the impossibility of evaluating the fair market value of the wife's marital rights.").

38. 26 U.S.C. § 1001(b).

39. *Davis*, 370 U.S. at 67-68.

40. *Id.* at 66.

41. *Id.* at 68 ("We now turn to the threshold question of whether the transfer in issue was an appropriate occasion for taxing the accretion to the stock.").

42. *Id.* at 70 ("[T]he inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership.").

43. *Id.* ("Regardless of the tags, Delaware seems only to place a burden on the husband's property rather than to make the wife a part owner thereof.").

44. *Id.* at 70-71.

45. *Id.* ("The effectuation of these marital rights may ultimately result in the ownership of some of the husband's property as it did here, but certainly this happenstance does not equate the transaction with a division of property by co-owners.").

46. *Id.* at 71 ("Having determined that the transaction was a taxable event, we now turn to…the measurement of the taxable gain realized by the taxpayer.").

47. *Id.* at 72.

Davis.[48]

The DuPont stock had a clearly ascertainable fair market value of $82,250.[49] As a result, the fair market value of the marital rights surrendered by Mrs. Davis was deemed to equal $82,250 and the amount realized by Mr. Davis was similarly $82,250.[50] From a policy perspective, the Court felt it was more consistent with the general purpose and intent of the taxing statutes to approximate the gain realized in a taxable transaction rather than ignore such gain completely.[51] The Court held that Mr. Davis realized a taxable gain on the transfer of stock to his former wife, and such gain could be quantified and must be recognized by Mr. Davis for federal income tax purposes.[52] Mr. Davis was taxed in the same way he would have been had he sold the stock to a stranger for its fair market value. In other words, the Supreme Court held in *Davis* that, unless both parties have an ownership interest in the property, a property transfer made incident to divorce should be treated as a taxable event just like any other arm's length sale transaction.

The holding in *Davis* generated a fair amount of controversy.[53] The tax treatment of property transfers between spouses involving various forms of ownership was frequently unclear, and litigation often resulted from varying state laws.[54] Moreover, many taxpayers felt that it was inappropriate for the government to intrude on intimate relationships, and to tax property transfers between spouses upon divorce was akin to doing just that.[55] *Davis* taxed a property transfer between spouses in the same manner as a property transfer between strangers, ignoring the obvious

48. *Id.* ("It must be assumed, we think, that the parties acted at arm's length and that they judged the marital rights to be equal in value to the property for which they were exchanged.").

49. *Id.* at 67.

50. *See* 26 U.S.C. § 1001(b); *Davis*, 370 U.S. at 72-73.

51. *Davis*, 370 U.S. at 72-73.

52. *Id.* at 71-73.

53. *See* Stephen E. Solomon, *Property Transfer Pursuant to Divorce-Taxable Event?*, 17 STAN. L. REV. 478, 490 (1965) ("[T]he *Davis* case is open to criticism…its result is not compelled."); Edward W. Turley, Jr., *Divorce and Taxes-Texas Style*, 48 TEX. L. REV. 721, 737 (1970) ("The *Davis* decision has not been enthusiastically received by the tax bar."); Note, *Should State Courts Determine Federal Tax Policy?* Imel v. United States, 47 U. COLO. L. REV. 533, 550 (1976) ("The time has come to overrule *Davis. Imel* reached the right result, but by the wrong methods. The transfer of property pursuant to a divorce settlement should not be a taxable event, not because the state court says that it is not, but because it is consistent with federal tax legislation and policy that it not be taxable.").

54. *See, e.g.*, Collins v. Comm'r, 412 F.2d 211 (10th Cir. 1969); Beth W. Corp. v. United States, 350 F. Supp. 1190 (S.D. Fla. 1972), aff'd per curiam, 481 F.2d 1401 (5th Cir. 1973); Imel v. United States, 523 F.2d 853 (10th Cir. 1975); United States v. Bosch, 590 F.2d 165 (5th Cir. 1979); Cook v. Comm'r., 80 T.C. 512 (1983), aff'd per curiam, 742 F.2d 1431 (2d Cir. 1984).

55. *See* Turley, *supra* note 53, at 737 ("The ABA Committee on Domestic Relations Tax Problems has advocated the overruling of *Davis*, stressing the point that a tax burden should not be added 'to the emotional and financial strains implicit in the tragedy of the breakup of a family.'").

emotional history present in the relationship.[56] Equating spouses with strangers also proved troublesome because it did not accurately reflect the economic reality that spouses usually represent a single economic unit, which is certainly not the case with strangers.[57]

Federal tax revenues also suffered as a result of the *Davis* decision.[58] Taxpayer non-compliance with *Davis* adversely impacted the federal budget.[59] The transferor spouse would often not report any gain on the transfer of appreciated property, even though the *Davis* decision mandated such tax treatment.[60] Nevertheless, the recipient spouse was still entitled to a "stepped up basis" in the property equal to its fair market value on the date of the transfer.[61] This unfortunate combination resulted in reduced revenue for the Treasury.[62]

B. Internal Revenue Code Section 1041

In response to the controversy generated by the *Davis* decision, Congress enacted Internal Revenue Code Section 1041 in 1984, which essentially overruled the holding in *Davis*.[63] Section 1041 created uniformity among the several States, notwithstanding the presence of differing state property laws. This code section unequivocally states that, for federal income tax purposes, no gain or loss shall be recognized on a transfer of property to a spouse or a former spouse if such transfer is incident to the divorce.[64] Thus, even when both parties do not have an

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56. Note, *Should State Courts Determine Federal Tax Policy?* Imel v. United States, 47 U. COLO. L. REV. 533, 549-50 (1976) ("The principal argument against recognition of capital gains on divorce settlements, however, concerns the peculiarly noncommercial context in which divorce settlements take place and the consequent problems of measuring 'gain.' Emotional factors often predominate during settlement negotiations; financial concessions serve to assuage guilt feelings and secure cooperation, rather than simply representing economic value received. [T]he words 'fair market value' would seem to indicate that the capital gains tax is to apply to transactions of a more commercial nature than a 'single transaction between a husband and wife made under the emotion, tension and practical necessities involved in a divorce proceeding.'" (citations omitted)).

57. *Id.*

58. *See* Brown, *supra* note 26. ("*Davis* was likely a net money loser for the Treasury, a factor which must have contributed heavily to the Treasury's decision to support a legislative abrogation of *Davis*." (citations omitted)).

59. *See* H.R. REP. NO. 432, pt. 2, at 1491-92 (1984) ("Furthermore, in divorce cases, the government often gets whipsawed.")

60. *Id.*

61. *See* Rev. Rul. 67-221, 1967-2 C.B. 63 (concluding that in a *Davis* situation there is no gain or loss to the recipient spouse and the recipient spouse's basis in the property received is its fair market value on the date of the transfer).

62. *See* Brown, *supra* note 26 ("*Davis* was likely a net money loser for the Treasury, a factor which must have contributed heavily to the Treasury's decision to support a legislative abrogation of *Davis*." (citations omitted)).

63. *See* H.R. REP. NO. 432, pt. 2, at 1491-92 (1984).

64. 26 U.S.C. § 1041.

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ownership interest in the property, property transfers between spouses, or between former spouses if such transfer is incident to the divorce, are now treated as nontaxable events for federal income tax purposes.[65]

Section 1041 only applies to married couples, but many couples who live together in an exclusive, committed relationship without marriage generally function in the same manner as a married couple.[66] They often pool their resources and operate as a single economic unit.[67] These cohabiting relationships are substantially similar to marriage, and when they dissolve, the emotional and financial dissolution process bears a striking resemblance to that which married couples experience upon divorce.[68] As a result, scholars and practitioners sometimes apply the logic and rationale for the enactment of Section 1041 to cohabiting adults, and advocate the extension of nontaxable federal income tax treatment to property transfers between cohabiting adults upon dissolution of their relationship.

II. THE STATE OF STATE LAW REGARDING NONTAXABLE PROPERTY TRANSFERS

In the years following the *Davis* decision,[69] there was extensive litigation questioning the taxability of property transfers made pursuant to divorce.[70] Since the holding in *Davis* was based on the Court's

65. *Id. See* BITTKER ET AL., *supra* note 8, ¶ 36.09[2] ("Section 1041…treats such transfers as nontaxable events."); BURKE & FRIEL, *supra* note 8, §§ 35.01–35.06; MERTENS LAW OF FEDERAL INCOME TAXATION, *supra* note 8, § 31A:63–67; CHIRELSTEIN, *supra* note 8, ¶ 5.04.

66. *See* Steven K. Berenson, *Should Cohabitation Matter in Family Law?*, 13 J. L. & FAM. STUD. 289, 290 (2011) ("[I]n at least some jurisdictions, the law considers the mere fact of cohabitation to be sufficient in and of itself to cause a sometimes significant alteration in the legal relationship between two parties. In some of these situations, the law treats cohabitation between unmarried partners essentially as being equivalent to marriage, thereby extending many of the same legal perquisites that come from marriage to such unmarried couples."); John M. Yarwood, Note, *Breaking Up Is Hard To Do: Mini-DOMA States, Migratory Same-Sex Marriage, Divorce, and a Practical Solution to Property Division*, B.U. L. REV. 1355, 1365 (2009) ("Unmarried cohabitating couples share property, domestic labor, children, and many other things that married and civilly unionized couples share.").

67. *See* Anthony C. Infanti, *Decentralizing Family: An Inclusive Proposal for Individual Tax Filing in the United States*, 2010 UTAH L. REV. 605, 615 ("[T]he class of potential joint return filers is underinclusive because it excludes many nontraditional families who actually do pool financial resources and act as a single economic unit.").

68. *See* 6 FAMILY LAW AND PRACTICE §65.08 (Arnold H. Rutkin ed., 2010) ("Ending a long-term, stable cohabitation relationship forces an individual to go through many of the same psychological traumas that he or she would experience during a divorce."); Yarwood, *supra* note 66, at 1365 ("[Unmarried cohabitating couples] also end their relationships, as many couples in legally recognized relationships do. This type of dissolution presents many of the same problems as marriage dissolution, especially if the couple has cohabitated for a long time.").

69. United States v. Davis, 370 U.S. 65 (1962).

70. *See, e.g.*, Collins v. Comm'r, 412 F.2d 211 (10th Cir. 1969); Beth W. Corp. v. United States, 350 F. Supp. 1190 (S.D. Fla. 1972), aff'd per curiam, 481 F.2d 1401 (5th Cir. 1973); Imel v. United States, 523 F.2d 853 (10th Cir. 1975); United States v. Bosch, 590 F.2d 165 (5th Cir. 1979); Cook v. Comm'r,

https://scholarship.law.uc.edu/uclr/vol89/iss4/3

examination of Delaware law, and Mrs. Davis's ownership interest under Delaware law, much of the litigation focused on the state law that controlled the property transfer at issue.[71] The critical question debated was whether the controlling state law deemed the property transfer a division of property between co-owners. If so, then for federal income tax purposes, the property transfer constituted a nontaxable event. As such, state law determinations of ownership rights and property interests greatly influenced the federal income tax treatment of property transfers.[72] Federal tax law has a long tradition of looking to state law to determine family relationships and ownership of property rights and has traditionally relied on state law to define property rights, while federal tax law has determined how those property rights should be taxed.[73] Therefore, the IRS should adopt this same approach to determine the taxability of property transfers between cohabiting adults upon dissolution of their relationship.

Property ownership rights are often granted to cohabiting adults upon dissolution of their relationship in the same way the court would grant property ownership rights under similar circumstances to a married couple upon divorce.[74] As a result, *Davis* and its progeny provide a model to develop a framework to analyze the federal income tax treatment of property transfers between cohabiting adults upon dissolution of their relationship. The individual facts and circumstances in a cohabiting relationship should be examined and considered to determine the appropriate federal income tax treatment of a property transfer upon

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80 T.C. 512 (1983), aff'd per curiam, 742 F.2d 1431 (2d Cir. 1984).

71. *See, e.g.*, *Collins*, 412 F.2d 211 (discussing Oklahoma law); *Beth W. Corp.*, 350 F.Supp. 1190 (discussing Florida law); *Imel*, 523 F.2d 853 (discussing Colorado law); *Bosch*, 590 F.2d 165 (discussing Florida law); *Cook*, 80 T.C. 512 (discussing Connecticut law).

72. *Davis*, 370 U.S. at 71 ("Although admittedly such a view may permit different tax treatment among the several States, this Court in the past has not ignored the differing effects on the federal taxing scheme of substantive differences [in state law] ….").

73. Cain, *Taxing Families Fairly*, *supra* note 3, at 838.

74. *See, e.g.*, Becker v. Ashworth, 252 P.3d 647 (Kan. Ct. App. 2011) (per curiam) ("Even if the parties were not married and merely cohabitated, the court may, in its discretion, make an equitable division of property either jointly accumulated by the parties or acquired with intent that both parties have an interest in the property."); Connell v. Francisco, 898 P.2d 831, 836 (Wash. 1995) (Income and property acquired during a meretricious relationship is characterized as community property in the same manner as if the couple had been married, and therefore, is subject to equitable division upon the dissolution of the relationship); Goode v. Goode, 396 S.E.2d 430, 438-39 (W.Va. 1990) (While indicating a preference for property division between unmarried cohabitating couples by contract principles, the court does allow for equitable division of property in the absence of a contract provided a "party claiming relief must demonstrate that equitable principles would provide the relief being sought."); Wilbur v. DeLapp, 850 P.2d 1151, 1153 (Or. Ct. App. 1993) (In making a property distribution upon the termination of the relationship of a non-marital cohabiting couple, "[t]he primary consideration . . . is the intent of the parties. However…in distributing the property of a domestic relationship, [the Court is] not precluded from exercising [its] equitable powers to reach a fair result based on the circumstances of each case.").

dissolution of the relationship.[75] Laws regulating nonmarriage should attempt to respect the myriad of choices that cohabiting adults have made in their relationship and apply the tax consequences that flow naturally from such choices, with a clear understanding that such choices may yield varying tax consequences.[76] If a transfer is deemed a division of property interests between the parties under state law, then for federal income tax purposes, the transfer should similarly be deemed a nontaxable division of property between co-owners. Based on the foregoing, the following property transfers between cohabiting adults are likely to be treated as nontaxable events.

A. Partition of Joint Property

If property is equally owned and titled in both names, the mere partition of such property is generally not a taxable event. Instead, it is a nontaxable division of property between co-owners. For example, if Party A and Party B jointly own 100 acres of land worth $100,000, 1,000 shares of stock in X corporation worth $100,000, and a bank account of $50,000, and each took half of each item, then no taxable transaction results. Alternatively, if Party A takes all the land and half of the bank account (a total of $125,000) and Party B takes all the stock and the other half of the bank account (a total of $125,000), then no taxable transaction results.[77]

75. A facts and circumstances inquiry to determine the appropriate federal income tax treatment is not new to the IRS. For example, whether an individual qualifies as an independent contractor or an employee for federal income tax purposes depends on the facts and circumstances of each case, *Independent Contractor (Self-Employed) or Employee?*, IRS (Apr. 13, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee. Likewise, whether an activity constitutes a trade or business for federal income tax purposes depends on the facts and circumstances of each case, *Business Activities*, IRS (May 26, 2020), https://www.irs.gov/businesses/small-businesses-self-employed/business-activities. With respect to property interests, however, well-established and longstanding federal income tax jurisprudence dictates that state law determines ownership and creates property rights.

76. *See* WARDLE & NOLAN, *supra* note 18, §§ 700, 706 (Facts and circumstances to consider may include, inter alia, the length of the relationship; the age and physical and emotional health of the parties; the income or property brought to the relationship by each person; the standard of living established during the relationship; any written agreement made by the parties before or during the relationship concerning property distribution; the economic situation of each person at the time the division of property becomes effective; the income and earning potential of each person; the contribution by each person to the education, training or earning power of the other person; the contribution of each person as to the acquisition of any property as well as the contribution of a person as a homemaker; the tax consequences to each person; the market and emotional value of the assets; the need for the custodial parent to remain in the home and keep possession of household effects; the debts and liabilities of each person and the ability of each person to pay those debts.); s*ee also* ECONOMIC RIGHTS OF UNMARRIED COHABITANTS ACT, at 3 (Nat'l Conf. of Commissioners on Uniform State L., Discussion Draft 2021), *available at* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=8c8ca36d-9185-a9db-9fb4-5c53428a8e89&forceDialog=0.

77. Hornback v. United States, 298 F. Supp. 977, 981 (W.D.Mo. 1969), cited with approval in

In *Beth W. Corporation v. United States*,[78] a Florida federal district court held that the distribution of property, held as tenants by the entirety, between husband and wife pursuant to a divorce property settlement agreement was a nontaxable division of property between co-owners.[79] This decision was affirmed by the Fifth Circuit Court of Appeals without opinion.[80] Jewell and Wiley Waldrep jointly held various parcels of real property as tenants by the entirety.[81] Pursuant to a property settlement agreement entered into during their divorce proceedings, each of the Waldreps conveyed to the other certain real properties they owned.[82] The property settlement agreement was structured to arrive at an equal division of the total value of jointly owned property.[83] The court examined the state law of Florida and determined that a wife holding such an interest is, in actuality as well as in theory, a co-owner of the subject property.[84] Thus, the conveyance to Jewell Waldrep of land jointly owned by her and husband constituted a nontaxable division of property between co-owners.[85]

Similarly, in *Cofield v. Koehler*,[86] a Kansas federal district court held that the equal division of the total value of property jointly owned by husband and wife in the divorce decree was not a taxable event.[87] Lester and Marguerite Cofield were issued, in their joint names, a substantial amount of United States Series E Savings Bonds.[88] They also accumulated other joint assets during their marriage, including a large amount of real estate and considerable personal property.[89] All property was held in both names.[90]

At the time of their divorce, the couple did not simply divide each of

Beth W. Corp. v. United States, 350 F. Supp. 1190, 1192 (S.D. Fla. 1972), aff'd per curiam, 481 F.2d 1401 (5th Cir. 1973).

78. *Beth W. Corp.*, 350 F. Supp. at 1190.

79. *Id.* at 1192 ("Thus the Waldrep transaction resembles a non-taxable division of property between co-owners." "Accordingly, it is the opinion of the Court that no taxable transaction took place….").

80. Beth W. Corp. v. United States, 481 F.2d 1401 (5th Cir. 1973).

81. *Beth W. Corp.*, 350 F. Supp at 1191.

82. *Id.*at 1190.

83. *Id.* at 1192.

84. *Id.* at 1191 ("The essence of the entireties concept is that each spouse is seised of the whole and not of a share, moiety, or divisible part.").

85. *Id.* at 1192 ("If husband and wife literally divide or partition the property…so that each just gets his own proper part, there is no taxable transaction involved." (citations omitted)).

86. Cofield v. Koehler, 207 F.Supp. 73 (D. Kan 1962).

87. *Id.* at 74.

88. *Id.* ("The court specifically found that these bonds were the joint accumulations of the husband and wife and were not purchased from separate funds of the wife.").

89. *Id.* at 73.

90. *Id.*

their joint assets in half.[91] Instead, they divided their entire marital estate in half.[92] Certain jointly owned assets were transferred in full to the husband in exchange for certain other jointly owned assets that were transferred in full to the wife.[93] The property transfers were equal in value.[94] The court ruled that the husband's transfer of savings bonds to his wife pursuant to their divorce decree did not result in the realization of income to him because the property transfers had been equal in value.[95] The equal division of the total value of property jointly owned by husband and wife in the divorce decree was held to be a nontaxable division of property between co-owners.[96]

The IRS adopted this position in Revenue Ruling 81-292.[97] This revenue ruling plainly stated that an approximately equal division of the total value of jointly owned property, under a divorce settlement agreement that provides for transferring some assets in their entirety to one spouse or the other, in a state that is not a community property state is a nontaxable division and does not result in the realization of gain or loss.[98] "The dignity of co-ownership," as the Court used the phrase in *Davis*, is present when property is jointly owned and titled in both names.[99] Cohabiting adults who choose to hold property as joint tenants should also be able to enjoy all the rights and privileges associated with ownership, since substantive property rights accompany joint tenancy under state law.[100] Thus, the equal division of the total value of property jointly owned and titled in both names of the cohabiting adults should similarly be a nontaxable division of property between co-owners and not a taxable event.[101]

91. *Id.* at 74.

92. *Id.*

93. *Id.* ("He exchanged these bonds…for other property of equal value, also jointly owned by them.").

94. *Id.*

95. *Id.* ("The effect of the divorce decree did no more than set apart to each in severalty the interest they owned in their [joint] property.").

96. *Id.* ("From the beginning the revenue laws have been interpreted as defining 'realization' of income as the taxable event….").

97. Rev. Rul. 81-292, 1981-2 C.B. 158.

98. *cf.* Rev. Rul. 73-476, 1973 -2 C.B. 300 (holding that IRC § 1031(a) precludes the recognition of any gain or loss realized on an equal division of the total value of property held by three individuals as tenants in common, thereby leaving open the possibility that gain or loss was realized, even if not recognized, on the transfer of property held as tenants in common).

99. *See* United States v. Davis, 370 U.S. 65, 70 (1962).

100. *See* Morgan v. Comm'r, 309 U.S. 78, 80 (1940) (State law creates legal interests and rights in property); *see also, e.g.*, Libby v. Lorrain, 430 A.2d 37 (Me. 1981) (partition action disentangling the property involvements of an unmarried couple who bought a house as joint tenants).

101. *See also* Rev. Rul. 74-347, 1974-2 C.B. 26 (describing an unequal division of jointly owned property, pursuant to a divorce decree, and holding that realization occurs only with respect to the amount in excess of an equal division of the jointly owned property).

B. *Division of Community Property*

For federal income tax purposes, there are nine community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.[102] The community property system is based on an equal economic partnership model in which the contributions, financial or otherwise, made by each member of the community are fully appreciated and equally valued.[103] Three community property states–California, Nevada, and Washington– make no distinction between the community property laws affecting married persons and the community property laws affecting domestic partners.[104]

Each member of the community equally contributes his or her industry to its prosperity and possesses an equal right to succeed to its property.[105] Therefore, each spouse or domestic partner is vested with an equal fifty percent ownership interest in all community property. Community property generally includes property acquired by a spouse or domestic partner while domiciled in the state during the course of the marriage or domestic partnership.[106] For many of the same reasons that the partition of joint property is a nontaxable event, it is well-established that no gain or loss will be recognized from the approximately equal division of the fair market value of community property in a community property state under a divorce settlement agreement that provides for the transfer of some assets in their entirety to one spouse or the other.[107]

Domestic partners are clearly unmarried couples[108] who have full community property rights under the laws of these three states.[109] Certainly, the division of entity rationale which applies to the approximately equal division of community property under a divorce

102. *See* DEP'T OF THE TREASURY, INTERNAL REVENUE SERVICE, PUB. 555, CAT. NO. 15103C, COMMUNITY PROPERTY (Mar. 2020). This Article does not address the federal tax treatment of income or property subject to the "community property" election under Alaska, Tennessee, and South Dakota state laws.

103. *See* Terry, *Separate and Still Unequal?*, *supra* note 19, at 646 (citations omitted).

104. All domestic partner references are to those domestic partners registered with the State of California in accordance with CAL FAM. CODE §§ 297–299.6 (West 2021), and those domestic partners registered with the State of Nevada in accordance with NEV. REV. STAT. ANN. §122A.100 (West 2020), and those domestic partners registered with the State of Washington in accordance with WASH. REV. CODE. ANN. §§ 26.60.030–040 (West 2021).

105. *See* Susan Kalinka, *Federal Taxation of Community Income: A Simpler and More Equitable Approach*, 1990 WIS. L. REV. 633, 637 (1990).

106. *See* CAL. FAM. CODE § 760 (West 2021); *see also* CAL. FAM. CODE § 297.5 (West 2021).

107. Rev. Rul. 76-83, 1976-1 C.B. 213; *see* Wren v. Comm'r, 24 T.C.M. (CCH) 290 (1965).

108. *See* Rev. Rul. 2013-17, 2013-38 I.R.B. 201; *see also* Smelt v. Cnty. of Orange, 447 F.3d 673 (9th Cir. 2006) (a domestic partner does not constitute a married individual); *In re* Rabin v. Schoenmann, 359 B.R. 242 (B.A.P. 9th Cir. 2007) (domestic partners are not identical to spouses).

109. *See* CAL. FAM. CODE § 297.5 (West 2021); NEV. REV. STAT. ANN. § 122A.200 (West 2020); WASH. REV. CODE ANN. § 26.60.080 (West 2021).

settlement agreement should similarly apply to the approximately equal division of community property upon dissolution of a domestic partnership.[110] Thus, the approximately equal division between domestic partners of the fair market value of community property upon dissolution of a domestic partnership should likewise be a nontaxable transaction with no gain or loss recognized to either domestic partner.

C. Transfer of Property to Satisfy an Equitable Interest in Property

Equitable distribution principles have been utilized to resolve property disputes between cohabiting adults arising from the dissolution of their relationship.[111] Equitable distribution, which is not the same as *equal* distribution, is generally defined as a fair and just meting out of property between interested parties.[112] It is a judicial division of property rights and obligations between individuals. The court does not necessarily divide the property equally, but attempts to make a fair and just allocation after considering all relevant factors.[113]

110. *See* Rev. Rul. 76-83, 1976-1 C.B. 213 for explanation of the "division of entity rationale" (When the aggregate fair market value of the community property received by or on behalf of each spouse is approximately equal, such division is not a taxable event.).

111. *See, e.g.,* Connell v. Francisco, 898 P.2d 831, 836 (Wash. 1995) (Income and property acquired during a meretricious relationship is characterized as community property in the same manner as if the couple had been married, and therefore, is subject to equitable division upon the dissolution of the relationship); Goode v. Goode, 396 S.E.2d 430, 438-39 (W.Va. 1990) (While indicating a preference for property division between unmarried cohabitating couples by contract principles, the court does allow for equitable division of property in the absence of a contract provided a "party claiming relief must demonstrate that equitable principles would provide the relief being sought."); Wilbur v. DeLapp, 850 P.2d 1151, 1153 (Ore. Ct. App. 1993) (In making a property distribution upon the termination of the relationship of a non-marital cohabiting couple, "[t]he primary consideration . . . is the intent of the parties. However…in distributing the property of a domestic relationship, [the Court is] not precluded from exercising [its] equitable powers to reach a fair result based on the circumstances of each case."); Becker v. Ashworth, No. 104,417, 252 P.3d 647, 2011 WL 2206635 (Kan. Ct. App. June 3, 2011) (per curiam) (unpublished) ("Even if the parties were not married and merely cohabitated, the court may, in its discretion, make an equitable division of property either jointly accumulated by the parties or acquired with intent that both parties have an interest in the property.").

112. AMERICAN LAW INSTITUTE, PRINCIPLES OF THE LAW OF FAMILY DISSOLUTION: ANALYSIS AND RECOMMENDATIONS, § 4.09, cmt. a (2002) ("The dominant model is 'equitable distribution,' in which the governing statute provides a list of 'factors' that the trial judge is authorized or directed to consider in deciding the fairest allocation of the property.").

113. *See* WARDLE & NOLAN, *supra* note 18, §§ 700, 706 (factors considered in equitable distribution include the length of the relationship; the age and physical and emotional health of the parties; the income or property brought to the relationship by each person; the standard of living established during the relationship; any written agreement made by the parties before or during the relationship concerning property distribution; the economic situation of each person at the time the division of property becomes effective; the income and earning potential of each person; the contribution by each person to the education, training or earning power of the other person; the contribution of each person as to the acquisition of any property as well as the contribution of a person as a homemaker; the tax consequences to each person; the market and emotional value of the assets; the need for the custodial parent to remain in the home and keep possession of household effects; the debts and liabilities and the ability of each

Regardless of who holds title to the property, a person who has made non-tangible contributions, such as domestic contributions to the household, may claim an equitable interest in the property upon dissolution of the relationship.[114] These equitable rights only come into identifiable form upon dissolution of the relationship; and when granted by the court, they translate into ownership rights in the property.[115] As a result, under state law, the property is determined to be co-owned by both parties. Accordingly, for federal income tax purposes, the transfer of property to satisfy an equitable ownership interest is likely to be treated as a nontaxable division of property between co-owners, even when only one person held title to the property.

In *Bosch v. United States*,[116] the Fifth Circuit held that the transfer of real estate, which was titled solely in the husband's name, constituted a nontaxable division of property between co-owners because such real estate was transferred to the wife to satisfy a special equity interest awarded to her pursuant to her divorce decree.[117] During her marriage, Lillian Bosch advanced more than $115,000 of her own funds to her husband to improve certain acres of land that were titled solely in his name.[118] On the basis of this financial contribution, a Florida divorce court recognized a special equity interest that Lillian Bosch held in the improved land.[119] Florida has long recognized the vested ownership right of a wife who contributed substantially to the growth and development of her husband's property.[120] To satisfy this special equity interest, Mr.

person to pay those debts; any other factors the court deems appropriate); *see also* ECONOMIC RIGHTS OF UNMARRIED COHABITANTS ACT, at 3 (Nat'l Conf. of Commissioners on Uniform State L., Discussion Draft 2021), *available at* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=8c8ca36d-9185-a9db-9fb4-5c53428a8e89&forceDialog=0.

114. *See* WARDLE & NOLAN, *supra* note 18, § 683 ("In response to the substantial disparity in economic consequences of divorce for men and women in common-law states, legislation authorizing judicial discretion to distribute some part of the property according to principles other than title began to be passed in the twentieth century."); *see also* AMERICAN LAW INSTITUTE, *supra* note 112, § 4.02 Reporter Notes cmt. a ("By the mid-1980s, however, all common-law states had moved to some form of 'equitable distribution,' under which the divorce court could allocate property on a basis other than title or the source of earnings used to acquire it….").

115. *See* WARDLE & NOLAN, *supra* note 18, § 684 ([an inchoate interest in the property acquired by the other] "ripens into an [ownership] interest of variable scope and duration, depending on how the judge sees the equities of the case.").

116. Bosch v. United States, 590 F.2d 165 (5th Cir. 1979).

117. *Id.* at 168.

118. *Id.* at 166.

119. *Id.* at 166 ("The [divorce] court's decree included the following finding: 'That the defendant (husband) is the owner of approximately 3500 acres of land, which is in the name of the defendant solely, but which have been managed and improved by the use of plaintiff's money, and in which the plaintiff has a special equity.'").

120. *Id.* at 167 ("Florida has long recognized a 'special equity' in a wife where she has made identifiable contributions to her husband's property during marriage even though the special equity only

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Bosch transferred one-third of the land to Mrs. Bosch.[121] On the basis of Florida law, the Fifth Circuit concluded that the divorce decree awarded Lillian Bosch a vested property interest in the improved land.[122] As a result, the transfer of one-third of the land to Mrs. Bosch to satisfy her special equity interest constituted a nontaxable division of property between co-owners and did not constitute a taxable event.[123]

A related group of cases, including *Imel v. United States*[124] (discussing Colorado law), *Collins v. Commissioner*[125] (discussing Oklahoma law), and *McIntosh v. Commissioner*[126] (discussing Montana law), determined that, upon dissolution of the marriage, both spouses automatically possess a vested interest in property held under a species of common ownership jointly acquired during the marriage. Essentially, these cases held that in *every* marriage the law of each respective state automatically grants ownership rights in all marital assets to both spouses, regardless of who actually holds title to the property, and such ownership rights vest upon dissolution of the marriage.[127] In each of these cases, the transfer to the wife, pursuant to the divorce decree, of property titled solely in the husband's name was deemed a nontaxable division of property between co-owners.[128]

In contrast, certain states reject the notion that both spouses in *every* marriage possess an automatic vested interest in all marital property upon divorce.[129] Even in those jurisdictions, however, state law does recognize that vested ownership rights might exist in property not titled in a person's name depending on the specific circumstances present in an individual marriage.[130] For example, in *Cook v. Commissioner*,[131] the Tax Court held, pursuant to a divorce decree, the transfer by a husband to his former

comes into actual identifiable form upon the termination of the marriage status.").

121. *Id.* at 166.

122. *Id.* at 167 ("The parties agree that the question whether this decree was a division of property interests between the parties or was an award in lieu of alimony is to be resolved by reference to state law.").

123. *Id.* at 168 ("We conclude that the Florida divorce court decree awarding the special equity to the wife in this case constituted a division of existing property interests, and it did not constitute a taxable event to the husband.").

124. Imel v. United States, 523 F.2d 853 (10th Cir. 1975).

125. Collins v. Comm'r., 412 F.2d 211 (10th Cir. 1969).

126. McIntosh v. Comm'r, 85 T.C. 31 (1985).

127. *Imel*, 523 F.2d at 855; *Collins*, 412 F.2d at 212; *McIntosh*, 85 T.C. at 43.

128. *Imel*, 523 F.2d at 857; *Collins*, 412 F.2d at 212; *McIntosh*, 85 T.C. at 44-45.

129. *See, e.g.*, Cook v. Comm'r, 80 T.C. 512, 522 (1983), aff'd per curiam, 742 F.2d 1431 (2d Cir. 1984) ("[T]he Supreme Court of Connecticut found that neither husband nor wife acquires by statute any right in the property of the other…[that] amount to co-ownership.").

130. *See, e.g.*, *id.* at 528 ("Judge Dube believed that Sheila had some sort of interest in these properties, tangible or intangible, legal or equitable, which became vested in her when the marriage contract was dissolved.").

131. *Id.* at 512.

wife of stock and certain real property, which was titled solely in the husband's name, was a nontaxable division of property between co-owners since the wife had an equitable interest in such property because she and her family had given or sold the property to her husband.

Sheila and Charles Cook divorced in 1976.[132] Sheila Cook was the daughter of John Gamble, one of the founders and principal stockholders of Proctor & Gamble ("P&G").[133] During the course of their marriage, Charles Cook received shares of P&G stock as gifts from Sheila Cook and her parents, and her parents also sold Mr. Cook certain real property from the Gamble family estate.[134] Under the circumstances, the divorce court judge believed that Sheila Cook possessed some interest in these properties, which became vested in her upon dissolution of their marriage, even though legal title to the properties was undoubtedly exclusively in Mr. Cook.[135] Pursuant to the Connecticut equitable distribution statute, the court ordered the transfer of P&G stock and certain real property to Sheila Cook in the divorce decree.[136] Given that the transfer of property was made to satisfy Mrs. Cook's vested interest in such property, the Tax Court held that the transaction was not taxable to Mr. Cook and was a nontaxable division of property between co-owners.[137]

Similarly, in *Beard v. Commissioner*,[138] the Tax Court held that cash payments from a husband to his former wife were not taxable and did not constitute alimony because the cash payments were made to satisfy her equitable interest in property that had been titled solely in his name. Shirley Beard and Richard Patterson had been married 28 years when they divorced in Michigan in 1975.[139] Neither Ms. Beard nor Mr. Patterson owned any property when they entered the marriage, so all marital property had been jointly acquired during their marriage.[140] Their largest marital assets were shares of common stock in the family business–almost

132. *Id.* at 513.

133. *Id.*

134. *Id.* at 514-16.

135. *Id.* at 528 ("Judge Dube believed that Sheila had some sort of interest in these properties, tangible or intangible, legal or equitable, which became vested in her when the marriage contract was dissolved.").

136. *Id.* at 527-28 ("[Judge Dube] apparently gave considerable weight to the last factor mentioned in Conn. Gen. Stat. Ann. sec. 46-51 which requires the divorce court to give consideration to the contribution of each party in the acquisition of the assets in making a division of property." (citations omitted)).

137. *Id.* at 528 ("We conclude that under these particular circumstances, the transfer of the properties was more in the nature of a division of property rather than a satisfaction of any marital obligations of petitioner to Sheila."); *cf.* Cook v. United States, 904 F.2d 107 (1st Cir. 1990).

138. Beard v. Comm'r, 77 T.C. 1275 (1981).

139. *Id.* at 1277.

140. *Id.*

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100% of which were held solely in Mr. Patterson's name.[141]

Michigan law provides for equitable distribution of property upon divorce.[142] As such, the divorce court determined that Ms. Beard was entitled to an equitable share of the marital property, regardless of who actually held title to the property, because she had properly raised a family and equally contributed to the family and business affairs.[143] Since Mr. Patterson would continue to operate the family business after the divorce, it was agreed that Mr. Patterson would compensate Ms. Beard in cash for the value of the shares of common stock that had been equitably apportioned to her, with such cash payments to be paid in equal installments over a certain period of time.[144] The Tax Court concluded that these cash payments were not taxable and did not constitute alimony because the cash payments were not a support allowance, but instead were made to satisfy Ms. Beard's vested property interest in the shares of common stock.[145]

Since equitable distribution principles have been extended to cohabiting adults when considering the division of property upon dissolution of their relationship, it certainly seems likely that a nontaxable division of property will result, no matter whose name is on the title, when property is transferred in satisfaction of an equitable property right.[146]

D. Cash Property Settlements

There are virtually no federal income tax cases that have been litigated questioning the taxability of property transfers between cohabiting adults upon dissolution of their relationship. There is, however, one case that discusses the taxability of cash proceeds received from the settlement of a lawsuit arising in connection with the dissolution of a cohabiting relationship: *Violet A. Reynolds v. Commissioner of Internal Revenue*.[147]

In *Reynolds*, Ms. Violet A. Reynolds petitioned the United States Tax Court to redetermine her federal income tax liability.[148] Ms. Reynolds and Mr. Gregg P. Kent cohabited as an unmarried couple for twenty-four

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141. *Id.* at 1278 ("In addition, the outstanding common stock of Shults Equipment was owned as follows: Richard, 1965 shares; Richard and Shirley (jointly with rights of survivorship), 35 shares; and an unrelated third party, 20 shares.").

142. *See* MICH. COMP. LAWS ANN. § 552.19 (West 2020).

143. *Beard*, 77 T.C. at 1279.

144. *Id.* at 1279-80 ("[Richard] shall pay the balance of $310,000.00 in monthly installments over a 121 month period commencing November 1, 1975.").

145. *Id.* at 1288-89 ("[W]e think that these payments more closely resemble a property settlement than a support allowance.").

146. *See* Cain, *Taxing Families Fairly*, *supra* note 3, at 825.

147. *See* Reynolds v. Comm'r, 77 T.C.M. 1479 (1999).

148. *Id.* at 1480.

years before their relationship dissolved.[149] In connection with the dissolution of their relationship, Ms. Reynolds entered into a settlement agreement with Mr. Kent.[150] Pursuant to that settlement agreement, Mr. Kent agreed to transfer certain property and cash to Ms. Reynolds in exchange for her full and complete release of any claims to any real or personal property acquired during their relationship that was titled in Mr. Kent's name or in the name of the company in which Mr. Kent was the majority shareholder.[151] The IRS argued that the transfer should be included in the gross income of Ms. Reynolds as compensation for homemaking services.[152] Ms. Reynolds challenged the IRS and instead asserted that the property and cash were excludable from her gross income as gifts from Mr. Kent.[153]

The taxability of proceeds recovered in settlement of a lawsuit rests upon the nature of the claim for which the proceeds were received and the actual basis of recovery.[154] Ascertaining the nature of the claim is a factual determination that is generally made by reference to the settlement agreement in light of the facts and circumstances surrounding it.[155] The Tax Court declared that the court must ask itself "in lieu of what was the payment received?"[156] The payment's ultimate character depends on the payor's dominant reason for making the payment.[157] The settlement agreement indicated that Mr. Kent paid the disputed amount to Ms. Reynolds in exchange for the surrender of her rights in most of the property purchased during their relationship.[158] Since the payor's intent controls the characterization of settlement proceeds, the Tax Court found

149. *Id.*

150. *Id.* at 1481.

151. *Id.* at 1482.

152. *Id.*

153. *Id.*

154. *Id.*(citations omitted).

155. *Id.*(citations omitted).

156. *Id.*(citations omitted).

157. *Id.*(citations omitted).

158. *Id.* ("The settlement agreement provided in pertinent part: WHEREAS, KENT in said case contends that REYNOLDS has no right, title, or interest, or legitimate claim in and to the real and personal property referred to therein, and further, KENT contends REYNOLDS has no right, title, or legitimate claim to any real and/or personal property of KENT, whether alleged in the case or not, and further, that Kent is not liable or responsible for any sums whatsoever; and WHEREAS, REYNOLDS contends that she has a claim to said real and personal property and to other property, both real and personal, which may belong to or stand in the name of KENT; and WHEREAS, each of the parties hereto disputes the other's contentions: and WHEREAS, the parties, KENT and REYNOLDS desire to resolve their respective differences concerning their respective claims and to memorialize their agreement resolving those differences, and further, forever place the dispute behind them * * * * * * *

1. In consideration for the full and complete release by REYNOLDS of any claims of any nature, including but not limited to, any sums of money, and/or claims to any real and/or personal property of KENT, KENT agrees to pay REYNOLDS the following sums, on the following terms….").

that Mr. Kent intended to perfect his sole possession of most of their joint property when he paid Ms. Reynolds the disputed amount.[159]

Interestingly, the Tax Court did not treat this transaction as a nontaxable division of property between co-owners.[160] Instead, the Tax Court stated that the sale of her property interest to Mr. Kent was a taxable event for which Ms. Reynolds must recognize gain to the extent the selling price exceeded her basis in the property.[161] The Tax Court, however, determined that her basis in the property equaled or exceeded the selling price, so there was no gain to be recognized, much in the same way a nontaxable division of property between co-owners does not yield any taxable gain.[162] Therefore, it appears that even when an equitable interest in property is exchanged for cash upon dissolution of a cohabiting relationship, there is generally no taxable income to be recognized based heavily on the facts and circumstances present.

III. THE TAXATION OF NONMARRIAGE

A. Family Law as a Guide

The number of adults choosing to live together in exclusive, committed relationships without marriage has steadily increased over the past few decades.[163] The rise in cohabitation has understandably led to questions regarding property divisions between cohabiting adults upon dissolution of their relationship. Many domestic relations courts and state legislatures have been willing to address these questions as family law jurisprudence more fully recognizes the changing landscape of the American family.[164]

159. *Id.* at 1483.

160. *cf.* Beard v. Comm'r., 77 T.C. 1275 (1981) (cash payment in settlement of property interest deemed not alimony and not includible in income of recipient because "payments more closely resemble a property settlement than a support allowance.").

161. *Reynolds*, 77 T.C.M. at 1483; *see* 26 U.S.C. § 1001(a).

162. *Reynolds*, 77 T.C.M. at 1484; *see* 26 U.S.C. § 1015(a).

163. *See* Wang & Parker, *supra* note 4 ("After decades of declining marriage rates and changes in family structure…the shares of adults cohabiting and raising children outside of marriage have increased significantly.").

164. *See, e.g.*, Libby v. Lorrain, 430 A.2d 37 (Me. 1981) (partition action disentangling the property involvements of an unmarried man and woman who bought a house as joint tenants); Connell v. Francisco, 898 P.2d 831, 836 (Wash. 1995) (Income and property acquired during a meretricious relationship is characterized as community property in the same manner as if the couple had been married, and therefore, is subject to equitable division upon the dissolution of the relationship); Goode v. Goode, 396 S.E.2d 430, 438-39 (W.Va. 1990) (While indicating a preference for property division between unmarried cohabitating couples by contract principles, the court does allow for equitable division of property in the absence of a contract provided a "party claiming relief must demonstrate that equitable principles would provide the relief being sought."); Wilbur v. DeLapp, 850 P.2d 1151, 1153 (Ore. Ct. App. 1993) (In making a property distribution upon the termination of the relationship of a non-marital cohabiting couple, "[t]he primary consideration…is the intent of the parties. However…in distributing the property of a

As the IRS considers the federal income tax consequences of property transfers between cohabiting adults upon dissolution of their relationship, an interdisciplinary approach that incorporates principles of family law is advisable.

Interdisciplinary work has been heralded as the path to creative problem solving because it draws insight from other fields, involves thinking across boundaries, and encourages the synthesis and integration of knowledge across disciplines.[165] When researchers from two or more areas of study pool their approaches and modify them so that they are better suited to the problem at hand, this amalgamation can truly benefit society.[166] Notably, some tax scholars have long advocated for an interdisciplinary approach to solve tax problems.[167]

Regrettably, the myth that the law of taxation is fundamentally different from other areas of the law persists.[168] Tax myopia, a concept discussed extensively by Paul Caron, is the tendency of the tax law to view itself as an isolated body of law separate from other areas of law; this misperception has impaired the development of tax law by ignoring

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domestic relationship, [the Court is] not precluded from exercising [its] equitable powers to reach a fair result based on the circumstances of each case."); Becker v. Ashworth, No. 104,417, 252 P.3d 647, 2011 WL 2206635 (Kan. Ct. App. June 3, 2011) (per curiam) (unpublished) ("Even if the parties were not married and merely cohabitated, the court may, in its discretion, make an equitable division of property either jointly accumulated by the parties or acquired with intent that both parties have an interest in the property."); *see also, e.g.*, ECONOMIC RIGHTS OF UNMARRIED COHABITANTS ACT, at 3 (Nat'l Conf. of Commissioners on Uniform State L., Discussion Draft 2021), *available at* https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=8c8ca36d-9185-a9db-9fb4-5c53428a8e89&forceDialog=0; CAL. FAM. CODE§ 297.5 (West 2021); NEV. REV. STAT. ANN. § 122A.200 (West 2020); WASH. REV. CODE ANN. § 26.60.080 (West 2021).

165. Janet Weinstein, *Coming of Age: Recognizing the Importance of Interdisciplinary Education in Law Practice*, 74 WASH. L. REV. 319, 322 (1999), *available at* https://digitalcommons.law.uw.edu/wlr/vol74/iss2/4 ("One aspect of creative problem solving that almost all approaches have in common is its interdisciplinary nature.").

166. Dave Owen & Caroline Noblet, *Interdisciplinary Research and Environmental Law*, 41 ECOLOGY L.Q. 887 (2015), *available at* https://repository.uchastings.edu/faculty_scholarship/1231 ("Interdisciplinary research…can be one of the most productive and inspiring of human pursuits—one that provides a format for conversations and directions that lead to new knowledge." (citations omitted)).

167. *See, e.g.*, Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up to be Tax Lawyers*, 13 VA TAX REV. 517, 531-54 (1994) (criticizing courts and commentators for ignoring nontax developments in statutory construction and legislative process theory in advocating unique role for legislative history in construing the Internal Revenue Code); Paul L. Caron, *Estate Planning Implications of the Right of Publicity*, 68 TAX NOTES 95, 95-96 (1995) (criticizing courts for subjecting right of publicity embodied in famous decedent's name to federal estate tax without consideration of how such interests are treated under state property law); Paul L. Caron, *The Role of State Court Decisions in Federal Tax Litigation:* Bosch, Erie, *and Beyond,* 71 OR. L. REV. 781 (1992) (criticizing courts and commentators for inadequate attention to principles of Erie R.R. v. Tompkins, 304 U.S. 64 (1938), in debate over appropriate mechanism to determine the meaning of state law in federal tax litigation); Paul L. Caron, *When Does Life Begin for Tax Purposes?*, 68 TAX NOTES 320, 324 (1995) (criticizing courts and Internal Revenue Service for grappling over definition of "person" for tax purposes without consideration of how the issue has been addressed in other areas of law).

168. Caron, *Tax Myopia,* supra note 167, at 531.

insights from other areas of law that should inform the tax debate.[169] The taxation of property transfers between cohabiting adults presents an opportunity to change or correct this myth and to engage in interdisciplinary work in contravention of this myth. A crucial part of the legal analysis will be missed if the taxability of property transfers between cohabiting adults upon dissolution of their relationship is determined in isolation of the principles of family law that are so fundamental to it.

B. The Primacy of State Law when Determining Property Ownership

In previous articles, this Author has discussed longstanding principles in federal tax law which dictate that state law determines ownership and creates property rights.[170] This proposed framework reinforces those principles. For more than a century, Congress has respected a state's determination of the property rights granted to its citizens for federal income tax purposes. Unless Congress decides to remove that right from the states, the IRS should respect a state's determination of property rights in accordance with principles of federalism. Several Supreme Court decisions provide that state law controls in determining the nature of the legal interest which the taxpayer has in property sought to be reached by the federal income tax statute.[171]

Utilizing principles of family law to address critical tax questions is not new. Federal tax law has a long tradition of looking to state law to determine family relationships and ownership of property rights, while federal tax law has determined how those property rights should be taxed.[172] An interdisciplinary approach that incorporates principles of family law would enhance the taxpayer experience and improve the administration of Congressional tax policies by eliminating uncertainty and providing consistency in the law. Taxpayers would also be able to engage in appropriate tax planning.

C. Substance over Form Prevails

Substance over form is a fundamental tax principle, which "provides that the tax consequences of a transaction are determined based on the underlying substance of the transaction rather than its legal form."[173] The

169. *Id.* at 518.

170. *See* Terry, *Separate and Still Unequal?*, *supra* note 19, at 641; Keeva Terry, *Same-Sex Relationships, DOMA, and the Tax Code: Rethinking the Relevance of DOMA to Straight Couples*, 20.1 COLUM. J. GENDER & L. 383 (2011), *available at* http://ssrn.com/abstract=1920852.

171. Terry, *Same-Sex Relationships, DOMA, and the Tax Code*, supra note 170, at 408.

172. Cain, *Taxing Families Fairly*, *supra* note 3, at 838.

173. Southgate Master Fund, L.L.C. v. United States, 659 F.3d 466, 479 (5th Cir. 2011) (citations omitted).

substance over form doctrine allows courts to recharacterize a transaction so that its taxable form corresponds to its economic substance.[174] The Supreme Court has endorsed this doctrine.[175] In applying the doctrine of substance over form, the Supreme Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed.[176]

The reality is that many couples choose to live together and pool their resources as one economic household. Substantively, cohabiting adults face many of the same economic challenges as a married couple. Therefore, when it comes to the dissolution of these relationships, the IRS should consider the substance of the relationship to determine the appropriate tax treatment. This approach comports with well-established Supreme Court precedent.

In *Commissioner of Internal Revenue v. Court Holding Co.*, the respondent corporation's sole asset was an apartment building.[177] The corporation was owned by two individual shareholders.[178] While the corporation still had legal title to the apartment building, it negotiated the sale of the property.[179] An oral agreement was reached as to the terms and conditions of sale, but soon after, the purchaser was advised by the corporation's attorney that the sale could not take place because it would result in a large income tax to the corporation.[180]

The next day, the corporation liquidated its assets, which made the two shareholders the new owners of the property in their individual capacities.[181] A sale contract was then executed between the new property owners and the same purchaser with substantially the same terms and conditions as previously negotiated by the corporation.[182] The Commissioner argued that, despite the liquidation of assets followed by the transfers of legal title, the corporation had not abandoned the sales negotiations and instead used mere formalities designed to make the transaction appear to be something other than what it was in order to avoid tax liability.[183] The Supreme Court agreed and stated that the incidence

174. *Southgate Master Fund*, 659 F.3d at 479.

175. *See* Frank Lyon Co. v. United States, 98 S. Ct. 1291 (1978).

176. Frank Lyon Co. v. United States, 98 S. Ct. 1291, 1298 (1978); *see* Blueberry Land Co. v. Comm'r, 361 F.2d 93, 101 (5th Cir. 1966) ("[C]ourts will, and do, look beyond the superficial formalities of a transaction to determine the proper tax treatment.").

177. 324 U.S. 331, 332 (1945).

178. *Id.* at 332–33.

179. *Id.* at 333.

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

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of taxation depends upon the substance of a transaction.[184] Therefore, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. The Court held that it was evident that the substance of the transaction was a sale by the corporation rather than a sale by the shareholders.[185]

The *Court Holding Co.* case illustrates how courts will take a holistic view of the circumstances when determining the substance of a transaction. One of the main considerations when determining the substance of a transaction is the party's motivation in conducting the transaction. In other words, a party's sole purpose for a transaction cannot be for a tax benefit. Instead, a taxpayer must be able to demonstrate that there was some non-tax motivation. Certainly, the motivation for cohabiting adults is rarely to secure a tax benefit, so there is little risk of subverting the legislative purpose of the Tax Code by taxing property transfers between cohabiting adults using the interdisciplinary approach of this proposed framework.

In *PPL Corp. v. Commissioner of Internal Revenue*, the United Kingdom privatized a number of government-owned companies, which became significantly profitable.[186] The U.K. subsequently imposed a windfall tax to account for the excess profits earned by the companies during the first four years of privatization.[187] A U.S. taxpayer, who was part owner of one of the affected companies, tried to take a foreign tax credit for the windfall tax, but the Commissioner contended that the windfall tax was not creditable for U.S. tax purposes.[188] In its analysis, the Supreme Court took a "commonsense approach."[189] The Court considered the predominant character of the tax and followed the substance over form doctrine to recognize that the U.K.'s windfall tax was nothing more than an income tax (in the U.S. sense) on actual profits above a certain threshold.[190] The Court stated that the Commissioner's approach in reading the Tax Code was too rigid as "tax law deals in economic realities, not legal abstractions."[191]

The Court's reasoning in rejecting the Commissioner's restrictive reading of the Tax Code is important, and it shows that the Tax Code should be read and viewed adaptively so that it can encompass new

184. *Id.* at 334.

185. *Id*.

186. 569 U.S. 329, 331–32 (2013).

187. *Id.* at 332.

188. *Id.* at 334.

189. *Id.* at 331.

190. *Id.* at 338.

191. *Id.* at 340 (citations omitted).

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economic realities. This is important when considering cohabiting adults, because the reality is that the number of people choosing to live together without marriage is substantially increasing. Therefore, the need for the IRS to provide guidance to cohabiting adults regarding the federal income tax consequences of the dissolution of their relationship, and property transfers resulting from such dissolution, has become more than an economic reality – it has become an economic necessity.

In *Frank Lyon Co. v. United States*, Frank Lyon was Frank Lyon Co.'s majority shareholder and board chairman. He also served on the board of Worthen Bank.[192] Worthen was planning the construction of a multistory bank and office building.[193] The bank, however, could not secure approval of its initial plan because of certain rules under Arkansas law and the regulations of the Federal Reserve System.[194] Nevertheless, the bank found a solution, which was to enter into a sale and leaseback arrangement with Lyon Co. as the borrower and New York Life Insurance Company as the lender.[195] As a result of this new plan, Lyon Co. claimed depreciation deductions on its federal income tax returns, which the Commissioner challenged.[196] The Supreme Court used the substance over form doctrine to analyze the "objective economic realities" and determine whether Lyon Co. was entitled to the deductions.[197] The Court concluded that this was not a sham business transaction and that it was Lyon Co.'s capital that was invested (and consequently risked) in the building according to the agreement.[198] Therefore, Lyon Co. was entitled to the depreciation deductions.[199]

Lyon is an important case because it highlights another factor courts are encouraged to consider under the substance over form doctrine –the actual investment and liabilities associated with the transaction.[200] This analysis goes beyond just merely looking at motives or facts that may have been incorporated in the decision-making process, but specifically examines the investment made and the liabilities incurred by the taxpayer. Considering the economic realities associated with cohabitating adults, there is little doubt that these relationships often require significant financial investment. When they dissolve, the emotional and financial dissolution process bears a striking resemblance to that which married

192. 98 S. Ct. 1291, 1293 (1978).
193. *Id.*
194. *Id.* at 1293–94.
195. *Id.* at 1294.
196. *Id.* at 1296.
197. *Id.* at 1298.
198. *Id.* at 1300, 1302.
199. *Id.* at 1302.
200. *Id.* at 1303.

Published by University of Cincinnati College of Law Scholarship and Publications, 2020

couples experience upon divorce. As a result, the substance of these relationships, not their form, should control and determine the tax consequences of property transfers between cohabiting adults.

CONCLUSION

As our society evolves, so do our relationship structures, and so must our Tax Code. In the twenty-first century, more and more couples who choose to maintain exclusive, committed relationships have opted not to marry. Many domestic relations courts and state legislatures have been willing to address questions regarding property divisions between cohabiting adults as family law jurisprudence more fully recognizes the changing landscape of the American family.[201] There is no need for federal tax law to recreate the wheel. If a transfer is deemed a division of property interests between the parties under state law, then for federal income tax purposes, the transfer should similarly be deemed a nontaxable division of property between co-owners. To ensure consistency and uniformity, as the IRS prepares to strengthen its ability to collect tax revenues, it is essential for the IRS to provide clear and specific guidance to this growing group of taxpayers, thereby ensuring they receive fair and equitable treatment.[202]

201. *supra* note 164.

202. *See* The American Families Plan Tax Compliance Agenda, U.S. Department of the Treasury (May 2021), *available at* https://home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf.