28 T.C. 682 (1957)

When property is held by tenants by the entirety, the surviving tenant's basis for depreciation purposes is the original cost, not the fair market value at the time of the other tenant's death, because the survivor's interest vests under the original conveyance, not by inheritance or devise.

Summary

In Arnold v. Commissioner, the Tax Court addressed the proper basis for calculating depreciation of real estate held by a husband and wife as tenants by the entirety. The court held that the surviving spouse could not use the stepped-up basis (fair market value at the time of death) because the property was not acquired by inheritance or devise, but rather, the survivor continued to hold the property under the original conveyance. This decision underscores the legal concept that with a tenancy by the entirety, the survivor's rights derive from the original grant of the property, not a new acquisition.

Facts

Antoinette and Joseph Arnold, husband and wife, acquired real estate as tenants by the entirety. The original cost of the property was $159,029.33, with $109,029.33 allocated to depreciable improvements. Joseph Arnold died, leaving his entire estate to Antoinette. The fair market value of the property at the time of Joseph's death was $650,000. Antoinette claimed depreciation on her 1954 income tax return based on the original cost of the property, but later filed a claim for a refund, arguing she was entitled to use the stepped-up basis based on the fair market value at the time of her husband's death.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Antoinette's 1954 income tax, disallowing the use of the stepped-up basis. Antoinette filed a petition with the Tax Court to contest this determination. The case was presented to the Tax Court on stipulated facts.

Issue(s)

1. Whether the basis for depreciation of the bus terminal property should be the original cost or the fair market value at the time of Joseph Arnold's death.

Holding

1. No, because the surviving spouse's interest in the property did not vest by inheritance or devise, but rather was continued under the original conveyance, and therefore the original cost basis should be used.

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Court’s Reasoning

The Tax Court relied heavily on the Supreme Court’s decision in *Lang v. Commissioner*, 289 U.S. 109 (1933). The court reiterated the established principle that a tenancy by the entirety creates a single ownership, with each spouse owning the entire estate. “The tenancy results from the common law principle of marital unity; and is said to be *sui generis*. Upon the death of one of the tenants ‘the survivor does not take as a new acquisition, but under the original limitation, his estate being simply freed from participation by the other;…’” The court rejected the taxpayer’s argument that the *Lang* case was wrongly decided and considered itself bound by the Supreme Court precedent. Because the property was not acquired by inheritance or devise, the stepped-up basis was not permitted under the applicable provisions of the Internal Revenue Code. The court acknowledged the potential hardship but noted that any remedy lay with Congress, not with the courts.

Practical Implications

This case is essential for understanding the implications of property ownership by tenants by the entirety for tax purposes. The ruling reinforces that a surviving spouse’s basis in property held as tenants by the entirety is determined from the original purchase price, not the fair market value at the time of the other spouse’s death, for depreciation purposes. This can lead to significantly lower depreciation deductions. Therefore, it highlights the importance of considering how property is titled and the potential tax consequences. The court’s reliance on a Supreme Court precedent demonstrates the importance of understanding existing case law. Attorneys advising clients should carefully explain the tax implications of holding property in this manner. Subsequent taxpayers in similar circumstances will need to consider this ruling.

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