Denver Law Review

Volume 37 | Issue 5 Article 5

January 1960

Estate and Ineritance Tax Problems Arising under Federal and Colorado Alternate Valuation Statutes

Thomas P. Sweeney

Estate and Ineritance Tax Problems Arising under Federal and Colorado Alternate Valuation Statutes

ESTATE AND INHERITANCE TAX PROBLEMS ARISING UNDER FEDERAL AND COLORADO ALTERNATE VALUATION STATUTES

BY THOMAS P. SWEENEY‡

This note was awarded the third prize of $50 in the 1960 writing competition sponsored by the Denver Clearing House Association Trust Officers.

INTRODUCTION

The economic circumstances which caused the passage of Alternate Valuation Date statutes were well stated in *Clark v. United States:*[1]

> The evident purpose was to give some partial relief from the burden of taxation of estate taxes in the case of sharply falling market prices between the date of death and a year thereafter. It was common knowledge that many large estates had been seriously embarrassed by the coincidence of heavy estate taxes and falling markets for securities during the period between the date of the decedent's death and the time when in ordinary course of administration, the executor could reasonably realize upon the securities for the payment of taxes and other costs of administration. The period of a year was doubtless selected because that is a customary period allowed for administration and distribution by an executor.[2]

When it is pointed out that the first Alternate Valuation Date Statute was passed in 1935,[3] it becomes apparent that such statutes were enacted to alleviate estate tax problems which were caused by the depression. In the early 1930's, the value of real and personal property held in an estate frequently would decline to such an extent that the value of the gross estate at the time of distribution was less than the amount of the estate and inheritance taxes payable out of the corpus of the estate. To overcome this hardship, statutes were passed which allowed the administrator or executor of an estate to value the estate as of the date of death or as of one year after death. However, property distributed during the one year period was still required to be evaluated as of the date of distributions.

At the outset it must be stated that there has been no Colorado Supreme Court decision involving the Colorado "Optional Valuation Date" statute. However, since the only substantial difference between the Colorado[4] and federal[5] statutes is the method of exercising the election under the statutes, Colorado might follow the federal court decisions.

---

‡ Mr. Sweeney is a senior student at the University of Denver College of Law.
1 33 F. Supp. 216 (1940).
2 *Id.* at 218.
3 Rev. Act of 1935, ch. 829, § 202, 49 Stat. 1022.
4 Colo. Rev. Stat. § 138-4-67 (Proposed Supp. 1959).
5 Int. Rev. Code of 1954, § 2032.

PROPERTY INCLUDED IN THE ESTATE

The federal statute provides, "the value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death."[6]

In applying section 2033 when the executor elects, under section 2032 (a)[7] to value the estate as of one year after date of death problems have arisen in determining the extent of the decedent's interest in property at the date of his death.

The problem of whether the decedent had a property interest in rents, dividends, and interest earned by the estate within one year after decedent's death was settled in *Maas v. Higgins.*[8] The decedent died on August 30, 1936. In the estate tax return the executor elected to have the value of the gross estate determined by valuing it as of one year after decedent's death. The commissioner of internal revenue included in the value of the estate rents, dividends and interest earned by the estate subsequent to the decedent's death. The Supreme Court, in holding that the commissioner of internal revenue had erroneously included in the value of estate the income earned after decednt's death, stated:

> In the appraisal of a decedent's estate, rent or interest accrued to the date of death is properly treated as a capital asset. So also, on the sale of an interest bearing security, it is the uniform practice to add to the value of the value of the obligation, as such, accrued interest to the date of sale. Since the statute says that, at the option of the executor, a bond may be valued as of one year subsequent to the decedent's death, the natural conclusion is that the usual method of valuation shall be pursued whichever date is selected. The method always adopted for valuation at death is the same used in fixing a sale price; that is, to take the market value of the bond and add accrued interest to the date of transfer, at the rate stipulated in the instrument. It is not believed that Congress, in providing for two dates of valuation, intended that a different method should be followed if one date were chosen rather than the other.[9]

A further explanation of the includibility of dividends is necessary because dividends received by the estate may be of such a nature that the decedent had a property interest in them at the date of his death. The regulations provide that dividends declared to stockholders of record on or before date of the decedent's death and not collected at the date of death constitute a part of the estate.[10] The regulations further provide that if dividends are declared to stockholders of record after the date of decedent's death with the effect that the shares of stock at the subsequent valuation date do not reasonably represent the same included property of the

6 Int. Rev. Code of 1954, § 2033.
7 Int. Rev. Code of 1954, (§ 2032(a).
8 312 U.S. 443 (1941); accord, Stuart v. Hassett, 41 F. Supp. 905 (1941); Howard v. United States, 40 F. Supp. 697 (1941); Clark v. United States, 33 F. Supp. 216 (1940).
9 Maas v. Higgins, *supra* note 8, at 448
10 Treas. Reg. § 20.2032-1(d)(4) (1958).

gross estate as existed at the date of the decedent's death are included property, except to the extent that they are payable out of earnings of the corporation after the date of the decedent's death.

Peoples-Pittsburgh Trust Co. v. United States[11] illustrates the application of the above mentioned regulations. In the *Peoples* case the executor elected to value the estate as of one year after the date of decedent's death. Plaintiff, as executor, received for the estate $9.25 per share during the year following the death of the decedent in payment of arrearages on 1,915 shares of United States Steel Corporation 7% cumulative preferred stock. The dividends are declared after the decedent's death. The earnings and profits of the United States Steel Corporation earned after the death of decedent were sufficient to pay all of the dividends. The Commissioner of internal revenue required the plaintiff to include the amount of the dividends in the value of the estate. The court in reversing the Commissioner's decision held that where the executor elected to have the decedent's estate valued for estate tax purposes as of one year after date of death, dividends received during the year in payment of arrearages on cumulative preferred stock owned by the estate were not subject to the estate tax.

A further illustration of the application of the same regulation is *McGehee v. Comm'r of Internal Revenue*,[12] which held that a stock dividend distributed as a capitalization of income of a corporation and subsequent to a gift in contemplation of death of the shares upon which the dividend was declared should not be regarded as a part of the gift and should not be included in the gross estate of the deceased donor.

VALUE OF PROPERTY INCLUDED

First to be considered is property distributed, sold, exchanged, or otherwise disposed of within one year after the date of decedent's death.[13] Before the value of such included property can be ascertained, a determination of the date of distribution, sale, exchange or other disposition, mentioned in section 2032 (a) (1),[14] must be made. The regulations set forth the tests for determining the date of distribution:

Property is considered as "distributed" upon that which occurs first:

(i) The entry of an order or decree of distribution, if the order or decree subsequently becomes final;
(ii) The segregation or separation of the property from the estate or trust so that it becomes unqualifiedly subject to the demand or disposition of the distributee; or
(iii) The actual paying over or delivery of the property to the distributee.[15]

It should be noted that the above regulation determines the date of distribution by indicating the overt acts which constitute a distribution.

---

11 54 F. Supp. 742 (1944).
12 260 F. 2d 818 (1958).
13 Int. Rev. Code of 1954, § 2032 (a) (1): "In the case of property distributed, sold, exchanged, or otherwise disposed of, within one year after decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition."
14 *Ibid.*
15 Treas. Reg. § 20.2032-1(c)(2) (1958).

As an illustration of what is not a distribution, it has been held that the division of the corpus of a revocable trust, included in the gross estate of the decedent for federal estate tax, for the purpose of facilitating the payment of the income therefrom to certain named individuals for life does not constitute a distribution of property within the meaning of section 2032 of the 1954 code.[16]

The date of sale, exchange or other disposition, according to the regulations, is the efective date of the contract, unless there is not a subsequent substantial performance of the contract.[17] The regulations define the effective date of a contract as the date it is entered into unless the contract specifies a different date.

It should be pointed out that the valuation of inventory of a sole proprietorship involves a unique problem. No profit would be realized upon the sale of inventory items owned at the time of death and disposed of during the one year period after death. The inventory must be valued for estate tax purposes on the basis of its value at the date of disposition thereof if within the one year period. This creates the problem of keeping detailed accounting records to trace the inventory disposed of within the one year period.[18]

Normally, when property included in the gross estate is distributed, sold, exchanged, or otherwise disposed of within one year of the decedent's death it is included at its fair market value on the date of distribution or other disposition. The value of such property which is affected by mere lapse of time will be considered below.

Next to be considered is the value of property included in the gross estate which has not been distributed or otherwise disposed of within one year after the decedent's death. The code provides that such property shall be valued as of the date one year after decedent's death.[19]

Estate of Hanch[20] demonstrates how section 2032 (a) (2) has been applied. In that case the executor elected to value the estate one year after death. The decedent had a one-third interest in the estate of his deceased wife, which had not yet been distributed at the date of his death. Distribution was made to his estate less than two months after his death. The question before the court was whether the amount to be included in Charles C. Hanch's estate was one-third of the value of his wife's estate as it was composed on October 22, 1946, but valued as of October 22, 1947, of specific assets distributed to his estate on December 18, 1946. The Tax Court held that the decedent's interest in his wife's estate must be measured by one-third of the value of her estate as it was composed on the date of his death, but valued one year thereafter, rather than by the specific assets that were subsequently distributed to his estate.

Consideration is now given to includible property which is affected by mere lapse of time. According to section 2032 (a) (3) such property shall be included at its value as of the time of death with adjustment for any difference in its value as of the alternate valuation date not due to a mere lapse of time.

The regulations define property which is affected by mere lapse

16 Rev. Rul. 57-495, 1957 Int. Rev. Bill. No. 43, at 31.
17 Treas. Reg. § 20-2032-1(c)(3) (1958).
18 Rev. Rul. 58-436, 1958 Int. Rev. Bill. No. 35, at 8 throws some light on the problem. See Price, "Alternate Valuation Date Problems." [e.g.] N.Y.U. 17th Inst. on Fed. Tax. p. 1245.
19 Int. Rev. Code of 1954, § 2032 (a)(2).
20 19 T.C. 65 (1952).

of time as patents, life estates of persons other than the decedent, remainders, reversions, and other like properties, interests or estates.[21]

The alternate valuation of a patent may be illustrated best by an example. Assume that the decedent owned a patent which, on the date of his death had an unexpired term of ten years and a value of $100,000. One year after death the patent, because of lapse of time and other causes, had a value of $80,000. The alternate value of the patent would be obtained by dividing $80,000 by 0.90 (ratio of the remaining life of the patent at the alternate date to the remaining life of the patent at the date of the decedent's death), and would, therefore, be $88,888.89.[22]

The manner for determining the value of life estates, remainders, and similar interests is stipulated in the regulations:

> The values of life estates, remainders, and similar interests are to be obtained by applying the methods prescribed in §20.2031-1, using (i) the age of each person, the duration of whose life may affect the value of the interest, as of the date of the decedent's death, and (ii) the value of the property as of the alternate date.[23]

Estate of Welliver[24] is an illustration of the application of the above regulations. In the *Welliver* case, the executrix elected to value the estate as of one year after death. Among the assets of the decedent's estate were nineteen single premium annuity contracts. Each contract provided for the payment of $100 annually to decedent during his life and after his death to his wife for life. The amount necessary to purchase nineteen comparable annuity contracts for the life of decedent's wife, computed on the basis of the annuity table and interest rate currently used by the issuing companies in calculating annuity premiums, was $26,706 on April 14, 1943, the date of decedent's death, and $25,821.20 on April 14, 1944. If computed on the basis of the annuity table and interest rates used by the companies when the nineteen contracts were made, the aggregate premiums for nineteen comparable annuity contracts for life of decedent's wife would be $21,577 on April 14, 1943, and $20,886.20 on April 14, 1944. On the estate tax return the nineteen contracts were included among the assets of the estate; their aggregate value under option was reported as $20,886.20, their value at death, as $21,557. The Commissioner assigned them a value of $26,706 in determining the value of the gross estate. In sustaining the Commissioner's contention, the Tax Court held that as the contracts were interests affected by a mere lapse of time their value at decedent's death is an amount includible in the gross estate. The value of the contracts at decedent's death is the amount for which comparable contracts could have been purchased from the issuing company under the annuity table and interest rate then used by it in computing premiums.

21 Treas. Reg. § 20.2032-1(f) (1958).
22 Treas. Reg. § 20.2032-1(f)(2) (1958).
23 Treas. Reg. § 20.2032-1(f)(1) (1958); Price, "Alternate Valuation Date Problems," [e.g.] N.Y.U. 17th Inst. on Fed. Tax p. 1245 at 1246-7 states, "To eliminate from the value as of the alternate date, changes in value due to mere lapse of time, the value of annuities, and of life, remainder and reversionary interests are to be obtained by applying the factor applicable as of the date of death, rather than as of the alternate date. However, the factor is applied to the reduced value of the property."
24 8 T.C. 165 (1947).

Estate of Hance[25] illustrates one possible result where the person whose life expectancy afects the value of the interest dies during the year period. Hance died on February 22, 1947, survived by his widow. The executor elected to value Hance's estate as of one year after date of death. The estate included seven single premium annuity contracts payable to the decedent for life and thereafter to his widow for life. The widow died on May 15, 1947, at the age of 83 years and 9 months. In the return the contracts were valued at $44,632.92. This valuation was arrived at by discounting at a rate of 4% the total payments which would have been received by the widow on the basis of her life expectancy at the time of decedent's death without regard for the fact that she died on May 15, 1947. The Commissioner determined that these contracts should be valued on the basis of the cost of similar policies issued on the date of decedent's death to a female applicant of the same age as the surviving widow. The total cost of such policies would have been $125,905.27. The petitioner conceded that the Commissioner had correctly valued the annuity policies as of the date of decedent's death but contends that because of the election to have the estate valued as of the date one year after death, the Commissioner erred in failing to allow an adjustment for the difference in value as of the later date not due to mere lapse of time. The Tax Court held that the amount to be included in the gross estate is the figure representing the payment actually received by the widow, notwithstanding that as of the optional date the annuities were worthless.[26]

It is apparent, that if the executor had not elected to value the estate as of the atlernate valuation date, the death of Mrs. Hance would not have affected the value of the annuity, but it would have been included in her husband's estate valued according to her life expectancy at the time of Hance's death.

SPECIAL RULES AFFECTING DEDUCTIONS

A section of the code[27] provides that there shall be no deduction if such deduction is in effect given by the alternate valuation. The

25 18 T.C. 499 (1952).

26 Price, "Alternate Valuation Date Problem," [e.g.] N.Y.U. 17th Inst. on Fed. Tax 1245 at 1247. "The Tax Court held that only the increase in the cost of the annuity between the decedent's death and the annuitant's death should be included in the decedent's estate. The Court based this conclusion on the fact that the annuity lost its value due to the annuitant's death, and not to mere lapse of time. The only loss in value due to mere lapse of time was the difference between the value of the annuity at the decedent's death and at the annuitant's death, and this was all that could be inlcuded in the decedent's estate."

27 Int. Rev. Code of 1954, § 2032 (b).

provisions contained in this section are designed to prevent the decline in value from resulting in a double deduction, and also correlate the value with the amount of the deduction. For example, the executor in valuing the taxable estate can deduct losses from fire, storm, shipwreck, theft or other casualties.[28] But, if alternate valuation is elected, such losses cannot be taken because the value of the property one year after death reflects the occurence of these deductions.

Section 2032 (b) further provides the means for evaluating property which is the subject of a charitable[29] or marital[30] deduction. Such property will be valued for purposes of the deduction in the following manner: the value as of the date of death will be adjusted to reflect the value as of the alternate valuation date. However, if any portion of the difference in value is attributable to a mere lapse of time, or to the occurrence or non-occurrence of a contingency adjustment will not be allowed as to this portion.

It is apparent from the language of section 2032 (b) that if the valuation of property for purposes of the charitable and marital deduction depends upon the duration of an individual's life, his life expectancy at the time of the decedent's death should be used, even though the alternate valuation date is elected and the measuring life ceases during the year period. The reason for this result is that the provision dealing with the charitable and marital deduction eliminates changes in value caused by mere lapse of time and changes in value resulting from the occurence or non-occurrence of a contingency. Therefore, when the person dies during the year period this is the occurrence of a contingency which is to be disregarded.[31]

TIME OF ELECTION

If the executor or administrator desires to take advantage of the provisions of the federal and Colorado alternate valuation statutes, he must so elect because these provisions do not operate automatically. The election, in the case of federal estate tax, must be indicated on the estate tax return, which, under section 6075 and 6018,[32] is required to be filed within fifteen months from the date of the decedent's death or within the period of any extension of time granted by the district director under section 6081.[33] However, in the case of Colorado Inheritance Tax, the election is exercised by filing with the inheritance tax commissioner, within fifteen months from the death of the decedent or any written extension therefrom granted by the commissioner, a supplement to the sworn statement required by statute,[34] setting forth the values applicable to each item of property included in the estates as of the alternate valuation date.[35]

After the expiration of the above mentioned times no election may be exercised, nor may a previous election be revoked. Also,

28 Int. Rev. Code of 1954, § 2054.
29 Int. Rev. Code of 1954, § 2055.
30 Int. Rev. Code of 1954, § 2056.
31 See Price, "Alternate Valuation Date Problems," N.Y.U. 17th Inst. on Fed. Tax 1245.
32 Int. Rev. Code of 1954, §§ 6075, 6018.
33 Int. Rev. Code of 1954, § 6018 (a).
34 Colo. Rev. Stat. § 138-4-42 (1953).
35 *Supra* note 4.

if the election is exercised it applies to all of the property included in the gross estate.[36]

Rosenfield v. United States[37] demonstrates the binding effect of the election. In that case the court held that where the election to have the gross estate of the decedent valued for estate tax purposes as of the date one year after death was made upon full disclosure of the facts, such election was binding upon the estate and could not be revoked after the expiration of the time for filing the return on the ground that the election was made upon a mistake as to the consequences of such election.

Estate of Downe[38] illustrates what constitutes a timely filing of the election. The estate tax return of Henry S. Downe was due on March 8, 1940. The return was mailed on March 8, 1940, but not received in the collector's office until March 9, 1940. The Tax Court held that the return must reach the collector's office on or before the date on which the return is required to be filed and therefore there was not a timely filing on the return. Consequently, Downe's estate could not be valued as of one year after the date of death.

The *Downe* case should be contrasted with *Doriss et al. v. Commissioner.*[39] In the *Doriss* case, the due date for filing of the estate tax return was April 14, 1938. On the morning of that date an estate tax return was mailed from New York City to Albany, and addressed to the collector of internal revenue at the latter city, whose offices were in the post office building. He maintained a post office box and sent for his mail several times a day, usually not after 2:30 P.M. His office hours were from 9 A.M. to 4:30 P.M. The return reached the Albany post office at 5 P.M. on April 14, and was placed in the collector's post office box. It was not called for by the collector until the following morning and was stamped received as of April 15. In this return the executor of the estate elected to have the gross estate valued as of a date one year after decedent's death. The Tax Court held that when the return in question had reached the collector's post office box, it had gone as far on its way to the collector as the post office department would take it. Thereafter it was subject to the control of the collector and available to him at any time. Under the circumstance shown here, the return was mailed in ample time to reach the office of the collector on the due date and was therefore timely filed within the meaning of the controlling regulation.

36 Treas. Reg. § 20.2032-1(b)(2) (1958).
37 254 F. 2d 940 (1958); Certiorari denied, 358 U.S. 833 (1958).
38 3 T.C. 967 (1943); Estate of Flinchbaugh 1 T.C. 653 (1943).
39 3 T.C. 219 (1944).

CONCLUSION

When it is called to mind that the income tax basis of property included in the gross estate is its value at the date of death, or the alternate valuation date if alternate valuation is used, it becomes apparent that in addition to the usual estate tax consequences arising from the alternate valuation, there are income tax consequences which may outweigh the estate tax consequences.

When Congress added this election to the law, it merely intended it as a relief measure for those estates which had suffered severe declines in value. In spite of the fact that it was enacted as a relief measure, the use of this election now presents problems undoubtedly not contemplated at the time of its passage. Therefore, it is necessary to consider, in addition to relative values, the inclusion of assets, their subsequent basis, income tax consequences and the effect on the beneficiary's legacies.[40]

40 See Price, "Alternate Valuation Date Problem," N.Y.U. 17th Inst. on Fed. Tax p. 1245 at 1265. 1265.

CASE COMMENT

LABOR RELATIONS – CONTRACTS – SET-OFF AND COUNTERCLAIM

John L. Lewis and others, as trustees for a union welfare and retirement fund, brought an action against Benedict Coal Corporation for payments allegedly due as the result of a collective bargaining agreement entered into between Benedict and The United Mine Workers of America. The company cross-claimed, asserting that the contract providing for the payments had been violated by the union and that the company was entitled to set-off damages arising from this breach against payments into the fund. The trial court found that the payments were due the trustees as alleged, but also found that Benedict was entitled to damages for the breach of the collective bargaining agreement by the union. The judgment against the union was given immediate execution with the proceeds to be paid into the registry of the court, while the judgment for the trustees was limited to satisfaction from the fund so created. The effect of this judgment, therefore, was allowance of the set-off against the third-party beneficiary of contract damages arising from a breach by the promisee. This decision was affirmed, except as to the amount of damages, by the Circut Court of Appeals, but was reversed by the Supreme Court on the grounds that it was against sound labor policy to allow such set-off. *Lewis v. Benedict Coal Corporation,* 80 Sup. Ct. 489 (1960).

Mr. Justice Frankfurter, in an excellently reasoned dissent, recognized the fact that this decision is against the great weight of authority of contract law and that sound labor policy did not require this decision.

The general rule is well established that the rights of a third-