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American Bar Reports on Income Tax Amendment to Avoid Accrual Method in Death Cases*

It cannot be doubted that the decisions in the case of *Helvering v. Enright*,¹ and *Pfaff v. Commissioner of Internal Revenue*,² if left unlimited by legislation, will result in great hardships upon the dependents of lawyers, doctors and other professional men, and of all taxpayers whose income consists largely of compensation for personal services not immediately paid for. Section 42 of the Internal Revenue Code requires that upon the death of taxpayers who have made Federal income tax returns on the basis of cash receipts (which is the basis used by nearly all individuals), the return for the year in which death occurs shall include "accrued" income as well. The result of the Supreme Court decisions above cited is that all uncollected and even undetermined compensation for personal services is to be included, at a valuation fixed (subject to review) by the Treasury Department.

While the two cases cited happened to involve the estates of members of partnerships, and certain specific objections to the tax were based upon partnership sections of the Internal Revenue Code, the results are by no means limited to members of partnerships but are fully applicable to lawyers practicing as individuals. Numerous decisions of the lower courts and Board of Tax Appeals since the *Enright* and *Pfaff* opinions were handed down, show the lengths to which the doctrine of those cases will be carried. In *Estate of Geo. W. Wickersham*³ (former U. S. Attorney General and member of Cadwallader, Wickersham & Taft), the "accrued" additional items upon which income taxes were assessed included more than \$78,000, "in connection with which no agreement with the client as to the amount of compensation existed at the time of decedent's death, and no other facts existed at that time from which it was possible to ascertain definitely the amount of the fee which would be charged or collected."

In *Estate of Lewis Cass Ledyard, Jr.*⁴ (member of Carter, Ledyard & Milburn), the additional assessment of tax by the Commissioner was more than \$300,000, although this was reduced somewhat by the Board, which allowed credit for a liability which was undetermined at the time of death.

*Article prepared by Frank M. Cobourn of Toledo, member of the firm of Welles, Kelsey, Cobourn & Harrington, under the auspices of the Taxation Section of the American Bar Association.

¹312 U. S. 636, 61 S. Ct. 777, 85 L. ed. 1093 (1941).

²312 U. S. 646, 61 S. Ct. 783, 85 L. ed. 1099 (1941).

³44 B. T. A. 619.

⁴44 B. T. A. 1056.

A computation of the additional income tax liability upon the estate of a lawyer dying November 1, 1941, with an annual net income of \$30,000 (\$25,000 for the 10-months' period) and having uncollected and undetermined fees amounting to \$45,000, shows additional income tax on the \$45,000 which was not actually received, of nearly \$26,000. When it is realized that the fees for such services are undetermined and uncollected and that there may be very considerable uncertainty and delay on both counts, and that the determination by the Treasury Department is likely to be at least a reasonably generous valuation, the extent of the hardship is apparent.

Even in cases involving much smaller amounts, the liability is likely to be unreasonably high, and the requirement of arranging for cash payment may make necessary the sale of other assets of the estate at a sacrifice. For example, with an annual income of \$6,000 (\$5,000 for the 10 months) and uncollected fees valued at \$10,000, the additional income tax on the amount not actually received is about \$2,360.

A great many lawyers, recognizing the severe and seemingly unfair tax burdens resulting from this situation, and believing that Congress never intended that Section 42 (which was adopted in its present form in the 1934 law) should be so interpreted, have written to the Treasury Department and to members of the House Ways and Means Committee and Senate Finance Committee, seeking some reasonable relief by amendment of the section. As a result of the report of its Federal Income Tax Committee and other memoranda and correspondence on the subject, the Tax Section of the American Bar Association, at its meeting in Indianapolis early in October, 1941, unanimously recommended an amendment as follows:

"Sec. 42. *Period in Which Items of Gross Income Included.* The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts (*other than undetermined amounts for personal services*) accrued up to the date of his death if not otherwise properly includable in respect of such period or a prior period."

The change from the present law consists of the insertion of the parenthetical clause which appears in italics. The explanation made in the American Bar Association Tax Section's report reads as follows:

"The above Resolution proposes a change in Section 42 of the Internal Revenue Code which, in its present form requires the inclusion in the last income tax return of a decedent of amounts of income 'accrued' up to the date of his death. This provision has been interpreted

so as to expand the concept of accrual to include items which are unascertained and uncertain in amount and which the decedent's estate may never become entitled to receive. As a result large amounts of income are being taxed in the last return of a decedent at a time before the executors have received the money with which to pay the tax and before it is determined that the estate will ever receive the money. The situation is particularly aggravating in cases where the income of a decedent is income from professional personal services, such as attorneys' fees, doctors' fees, etc. The proposed Resolution recommends that undetermined amounts for personal services be excluded from the last return of a decedent."

This recommendation, as part of the Taxation Section's report, was approved and recommended by the House of Delegates on behalf of the American Bar Association. At the meeting of the Ohio State Bar Association in Toledo October 23rd last, the Taxation Section by the unanimous vote of those present approved the amendment as previously recommended by the American Bar Association, and this action has now been approved by the officers and Executive Committee of the Ohio State Bar Association. It is submitted for the consideration of Ohio lawyers with the suggestion that those approving it do what they can to influence officials of the Treasury Department, Representatives and Senators to approve and enact this amendment or similar remedial legislation.

Other forms of amendments have been submitted and several were carefully considered by members of the Tax Section of the American Bar Association, but the one which was approved, as above set forth, seemed most desirable because of its simplicity and the fact that practically all it undertakes to do is to revise the concept of accrued income within limits which probably go as far as Congress intended when Section 42 was changed to its present form. The amendment in no way changes or interferes with the basic purpose of that section, which is that all actually accrued income should be subject to tax at some proper time, but merely eliminates from tax as not being "accrued," certain items which have never been looked upon as income, and as a practical matter are not such prior to or at the time of decedent's death.

Denver Bar Association to Hear Address on Price Control Act of 1942

The next regular monthly meeting of the Denver Bar Association will be held on April 6 at 12:15 p. m. in the Chamber of Commerce dining room. The principal address will be given by John A. Carroll, Regional Attorney for the Office of Price Administration, on the subject, "Legal History and Analysis of the Emergency Price Control Act of 1942."