



NORTH CAROLINA LAW REVIEW

Volume 53 | Number 1

Article 10

11-1-1974

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Recommended Citation

Hugh F. Oates Jr., *Tax -- Only God Knows For Sure But the I.R.S. Makes a Good Guess -- Use of the Treasury Department's Actuarial Tables*, 53 N.C. L. REV. 161 (1974).

Available at: <http://scholarship.law.unc.edu/nclr/vol53/iss1/10>

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self-restraint in the determination of standing questions.⁸⁰

A transaction-investor standard of standing determines standing not on the merits of the plaintiff's case, but on the neutral principles discernible from the position of the plaintiff vis-a-vis the investment decision-making process.⁸¹ At the same time, the standard tends to eliminate plaintiffs with unprovable claims.⁸² The transaction concept provides an element of flexibility,⁸³ and the decision-making approach provides some certainty. Finally, the lessons of the *Birnbaum* experience are not ignored.

C. CLINTON STRETCH

Tax—Only God Knows For Sure But the I.R.S. Makes a Good Guess—Use of the Treasury Department's Actuarial Tables

An individual's life expectancy determines, in many tax situations, the number of tax dollars the federal government will receive. Consequently, the method used to measure this expectancy is extremely important to both the Internal Revenue Service and the taxpayer. However, the courts disagree¹ on whether this valuation should be based upon actual expectancy or actuarial expectancy.²

agree that Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." *Id.* at 12.

80. See notes 55 & 78 and accompanying text *supra*.

81. See note 4 *supra*.

82. This was the concern of the court in *Manor Drug*; see note 21 *supra*.

83. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971).

1. Compare *Miami Beach First Nat'l Bank v. United States*, 443 F.2d 116 (5th Cir. 1971), with *Continental Ill. Nat'l Bank & Trust Co. v. United States*, 32 Am. Fed. Tax R.2d 6235 (N.D. Ill. 1973).

2. "Actual expectancy" involves consideration of all facts pertinent to an individual's state of health. "Actuarial expectancy" is determined by extensive averaging of the population as a whole and does not consider the state of health of the specific individual in question.

The statutory foundation for the actuarial tables is INT. REV. CODE OF 1954, § 7805(a), which authorizes the issuance of "all needful rules and regulations" for the enforcement of the Internal Revenue Code. These tables are used by the Internal Revenue Service for a variety of tax purposes in valuing annuities, life estates, remainders and reversions. Some of these purposes are: (a) Valuation of general life estates with remainder interests to others; (b) Valuation of life annuities [*But see* ABA, Memorandum of Feb. 11, 1974 (Proposal C) concerning changes in section 72(b) of the Internal Revenue Code]; (c) Valuation of income interests in funds for terms for years; (d) Valuation of annuity interests for terms for years; (e) Valuation in corporation-stockholder

In *Merchants National Bank v. United States*³ a federal district court recently held that actuarial tables could not be used conclusively in valuing a life estate for purposes of the estate tax credit under section 2013 of the estate and gift tax provisions of the Internal Revenue Code.⁴ The case involved an action for a partial refund of estate taxes paid by plaintiff, the executor of decedent's estate. Plaintiff had earlier failed to take a section 2013 credit for the tax paid on prior transfers to the decedent by the estate of her brother, who died eight months prior to decedent. The plaintiff argued that the value of decedent's life interest for purposes of the credit should be determined solely from the applicable actuarial tables.⁵ However, *Merchants National* reversed its earlier memorandum decision⁶ and held that "actuarial tables are not the exclusive factor to be used in valuing life estates, but that other factors tending to show a shorter or longer life expectancy, if they have probative value, may be considered also."⁷ The decision thus reduces the tables to mere evidentiary status. Although the court believed that the exclusive use of the actuarial tables was the better practice, it stated that "the weight of authority is definitely to the contrary."⁸ "The court's acquiescence in outside authority is unfortunate, for there are strong arguments supporting its belief that the actuarial tables should be used exclusively.

Merchants National relied on *Miami Beach First National Bank v. United States*,⁹ *Estate of Lion v. Commissioner*¹⁰ and Revenue Ruling 66-307.¹¹ *Miami* involved the valuation of a charitable remainder interest via determination of the life expectancy of decedent's widow who

annuity agreements; (f) Valuation in income tax charitable contribution deductions, INT. REV. CODE OF 1954, § 170, estate tax charitable deductions, *id.* § 2055(e)(2)(A), and gift tax charitable deductions (*id.* § 2522(c)(2)(A)) for remainder interests placed in trust.

3. P-H 1973 FED. TAXES, EST. & GIFT (33 Am. Fed. Tax R.2d) ¶ 147,870 (D. Kan. June 26, 1973).

4. INT. REV. CODE OF 1954, § 2013 provides:

(a) GENERAL RULE.—The tax imposed by section 2001 shall be credited with all or part of the amount of the Federal estate tax paid with respect to the transfer of property (including property passing as a result of the exercise or non-exercise of a power of appointment) to the decedent by or from a person (herein designated as a "transferor") who died within 10 years before, or within 2 years after, the decedent's death. . . .

5. Treas. Reg. § 20.2031-7(f), table I (1958).

6. *Merchants Nat'l Bank v. United States*, 31 Am. Fed. Tax R.2d 1446 (D. Kan. 1973).

7. P-H 1973 FED. TAXES, EST. & GIFT at 149, 336.

8. *Id.*

9. 443 F.2d 116 (5th Cir. 1971).

10. 438 F.2d 56 (4th Cir. 1971).

11. 1966-2 CUM. BULL. 429.

was afflicted with a number of serious medical conditions at the time of her husband's death. The court spoke of the "presumptive correctness" of the actuarial tables, but concluded that sufficient evidence regarding the *actual* life expectancy could overcome this presumption.¹² However, the court held that in this case the actuarial tables should be used exclusively, because testimony concerning the widow's actual life expectancy was highly speculative and therefore insufficient to overcome the presumption.

In setting forth its general test of "presumptive correctness", the court noted that the Treasury Regulations also anticipate this approach in section 20.2031-1(b), which provides in part that "[a]ll relevant facts and elements of value as of the applicable valuation date shall be considered in every case."¹³ This argument seems very tenuous, however, since this regulation is merely the *general* valuation section for gross estates. Section 20.2031-7, on the other hand, specifically concerns valuation of life expectancy, and such calculations are based on the tables set forth in this latter section. Arguably, this section takes precedence over the more general section on valuation of gross estates.¹⁴

In *Estate of Lion*, the other case relied on by *Merchants National*, the issue was whether an estate tax credit¹⁵ should be allowed for property previously subjected to estate tax. The credit was claimed for a life estate in a residuary trust created by decedent's husband with whom she died in a common accident. The court did not allow the credit, holding that the value of Mrs. Lion's life estate at the time of the transfer was zero and that the actuarial tables would not be applied "where there is reasonable certainty that use of the tables would violate reason and fact."¹⁶ The court concluded that it would be unreasonable to value Mrs. Lion's life interest by use of the tables¹⁷ since a hypothet-

12. 443 F.2d at 119.

13. *Id.* at 119-20, quoting Treas. Reg. § 20.2031-1.

14. *Merchants Nat'l Bank v. United States*, 31 Am. Fed. Tax R.2d 1446, 1447 (D. Kan. 1973).

15. INT. REV. CODE OF 1954, § 2013.

16. 438 F.2d at 61; see *Estate of Hoelzel*, 28 T.C. 384 (1957); *Estate of Butler*, 18 T.C. 914 (1952); *Huntington Nat'l Bank*, 13 T.C. 760 (1949); *Estate of Nellie H. Jennings*, 10 T.C. 323 (1948).

17. The court also used language in the regulations to sustain its decision that strict use of the tables is not required:

That the tables may or may not reflect "recognized valuation principles" is implicit in the use of the phrase "see especially § 2031-7" . . . , rather than an imperative phrase, for example, "as determined by § 20.2031-7," or an expression of like import. The regulations thus leave room for departure from strict application of the tables.

438 F.2d at 60.

ical buyer would have paid nothing for her "interest" at the time of the transfer.¹⁸ *Estate of Lion* therefore provides strong precedent for selective use of the regulation tables.¹⁹

Finally, Revenue Ruling 66-307 states that outside evidence will be allowed for valuing life and remainder interests for purposes of computing the allowable credit for tax on prior transfers, when the death of a life tenant from known causes is predictable and imminent on the valuation date.²⁰ Although the court in *Merchants National*, an opinion written by Judge Templar, upheld this ruling, it had been invalidated a few days earlier by a district court in *Continental Bank & Trust v. United States*²¹ as being in direct conflict with the regulations. *Continental* demanded strict use of the tables even though the decedent-life tenant was seventy-five years old and suffering from incurable cancer and even though medical testimony estimated her life expectancy to be less than six months at the time of the transfer.²² Ironically, *Continental* cited the earlier memorandum decision of *Merchants National* as authority for requiring exclusive use of the Treasury tables.²³ Evidently, Judge Templar was not aware that his earlier memorandum decision had gained support when he reversed himself and withdrew the earlier opinion.²⁴

There are substantial arguments supporting Judge Templar's earlier memorandum decision. For example, the justification often given for favoring actual expectancy over actuarial expectancy is the unreliability of actuarial tables as valuation devices per se, without regard to policy considerations. Generally, these doubts have been rejected

18. *Id.* at 62. Although it may seem unreasonable to use the actuarial tables in "simultaneous death" cases, the court's hypothetical buyer test is an equally imperfect method of valuation, which is deficient when applied in other situations. A hypothetical buyer would pay little or nothing for the life estate of a person with an incurable disease. Nevertheless, the person could possibly live for a long time and the value to him might therefore be much greater than the market value.

19. "Where at the time of the transferor's death it was unmistakable to one in possession of the facts that the transferee's life would be radically shorter than predicted in the actuarial tables, the value of a transferred life estate may be reduced accordingly for purposes of calculating the tax credit under § 2013." *Id.*

20. The ruling refers to the principle of *Nellie H. Jennings*, 10 T.C. 323 (1948) and also cites *Estate of Nicholas Murray Butler*, 18 T.C. 914 (1952), *acquiesced in*, 1953-1 CUM. BULL. 3; *Huntington Nat'l Bank*, 13 T.C. 760 (1949), *acquiesced in in part*, 1950-1 CUM. BULL. 3; *Estate of John Halliday Denbigh*, 7 T.C. 387 (1946), *acquiesced in*, 1953-1 CUM. BULL. 4.

21. 32 Am. Fed. Tax R.2d 6235 (N.D. Ill. 1973).

22. *Continental* involved the tax credit under section 2013.

23. 32 Am. Fed. Tax R.2d at 6236.

24. The cases were decided fourteen days apart. In light of *Continental*, Judge Templar could conceivably return to his earlier decision when the opportunity arises.

by the courts²⁵ except in cases in which there are unusual circumstances.²⁶ Arguably, the tables should be applied conclusively under all circumstances. As evaluation devices the actuarial tables are "broadly equitable"²⁷ tools for both the taxpayer and the Service. Courts have said that "the United States is in business with enough different taxpayers so that the law of averages has ample opportunity to work."²⁸ Consequently, in the long run all parties benefit from strict use of the tables; unreasonable results from the government's point of view even out, and extremely harsh results for the taxpayer²⁹ have been softened by new Code sections.³⁰

Valuation of life expectancy under any method is at best imprecise; thus, a method that is systematically applied has a quality of certainty that is advantageous for many reasons, administrative convenience being one of the most important. As Justice Holmes stated in a Supreme Court case dealing with actuarial tables: "[Value] as the word is used by the law . . . depends largely on more or less certain prophecies of the future; and the value is no less real at that time if later the prophecy turns out false than when it comes out true."³¹ The tables provided by regulations necessarily deal with probabilities, but they apply indiscriminately to all individuals and incorporate in their statistics the possibility of premature death as well as longevity.³² Systematic application of the tables for valuation will consequently save much time, preclude spurious arguments by both the Service and the taxpayer,³³ and relieve the courts of the burden of calculating imponderables. Moreover, the courts have emphasized the desirability of using the tables in uncertain and speculative situations in order to avoid unnecessary complexity and confusion.³⁴

25. 1 J. MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION § 7.07, at 416 (1959).

26. See Rev. Rul. 66-307, 1966-2 CUM. BULL. 429.

27. Estate of Irma E. Green, 22 T.C. 728, 732 (1954).

28. Rosen v. Commissioner, 397 F.2d 245, 248 (4th Cir. 1968); Gelb v. Commissioner, 298 F.2d 544, 552 (2d Cir. 1962).

29. See Ithaca Trust Co. v. United States, 279 U.S. 151 (1929).

30. E.g., INT. REV. CODE OF 1954, § 2013 (tax credit for prior transfers).

31. 279 U.S. at 155.

32. See Miami Beach First Nat'l Bank v. United States, 443 F.2d 116, 120 (5th Cir. 1971).

33. See Palfrey v. United States, 36 F. Supp. 153 (D. Mass. 1940) in which the taxpayer argued that "the beneficiaries of this life estate were of such a type, that is, people independently wealthy and without business cares or worries, that it was reasonably certain that they would live longer than the term of years allotted to them by [the tables]." *Id.* at 156.

34. See Chauncery Stillman, 24 P-H Tax Ct. Mem. 478 (1965); Estate of Irma

The *Miami* court stated that even though there are some discrepancies in the tables which may prove unfortunate for individual taxpayers, these discrepancies may have to be suffered in the interest of a simplified overall administration of the tax laws.³⁵ This argument cuts both ways, however, and the government should accept its share of unfortunate tax results because of use of the tables. Nevertheless, courts have generally allowed the "presumptive correctness" of the tables to be rebutted only in favor of the Commissioner, as seen in *Miami* and *Merchants National*, where the government argued inconsistently in the two cases and won in both. Strict use of the tables at least would place the cost of administrative convenience on both parties equally, even though the government can more easily bear the burden.

In the earlier memorandum decision of *Merchants National* the court developed an ingenious actuarial argument for the exclusive use of the regulation tables:

If the tables were not determinative in arriving at the value of a life estate, and the IRS were allowed to prove the probability of death at a date prior to that used in the actuarial tables, then, of course, the tables would need to be revised to take these people out of the sample, because the life expectancy of people in good health would rise when not considered along with the people in bad health. If it were accepted, as defendant [IRS] suggests, that the presumptive correctness of the actuarial tables are overcome where extrinsic evidence shows ill health and a probability of early death, then the presumptive correctness would be overcome in all cases where this could not be shown also, because the tables include consideration of sickly people.³⁶

The only rebuttal to such an argument is that the persons who come within the purview of Revenue Ruling 66-307 are so few that they have a negligible effect on the actuarial factors in the table—a position that might be difficult to uphold.

Another argument for the conclusive and systematic application of the actuarial tables might be termed "the maintenance of the court's integrity." Consider the following hypothetical: *X* devises certain property to a charity with an intervening life estate in favor of his son *Y* who has an incurable disease. At *X*'s death his executor argues that the tables are unrealistic because of *Y*'s condition (the lower the value of *Y*'s life interest, the greater the charitable deduction allowed), but

E. Green, 22 T.C. 728 (1954); cf. *McMurty v. Commissioner*, 203 F.2d 659 (1st Cir. 1953).

35. 443 F.2d at 119.

36. 31 Am. Fed. Tax R.2d at 1447.

the Commissioner argues that the tables should be conclusive of *Y*'s life expectancy. *Y* dies shortly after his father and his executor (who may be the same as was his father's) applies for the tax credit for prior transfers. Here the executor argues that the tables should be conclusive of *Y*'s life expectancy at the time of the prior transfer (the greater the value of the life interest, the more credit allowed). The Commissioner now argues, however, that actual expectancy should be used to value the interest, because use of the tables would cause unreasonable results. Some courts have stressed that the tables affect an averaging of results and that the Commissioner "may not switch back and forth for the sake of revenue."³⁷ Strict utilization of the regulation tables would prevent such insults to the courts' integrity.

Most of the arguments against exclusive use of actuarial tables arose when the old actuarial tables were in effect.³⁸ These tables assumed an interest factor of three and one-half percent per year and were based on mortality figures derived from the 1939-1941 census.³⁹ Since they were based on outmoded assumptions and data, the tables were quickly recognized as inadequate,⁴⁰ it was generally felt that they should not be used exclusively in all cases. Several courts rejected the tables because the assumed rate of interest was unrealistic,⁴¹ but even these cases required an extreme discrepancy to overcome the presumption in favor of the tables.

New tables are presently in effect for transactions occurring after December 31, 1970 for valuation of annuities, life estates, terms for years, remainders and reversions.⁴² These tables are based on actuarial data supplied by the 1959-1961 census and assume a six percent interest rate, compounded annually. Therefore, many of the arguments against exclusive use of actuarial tables that pertained to the antiquated 1952 tables are no longer cogent. In addition to increased life expectancy figures and interest rates, the new tables provide separate male and female listings, recognizing the actuarial fact that women normally outlive men. Commentators contend that the revised Regu-

37. *Rosen v. Commissioner*, 397 F.2d 245 (4th Cir. 1968).

38. The old tables cover transactions effected between 1952 and December 30, 1970.

39. Lyon, *The Effect on Estate Planning of the New Valuation Tables for Life Estates, Etc.* N.Y.U. 30TH INST. ON FED. TAX 669, 670 (1972).

40. *Id.* at 671.

41. *Huntington Nat'l Bank*, 13 T.C. 760 (1949); *Security-First Nat'l Bank*, 35 B.T.A. 815 (1937).

42. *Treas. Reg. § 20.2031-10(f)* (1958).

lations should bring about acceptance of actuarial tables by both the courts and the taxpayers.⁴³

The courts and the Service have already agreed to apply conclusively the actuarial tables to code sections 2037(a)(2), regarding transfers taking effect at death, and 2042(2), regarding the possibility of a reversion interest in life insurance proceeds. Revenue Ruling 66-307, which promulgates nonconclusive use of the tables for section 2013, specifically excepts sections 2037 and 2042 from its purview:

However, it [principle of valuation allowing evidence outside the tables] may not be applied in computing the value of a decedent's reversionary interest for the purpose of sections 2037(b) and 2042(2) of the code. In these sections Congress has provided a rule of administrative convenience which requires the application of actuarial tables notwithstanding the facts of the decedent's death or the facts surrounding his death.⁴⁴

The theory supporting strict use of the actuarial tables in these sections was discussed by the Tax Court in *Estate of Dwight B. Roy, Jr.*⁴⁵ The court pointed to the five percent "trigger" factor⁴⁶ in sections 2037 and 2042 as evidence of a legislative mandate that the calculation of value for these sections be mechanical and that the use of the tables be exclusive.⁴⁷ This theory is apparently based on the court's belief that the five percent factor was an arbitrary figure chosen by the legislature. However, the court may have been concerned with more than legislative intent when this decision was reached. If strict use of the tables were not applied to these sections, both the taxpayer and the Commissioner would plague the court with evidence seeking to vary the life expectancy from that reported in the table, either to trigger or to avoid triggering the five percent factor. And in these sections a few years difference in life expectancy could be crucial, for, once the five percent level is reached, there is a full inclusion—not just a five percent inclusion.

43. Lyon, *supra* note 39, at 692. Of course, if the courts adopt strict use of the tables in all tax situations, it would be imperative that the tables be periodically updated to recognize realistic figures for both life expectancy and interest rate. The gain realized from administrative convenience alone should justify the cost of keeping the tables in line with current values.

44. 1966-2 CUM. BULL. 430.

45. 54 T.C. 1317 (1970).

46. These sections are "triggered," *i.e.* cause an inclusion in the gross estate, whenever a decedent's interest value reaches 5% of the total value of the property in question. There is then a full inclusion of the property and not just a 5% inclusion.

47. 54 T.C. at 1323.

Finally, the *Merchants National* decision has an impact upon estate tax planning. When the planner cannot rely exclusively on the actuarial tables, his client's ultimate tax liability is unnecessarily speculative.⁴⁸ An example of the planning ramifications of the method used for valuation can be seen in the establishment of a private annuity agreement. Whether the actuarial tables will be strictly used is very important for the estate planning of the transferor. The estate and gift tax advantages of the annuity agreement may be preserved only if the present value of the annuity promise equals the fair market value of the property at the time of the transfer.⁴⁹ Only by relying on the tables can the planner ascertain such present value with certainty. If property worth 100,000 dollars is transferred in exchange for an annuity promise worth 50,000 dollars, a potentially taxable gift of 50,000 dollars has been made. Consequently, it is important for the planner to know how the Commissioner will determine present value. Likewise, a planner cannot satisfactorily advise a client concerning disposition to a disabled relative if he cannot rely on the conclusiveness of the Regulation tables.

Hopefully, the courts will transpose the presumptive correctness of the Treasury's actuarial tables into a conclusive presumption of law. In light of the administrative convenience that would be fostered, the reliability of the new tables and the boon to estate planning that would result, the courts have ample reasons to do so.

HUGH F. OATES, JR.

Uniform Commercial Code—§ 2-702: Conflict with § 67c(1)(A) of the Federal Bankruptcy Act

In the recent case of *In re Federal's, Inc.*¹ the question of whether section 2-702(2) of the Uniform Commercial Code creates a statutory lien that is invalid against the trustee in bankruptcy was before the court. Section 2-702(2) of the Uniform Commercial Code per-

48. Estate tax liability is always indefinite at the planning stage. But, if the tables may be relied upon conclusively, the planner at least has an idea of the outer limits of tax liability.

49. Lyon, *supra* note 39, at 677.

1. 12 UCC Rep. Serv. 1142 (E.D. Mich. 1973).