



1961

Recent Case Notes

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Recommended Citation

James C. Slaughter, *Recent Case Notes*, 15 Sw L.J. 628 (1961)
<https://scholar.smu.edu/smulr/vol15/iss4/9>

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RECENT CASE NOTES

Estate Taxation — Net Estate — Time of Valuation of Claims Against Estate

Estate at the time of decedent's death had a claim against it by virtue of a divorce decree between the decedent and his wife. The decree required decedent to pay his wife forty dollars per week until her death or remarriage and provided that these payments would be a charge against decedent's estate if he should predecease his wife. After decedent's death on July 8, 1952, his administrator continued to make weekly payments until June 1953, when the wife remarried. In the estate tax return, filed on July 28, 1953, decedent's administrator sought a deduction under section 812(b)(3)¹ of \$27,058.30, the actuarial present value of his wife's right to future payments computed as of the time of decedent's death, which the Tax Court held was correct. *Held, reversed*: Where, prior to the date on which the estate tax return is filed, the total amount of a claim against the estate is clearly established under state law, the estate may obtain no greater deduction than the established sum even though the amount is ascertained through events occurring after decedent's death. *Commissioner v. Estate of Shively*, 276 F.2d 372 (2d Cir. 1960).

The federal estate tax is a tax imposed upon the transfer of the entire "net estate" and not upon any particular legacy, devise, or distributive share.² Under the Internal Revenue Code of 1939 the basis for the estate tax was the "net estate," *i.e.*, the "gross estate" less allowable exemptions and deductions.³ Among the deductions are claims against the estate allowable by the laws of the jurisdiction under which the estate is being administered.⁴ The amounts that may be deducted as claims against a decedent's estate are only those that

¹ Int. Rev. Code of 1939, § 812, in pertinent parts, reads as follows:

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate -

. . . .
(b) Expenses, losses, indebtedness and taxes. Such amounts -
. . . .
(3) for claims against the estate,
. . . .

as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered

² *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921); *Treas. Reg. § 20.0-2(a)* (1958).

³ Int. Rev. Code of 1939, §§ 810, 860, 935. Under the 1954 Code the basis is the "taxable estate" which is computed in substantially the same manner. Int. Rev. Code of 1954, § 2053(a).

⁴ Int. Rev. Code of 1939, § 812(b); Int. Rev. Code of 1954, § 2053(a).

represent personal obligations of the decedent existing at the time of his death, whether or not then matured.⁵ Thus, a claim based upon an agreement by which a wife relinquishes her right to support during her husband's life in consideration of sums payable in whole or in part at or after his death is not deductible from the husband's gross estate.⁶ However, if a separation agreement is incorporated in a divorce decree, the claim given by the divorce court is not founded upon a promise or agreement, but upon the command of the court, and thus the claim is allowable as a deduction.⁷ A claim may even be deductible though it is contingent at the time of death.⁸ Since it has long been the custom in federal courts to use actuarial tables in order to appraise the value of future interests,⁹ they are often used in computing the amount deductible from the value of the gross estate for estate tax purposes where the claim against the estate is for future payments due a decedent's divorced wife under a divorce decree.¹⁰

The time at which the net estate is to be valued for federal estate tax purposes has varied in the past. One theory establishing death as the time at which the estate is to be valued was based on the principle that the tax is on the act of the testator passing the property and not on the receipt of the property by the heirs, legatees or devisees;¹¹ therefore, since the property passes at the time of the death of the decedent, subsequent events should not affect the value of the estate for the purposes of taxation.¹² However, a series of cases beginning with *Herold v. Kahn*¹³ enunciat-

⁵ Treas. Reg. § 20.2053-4 (1958).

⁶ *Adriance v. Higgins*, 113 F.2d 1013 (2d Cir. 1940); *Helvering v. United States Trust Co.*, 111 F.2d 576 (2d Cir. 1940); *Meyer's Estate v. Commissioner*, 110 F.2d 367 (2d Cir. 1940).

⁷ Since a divorce court is free to disregard all allowances made in a separation agreement, the allowances are the court's own, even in cases where it expressly accepted as proper the allowances actually agreed upon in the separation agreement. *Commissioner v. Maresi*, 156 F.2d 929 (2d Cir. 1946); *Commissioner v. Swink*, 155 F.2d 723 (4th Cir. 1946); *Yoke v. Fleming*, 145 F.2d 472 (4th Cir. 1944); *Commissioner v. State St. Trust Co.*, 128 F.2d 618 (1st Cir. 1942); *Mason's Estate*, 43 B.T.A. 813 (1941); *Edythe C. Young*, 39 B.T.A. 230 (1939).

⁸ *Guggenheim v. Helvering*, 117 F.2d 469 (2d Cir.), cert. denied, 314 U.S. 621 (1941); *Commissioner v. Kelley*, 84 F.2d 958 (7th Cir.), cert. denied, 299 U.S. 603 (1936); *Stewart v. Commissioner*, 49 F.2d 987 (10th Cir. 1931); *Percy B. Eckhart*, 33 B.T.A. 426 (1935).

⁹ *Simpson v. United States*, 252 U.S. 547 (1920).

¹⁰ *Commissioner v. Maresi*, 156 F.2d 929 (2d Cir. 1946).

¹¹ *Knowlton v. Moore*, 178 U.S. 41 (1899).

¹² *Hooper v. Bradford*, 178 Mass. 95, 59 N.E. 678 (1901) (Holmes, C.J.), construed Mass. Pub. Stat. 1891, ch. 425, which fixed no time at which value was to be taken for inheritance tax purposes. The case has been widely followed by the federal courts. E.g., *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929) (Holmes, J.); *Robbins v. Commissioner*, 111 F.2d 828 (1st Cir. 1940); *Myers v. United States*, 51 F.2d 145 (Ct. Cl. 1931).

¹³ 159 Fed. 608 (3d Cir. 1908).

ed the view that although liability for the tax is fixed at the time of the decedent's death, often the amount of the net estate can be determined only by facts occurring subsequent to death; the use of mortality tables to ascertain a life expectancy which affects the value of the net estate is only justified when no better evidence is available. Thus, if the value of a life interest is known before payment of taxes, that value should be used.¹⁴ More recent cases, however, have repudiated this theory in certain situations. With respect to the time of valuing decedent's net estate when the remainder of the estate will go to charity after termination of a life estate, *Ithaca Trust Co. v. United States*¹⁵ returned to the earlier doctrine, holding that the estate transferred is to be valued as of the time of the testator's death, *i.e.*, the time when the testator transfers the property. This doctrine has been applied: where a remainder was willed to a charitable organization;¹⁶ where part of the estate involved bonds and the decedent died between the bonds' interest payment dates;¹⁷ where between the time of death of the decedent and the date when the tax was to be paid, the estate, consisting largely of stocks, rose in value;¹⁸ where a contingent claim against the estate was present at the time of the death of the decedent but was void at the time of the payment of the tax, the claim differing from that in the principal case only in that it was for a definite, known amount rather than for an amount to be determined by mortality tables.¹⁹

The decision in the principal case indicates a return to the *Herold v. Kahn* doctrine,²⁰ for the first basis for the court's decision was that the net estate is not to be determined as of the time of death if

¹⁴ *Union Trust v. Heiner*, 19 F.2d 362 (W.D. Pa. 1927); *Boston Safe Deposit & Trust Co. v. Nichols*, 18 F.2d 660 (D. Mass. 1927).

¹⁵ 279 U.S. 151 (1929). Testator devised a life estate with a remainder to a charity. At the time of his death, the life tenant was still alive, but died before expiration of the time for filing the tax return. Hence, the facts are similar to those in the principal case.

¹⁶ *Delbridge v. United States*, 89 F. Supp. 845 (E.D. Mich. 1950); *Estate of Kirkwood*, 23 B.T.A. 955 (1931).

¹⁷ *Estate of King*, 18 T.C. 414 (1952). The court held that the net estate was to be valued without including the amount of interest later received.

¹⁸ *Hooper v. Bradford*, 178 Mass. 95, 59 N.E. 678 (1901). See note 12 *supra*.

¹⁹ *Winer v. United States*, 153 F. Supp. 941 (S.D.N.Y. 1957).

²⁰ 276 F.2d at 375. The court states that the purpose of § 812(b) is:

[T]o define that portion of the property of a decedent that is subject to an estate tax and in so doing it eliminates from estate taxation those portions of decedent's gross estate that do not pass by way of a gift taking effect at death and those portions that although they do pass, pass by way of tax-exempt gift . . . Obviously this purpose would not be served if a deduction were permitted for claims against an estate which though having vitality as of date of death, could never be enforced as of the day the estate tax return is filed. The property which might have been subject to such a claim were it enforceable is now certain to pass by way of a gift taking effect at death. To permit an estate such a deduction would be to prefer fiction to reality and defeat the clear purpose of Section 812.

subsequent events provide certainty as to its value. However, even cases supporting this doctrine admit that if by the time of payment of the tax the subsequent events have not occurred, the estate is to be determined by claims present at the time of death on the basis of computations through mortality tables regardless of when thereafter the contingency occurs.²¹ These cases point out that the purpose of section 812(b) is to determine that portion of the property of the decedent subject to an estate tax and to eliminate those portions of decedent's gross estate that do not pass by devise or descent.²² Thus, although at death it may appear that because of a claim against the estate a portion of the estate will not pass by devise or descent, if before the filing of an estate tax return the claim is no longer present, then this property becomes certain to pass by devise or descent. Therefore, it is absurd to resort to statistical probabilities when facts are known, and since mortality tables are not required to be used, the actual fact rather than a mere convenient fiction should determine the estate.²³ The court, however, overlooked the fact that, since many claims at the time of the death of the decedent may well be contingent, subsequent events may cause the contingency to occur and defeat the claim, thus causing the heirs, legatees and devisees to receive a different amount of property from that which was passed at the time of death. If subsequent events are determinative, the tax is essentially upon receipt of the property, which is contrary to the weight of authority that the tax is on the act of the testator and not on the receipt of the property,²⁴ *i.e.*, the value of the estate should be determined as of the time when the act is done, the decedent's death. The second basis for the decision in the principal case was that section 812(b) permits deduction only of those claims against the estate which are allowed by the laws of the jurisdiction under which the estate is being administered,²⁵ and, since the claim in question was never allowed by a state court, it is unenforceable. The court, however, ignored authority that the term "allowed" is not to be construed to mean that, unless a claim has been allowed by the state, no deduction will be permitted. Deductibility is not conditioned on

²¹ *Herold v. Kahn*, 159 Fed. 608 (3d Cir. 1908).

²² *Kahn v. United States*, 20 F. Supp. 312 (S.D.N.Y. 1937).

²³ See case cited note 21 *supra*.

²⁴ *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929); *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921); *Knowlton v. Moore*, 178 U.S. 41 (1899); *Winer v. United States*, 153 F. Supp. 941 (S.D.N.Y. 1957); *Delbridge v. United States*, 89 F. Supp. 845 (E.D. Mich. 1950); *Estate of King*, 18 T.C. 414 (1952); *Estate of Kirkwood*, 23 B.T.A. 955 (1931); *Hooper v. Bradford*, 178 Mass. 95, 59 N.E. 678 (1901).

²⁵ See statute cited note 1 *supra*.

the claim's allowance by a local court, but rather upon its enforceability under local law.²⁶

In certain situations, *e.g.*, the passing of a remainder of the estate as a tax-exempt gift to charity, the law is definitely established that mortality tables at the time of death should be used in determining the life interest rather than events subsequent to death.²⁷ An analogy to the charity cases should be valid in deciding the claims cases. Moreover, the policy for the determination of the gross estate (from which the claims are deducted to determine the net estate) is that death is the time at which it should be valued.²⁸ However, the value of the gross estate may be determined, if the executor so elects, by valuing the property at a date one year after the death of the decedent.²⁹ Unless the optional valuation date is selected, the value to be employed is the fair market value on the date of death; events occurring subsequent to that time do not influence the valuation.³⁰ It seems totally inconsistent that, in reference to the gross estate, which very often may be influenced by subsequent events, one theory would be followed, while, in reference to the net estate, a completely different theory would be followed. It would certainly be more logical if the reasoning of the established law for determination of gross estates and of net estates with remainders to tax-exempt charities were also the reasoning in cases involving the determination of net estates where contingent claims are present.

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²⁶ *Smyth v. Erickson*, 221 F.2d 1 (9th Cir. 1955); *Winer v. United States*, 153 F. Supp. 941 (S.D.N.Y. 1957); *Treas. Reg. § 20.2053-1(b)(2)* (1958).

²⁷ *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929).

²⁸ *Int. Rev. Code of 1954, § 2031.*

²⁹ *Int. Rev. Code of 1954, § 2032(a).*

³⁰ *Rabkin & Johnson, Federal Income, Gift & Estate Taxation § 52.10* (1958).