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Federal Taxation (1959-1967)

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10. Abe died in 1955 owning $100,000 in life insurance on his own life. The proceeds of the policies were payable to his estate. By his will he established a trust of one-half of the life insurance proceeds, the income of which was to be paid his widow for her lifetime, and upon her death the principal to his daughter Ann.

(1) Are the proceeds of the policy subject to Federal estate taxation in Abe's estate? (2) Does the bequest of the $50,000 annuity qualify for the marital deduction provision of the Federal Estate Tax law?

(FEDERAL TAXATION) (1) Under the 1954 IRC #2042 life insurance is part of the gross estate.

(2) Under #2056 no gift to the wife of a terminable interest qualifies for the marital deduction.

10. Six years ago you drew a will for Jonathan Jones, a widower and at that time 78 years of age. By his will he gave his daughter Cora property having a value of $100,000. Cora was his only child, was unmarried and an invalid. The remainder of his property of the value of $156,000 was left to charity. Mr. Jones now comes to your office and says that he has become greatly concerned over the welfare of his daughter as her health is getting progressively worse and as he is her sole means of support. Moreover, he states his fear that the provisions made for her by his will are not adequate due to the rising cost of living, and that he wishes to make her an immediate gift of securities having a market value of $100,000. He states that he wishes this gift to be in addition to the provisions made for Cora by his will. He tells you that he realizes that a gift tax will have to be paid on the transfer of the securities, but that he wishes advise on whether there may be a further Federal tax consequence resulting from the gift. What should you advise him?

(FEDERAL TAXATION) Since Jones is now 84 years of age there is a strong probability that he will die within three years. If he does so there is a presumption (which would be most difficult to rebut) that the gift was made in contemplation of death. If so, the higher estate tax will have to be paid. However, it may still be advisable to make the gift, as the amount of the gift tax paid would diminish his estate and hence lessen the total of the estate tax, and he would be entitled to a credit on the estate tax for the amount of any gift tax he may have paid.

10. In 1951, Mr. Feeble executed an irrevocable trust agreement by which he transferred to the Doeville National Bank, as Trustee, certain of his property then having a fair market value of $100,000. The agreement provided that all income from the trust property should be paid to Mr. Feeble during his lifetime and that, upon his death, the property should be sold and the proceeds distributed equally among his four grandchildren. On the creation of the trust, Mr. Feeble properly paid a Federal gift tax computed on the then value of the remainder interest of his grandchildren. Mr. Feeble died intestate in April of 1960, survived by his four grandchildren. At the time of Mr. Feeble's death, the trust property had a fair market value of $240,000. The Administrator of Mr. Feeble's estate now asks your advice as to the extent, if any, that the Federal estate tax law is applicable to this situation.

What should you advise?

(FEDERAL TAXATION) Since Feeble retained an interest in the subject matter of the trust during his lifetime the whole $240,000 is part of his gross estate. He is, however, entitled to a credit for the amount of the gift tax paid in 1951. See Section 2036(a) of the Internal Revenue Code of 1954.
10. Decedent in 1932 bought one hundred shares of M & N Corporation common stock for $50 per share. In 1944 the Corporation declared a stock dividend of two shares for every one held by the stockholders, and on Jan. 16, 1961, stockholders, pursuant to a proper corporate resolution, were given the right to subscribe to one share of stock at $85 for each ten shares owned. Decedent exercised this right as the stock was then selling at $100 per share. Decedent died March 14, 1961, owning the three hundred and thirty shares of stock which then had a market value of $125 per share. By his will Decedent bequeathed this stock to his son, John.

Assuming that the net estate amounts to $300,000, how ought you to answer the following questions asked you by the executor and John?

(1) Is there any income tax liability on the estate because of the increase in market value of this stock?

(2) If John sells this stock, what, if anything, is its basis for income tax to him?

(FEDERAL TAXATION) (1) I.R.C. Sec. 102 excludes from gross income the value of property acquired by bequest or inheritance. Neither the estate nor John has any taxable income by reason of the increase in market value between the time of Decedent's acquisition of the stock and his death.

(2) A legatee's basis for property acquired from a Decedent is the fair market value of the property at the decedent's death (IRC Sec. 1014) or at the applicable valuation date if the executor elects it under IRC Sec. 2032. John's basis will be the $125 per share market value at date of Decedent's death.
10. Herbert Hertz, a resident of Virginia, owns real and personal property having a fair market value of approximately $230,000. It is estimated that his debts and the costs of administration of his estate will be approximately $20,000. Herbert is married to Wanda and has four children. Wanda has no property. Herbert desires to transfer his property by will in such manner as to result in the least federal estate tax both to his estate and to Wanda’s estate upon her death. In preparing his will, how would you provide for the disposal of his property in order to obtain this result?

(FEDERAL TAXATION) I would advise Hertz to leave half to the wife absolutely so as to take full advantage of the marital deduction. He could then leave the other half to his children. He would be entitled to the $60,000 exemption and taxable only on $45,000. When the wife dies she would also be entitled to an additional $60,000 exemption.

10. Brock Ballard owned real estate which he purchased for $25,000 in 1945. In 1962, when the property had a fair market value of $75,000, he transferred it to the newly formed “Ballard Corporation.” In return, he received 100% of the capital stock of the corporation, having a fair market value of $75,000.

What, if any, was Brock Ballard’s taxable gain on this transaction?

(TAXATION) None. In substance he has merely changed one asset into another asset and he would not realize a taxable gain until he sells the stock. The basis of the stock will be the same as the basis for the real estate—$25,000. See Section 351 of the Internal Revenue Code.

10. Edmund Welton consults you, telling you that he has been financially successful in business, and that he now wants to make gifts to his seven grandchildren. His plan is to give to each of them outright a block of securities, each block having a current market value of $20,000. He also tells you that his wife is anxious to see that the gifts are made immediately and is willing to sign whatever tax returns are necessary. Neither of them has ever before made gifts of any kind. Welton asks you what part, if any, of his proposed gifts would be taxed under the Federal gift tax laws, if the gifts were made entirely in 1963. How should you advise him?

(TAXATION) In the case of a husband and wife each has a grand total of $30,000 lifetime immunity from the gift tax and each has a $3,000 total exemption per donee per year, and if they agree on a gift or gifts these two can be combined. Seven times $6,000 is $42,000 for the annual exemption and two times $30,000 is $60,000 for the lifetime exemption. Total gifts of $140,000 less the $102,000 would make $38,000 taxable under the Federal gift tax laws. See Internal Revenue Code ##2503 and 2521.
Motorist, aged 66, was involved in an automobile accident in which he received painful and permanent injuries. During the taxable year he spent $1,000 for hospitalization, $750 for nurses, $500 for doctors, and $100 for drugs. The drugs were purchased because of an illness not connected with the accident. He was employed at a salary of $800 per month and because of the injuries received he lost six months from work and at the end of that time was unable to perform all of his previous duties and his salary was reduced to $500 per month, with no hope of the salary cut being restored.

As the result of suit Motorist collected from the opposing driver $25,000 for the personal injuries sustained by him as a result of the accident.

How ought you answer the following questions put to you by Motorist in regard to his Federal Income Tax?

1. Is all or any part of the recovery of $25,000 subject to income tax?
2. Can he deduct any part of the hospital, nurses', doctors' or drug bills?
3. Can he claim a loss or deduction because of his decreased earning power?
4. He paid his lawyer $5,000 for his services in securing the judgment; is this a proper deduction?
5. He received $2,500 on an accident insurance policy; should this be taken into account for taxation?

**FEDERAL TAXATION**

1. No. This is not income, but compensation for injury.
2. Yes, drugs in excess of 1% of his income. Since he is over 65 he may deduct all other medical expenses unless he has been compensated for them by insurance, or the $25,000 damages for personal injuries.
3. No. The $25,000 damages for personal injuries are in part for such loss of earning power, and his future income taxes may be less.
4. No. Expenses incurred to obtain that which is not taxable as income are not allowed as a deduction.
5. No. This is expressly excluded under the law.

Ben Blue died testate in 1952, possessed of a net estate consisting of 10,000 shares of General Motors Common stock, then valued at $45 per share. His Will established a trust which provided that the income should be payable to his widow Mabel for her life, and after her death the remainder in fee, free of the trust, should be paid over to his two spinster sisters, Helen and Bess. Petersburg Trust Company qualified as Executor and Trustee under the Will.

How ought you advise on the following tax questions:

(a) What valuation should be used by Ben Blue's Executor for Federal Estate Tax purposes?
(b) What valuation should be used for the interests of Helen and Bess under Virginia Inheritance Tax laws?

**TAXATION**

(a) For Federal Estate tax purposes the stock should be valued at $50,000, its value as of Blue's death, irrespective of the future interests created, I.R.C. Sec.2031, except as the executor may elect the alternate valuation as one year after date of death. IRC Sec.2032. It may be noted that no marital deduction would be allowed for Mabel Blue's life interest in the trust, which is a non-qualifying terminable one, although the issue is not posed by the form of the question.

(b) Under Va.58-173 the remainder interests of Helen and Bess will be assessed at the full value of the property when their interests therein become possessory. The Department of Taxation may effect settlement of the entire tax on estates in which remainders are involved without awaiting termination of prior estates in which case the total tax is apportioned between life tenant and remainderman as per tables and provisions of 55-269 to 55-271.
Yokum purchased a manufacturing plant and an adjoining office building for $100,000. Slightly more than one year later, when the property was worth $150,000, Yokum transferred the property to Zero Corporation in exchange for all the capital stock of that corporation. Shortly thereafter, and after taking all proper steps, Zero Corporation sold the same property to Jones & Co. for $140,000. The following day Yokum sold all the capital stock of Zero Corporation for $120,000.

With respect to Federal taxation:
(a) To what extent, if any, did Yokum incur a taxable gain or loss when he exchanged the office building and manufacturing plant to Zero Corporation for all its capital stock?
(b) To what extent, if any, did Zero Corporation incur a taxable gain or loss upon its sale of the property to Jones & Company?
(c) To what extent, if any, did Yokum incur a taxable gain or loss when he sold all the capital stock of Zero Corporation?

(Federal Taxation) (a) Since Yokum owned more than 80% of the stock of the corporation after the exchange there is no gain or loss but the base for the corporation and for Yokum is Yokum's original base of $100,000. I.R.C. #351. (b) A gain of $40,000 since it sold at $140,000 over its base. I.R.C. #362(a) (c) A gain of $20,000 since Yokum sold at $20,000 over his base. I.R.C. #358(a).

10. In 1941, Hub and Mom Flain-Polk, husband and wife, bought their home, in Buena Vista, Va., for $50,000. They used as a down payment $12,500 that Mom had inherited from her father, and took title as "joint tenants with right of survivorship, and not as tenants in common," giving their joint note for the balance. The note was paid in full, in 1961, from Hub's earnings. In 1965 Hub died, survived by Mom. Mom consults you and makes the following inquiries:
(1) To what extent, if at all, is this home part of Hub's estate for Federal Estate Tax purposes?
(2) To what extent, if at all, is this home part of Hub's estate for Virginia Inheritance Tax purposes?

(Taxation) (1) Since Hub contributed three fourths of the cost of the home $37,500 of the $50,000 will be part of Hub's estate for Federal Estate Tax purposes. Note: This answer assumes that the value of the home at Hub's death was $50,000. If it were more or less the amount would be three-fourths of the value as of the date of Hub's death. See I.R.C. 2040.
(2) Under the last paragraph of §58-153 as amended in 1962 only one half of the $50,000 home would be included since the property in question is a single family residence occupied by a husband and wife as joint tenants (or as tenants by the entireties) with survivorship.

10. William Wealthy in 1960, purchased 100 shares of Xerox stock for $1000. On June 1, 1966, Wealthy gave to his son, Doless, all of this stock, which then had a market value of $10,000. Having his customary need for cash, Doless thirty days later sold all the stock for $15,000.

State briefly the income tax consequences applicable to Doless, including his basis for the stock and the nature and amount of his gain, if any, under
(1) Federal Law and (2) Virginia Law.

(Taxation)
1. The basis, by Federal law, is $1000 (donor's basis plus gift tax paid, if any) with long term capital gain of $4000 (donee takes on donor's holding period).
2. The basis by Virginia law is $10,000 (fair market value at time of gift) and the $5,000 capital gain is treated the same as other ordinary income.
Homer bought his home in 1954 for $10,000 and lived in it until he became sixty years old in 1964, whereupon he decided to sell it and did so for the sum of $10,000, out of which he paid his real estate agent $2,000 for making the sale. Homer had installed a new heating system in 1954 at a cost of $1,000, painted the house every two years at a cost of $200, the last time being in 1962, refinished all floors and woodwork in 1956, at a cost of $500 and built an additional room in 1963 at a cost of $1,000. Nine months after the sale of this house, Homer purchased another house to live in for the price of $18,000.

In what amount and on what basis is the selling price subject to federal income taxation?

FEDERAL TAXATION) The taxable income is $20,000. The net proceeds of the house were $38,000. The base of the house was $10,000 plus $2,000 capital improvements (added room and new heating system). The gain realized was thus $26,000. This gain is taxable to the extent that the net amount received ($38,000) exceeds the cost of the new residence ($18,000) or $20,000. The remaining $6,000 of the realized gain goes in diminution of the base of the new residence. The painting and refinishing jobs were maintenance current expenses having no effect on the base of the house to which they were done.

The $20,000 is a long term capital gain. The taxpayer has the option to treat it as such, or, he may find it to his advantage, if he is in a high enough bracket, to compute and pay the alternative tax.

Decedent, a resident of Roanoke, Va., died testate January 1, 1966. On January 2, 1960, he had given by deed to each of his three sons securities of the market value of $25,000, but of a date of death market value of $50,000. In the deed of gift Decedent retained the income from these securities for his life.

Decedent had life insurance amounting to $30,000, payable to his wife and at the time of his death owned real estate of the market value of $60,000, which he had inherited some years ago, and securities of the date of death market value of $100,000, but which only cost him $25,000.

Decedent devised his wife all of his real estate and bequeathed her one-half of his securities. The remainder of his property was bequeathed equally to his three sons. Assume that Decedent had just enough money, in addition to the above assets, to pay debts and cost of administration, that the date of death values had not changed during administration, and that you are engaged to make off his Federal Estate Tax Return. (a) Which of the above items should be included in the estate for tax purposes? (b) At what value should each includable item be returned?

(FEDERAL TAXATION) The securities given to the sons in 1960 and in which decedent retained the income right for his life included in his estate for tax purposes at market value at date of death, $50,000. IRC #2036.

Life insurance proceeds of $30,000 are to be included in his estate in the full amount irrespective of the designation of his wife as beneficiary, provided that he had not assigned to her all of his incidents of ownership in the policy prior to his death. IRC #2042.

The real estate owned by him at his death is to be included at its value of $60,000 irrespective of any dower rights that his wife may have in it.

The securities which cost him $25,000 are to be included at their market value of $100,000 as of the date of his death.
John Gibbons is a wealthy individual who has offered to purchase all the assets of Alpha Corporation. The stockholders of Alpha Corporation are opposed to having it sell its assets, since they fear that will cause a sizable taxable gain to the Corporation and, upon distribution of the cash proceeds of the sale among the stockholders, they too will have a taxable gain. As a counter-offer, the stockholders have offered to sell Gibbons all the capital stock of Alpha Corporation. Gibbons has refused to accept this counter-offer. The stockholders now ask you to advise them whether there is any plan which they might follow whereby the assets of Alpha Corporation can be sold to Gibbons without both the stockholders and the Corporation incurring a taxable gain. What should you advice be?

(TAXATION) Advise the shareholders that if the corporation, pursuant to I.R.C. #337, distributes all of its assets in complete liquidation within 12 months after the adoption of a plan of liquidation, no gain or loss shall be recognized to the Corporation from the sale of property during such 12 month period. The 12 month period begins on the date of adoption of the plan and all of the assets (less assets retained to meet claim) must be distributed within that period. The amount distributed to the shareholders in complete liquidation of the corporation would, pursuant to I.R.C. #331, be treated as in full payment in exchange for the stock. The gain or loss to the shareholder would be determined under #1001 by comparing the amount of the distribution with the cost or other basis of the stock. Under #1002, the entire amount of such gain or loss would be recognized subject to the further provision of the I.R.C. Thus, under such a plan of complete liquidation, the corporation would not incur a taxable gain during the 12 month period following liquidation and the shareholders would be subject to tax at capital gain rates on the excess received over the adjusted basis of their stock.

10. I.M., Oppressed, a cash basis calendar year taxpayer, owns Black Acre, containing 200 acres without buildings or other improvements. The Highway Department has condemned 10 acres, for which the Condemnation Commissioners awarded $400 per acre, or a total of $4,000, for the land taken, and the same Commissioners also awarded $8,000 for damages to the residue. Oppressed paid, several years ago, $300 per acre for the land. He was not represented by counsel and incurred no expense in obtaining the award.

He consults you as to the proper Federal Income Tax treatment of the proceeds. What would you advise.

(a) In regard to the $400 per acre for the land taken?
(b) In regard to the $8,000 for damages to the residue?

(INCOME TAX) (a) In regard to the $400 per acre paid for the land. $100 per acre will be taxed as a capital gain.
(b) There is no present tax in regard to the $8,000 paid for damage to the residue. However, the basis of the remaining land must be reduced by this amount. See Sec.1033 of the IRC.