
Identification of Income in Respect of a Decedent: The Case for Using Assignment of Income Precedents

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IDENTIFICATION OF INCOME IN RESPECT OF A DECEDENT: THE CASE FOR USING ASSIGNMENT OF INCOME PRECEDENTS

*John G. Steinkamp**

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Death closes the decedent's final income tax year.¹ Only gross income determined under the decedent's method of accounting is taxed in his final return.² Returns of cash method decedents include income they actually or constructively received;³ returns of accrual method taxpayers include income they had a fixed right to receive, the amount of which can be determined with reasonable accuracy.⁴ Amounts not taxable in decedents' final returns, however, do not escape income taxation by reason of death if they constitute items of gross income in respect of a decedent (IRD).⁵

Income in respect of a decedent is the concept Congress enacted to tax earned, but untaxed, amounts that would have been included in decedents' gross incomes had they lived. IRD is gross income to decedents' successors⁶ under the rules currently set forth in the Internal Revenue Code (I.R.C.) section 691.⁷ Although the right to receive an item of IRD constitutes property for local law purposes, the general rule of section 1014 that property acquired from a decedent receives a new basis equal to its estate tax value⁸ does not apply to items of income in respect of a decedent.⁹ Section 691 income in respect of a decedent and section 1014 property are mutually exclusive categories.¹⁰

1. I.R.C. §§ 441(b)(3), 443(a)(2). All references herein are to the Internal Revenue Code of 1986 as amended and in effect as of the date of this article unless otherwise indicated.

2. *Id.* § 451(a); Treas. Reg. § 1.451-1(b)(1) (as amended in 1993).

3. Treas. Reg. § 1.451-1(a) (as amended in 1993).

4. *Id.*

5. I.R.C. §§ 61(a)(14), 691.

6. In this article "decedents' successors" refers to the persons taxable on income in respect of a decedent under section 691(a)(1). The code provides that a successor is:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

I.R.C. § 691(a)(1).

7. The income in respect of a decedent rules were first enacted in section 134 of the Revenue Act of 1942 as I.R.C. § 126. Revenue Act of 1942, ch. 619, § 134, 56 Stat., pt. 1, 798, 830-34. For purposes of consistency, references in this article to the applicable statute will generally be to section 691, even though section 126 governed taxation at the time under discussion.

8. I.R.C. § 1014(a).

9. *Id.* § 1014(c).

10. *Id.* § 1014(c); Estate of Davison v. United States, 292 F.2d 937, 940 (Ct. Cl. 1961); H.R. REP. NO. 77-2333, at 84 (1942), reprinted in 1942-2 C.B. 372, at 436; S. REP. NO. 77-1631, at 101 (1942), reprinted in 1942-2 C.B. 504, at 580.

Property which constitutes income in respect of a decedent is potentially subject to double taxation. Not only will it be subject to income taxation after death, but its date of death fair market value will usually¹¹ be included in the decedent's gross estate for federal estate tax purposes.¹² Double taxation does not always result, however, because items need not be included in the gross estate in order to constitute IRD¹³ and, even if included, the amounts subject to taxation may differ.¹⁴ In order to furnish some relief from double taxation, Congress provided to the person required to include IRD in income a deduction for federal estate tax attributable to the IRD.¹⁵

Income in respect of a decedent issues should be considered both before and after death.¹⁶ Before death, assets should be classified as either property entitled to a section 1014 basis or as income in respect of a decedent. Once identified, planning can be undertaken to minimize potential taxes. For example, appreciated property that would be entitled to a section 1014 basis could be retained until death to receive the favorable basis adjustment. Actions that would convert such property into an item of income in respect of a decedent, such as an installment sale, could be avoided. On the other hand, if an IRD item is already owned, it could be specifically devised to several lower tax bracket beneficiaries to reduce the eventual income tax burden.

After death, identification of income in respect of a decedent is necessary to lessen its income taxation under the IRD rules. While IRD is not generally included in income until payment is received,¹⁷ the transfer of the right to receive IRD may accelerate taxation.¹⁸ For example, funding a pecuniary devise with a right to receive an item of IRD causes recognition of income without producing cash with which

11. I.R.C. § 2031. The executor, however, may elect to value assets at other than date of death in certain estates under section 2032 or to value certain property at other than fair market value under section 2032A.

12. See *id.* §§ 2033-2044.

13. See John S. Brown, *Income in Respect of a Decedent*, 55 CORNELL L. REV. 211, 216 n.34 (1970).

14. Since the amount of income in respect of a decedent subject to income tax generally depends on the amount actually received after death, the amount subject to income tax may be less than, equal to, or greater than the amount included in a decedent's gross estate. See Treas. Reg. § 1.691(a)-(5)(c) (as amended in 1965).

15. I.R.C. § 691(c).

16. See M. CARR FERGUSON ET AL., *FEDERAL INCOME TAXATION OF ESTATES, TRUSTS, AND BENEFICIARIES*, 3:128-132 (2d ed. 1996 & Supp. 1996) (discussing various ways to minimize the tax consequences of income in respect of a decedent); Jonathan G. Blattmachr, *Income in Respect of a Decedent*, 12 PROB. NOTES 47, 51-53 (1986).

17. I.R.C. § 691(a)(1).

18. *Id.* § 691(a)(2).

to pay the tax.¹⁹ On the other hand, an estate's distribution of the right to receive IRD to a residuary devisee will not accelerate taxation and may shift future income taxation to lower tax bracket taxpayers.²⁰

Since identification of income in respect of a decedent is essential to its proper taxation, it would seem that Congress would have carefully defined the term to include all items it intended to tax and to exclude items that were to receive a new basis under section 1014. It did not. Although Treasury Regulations contain a general definition²¹ and several examples²² of income in respect of a decedent, the task of determining the meaning of the term has fallen to the courts.²³

The courts, unfortunately, have expounded alternative and inconsistent tests for identifying income in respect of a decedent. The articulated tests are confounding, moreover, because courts have at times decided cases on the basis of the statutory language and at other times on policy grounds. No universal test has yet been announced; nor can one be devised because of the variety of settings in which income in respect of a decedent can arise.²⁴ Almost every item of gross income under section 61 can constitute income in respect of a decedent.²⁵ Courts, in deciding whether a particular item is IRD, have considered factors deemed pertinent to characterization of the particular item at issue.

19. See *Kenan v. Commissioner*, 114 F.2d 217 (2d Cir. 1940).

20. I.R.C. § 691(a)(2); Treas. Reg. § 1.691(a)-4(b)(2) (1957).

21. The regulations provide:

(b) *General definition.* In general, the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent. See the regulations under section 451. Thus, the term includes—

- (1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;
- (2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an accrual method of accounting; and
- (3) Income to which the decedent had a contingent claim at the time of his death.

See sections 736 and 753 and the regulations thereunder for "income in respect of a decedent" in the case of a deceased partner.

Treas. Reg. § 1.691(a)-1(b) (as amended in 1965).

22. Treas. Reg. § 1.691(a)-2(b) (1957).

23. See, e.g., *Rollert Residuary Trust v. Commissioner*, 80 T.C. 619, 629 (1983), *aff'd*, 752 F.2d 1128 (6th Cir. 1985); *Estate of Peterson v. Commissioner*, 74 T.C. 630, 638 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981).

24. *Trust Co. of Ga. v. Ross*, 262 F. Supp. 900, 910 (N.D. Ga. 1966), *aff'd*, 392 F.2d 694 (5th Cir. 1967) (per curiam); *Estate of Davison v. United States*, 292 F.2d 937, 940 (Ct. Cl. 1961).

25. *Commissioner v. Linde*, 213 F.2d 1, 7 (9th Cir. 1954).

An integral part of federal income tax law is the judicially developed donative assignment of income doctrine.²⁶ While the I.R.C. defines "gross income" in section 61, it does not specifically identify the taxpayer who must pay tax on the income.²⁷ Courts, under section 61 and its precursors, determined that "gross income" includes the notion that income is to be taxed to a particular taxpayer, the one who earned it, and that assignment of the right to receive income is ineffective to shift its taxation to another.²⁸ The doctrine protects the progressive federal income tax against transfers intended to reduce the overall tax burden.

When Congress enacted the income in respect of a decedent rules in 1942, the assignment of income doctrine was well established. Landmark Supreme Court decisions which delineated important parameters of the doctrine had been decided in the twelve years preceding enactment.²⁹ Congress, no doubt aware of the assignment of income cases, enacted section 691 to tax "gross income in respect of a decedent." The new statutory scheme provided rules to tax income assigned at death, just as the assignment of income doctrine provided rules to tax income assigned during life.

Considered in this context, the lack of a statutory definition of income in respect of a decedent emerges as a deliberate legislative decision rather than an unfortunate oversight. Congress, except in a limited number of areas,³⁰ has not attempted to codify the circumstances that trigger the assignment of income doctrine. By using the nebulous term "gross income in respect of a decedent," Congress implicitly relied upon the courts to give content to the phrase in a manner consistent with good tax policy³¹ and fundamental principles of federal income taxation.³²

26. See generally James S. Eustice, *Contract Rights, Capital Gain, and Assignment of Income—The Ferrer Case*, 20 TAX L. REV. 1 (1964); Charles S. Lyon & James S. Eustice, *Assignment of Income: Fruit and Tree as Irrigated by the P.G. Lake Case*, 17 TAX L. REV. 293 (1962); Lloyd G. Soll, *Intra-Family Assignments: Attribution and Realization of Income*, 6 TAX L. REV. 435 (1951).

27. See Soll, *supra* note 26, at 435.

28. Commissioner v. Reece, 233 F.2d 30, 32-33 (1st Cir. 1956).

29. See, e.g., Harrison v. Schaffner, 312 U.S. 579 (1941); Helvering v. Eubank, 311 U.S. 122 (1940); Helvering v. Horst, 311 U.S. 112 (1940); Helvering v. Clifford, 309 U.S. 331 (1940); Blair v. Commissioner, 300 U.S. 5 (1937); Burnet v. Leininger, 285 U.S. 136 (1932); Lucas v. Earl, 281 U.S. 111 (1930).

30. See, e.g., I.R.C. §§ 671-678 (grantor trusts); *id.* § 704 (family partnerships).

31. See Note, *Income in Respect of Decedents: The Scope of Section 126*, 65 HARV. L. REV. 1024, 1032 (1952).

32. See Deborah A. Geier, *Interpreting Tax Legislation: The Role of Purpose*, 2 FLA. TAX REV. 492, 509 (1995) (suggesting that "Congress often uses the best words that it could have chosen in the situation to capture an idea—'capital expenditure,' 'cost,' 'gift,'—but the words

Judicial inability to adequately define income in respect of a decedent or to develop a universally applicable test is a result of the general failure of judges³³ to recognize that donative assignment of income and income in respect of a decedent cases involve a common inquiry—whether the item transferred was “earned” income or property. The character of the item transferred and the status of ongoing transactions must be considered in making that determination in both contexts. Courts should acknowledge that income in respect of a decedent can be identified by using the same factors used in donative assignment of income cases and identify IRD by reference to, and in a manner consistent with, the substantial body of donative assignment of income case law.

The history of taxation of decedents’ earned, but untaxed, income at death is reviewed in Part I. The scope of income in respect of a decedent is addressed in Part II. Judicial efforts to identify income in respect of a decedent are discussed in Part III. The case for identifying income in respect of a decedent by reference to donative assignment of income precedents is made in Part IV. Taxation of selected items transferred during life and at death is compared in Part V.

I. THE STATUTORY HISTORY

A. Pre-1934

In the early days of federal income taxation, amounts not actually or constructively received by cash method taxpayers during their lives entirely escaped income taxation at death.³⁴ Deceased individuals and their estates were then,³⁵ as they are now,³⁶ separate entities for federal income tax purposes. Amounts that cash taxpayers had earned during their lives were not includible in their final returns absent actual or constructive receipt, nor were such amounts income to their estates or successors when received because they were consid-

nevertheless cannot be given meaning without resort to the larger statutory structure of an income tax”) (citations omitted).

33. Several judges have recognized that assignment of income and income in respect of a decedent are related and that precedent in one line of cases is relevant in deciding cases in the other. *See, e.g.*, *Tatum v. Commissioner*, 400 F.2d 242, 247 & n.18 (5th Cir. 1968); *Estate of Sidles v. Commissioner*, 65 T.C. 873, 890, 896 (1976) (Tannewald, J., dissenting in part).

34. *Kemper v. Commissioner*, 14 B.T.A. 931, 933 (1928) (salary and bonuses); *Heller v. Commissioner*, 10 B.T.A. 53, 56 (1928) (accrued interest and rent); *Nichols v. United States*, 64 Ct. Cl. 241, 245 (1927) (partnership income); *Frank v. Commissioner*, 6 B.T.A. 1071, 1072 (1927) (accrued interest); *Held v. Commissioner*, 3 B.T.A. 408, 408 (1926) (salary).

35. *Nichols*, 64 Ct. Cl. at 245.

36. *See* I.R.C. § 6012; *Biewer v. Commissioner*, 341 F.2d 394, 396 (6th Cir. 1965).

ered corpus.³⁷ Although Congress had expressly exempted only unrealized appreciation of property from post-death income taxation by the predecessor of section 1014, exclusion of items otherwise taxable was "purely the unanticipated result of principles of general estate law."³⁸

Accrual basis taxpayers, however, received less favorable income tax treatment at death. Amounts properly accrued under their method of accounting were taxed in their final returns, regardless of receipt.³⁹ Only income not properly accrued, such as amounts as to which the decedent had only a contingent right or which were indeterminable with reasonable accuracy, escaped income taxation upon the death of accrual method taxpayers.

B. 1934-1942

In 1934, Congress acted to eliminate the loss of revenue caused by the death of cash method taxpayers.⁴⁰ It amended section 42 of the Internal Revenue Code to require that amounts "accrued" up to the date of death, if not otherwise includible in a return for the decedent, be included in the decedent's final return.⁴¹ Congress also provided that deductions accrued to the date of death, not otherwise properly allowable to the decedent, were to be allowed in the decedent's final return.⁴²

Congress, however, did not define "accrued" in the statute, nor did the legislative history disclose an intended meaning for the term different from its meaning under other code sections.⁴³ Determination of whether an item was accrued, however, was critical to the application of the statute. That question, moreover, was a mixed question of fact, law, and accounting practice.⁴⁴ No single accrual system existed⁴⁵ and accrual had no generally accepted meaning.⁴⁶ Although two re-

37. *Heller*, 10 B.T.A. at 56; *Nichols*, 64 Ct. Cl. at 245.

38. Abraham S. Guterman, *New Problems Under Section 126 in Income and Estate Taxes*, 24 TAXES 633, 633 (1946).

39. *Id.* at 634.

40. H.R. REP. NO. 73-704, at 24 (1934), *reprinted in* 1939-1 C.B. 554, 572; S. REP. NO. 73-558, at 28 (1934), *reprinted in* 1939-1 C.B. 586, 608.

41. Revenue Act of 1934, ch. 277, § 42, 48 Stat., pt. 1, 680, 694 (1934).

42. *Id.* § 43.

43. Stephen M. Farrand & Knox Farrand, *Treatment of Accrued Items in the Event of the Death of a Taxpayer*, 13 S. CAL. L. REV. 431, 437 (1940).

44. Charles C. Parlin, *Accruals to Date of Death for Income Tax Purposes*, 87 U. PA. L. REV. 295, 302 (1939).

45. *Id.* at 301.

46. Farrand & Farrand, *supra* note 43, at 438; Note, *Income Accrued to a Decedent Partner Under the Federal Revenue Acts*, 50 YALE L.J. 170, 172-73 (1941).

quirements for accrual could be identified under the “all events test” (a right to receive income the amount of which could be determined with reasonable accuracy),⁴⁷ section 42 appeared to require creation of an accrual method of taxation for taxpayers for whom the concept was entirely new.⁴⁸

The legislative history suggested that the 1934 amendments would only affect cash method taxpayers and place them on the accrual method at death.⁴⁹ The gap in the cash method that permitted cash method decedents to escape taxation on accrued income was thereby closed.⁵⁰ Although section 42 was not limited to cash method taxpayers, nothing in the legislative history suggested that the new provisions would alter taxation of accrual basis decedents.⁵¹ The problem Congress had identified was that income of cash basis taxpayers was escaping taxation at death.⁵² No loss-of-revenue-at-death problem appears to have been perceived in the case of accrual basis taxpayers whose final returns already included income accrued to death.

Congressional failure to define “accrued” meant that the courts would determine its meaning. Early decisions interpreted it in a straightforward, limited manner as merely placing cash method taxpayers on the accrual method.⁵³ For example, in *Fehrman v. Commis-*

47. Farrand & Farrand, *supra* note 43, at 439; Note, *Income Accrued to a Decedent Partner Under the Federal Revenue Acts*, *supra* note 46, at 173.

48. Parlin, *supra* note 44, at 301.

49. H.R. REP. NO. 73-704, at 24 (1934), *reprinted in* 1939-1 C.B. 554, 572; S. REP. NO. 73-558, at 28 (1934), *reprinted in* 1939-1 C.B. 586, 608.

50. *Estate of Lambert v. Commissioner*, 40 B.T.A. 802, 808 (1939). The Board of Tax Appeals found section 42 to be a reasonable solution to the problem presented by the death of a cash method taxpayer:

The cash system of accounting is one that has a proper use only where there is a future period for taxing income received subsequently to the period in which the right to receive accrues. It is only because of the existence of such future period that the taxing of the property represented by the accrual is postponed until the actual period of collection. Thus, where a taxpayer, reporting on a cash basis and deferring the inclusion of receivables acquired in one year until the future period of their collection, dies, the possibility of the existence of such future period ceases. One of the conditions supporting the use of the cash system is, therefore, then eliminated and such system becomes no longer applicable to correctly reflect income.

Id.

51. H.R. REP. NO. 73-704, at 24 (1934), *reprinted in* 1939-1 C.B. 554, 572; S. REP. NO. 558, at 28 (1934), *reprinted in* 1939-1 C.B. 586, 608.

52. *Id.*

53. *Fehrman v. Commissioner*, 38 B.T.A. 37, 42 (1938). The board stated:

[T]he purpose of Congress was to treat the income of a decedent as though he were on an accrual basis even though he was actually on a cash basis and kept his books on a cash basis, and that the phrase “amounts accrued up to the date of his death” means those amounts which would be properly included in a decedent’s income if he were on an accrual basis as distinguished from a cash basis.

sioner,⁵⁴ the Board of Tax Appeals held that a cash taxpayer's unpaid compensation, determined as a percentage of annual profits after his death, was not "accrued" for purposes of section 42 because the amount would not have been income in an accrual taxpayer's final return.⁵⁵

The period of a limited interpretation of "accrued" ended with the Supreme Court's 1941 decision in *Helvering v. Estate of Enright*.⁵⁶ Enright was a partner in a law firm at the time of his death.⁵⁷ Both the decedent and the partnership reported income on the cash method.⁵⁸ The Court had to decide whether the deceased attorney's final return was to include, as "accrued" income, his share of profits that had been earned, but not received, by the partnership at the time of his death.⁵⁹

The Court, in determining the meaning of "accrued" under section 42, rejected traditional tax accounting meanings⁶⁰ as well as a definition found elsewhere in the code.⁶¹ Although the Court acknowledged the congressional objective of putting cash taxpayers on the accrual basis, that purpose did not answer the meaning of accrual for cash taxpayers.⁶² The Court concluded that accrual was to be construed to fulfill the congressional intent "to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns."⁶³

The Court held that if the decedent had a right to income that could be approximately valued, it would be considered "accrued" for purposes of section 42:

The completion of the work in progress was necessary to fix the amount due but the right to payment for work ordinarily arises on partial performance. Accrued income under § 42 for uncompleted operations includes the value of the services rendered by the dece-

Id.; accord *Estate of McGlue v. Commissioner*, 41 B.T.A. 1186, 1193 (1940), *rev'd*, 119 F.2d 167 (4th Cir. 1941); *Estate of Lambert v. Commissioner*, 40 B.T.A. 802, 806 (1939).

54. 38 B.T.A. 37 (1938).

55. *Id.* at 42.

56. 312 U.S. 636 (1941).

57. *Id.* at 637-38.

58. *Id.* at 637.

59. *Id.*

60. *Id.* at 643.

61. *Id.* at 644.

62. *Id.* ("Accounts kept consistently on a basis other than cash receipts might treat accruals quite differently from a method designed to reflect the earned income of a cash receipt taxpayer.")

63. *Id.* at 644-45.

dent, capable of approximate valuation, whether based on the agreed compensation or on quantum meruit.⁶⁴

The amounts in *Enright* met those requirements and were taxable in the decedent's final return.⁶⁵

Enright "gave the word 'accrued' a meaning beyond that generally used in referring to a taxpayer on the accrual basis."⁶⁶ It exacerbated the "bunching" of income problem that was inherent in section 42 after 1933.⁶⁷ Although this problem affected both cash and accrual method taxpayers, it was particularly burdensome for cash method taxpayers. Not only was all income received by cash method taxpayers taxed in their final returns, but amounts that would not have been taxed in accrual method taxpayers' final returns under prior law were taxed in those returns.⁶⁸ Accrual caused taxation without receipt of cash with which to pay the tax and permitted taxation of "amounts that might never be collected or collected only after many years"⁶⁹ at substantially higher rates.⁷⁰

C. 1943-Present

Congress responded to *Enright*⁷¹ by repealing the accrual-at-death provisions and by enacting a new statutory scheme in the Revenue Act of 1942.⁷² Thereafter, decedents' final returns were to be prepared as they had been before 1934. In order to insure that accrual method, as well as cash method, decedents received relief from the "bunching" problem,⁷³ section 42 was amended to provide that amounts accrued in accrual taxpayers' final returns (other than amounts includible by a partner under section 182) solely by reason of death would not be included in their final returns.⁷⁴

64. *Id.* at 645.

65. *Id.*

66. *Commissioner v. Linde*, 213 F.2d 1, 5 (9th Cir. 1954).

67. *Guterman*, *supra* note 38, at 634.

68. *See, e.g.*, *First Nat'l Bank & Trust Co. of Montclair v. Manning*, 196 F.2d 247, 248 (3d Cir. 1952) (holding that a lump sum payment under an employment contract to a deceased employee's estate was "accrued" under section 42 even though amount would have been paid to the employee over a nine-year period had he lived); *Helvering v. McGlue's Estate*, 119 F.2d 167, 169-70 (4th Cir. 1941) (holding that executor fees to which the decedent had a fixed claim but the amount of which depended on the events that had not occurred were "accrued" under section 42).

69. *Estate of Davison v. United States*, 292 F.2d 937, 939 (Ct. Cl. 1961).

70. *Trust Co. of Ga. v. Ross*, 262 F. Supp. 900, 907 (N.D. Ga. 1966), *aff'd*, 392 F.2d 694 (5th Cir. 1967) (per curiam).

71. *See Estate of Riegelman v. Commissioner*, 253 F.2d 315, 318 (2d Cir. 1958).

72. Revenue Act of 1942, ch. 619, § 134, 56 Stat., pt. 1, 798, 830-34 (1942).

73. *Guterman*, *supra* note 38, at 634.

74. § 134(a), 56 Stat., pt. 1, at 830.

In place of the accrual-at-death provisions, Congress enacted section 126,⁷⁵ the precursor of section 691, to prevent income from escaping taxation at death. The new section required “[t]he amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period” to be taxed not to the decedent in his final return, but to the recipient of the right to receive the income generally at the time of payment.⁷⁶ All recipients of IRD were thus put on the cash method for IRD items regardless of their usual method. Special rules, however, caused taxation of income in respect of a decedent before collection in the case of certain transfers of the right to receive the IRD.⁷⁷ The character of the income to the successor was to be determined by reference to the character it would have had in the decedent’s hands had he lived and received it.⁷⁸

The income in respect of a decedent provisions were made applicable to returns for tax years ending after December 31, 1942.⁷⁹ But, in order to provide greater relief from the burdensome provisions of prior law, Congress made section 126 retroactive to decedents who died after December 31, 1933, if the estate and the person entitled to the income consented to be taxed as if provisions corresponding to those under section 126 had been applicable.⁸⁰

Section 126 was reenacted, substantially unchanged, as section 691 of the Internal Revenue Code of 1954.⁸¹ Since 1942, Congress has fine-tuned the statutory scheme on several occasions. For example, Congress has specifically addressed income in respect of prior decedents,⁸² installment obligations,⁸³ and application of section 691 in the case of deceased partners.⁸⁴

II. THE SCOPE OF INCOME IN RESPECT OF A DECEDENT

When Congress acted in 1942, it did not solve the “bunching” problem of prior law by simply shifting taxation of section 42’s “accrued” income from decedents’ final returns to their successors’ returns. It repealed the accrual-at-death provisions and employed an entirely

75. *Id.* at 831-32.

76. *Id.* at 831.

77. *Id.*

78. *Id.*

79. § 134(f), 56 Stat., pt. 1, at 832.

80. § 134(g), 56 Stat., pt. 1, at 832-34.

81. Internal Revenue Code of 1954, § 691, 68A Stat. 1, 235-38.

82. I.R.C. § 691(a)(1).

83. *Id.* § 691(a)(4), (5).

84. *Id.* § 691(e).

new concept to address the problem it had identified in 1934. Congress mandated that "all items of gross income in respect of a decedent" be taxed to decedents' successors under a new statutory scheme.

The initial question in the identification of income in respect of a decedent concerns its scope. Although this issue is related to the question of how IRD should be identified, it is a distinct, preliminary question. Only after the congressional purpose is ascertained can the criteria for identification of IRD be determined.

Three possibilities exist as to the intended scope of gross income in respect of a decedent. First, IRD might only include amounts that would have been income to accrual method taxpayers and reported in their final returns under pre-1934 law (retreat from existing law). Second, IRD might only include amounts that would have been "accrued" income under section 42 as interpreted by the Supreme Court in *Enright* (continuation of existing law). Finally, IRD might include all amounts of earned, but untaxed, income that would have been income under the decedent's method of accounting had he lived, even if such amounts would not have been "accrued" under section 42 (expansion of existing law). Determination of the scope of IRD requires consideration of the problems to which Congress responded in 1934 and 1942, the statutory language, and the legislative history.

A. *Retreat from Existing Law*

Congress could have had limited objectives in 1942—eliminate the "bunching" problem it had created in section 42, prevent income from escaping taxation at death, and tax cash and accrual basis taxpayers on substantially the same amount of income. All three objectives could have been accomplished by taxing successors of deceased cash method taxpayers on income that would have been included on accrual taxpayers' final returns under pre-1934 law.⁸⁵ Section 691, so viewed, would merely have caused the same amount of income to be taxed in the case of all decedents, cash and accrual,⁸⁶ albeit at different times and in a different manner.

But if Congress had intended to retreat from the taxation of "accrued" income as broadly construed in *Enright*, it could have done so

85. See Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1027 (suggesting that "[i]f stress is placed on the words 'of a decedent,' it might be taken to refer merely to amounts which were actually realized by the decedent in the sense that had he been on the accrual system he would have reported them") (footnote omitted).

86. See *id.* at 1031 ("It is true that nothing in the section can be found which is inconsistent with the view that its only purpose was to equalize treatment of the cash and accrual-basis taxpayer.").

by narrowly defining IRD to achieve that limited objective or by confining section 691 to cash method taxpayers.⁸⁷ The legislative history, however, clearly indicates a congressional intent that accrued income under section 42 continue to be subject to taxation under the new statutory scheme.⁸⁸ By taxing "gross income in respect of a decedent," a term more encompassing than "accrued" income and equally applicable to cash and accrual method taxpayers, Congress clearly rejected a retreat from existing law.

B. Continuation of Existing Law

Congress could have intended only to solve the "bunching" problem under prior law and to continue taxing amounts that would have been "accrued" income under section 42. Some litigants⁸⁹ and commentators⁹⁰ initially suggested that Congress acted in 1942 with these limited objectives in mind. Implicit in such a position was the acknowledgment that Congress, at a minimum, intended to continue taxing amounts that had been taxed under prior law.

The legislative history plainly demonstrates that Congress intended to continue taxing income that was considered "accrued" under prior law in a way that avoided the hardship which resulted "from including in the income for the decedent's last taxable period amounts which ordinarily would be receivable over a period of several years."⁹¹ That history, however, does not necessarily support the conclusion that income in respect of a decedent was to be limited to such amounts. Indeed, other language in the committee reports suggests that "gross income in respect of a decedent" was a broader concept than "accrued" income under section 42 and would cause taxation of amounts that would not have been considered "accrued" under prior law.⁹² It is this latter position that the courts would adopt in their efforts to

87. See *id.* at 1027.

88. H.R. REP. NO. 77-2333, at 84 (1942), *reprinted in* 1942-2 C.B. 372, 435-36; S. REP. NO. 77-1631, at 101 (1942), *reprinted in* 1942-2 C.B. 504, 579-80.

89. See, e.g., *Hess v. Commissioner*, 271 F.2d 104, 108 (3d Cir. 1959); *United States v. Ellis*, 264 F.2d 325, 327 (2d Cir. 1959); *Commissioner v. Linde*, 213 F.2d 1, 6 (9th Cir. 1954).

90. Guterman, *supra* note 38, at 634; Frank C. Scott, *A Critique of Section 126*, 26 TAXES 127, 129 (1948).

91. H.R. REP. NO. 77-2333, at 84 (1942), *reprinted in* 1942-2 C.B. 372, 435-36; S. REP. NO. 77-1631, at 101 (1942), *reprinted in* 1942-2 C.B. 504, 579-80.

92. H.R. REP. NO. 77-2333, at 84 (1942), *reprinted in* 1942-2 C.B. 372, 436 ("All amounts of gross income which are not includible in the income of the decedent will, when received, be includible in the income of the person receiving such amounts by inheritance or survivorship from the decedent under section 126."); S. REP. NO. 77-1631, at 101 (1942), *reprinted in* 1942-2 C.B. 504, 580.

give content to the meaning of "gross income in respect of a decedent."

C. Expansion of Existing Law

Merely changing the time of taxation and the identity of the taxpayer for decedent's "accrued" income might not have resulted in the taxation of all items that Congress believed should be subject to income taxation after death. The Supreme Court in *Enright* held that Congress intended to tax amounts that had been "earned" during decedent's life under section 42,⁹³ amounts to which decedent possessed a right at the time of his death, although the amount was not ascertainable with certainty.⁹⁴ Contingent amounts, to which decedent possessed no right, presumably would not have been considered "accrued" under section 42,⁹⁵ even though decedent possessed an expectation that had value.⁹⁶

The language of section 691 and the statutory scheme suggest a more encompassing approach to taxing earned, but untaxed, income transferred at death than simply taxing "accrued" income to which decedent had a right on his final return.⁹⁷ Since income in respect of a decedent is generally not taxed until received by decedent's successor, perhaps decedent need not have possessed an enforceable right to the item in order for the post-death receipt to be IRD.⁹⁸ Statements in the committee reports that "[a]ll amounts of gross income which are not includible in the income of the decedent will, when received, be includible in the income of the person receiving such amounts"⁹⁹ support such a view.¹⁰⁰

93. *Helvering v. Estate of Enright*, 312 U.S. 636, 644-45 (1941).

94. *Id.* at 645; Kenneth W. Gemmill, *Accruals to Date of Death for Income Tax Purposes*, 90 U. PA. L. REV. 702, 704 (1942) ("Here then is the decision of the *Enright* case—if the decedent was entitled, at the time of his death, to payment for work done though the amount was not then fixed, there is an accrual under Section 42.").

95. Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1026.

96. See Gemmill, *supra* note 94, at 705 ("In such case there is no fixed right to payment of any amount at date of death. Although such an expectancy might have value depending upon one's appraisal of the case at hand, there is no accrual of income.").

97. See John W. Drye, Jr., *The Taxation of a Decedent's Income*, 8 TAX L. REV. 203, 210 (1953); Walter D. Freyburger, *Employee Benefit Plans—Taxability of Death Benefits*, 23 TAXES 962, 966 (1945); Edward N. Polisher, *Income in Respect to the Decedent—Its Federal Income and Estate Tax Implications*, 56 DICK. L. REV. 269, 282 (1952); Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1026.

98. Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1026.

99. H.R. REP. NO. 77-2333, at 84 (1942), *reprinted in* 1942-2 C.B. 372, 436; S. REP. NO. 77-1631, at 101 (1942), *reprinted in* 1942-2 C.B. 504, 580.

100. Polisher, *supra* note 97, at 274-75. The author concluded:

An argument in favor of an expanded scope of taxation under section 691 was made in a 1952 *Harvard Law Review* Note:

[I]f Congress was expanding Section 42, it may be argued that the vagueness of Section 126 was intended to give the Commissioner and the courts discretion in deriving the content from considerations of wise tax policy, and that an expansive approach such as that evinced by *Enright* would produce more rational results. The phraseology of Section 126(a)(3) is capable of meaning that the successor shall stand in decedent's shoes and be treated as decedent would have been had he lived, that the applicability of the section is not to be determined by the nature of the "right" at decedent's death.¹⁰¹

Other commentators concluded that more items could be taxed under the new concept of income in respect of a decedent than under the prior law's taxation of "accrued" income.¹⁰²

Two cases played important roles in determining the scope of income in respect of a decedent. The first, *O'Daniel's Estate v. Commissioner*,¹⁰³ required the court to address the argument that IRD was limited to amounts the decedent had a legally enforceable right to receive at death.¹⁰⁴ The item in question was an employee bonus awarded after the employee's death to which the decedent had not had a legally enforceable right.¹⁰⁵ The court held the right to receive income in respect of a decedent is "not necessarily a legally enforceable right" and that the bonus was IRD because it was "derived through rights he had acquired, which, even if not fixed at the time of his death, were then expectancies which later bore fruit."¹⁰⁶ The Second Circuit's concept of "right" was inconsistent with common law principles which required enforceability.¹⁰⁷ The court viewed "the term as merely a convenient way of describing all income items coming into a successor's hands because of decedent's death."¹⁰⁸

The adoption of the rationale that the tax life of the decedent is to be extended to include those items which he would have reported ultimately as income, had death not intervened, is obviously a somewhat different proposition than the concept of "accrued items" in the *Enright* decision. It does, however, conform with the spirit and the wording of Section 126, and also with the Reports of the House Ways and Means Committee and the Senate Committee on Finance.

Id. at 276.

101. Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1032.

102. See Drye, *supra* note 97, at 203; Freyburger, *supra* note 97, at 966; Polisher, *supra* note 97, at 282; Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1026.

103. 173 F.2d 966 (2d Cir. 1949).

104. *Id.* at 967-68.

105. *Id.* at 967.

106. *Id.* at 968.

107. Polisher, *supra* note 97, at 275.

108. See Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1027 (footnote omitted).

The second case, *Commissioner v. Linde*,¹⁰⁹ required the court to address the argument that income in respect of a decedent was a relief provision limited to taxing amounts that would have been “accrued” income under prior law.¹¹⁰ In rejecting that position, the court held:

[W]hile Sec. 126 was designed to relieve this bunching [problem], there is nothing in the legislative history or in the text of Sec. 126 to indicate that it was intended to be anything other than an improved device to accomplish the general purpose of the internal revenue code that all income should pay a tax and that death should not rob the United States of the revenue which otherwise it would have had. We think it clear that the intent of Congress continued to be as stated in the Enright case “to cover into income the assets of decedents, earned during their life and unreported as income.”¹¹¹

Linde, harshly criticized as “but a paraphrase of the [*Harvard Law Review*] note in abridged form,”¹¹² would be relied upon repeatedly by courts as having established that section 691 expanded taxation of earned, but untaxed, income transferred at death.¹¹³

D. Summary

Section 691’s taxation of “gross income in respect of a decedent” represented an expanded effort to tax all earned, but untaxed, income of decedents. In 1934, Congress had attempted to solve the problem of income that escaped taxation at death by requiring that decedents’ final returns include income “accrued” up to the time of death. The “bunching” problem that initial effort created prompted Congress to revisit the issue in 1942. Congress’ solution was to repeal the prior law and enact a new statutory scheme designed to tax “[a]ll amounts of gross income which are not includible in the income of the decedent.”¹¹⁴ “Accrual,” an accounting concept, was discarded and the more encompassing phrase “gross income in respect of a decedent” was enacted so “that death should not rob the United States of the revenue which otherwise it would have had.”¹¹⁵

109. 213 F.2d 1 (9th Cir. 1954).

110. *Id.* at 5.

111. *Id.* (footnote omitted).

112. Frank C. Scott, *The Strange Case of Commissioner v. Linde*, 33 TAXES 675, 677 (1955).

113. See, e.g., *United States v. Ellis*, 264 F.2d 325, 328 (2d Cir. 1959); *Estate of Riegelman v. Commissioner*, 253 F.2d 315, 318 (2d Cir. 1958); *Estate of Sidles v. Commissioner*, 65 T.C. 873, 879 (1976), *aff’d*, 553 F.2d 102 (8th Cir. 1977); *Estate of Davison v. United States*, 292 F.2d 937, 941 (Ct. Cl. 1961).

114. H.R. REP. NO. 77-2333, at 84 (1942), *reprinted in* 1942-2 C.B. 372, 436; S. REP. NO. 77-1631, at 101 (1942), *reprinted in* 1942-2 C.B. 504, 580.

115. *Linde*, 213 F.2d at 5 (footnote omitted).

III. JUDICIAL EFFORTS TO IDENTIFY INCOME IN RESPECT OF A DECEDENT

Judicial efforts to identify income in respect of a decedent have resulted in development of several court-devised tests. Courts have alternatively relied upon the statutory language, legislative history, and Treasury Regulations as supporting, if not mandating, a particular analysis. Application of all judicially developed tests is fact intensive. The fact-based nature of the inquiry precludes adoption of a single test appropriate to identify income in respect of a decedent in all the settings in which it can arise.

A. *The Income to Decedent If He Had Lived Test*

The test to determine which post-death receipts constitute income in respect of a decedent might be found through careful examination of the statutory language. Section 691(a)(1) provides for taxation "of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period."¹¹⁶ Section 691(a)(3) provides that IRD has the same "character which it would have had in the hands of the decedent if the decedent had lived and received such amount."¹¹⁷ Income in respect of a decedent, consequently, may simply be earned income which was not taxable to the decedent because of his method of accounting, but which would have been included in the decedent's income at some point had he lived.

Support for an income to decedent if he had lived test can be found in early decisions. The fact that amounts would have been income to the decedent was sometimes stated in such a way as to suggest it was dispositive.¹¹⁸ At other times, although the case was decided under an alternative test, the fact that the item would have been income to the decedent was cited as an important factor.¹¹⁹ For example, in *Commissioner v. Linde*, the Ninth Circuit concluded:

116. I.R.C. § 691(a)(1).

117. *Id.* § 691(a)(3).

118. *Latendresse v. Commissioner*, 26 T.C. 318, 324-26 (1956), *aff'd*, 243 F.2d 577 (7th Cir. 1957) ("Had the renewal commissions . . . been paid to Frank while he lived, they would unquestionably have been taxable to him. . . . Accordingly, we hold that those commissions are taxable to her as ordinary income, in the year of receipt, under section 126(a) of the Internal Revenue Code."); *Estate of Remington v. Commissioner*, 9 T.C. 99, 104-05 (1947) ("If the payments of a portion of the commissions on insurance had been made to decedent, they could have been nothing but income. . . . Such a view of the case could be dispositive of it.")

119. *See, e.g., O'Daniel's Estate v. Commissioner*, 173 F.2d 966, 967 (2d Cir. 1949); *Estate of Bausch v. Commissioner*, 14 T.C. 1433, 1438-39 (1950), *aff'd*, 186 F.2d 313 (2d Cir. 1951); *Estate*

If the decedent had lived until the day when these crop pool proceeds were paid to him the payments so received would have been ordinary income. Sec. 126 itself contains strong evidence of congressional intent to see to it that the tax upon income which would have been derived had the decedent lived should not be lost to the treasury in consequence of his death.¹²⁰

Linde, however, was decided under the economic activities test.¹²¹

In 1961, the I.R.S., perhaps encouraged by the language in the case law, argued for use of the income to decedent if he had lived test in *Estate of Davison v. United States*.¹²² The I.R.S. contended "that income in respect of a decedent is *merely* that money which would have been reported as income by the decedent if she had but lived to collect it herself."¹²³ Such a test, however, was rejected as overly inclusive:

We do not agree with the defendant that all money received by the estate is to be treated as it would have been if the decedent had lived and received it. That comprehends too much, and does not adequately distinguish between income earned by the decedent and income earned entirely by the estate after decedent's death.¹²⁴

The court, nonetheless, held the fact that the amounts "would have been income to the decedent had she but lived to receive them" was an element in the concept of income in respect of a decedent.¹²⁵

B. *The Economic Activities Test*

The "gross income" to be taxed under section 691 must be "in respect of a decedent." Since one must usually perform services or arrange for the use or disposition of property in order to receive gross income, some activity on the part of the decedent that resulted in the post-death payment is implied.¹²⁶ Section 691(a)(3)'s reference to "the transaction in which the right to receive the income was originally derived" suggests an act or series of acts performed by the decedent or on the decedent's behalf which directly led to the payment.¹²⁷ A comparison of the decedent's activities with those of his successor to determine whose activities were primarily responsible for the post-

of *Narischkine v. Commissioner*, 14 T.C. 1128, 1130-31 (1950), *aff'd*, 189 F.2d 257 (2d Cir. 1951) (per curiam).

120. 213 F.2d at 4.

121. *Id.*

122. 292 F.2d 937, 940 (Ct. Cl. 1961).

123. *Id.* (emphasis added).

124. *Id.* (citations omitted).

125. *Id.* at 942.

126. See FERGUSON ET AL., *supra* note 16, at 3:10 ("[T]he income must have been attributable to the decedent's services, the decedent's sales, or the decedent's income-producing property.") (footnote omitted).

127. See I.R.C. § 691(a)(3).

death payment may be necessary to identify income in respect of a decedent.

In 1949, the Second Circuit adopted an economic activities test in *O'Daniel's Estate v. Commissioner*.¹²⁸ O'Daniel died in 1943, while employed by a company which had an employee bonus plan.¹²⁹ Employees had no enforceable rights under the plan until shares were designated.¹³⁰ The decedent's bonus was not designated until 1944.¹³¹ In holding the bonus constituted income in respect of a decedent, the Second Circuit focused on the person whose economic activities resulted in the post-death payment.¹³² The court concluded that the bonus was compensation for the decedent's services and "any right to receive it that was realized by his estate was acquired through him and never arose in any other way or through any other source."¹³³ The fact that the decedent had no legal right to the bonus at the time of his death did not matter.¹³⁴ The court concluded that the right referred to in the statute as having been acquired from the decedent was "not necessarily a legally enforceable right but merely any right derived through his services rendered while living."¹³⁵

In the late 1950s, the Second Circuit had little difficulty in using the economic activities test to identify income in respect of a decedent in the personal service partnership context. In *Estate of Riegelman v. Commissioner*,¹³⁶ the decedent had been a partner in a law firm.¹³⁷ His estate was entitled to certain payments after his death under the partnership agreement.¹³⁸ Although the case involved only an estate tax issue,¹³⁹ the court in dictum concluded that the post-death payments were income in respect of a decedent.¹⁴⁰ It used the economic activities test, finding that the payments were "the fruits of the man's professional activity" and "were [not] attributable to anything done by Riegelman's estate."¹⁴¹ The very next year, the Second Circuit squarely held that post-death partnership payments constituted in-

128. 173 F.2d 966 (2d Cir. 1949).

129. *Id.* at 967.

130. *Id.*

131. *Id.*

132. *Id.* at 967-68.

133. *Id.* at 967.

134. *Id.* at 968.

135. *Id.*

136. 253 F.2d 315 (2d Cir. 1958).

137. *Id.* at 316.

138. *Id.*

139. *Id.*

140. *Id.* at 319.

141. *Id.*

come in respect of a decedent under the economic activities test in *United States v. Ellis*.¹⁴²

Second Circuit decisions established the economic activities test.¹⁴³ They suggested that almost all post-death employee and partnership payments would be income in respect of a decedent.¹⁴⁴ The relationship between a decedent's activities and the post-death payment (as well as the absence of activities by a decedent's successors) suggested the economic activities test was sufficient to identify IRD in compensation related cases. But could the economic activities test be used to identify noncompensatory amounts as income in respect of a decedent?

The Ninth Circuit held the economic activities test could in *Commissioner v. Linde*.¹⁴⁵ The decedent had been a member of several cooperative marketing associations to which he had delivered grapes during his life.¹⁴⁶ The cooperatives were to process the grapes into wine, sell the products, and distribute the net proceeds to their members based on the quantity of grapes delivered.¹⁴⁷ Wine made from grapes delivered by the decedent had not been sold at the time of his death.¹⁴⁸ If the decedent had died possessing the grapes, his estate would have been entitled to a new basis as the grapes would have been property acquired from a decedent.¹⁴⁹ If the grapes had been processed into wine which had been sold during the decedent's life, the post-death payments would have been IRD in the form of an account receivable possessed at death.¹⁵⁰ The court had to decide whether the proceeds were IRD where the grapes had been delivered before death but the sales occurred after death.¹⁵¹

142. 264 F.2d 325, 327 (2d Cir. 1959) ("This [partnership] contract did not result from any bargain between the surviving partners and Ellis' estate but stemmed solely from Ellis' efforts and bargaining position during his lifetime.").

143. See, e.g., *Ellis*, 264 F.2d at 327; *Estate of Riegelman*, 253 F.2d at 319; *Bausch's Estate v. Commissioner*, 186 F.2d 313, 314 (2d Cir. 1951); *O'Daniel's Estate v. Commissioner*, 173 F.2d 966, 968 (2d Cir. 1949).

144. See *Ellis*, 264 F.2d at 327; *Estate of Riegelman*, 253 F.2d at 319; *Bausch's Estate*, 186 F.2d at 314; *O'Daniel's Estate*, 173 F.2d at 968.

145. 213 F.2d 1, 4 (9th Cir. 1954).

146. *Id.* at 2.

147. *Id.*

148. *Id.*

149. See Rev. Rul. 58-436, 1958-2 C.B. 366, *modified*, Rev. Rul. 64-289, 1964-2 C.B. 173; see also *Estate of Burnett v. Commissioner*, 2 T.C. 897, 903 (1943) (holding raised crops were not "accrued" income under section 42 of pre-1943 law).

150. Treas. Reg. § 1.691(a)-2(b) ex. 5(i)(1957).

151. *Linde*, 213 F.2d at 2.

The court used the economic activities test and decided the payments were income in respect of a decedent.¹⁵² It compared the activities of the decedent with those of his estate:

We think that the text of section 126 as well as the history of the legislation relating to the income of a decedent demonstrate the soundness of the O'Daniel decision and that the principles there expressed must be applied in the instant case. . . . The payments which the taxpayer received in 1945 were realized under and in consequence of contracts and deals made by the decedent in his lifetime. No act or thing taken or performed by the taxpayer operated to procure or to give rise to this payment. Such payments had their source exclusively in the decedent's contract and arrangement with the cooperative associations.¹⁵³

The decedent's delivery had converted his interest from one in property to a right to collect sale proceeds.¹⁵⁴ Consequently, the fact that the sale occurred after the decedent's death did not matter.¹⁵⁵ The decedent had placed the property beyond his control under an arrangement which would lead to his receipt of sale proceeds.¹⁵⁶ His successors did not receive section 1014 property, but the right to collect those sale proceeds after his death.¹⁵⁷

By 1966, the economic activities test was widely, if not exclusively, used to identify income in respect of a decedent.¹⁵⁸ It is not surprising, therefore, that the district court in *Trust Co. of Georgia v. Ross* used that test to determine whether proceeds of a stock sale completed after the decedent's death were IRD.¹⁵⁹ The court concluded that the proceeds were IRD because the decedent's economic activity had produced the income and, at the time of his death, he "had only to await the date of the closing to receive the sums due under the contract of sale" he had negotiated.¹⁶⁰ It found the estate's activities

152. *Id.* at 3.

153. *Id.* at 4.

154. *Id.* at 7; Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1030 n.46.

155. *Linde*, 213 F.2d at 3.

156. *Id.* at 4.

157. *Id.* at 2.

158. *See, e.g.*, *Bernard v. United States*, 215 F. Supp. 256, 260 (S.D.N.Y. 1963); *Estate of Davison v. United States*, 292 F.2d 937, 941-42 (Ct. Cl. 1961).

159. *Trust Co. of Ga. v. Ross*, 262 F. Supp. 900, 907-08 (N.D. Ga. 1966), *aff'd on other grounds*, 392 F.2d 694 (5th Cir. 1967) (*per curiam*) ("The cases have held consistently that the criterion of taxability of income as income in respect of a decedent is whether the post-death payments are in fact due to the services performed by or economic activities of the decedent.") (citations omitted).

160. *Id.* at 909.

in consummating the closing “merely perfunctory and of no material significance.”¹⁶¹

The Fifth Circuit affirmed on appeal but rejected the economic activities test.¹⁶² The court noted:

Although it is pertinent to inquire whether the income received after death was attributable to activities and economic efforts of the decedent in his lifetime, these activities and efforts must give rise to a right to that income. And the right is to be distinguished from the activity which creates the right [to receive income]. Absent such a right, no matter how great the activities or efforts, there would be no taxable income under § 691.¹⁶³

The economic activities test was held to be “open-ended and somewhat inadequate” considering the scope of section 691.¹⁶⁴

Support for a rejection of the economic activities test was found in a Treasury Regulation example.¹⁶⁵ Two transactions were addressed. In the first, the decedent, A, had sold and delivered apples to X but had not received payment at the time of his death.¹⁶⁶ In the second, the decedent, A, had entered negotiations for the sale of apples to Y, but no agreement had been reached, nor had any apples been delivered, at the time of his death.¹⁶⁷ After death, the decedent’s executor received payment for the sale to X and completed the sale to Y.¹⁶⁸ The regulation provided that only the proceeds received in the sale to X were income in respect of a decedent.¹⁶⁹

The Fifth Circuit found the regulation inconsistent with use of the economic activities test:

Note that the sale to Y was not complete. No contract had been effected. Yet negotiations had commenced and been carried on by A, the decedent, prior to his death. The sale went through after A’s death. The regulations state that this is *not* income in respect of a decedent. However a contrary result could easily be reached under the broad test used by the District Court since it could well be found that the sale was a result of the negotiations by A, or a result of the “services performed by or the economic activities of the decedent” during his lifetime. What is lacking in the example, of course, is any *right* on A’s part to receive the income prior to his death.¹⁷⁰

161. *Id.*

162. *Trust Co. of Ga. v. Ross*, 392 F.2d 694, 695 (5th Cir. 1967) (per curiam).

163. *Id.*

164. *Id.*

165. *Id.* at 696 n.3 (citing *Treas. Reg. § 1.691(a)-2 ex. 5 (i) (1957)*).

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

The court held post-death sales proceeds would be income in respect of a decedent only if the decedent had a right to receive the proceeds at the time of his death.¹⁷¹

The right to income test soon displaced the economic activities test in the identification of income in respect of a decedent.¹⁷² Nonetheless, the level of a decedent's activities and that of his successor remains an important, if no longer conclusive, factor in the identification of IRD. Two cases illustrate the continuing importance of a decedent's economic activities.

In *Collins v. United States*, the district court had to decide whether post-death payments required by employment contracts negotiated by a decedent were income in respect of a decedent.¹⁷³ Characterizing the payments as IRD under the right to income test posed a problem if the court had to conclude that the decedent possessed a right to receive the amounts because the decedent could never have received the amounts in question.¹⁷⁴ The court questioned the applicability of the right to income test in the employment context but, nonetheless, found the necessary right:

It is submitted that where one is dealing with post-death payments attributable to the personal services of a decedent and payable upon his death, the right to receive the money has certainly matured and the decedent's entitlement to the payments is simply not relevant. If, however, decedent's entitlement is a *sine qua non* of income in respect of a decedent, I submit that such entitlement could be found under the facts of the case at bar. The decedent here bargained for these payments in return for his personal services and for his remaining employed up to the date of his death. The consideration for those payments flowed entirely from him.¹⁷⁵

The court clearly would have preferred to use the economic activities test but felt compelled to find an entitlement under the right to income test.¹⁷⁶

In *Estate of Sidles v. Commissioner*, the Tax Court had to determine whether post-death corporate liquidation distributions were IRD where the liquidation was in process, but not completed, at the time of

171. *Id.* at 696.

172. *See, e.g.*, *Estate of Peterson v. Commissioner*, 667 F.2d 675, 679 (8th Cir. 1981); *Halliday v. United States*, 655 F.2d 68, 71 (5th Cir. 1981); *Claiborne v. United States*, 648 F.2d 448, 452 (6th Cir. 1981); *Keck v. Commissioner*, 415 F.2d 531, 534-35 (6th Cir. 1969); *Estate of Sidles v. Commissioner*, 65 T.C. 873, 880 (1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977).

173. 318 F. Supp. 382 (C.D. Cal. 1970), *aff'd*, 448 F.2d 787 (9th Cir. 1971) (per curiam).

174. *Id.* at 389.

175. *Id.*

176. *Id.*

the sole shareholder's death.¹⁷⁷ The court's findings indicate that the decedent's activities were the most important factor in its determination that the decedent had a right to income at the time of his death.¹⁷⁸ The court found, for instance, that "[t]he liquidating distribution had its source exclusively in decedent's actions";¹⁷⁹ the decedent's "vote for liquidation created a right to receive" the distribution;¹⁸⁰ "[t]he estate's right to such proceeds derived solely from decedent's death and not from its own efforts";¹⁸¹ and "[w]hatever actions the estate took were of no material significance."¹⁸² Actions of the corporation necessary to make the liquidating distribution, similarly, were dismissed as "mere formalities; ministerial acts necessary to complete the liquidation under State law."¹⁸³ *Sidles* suggests that the economic activities test survives beneath the surface of the right to income test; if the post-death payment is clearly attributable to the decedent's activities, the transaction will be found to have "sufficiently matured" as of the decedent's death so as to have created the necessary "right" to receive the income when subsequently realized.¹⁸⁴

C. *The Right to Income Test*

Several factors support the conclusion that the decedent must have possessed a right to receive income at the time of his death for it to constitute income in respect of a decedent. First, Congress used "right" thirteen times in the three subsections of section 691(a).¹⁸⁵ Section 691(a)(1) provides for taxation of the person who acquired the "right" to receive IRD from the decedent.¹⁸⁶ Section 691(a)(2) provides rules for taxation of IRD upon certain transfers of the "right" to receive it.¹⁸⁷ And section 691(a)(3) provides that the "right" shall be treated as if it had been acquired by a decedent's successor in the transaction in which the "right" to receive the income

177. 65 T.C. 873 (1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977).

178. *Id.* at 881.

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*; see *Claiborne v. United States*, 648 F.2d 448, 452 (6th Cir. 1981) ("The basic thrust of the Congressional purpose appears to us to be to include in income accounted for under § 691 all income where economic activities had progressed to the point of either legal or equitable entitlement.").

185. I.R.C. § 691(a).

186. *Id.* § 691(a)(1).

187. *Id.* § 691(a)(2).

was originally derived.¹⁸⁸ Second, the legislative history can be read to support a right to income requirement.¹⁸⁹ Finally, Treasury Regulations provide that income in respect of a decedent refers to "amounts to which decedent was entitled as gross income" at death.¹⁹⁰

1. *Recognition of the Right to Income Test*

In *O'Daniel's Estate v. Commissioner*,¹⁹¹ the estate contended that a post-death bonus was not income in respect of a decedent because the decedent had not possessed a legally enforceable right to the payment at the time of death.¹⁹² The Tax Court disagreed and held the bonus was IRD.¹⁹³ The Second Circuit, on appeal, also rejected a legally enforceable right requirement:

The bonus was derived through rights he had acquired, which even if not fixed at the time of his death were then expectancies which later bore fruit. It seems apparent from what we have already said that "the right . . . acquired by the decedent's estate from the decedent" which is referred to in Section 126(a)(1)(A) is not necessarily a legally enforceable right but merely any right derived through his services rendered while living.¹⁹⁴

The court found "[s]uch a right" as it had in mind had passed to the decedent's estate with the result that the bonus was income in respect of a decedent.¹⁹⁵

Although the Second Circuit purported to find a "right" in *O'Daniel's*, it actually held an "expectancy" that arose in the employment context was income in respect of a decedent under the economic activities test.¹⁹⁶ Shortly after the decision, a commentator correctly concluded that the court's "liberal interpretation of 'right' views the term as merely a convenient way of describing all income items coming into a successor's hands because of decedent's death"¹⁹⁷ and, furthermore, "[i]f it is correct, there evidently can be no limitation inferred from the phrase [right to receive the amount] under discussion."¹⁹⁸ The Second Circuit's opinion nine years later in *Estate of*

188. *Id.* § 691(a)(3).

189. H.R. REP. NO. 77-2333, at 185 (1942), reprinted in 1942-2 C.B. 372, 437; S. REP. NO. 77-1631, at 101-02 (1942), reprinted in 1942-2 C.B. 504, 581.

190. Treas. Reg. § 1.691(a)-1(b) (as amended in 1965).

191. 10 T.C. 631 (1948), *aff'd*, 173 F.2d 966 (2d Cir. 1949).

192. *Id.* at 632.

193. *Id.*

194. *O'Daniel's Estate v. Commissioner*, 173 F.2d 966, 968 (2d Cir. 1949).

195. *Id.*

196. See Polisher, *supra* note 97, at 275.

197. Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1027.

198. *Id.*

Riegelman v. Commissioner, a case decided under the economic activities test, supports such a conclusion.¹⁹⁹

In 1967, however, the Fifth Circuit rejected the economic activities test and adopted the right to income test in *Trust Co. of Georgia v. Ross*.²⁰⁰ Before the court justified use of a right to income test, however, it sought to reconcile decisions under the economic activities test with the test it would adopt.²⁰¹ While noting that courts had employed the economic activities test in earlier cases, the court observed that “the *ratio decidendi*” in those cases depended on the subsisting facts.²⁰² The court suggested close examination of the facts in several of those cases indicated the courts were dealing with payments made “pursuant to rights created by the decedent during his lifetime” or “pursuant to . . . contract[s]” entered into by the decedent.²⁰³ Those earlier decisions, consequently, although decided under the wrong test, would have been decided the same way under the right to income test.

The court, finding “[t]he tortuous language of the statute . . . of little help in divining the proper test,”²⁰⁴ relied upon the general definition of IRD in the regulations to support adoption of the right to income test.²⁰⁵ The regulations provide that income in respect of a decedent refers to “amounts to which a decedent was *entitled* as gross income but which were not properly includible” in the decedent’s gross income prior to his death.²⁰⁶ An example in the regulations was also cited in support of a right to income requirement.²⁰⁷ Although *Trust Co. of Georgia* represented an important turning point in the identification of income in respect of a decedent, it provided few answers as to what the right to income test required.

199. 253 F.2d 315 (2d Cir. 1958). The court stated:

In *O’Daniel’s Estate v. Commissioner*, we held payments made to the estate of the decedent taxable as “income in respect of a decedent” even though the decedent had no enforceable right to the payments during his lifetime. Although the opinion intimated that the right to the payment might have been accrued under the rationale of *Helvering v. Enright’s Estate*, our decision in *Bausch’s Estate v. Commissioner*, was a square holding that “accrual” of a payment during decedent’s lifetime was not necessary.

Id. at 318-19 (citations omitted).

200. *Trust Co. of Ga. v. Ross*, 392 F.2d 694, 695 (5th Cir. 1967) (per curiam).

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.* at 696.

205. *Id.*

206. *Id.*

207. *Id.* at 696 n.3.

The Sixth Circuit adopted the Fifth Circuit's right to income test in its 1969 decision in *Keck v. Commissioner*.²⁰⁸ The issue in *Keck* was whether post-death corporate liquidation distributions were income in respect of a decedent.²⁰⁹ In rejecting the economic activities test, the court held that absent a right to income, no matter how great the decedent's activities, there is no income under section 691.²¹⁰ Because the liquidation in *Keck* was subject to a number of material contingencies at the date of the decedent's death, the court held the decedent did not possess a right to the proceeds and the amounts were not income in respect of a decedent.²¹¹

The 1976 Tax Court case of *Estate of Sidles v. Commissioner*²¹² underscores the difficulty courts have had in employing the right to income test. Sidles, the sole shareholder of a corporation, approved a plan of complete liquidation four months before his death.²¹³ The liquidation, incomplete when Sidles died, was completed by his estate five months after his death.²¹⁴ Both parties relied on the right to income test to support their contrary positions.²¹⁵ The taxpayer's position was that no right to liquidation proceeds existed until the corporation's board of directors authorized the distribution after the decedent's death.²¹⁶

The Tax Court, citing *Trust Co. of Georgia*, held that section 691 requires that the decedent must have possessed a right to the income at the time of his death.²¹⁷ Whether the decedent possessed the requisite right was a question of fact to be determined by consideration of relevant factors.²¹⁸ One of those factors was whether the income resulted from the decedent's economic activities and efforts.²¹⁹ The court concluded that the right to income test required the court to determine "whether the transaction had sufficiently matured as of decedent's death so as to create in him a right to receive the income when it was subsequently realized."²²⁰

208. 415 F.2d 531, 534-35 (6th Cir. 1969).

209. *Id.* at 533.

210. *Id.* at 535.

211. *Id.* at 534-35.

212. 65 T.C. 873 (1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977).

213. *Id.* at 875.

214. *Id.*

215. *Id.* at 877.

216. *Id.* at 878.

217. *Id.* at 880.

218. *Id.* at 880 & n.5.

219. *Id.*

220. *Id.* at 880.

The court concluded the decedent had an absolute and unconditional right to the liquidating distribution at the time of his death on the basis of the decedent's economic activities.²²¹ The court found that the decedent's actions were the source of the distribution, his vote for liquidation had created the right to receive the distribution, and the estate's right to the proceeds resulted solely from the decedent's death and not from the estate's own efforts.²²² The fact that Sidles, as sole shareholder, could have rescinded the transaction was unimportant since he had not done so.²²³ The decedent's activities and the lack of any material contingencies, as had existed in *Keck*, led the court to conclude that the transaction had sufficiently matured as of the decedent's death to have created a right to the distribution.²²⁴

Separate opinions in *Sidles* illustrate the disagreement over what the right to income test requires. Two judges concurred in the result but concluded, at least in the sale proceeds context, that the decedent must have possessed a legal right to income at death for the proceeds to be income in respect of a decedent.²²⁵ Two judges concurred in the conclusion that the amounts were IRD in large part because of the control the decedent possessed over the liquidation as sole shareholder.²²⁶ Three judges dissented on the ground that no right to income existed because the liquidation had not proceeded to a point beyond the control of the sole shareholder—the decedent or his estate could have rescinded the liquidation resolution.²²⁷

*Claiborne v. United States*²²⁸ required the Sixth Circuit to consider the nature of the right to income required under section 691. The decedent had granted an option to purchase her farm property in 1967.²²⁹ The contract provided that if the option was exercised, it would become a binding agreement.²³⁰ The buyer exercised the option during the decedent's life and, with her agent's permission, Ford Motor Company entered into possession of the property.²³¹ The

221. *Id.* at 881 & n.6.

222. *Id.* at 881.

223. *Id.*

224. *Id.* at 882.

225. *Id.* at 888 (Hall, J., concurring).

226. *Id.* at 889-90 (Tannewald, J., dissenting in part).

227. *Id.* at 896 (Featherston, J., dissenting).

228. 648 F.2d 448 (6th Cir. 1981).

229. *Id.* at 449.

230. *Claiborne v. United States*, 449 F. Supp. 4, 5 (W.D. Ky. 1978), *vacated*, 648 F.2d 448 (6th Cir. 1981).

231. *Id.*

owner died before the closing, which occurred sixteen days after her death.²³²

The district court had held that the post-death proceeds were not income in respect of a decedent because the decedent had not had the necessary right to income at the time of her death.²³³ Its decision rested upon its findings that the buyer could not have been compelled to purchase the property and that the decedent's remedy was limited to the option consideration already paid as liquidated damages.²³⁴ The buyer's entry into possession was dismissed because it was under authority granted by the seller's agent.²³⁵

The district court's decision was rejected on appeal.²³⁶ The Sixth Circuit assumed that section 691 required the decedent to have had an "enforceable" right to income at death²³⁷ and rejected the economic activities test "which would exclude any consideration of enforceability as an aspect of entitlement."²³⁸ The court acknowledged that, as a strict matter of law, the decedent did not have a right to the purchase price at death.²³⁹ However, the court concluded the decedent was entitled to specific performance of the contract under local law because of Ford's entry upon the land and exercise of the option.²⁴⁰ Finding "[t]he basic thrust of the Congressional purpose . . . to be to include in income accounted for under § 691 all income where economic activities had progressed to the point of either legal or equitable entitlement," the court held the proceeds were income in respect of a decedent.²⁴¹

2. *Alternative Formulations*

a. *Substantial Certainty of Receipt Test*

*Halliday v. United States*²⁴² required the Fifth Circuit to revisit its decision in *Trust Co. of Georgia* and consider the requirements of the right to income test. The issue in *Halliday* was whether certain insurance renewal commissions were income in respect of a decedent.²⁴³

232. *Id.*

233. *Id.* at 6.

234. *Id.*

235. *Id.*

236. *Claiborne v. United States*, 648 F.2d 448, 452 (6th Cir. 1981).

237. *Id.* at 451.

238. *Id.* at 452; see Gilbert P. Verbit, *Income in Respect of a Decedent*, 56 ST. JOHN'S L. REV. 419, 437 (1982) (discussing the Sixth Circuit's reasoning in *Claiborne*).

239. *Claiborne*, 648 F.2d at 451.

240. *Id.*

241. *Id.* at 452.

242. 655 F.2d 68 (5th Cir. 1981).

243. *Id.* at 69.

The district court had held the commissions were not IRD because the decedent did not have a legal right to receive the commissions.²⁴⁴ It had concluded that the concept of income in respect of a decedent included only sums to which the decedent was legally entitled at the time of his death.²⁴⁵

The Fifth Circuit reversed because the district court had applied an incorrect standard for determining income in respect of a decedent.²⁴⁶ The court held that the code, the regulations, and its earlier decision in *Trust Co. of Georgia* did not require the decedent have a legally enforceable right to income in order for a post-death payment to constitute income in respect of a decedent.²⁴⁷ Such a requirement, the court concluded, would permit taxpayers to avoid application of section 691 by failing to include payment obligations in binding contracts.²⁴⁸

The Fifth Circuit not only rejected a legally enforceable right to income test in *Halliday* but articulated a formulation of the right to income test that required examination of the probability of payment as of the decedent's date of death.²⁴⁹ It held "that for purposes of Section 691, a right to income arises where the evidence shows a substantial certainty that benefits directly related to the decedent's past economic activities will be paid to his heirs or estate upon his death, notwithstanding the absence of a legally enforceable obligation."²⁵⁰ That determination is a question of fact for the trial court.²⁵¹ The renewal commissions in *Halliday* were held to be income in respect of a decedent because the court concluded the decedent had a sufficiently certain right, albeit not necessarily a legally enforceable one, to receive the commissions.²⁵²

A few years later, the Tax Court and Sixth Circuit employed the substantial certainty of receipt test in *Rollert Residuary Trust v. Commissioner*.²⁵³ An issue in *Rollert* was whether a bonus awarded after an employee's death was income in respect of a decedent.²⁵⁴ *Rollert*, an employee of General Motors Corporation, died November 27,

244. *Birmingham Trust Nat'l Bank v. United States*, 46 A.F.T.R. 2d 80-5999, 80-6002 (N.D. Ala. 1980), *rev'd sub nom.* *Halliday v. United States*, 655 F.2d 68 (5th Cir. 1981).

245. *Id.*

246. *Halliday*, 655 F.2d at 69.

247. *Id.* at 71.

248. *Id.*

249. *Id.* at 72.

250. *Id.*

251. *Id.*

252. *Id.*

253. 80 T.C. 619 (1983), *aff'd*, 752 F.2d 1128 (6th Cir. 1985).

254. *Id.* at 628.

1969.²⁵⁵ Although no rules dealt with awarding of bonuses to deceased employees, the corporate practice had been to award bonuses to employees who had at least two months of service in the year of death and met other requirements.²⁵⁶ Annual bonuses were contemplated, but a committee had the right to modify or suspend the plan.²⁵⁷ A substantial bonus was awarded after the decedent's death on March 2, 1970, with respect to the decedent's 1969 employment.²⁵⁸

The Tax Court acknowledged the uncertain boundaries of the right to income test in *Rollert*.²⁵⁹ It found the appellate opinions in *Trust Co. of Georgia*, *Keck*, and *Claiborne* had "left considerable room for disagreement over exactly what constitutes a right or entitlement to income."²⁶⁰ *Trust Co. of Georgia* was read as having held that a right to income exists even if a few ministerial aspects of the transaction have not been completed at death.²⁶¹ *Keck* was read as having held that material contingencies will negate the existence of the required right.²⁶² *Claiborne*, although holding that a legal or equitable right to income at death would suffice, was not read as having held that "a right enforceable at law or in equity is an absolute prerequisite to finding a pre-death entitlement to income."²⁶³

The Tax Court determined, however, that the right to income test had been clarified by the Fifth Circuit's decision in *Halliday* and its own decision in *Estate of Peterson v. Commissioner*.²⁶⁴ The Tax Court found *Halliday*'s substantial certainty of receipt test consistent with the four-factor test it had articulated in *Peterson*.²⁶⁵ Employing the right to income test in light of these decisions, the court concluded that *Rollert* had a substantial certainty of receiving a bonus at the time of his death.²⁶⁶ *Rollert*'s substantial certainty of receipt meant the right to income required by section 691 existed and that the bonus was income in respect of a decedent.²⁶⁷

255. *Id.* at 621.

256. *Id.* at 624.

257. *Id.* at 622.

258. *Id.*

259. *Id.* at 631.

260. *Id.*

261. *Id.*

262. *Id.*

263. *Id.*

264. *Id.* at 631-32 (citing *Estate of Peterson v. Commissioner*, 74 T.C. 630 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981)).

265. *Id.* at 632.

266. *Id.* at 635.

267. *Id.*

On appeal, the Sixth Circuit reviewed its decisions in *Keck* and *Clairborne* and the test to be employed under section 691 to identify income in respect of a decedent.²⁶⁸ The court rejected a legally enforceable right requirement and held that “[t]he key test for determining whether the decedent had a ‘right’ or was ‘entitled’ to the post-mortem bonus should be based on the likelihood, at the time of his death, that he would receive the bonus, *not* on his legal rights to it.”²⁶⁹ Because there was a substantial certainty at the time of Rollert’s death that he would receive a bonus, he had the necessary right to income and the bonus was income in respect of a decedent.²⁷⁰

b. Four-Factor Test

In *Estate of Peterson v. Commissioner*,²⁷¹ the court had to determine whether post-death sale proceeds from raised calves were income in respect of a decedent.²⁷² Peterson entered a contract on July 11, 1972, for the sale of approximately 3,300 calves.²⁷³ The contract permitted Peterson to designate the delivery dates so long as delivery was before November 1, 1972, with respect to certain calves, and December 15, 1972, with respect to others.²⁷⁴ The risk of loss was with Peterson until delivery.²⁷⁵ Peterson died November 9, 1972, without having delivered any calves or having designated a delivery date.²⁷⁶ His estate raised and fed the cattle and made delivery in December of 1972.²⁷⁷

The Tax Court engaged in a comprehensive review of income in respect of a decedent case law in *Peterson* and distilled four requirements to be used to determine whether a decedent possessed a right to sales proceeds at the time of his death.²⁷⁸ The four factors were:

- (1) whether the decedent entered into a legally significant arrangement regarding the subject matter of the sale, (2) whether the decedent performed the substantive (nonministerial) acts required as preconditions to the sale, (3) whether there existed at the time of the decedent’s death any economically material contingencies which might have disrupted the sale, and (4) whether the decedent would have eventually received the sale proceeds if he or she had lived.²⁷⁹

268. *Rollert Residuary Trust v. Commissioner*, 752 F.2d 1128, 1131-32 (6th Cir. 1985).

269. *Id.* at 1132.

270. *Id.*

271. 74 T.C. 630 (1980), *aff’d*, 667 F.2d 675 (8th Cir. 1981).

272. *Id.* at 630.

273. *Id.* at 631-32.

274. *Id.* at 632.

275. *Id.*

276. *Id.* at 634.

277. *Id.*

278. *Id.* at 639.

279. *Estate of Peterson v. Commissioner*, 667 F.2d 675, 677-78 (8th Cir. 1981).

The court cautioned, however, that its list was not “meant to be an ironclad formulation” of IRD because “[t]he innumerable types of sales transactions and the different stages at which the seller’s death may intervene make any formulation of a list of criteria susceptible to change.”²⁸⁰

Utilizing the four-factor test, the Tax Court held that the sale proceeds were not income in respect of a decedent because the second requirement had not been met—the decedent had not performed the substantive acts required under the contract.²⁸¹ While two-thirds of the calves were deliverable at the time of the decedent’s death, the remaining one-third were too young for delivery.²⁸² The estate’s activities in raising and feeding the calves so that they would satisfy the terms of the contract were not merely “perfunctory or ministerial” but were “substantial and essential acts.”²⁸³

In its appeal to the Eighth Circuit, the I.R.S. did not challenge the four-factor test but contended that the portion of proceeds attributable to the calves that had been deliverable at death were income in respect of a decedent.²⁸⁴ The court rejected that position and concluded that the Service’s “apportionment or allocation argument incorrectly emphasizes the condition or character of the subject matter of the sale instead of the status of the transaction itself at the time of the decedent’s death.”²⁸⁵ Focusing on the status of the transaction at the decedent’s death, the Eighth Circuit held the proceeds were not IRD because the estate’s acts in performing the contract could not be characterized as ministerial or minor.²⁸⁶ Although the Tax Court had focused on the raising and feeding of the calves,²⁸⁷ the Eighth Circuit found the nonministerial acts included not only their care and feeding but also delivery to the buyer.²⁸⁸

Eleven years later, the Tax Court decided *Estate of Napolitano v. Commissioner*²⁸⁹ by considering two of the factors in the court’s four-factor test.²⁹⁰ Napolitano had entered into a contract to sell property shortly before his death.²⁹¹ The contract required the property be

280. *Estate of Peterson*, 74 T.C. at 639 n.9.

281. *Id.* at 644.

282. *Id.*

283. *Id.*

284. *Estate of Peterson*, 667 F.2d at 678.

285. *Id.* at 679.

286. *Id.* at 681.

287. *Estate of Peterson*, 74 T.C. at 644.

288. *Estate of Peterson*, 667 F.2d at 681.

289. 61 T.C.M. (RIA) 1633 (1992).

290. *Id.* at 1635 & n.7.

291. *Id.* at 1633.

conveyed free of any violations of local law.²⁹² At the time of Napolitano's death, three violations existed that had not been resolved.²⁹³ Post-death negotiations resulted in a price reduction and the transfer of the property subject to the violations.²⁹⁴ The Tax Court held the sale proceeds were not income in respect of a decedent.²⁹⁵ While Napolitano had entered into a legally significant relationship by executing the sales contract, he had not performed the substantive (nonministerial) acts required as preconditions to the sale.²⁹⁶ The property was not in a deliverable state on the date of death.²⁹⁷ The sale of the property, consequently, had not ripened to the point where the decedent had a right to the sale proceeds at the time of his death.²⁹⁸

D. Summary

Congress enacted the income in respect of a decedent rules in 1942. Since that time, courts have struggled to articulate tests to be used and factors to be considered in identifying IRD. None of the tests announced to date is entirely satisfactory.

The income to the decedent if he had lived test is too inclusive to serve as a test to identify income in respect of a decedent. Under such a test, all proceeds from the post-death sale of appreciated property would be income in respect of a decedent because they would have been income to the decedent had he lived and received them. When Congress enacted section 691, however, it did not repeal the stepped-up basis rule under section 1014 for property acquired from a decedent. Consequently, the critical task for any IRD test is to distinguish between "earned" income and property. The income to the decedent if he had lived test fails to do so.

Nonetheless, determining if the item would have been income to the decedent if he had lived can serve as a threshold determination in all IRD cases.²⁹⁹ Unless the amount would have been income to the decedent under his method of accounting had he lived, the amount is

292. *Id.*

293. *Id.* at 1634.

294. *Id.*

295. *Id.* at 1636.

296. *Id.*

297. *Id.*

298. *Id.*

299. See FERGUSON ET AL., *supra* note 16, at 3:10 (listing the fact that "the item of income must have been taxable to the decedent had the decedent survived to the time income realization occurred" as the first of four salient characteristics of income in respect of a decedent).

not income in respect of a decedent after his death.³⁰⁰ In the case of amounts which the decedent could not have received, such as amounts payable to survivors pursuant to an employment contract, this determination must be made under the assumption that the decedent could have received the amounts in question. If the question is answered affirmatively, the inquiry must proceed to consideration of other factors or tests to determine if the amount is income in respect of a decedent.

The economic activities test is sufficient to characterize correctly certain post-death payments as income in respect of a decedent. Amounts paid by a decedent's employer pursuant to a contract negotiated by the decedent and ordinary income amounts that accrue with the passage of time attributable to the decedent's ownership of property (i.e., interest and rent) can be properly identified under such a test. Such amounts are entirely attributable to the decedent's activities (the rendering of services or ownership of property) and should not escape taxation at death.

The economic activities test, however, is ill-suited to characterize correctly all post-death receipts. It provides insufficient guidance in the case of post-death payments that are attributable not only to a decedent's activities, but also to activities of his successors. For example, income from the disposition of property is not always correctly classified under the economic activities test. A mere comparison of a decedent's activities with those of his successors could result in taxation of items that should not be taxed as income in respect of a decedent.³⁰¹

The right to income test is presently employed to identify income in respect of a decedent. Courts have not always agreed, however, as to what constitutes a right to income under section 691. Must the decedent have had a right, enforceable at law or equity, to income at the time of death? Such a requirement could permit substantial amounts (i.e., post-death bonuses) that should be taxed as IRD to escape taxa-

300. See *Miville v. Commissioner*, 29 T.C.M. (CCH) 856, 862 (1970) (holding that payments under a property settlement agreement were not income in respect of a decedent because "such payments would not have been taxable to the [decedent] had she lived to receive them").

301. *Estate of Peterson v. Commissioner*, 74 T.C. 630, 645 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981). The court recognized the limitations of the economic activities test:

We do not doubt that the decedent's efforts contributed far more to the completion of the contract than those of the estate, but a weighing of the relative efforts is not the test envisioned by section 691. Under respondent's [economic activities] formulation, any work-in-progress which was the subject of a predeath contract of sale could constitute income in respect of a decedent if the major part of the work had been completed prior to the decedent's death. The statute, however, does not reach so broadly.

Id. (citation omitted).

tion at death. Should courts engage in a probability analysis to determine whether there was a substantial certainty that a decedent would have received an amount had he lived? Since such an inquiry would arise only in cases where a post-death payment was received, would the determination of probabilities be influenced by the post-death facts? Should courts use the Tax Court's four-factor test? While such a test may be adequate to classify sales proceeds, it is less helpful in characterizing employment-related amounts. In the final analysis, is a court's determination that a decedent possessed a right to income anything more than shorthand for the court's conclusion that the item under consideration should be taxed as income in respect of a decedent?³⁰²

IV. THE CASE FOR USING ASSIGNMENT OF INCOME PRECEDENTS TO IDENTIFY INCOME IN RESPECT OF A DECEDENT

When Congress amended section 42 in 1934 to tax "accrued" income in decedents' final returns, there is no indication that it had assignment of income cases in mind. In fact, few assignment of income cases had been decided by the Supreme Court at that time.³⁰³ Congress, moreover, was not concerned with preventing income from being shifted to lower-bracket taxpayers but with taxing income that was entirely escaping taxation at death.

The congressional solution to that problem, nonetheless, was consistent with what the Supreme Court would call "the first principle of income taxation: that income must be taxed to him who earns it."³⁰⁴ Section 42 required that "accrued" income be taxed to its earner in the last return that would be filed for that person.³⁰⁵ However, by taxing "accrued" income at the time of its transfer, Congress employed a different timing rule in section 42 than would be adopted in donative assignment of income cases. Generally, assignment of income does not accelerate taxation and the assignor is taxed only when his assignee receives the income.³⁰⁶ Deferral of taxation for income

302. See Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1027.

303. See *Burnet v. Leininger*, 285 U.S. 136 (1932); *Lucas v. Earl*, 281 U.S. 111 (1930).

304. *Commissioner v. Culbertson*, 337 U.S. 733, 739-40 (1949).

305. See Revenue Act of 1934, ch. 277, § 42, 48 Stat. 680, 694 (1934).

306. *Friedman v. Commissioner*, 41 T.C. 428, 436 (1963), *aff'd*, 346 F.2d 506 (6th Cir. 1965). The court stated:

A cash basis taxpayer is not taxable on income until he receives it actually or constructively. The making of a gift of his right to receive income does not cause such income to be received until the donor derives the economic benefit of having the income received by his donee.

assigned at death, however, was simply not an option if the earner was to be taxed.³⁰⁷

When Congress reconsidered section 42 in 1942, the assignment of income doctrine was well-established as a result of landmark Supreme Court decisions in the twelve years immediately preceding enactment.³⁰⁸ Congress, no doubt aware of those cases,³⁰⁹ acted to provide relief from the "bunching" problem under section 42 in a manner that would not permit income to escape taxation at death. It shifted taxation of a decedent's earned, but untaxed, income to the decedent's successors under the concept of gross income in respect of a decedent. The harsh results produced by section 42—the bunching of income into the decedent's final return and taxation of amounts that might never be received—were thereby eliminated.

Congress suspended the general principle that income cannot be effectively assigned for income tax purposes in section 691. In fact, in order to solve the problems under prior law, it mandated that the decedent's successors become the owners of the decedent's earned, but untaxed, income assigned at death.³¹⁰ Shifting taxation to the decedent's successors meant the income could be taxed when received by the assignee, consistent with the usual assignment of income timing rule.

Others have recognized that income in respect of a decedent and assignment of income are related.³¹¹ The leading commentators, while noting that "[t]he problem of distinguishing rights to income

Id.; Rev. Rul. 72-312, 1972-1 C.B. 22, 22; Rev. Rul. 69-102, 1969-1 C.B. 32, 33 ("It has been consistently held that a gift of income does not operate to accelerate the year of taxability."); Rev. Rul. 60-370, 1960-2 C.B. 203, 205; see Lyon & Eustice, *supra* note 26, at 354-56.

307. See I.R.C. §§ 441(b)(3), 443(a)(2).

308. See *Harrison v. Schaffner*, 312 U.S. 579 (1941); *Helvering v. Eubank*, 311 U.S. 122 (1940); *Helvering v. Horst*, 311 U.S. 112 (1940); *Helvering v. Clifford*, 309 U.S. 331 (1940); *Blair v. Commissioner*, 300 U.S. 5 (1937); *Burnet v. Leininger*, 285 U.S. 136 (1932); *Lucas v. Earl*, 281 U.S. 111 (1930).

309. See *Apkin v. Commissioner*, 86 T.C. 692, 696 (1986) ("[A]ny possible application of the [assignment of income] principles of *Horst* in the case of income in respect of a decedent was specifically taken into account by Congress in 1942 when it enacted the predecessor to section 691.").

310. See I.R.C. § 691(a)(1).

311. See, e.g., Donald H. Gordon, "Income in Respect of a Decedent" and Sales Transactions, 1961 WASH. U. L.Q. 30, 36; Lyon & Eustice, *supra* note 26, at 300, 385; Walter H. Nunnallee, *The Assignment of Income Doctrine as Applied to Section 1041 Divorce Transfers: How the Service Got It Wrong*, 68 OR. L. REV. 615, 644 (1989) ("Congress viewed the transfer of income items at a taxpayer's death (known as 'income in respect of a decedent') as a de facto assignment of income from the decedent to his estate or beneficiaries."); Note, *Sales Transactions and Income in Respect of a Decedent*, 3 GA. L. REV. 606, 613-15 (1969).

from property prompts reference to the assignment of income cases,"³¹² contend:

Two basic issues lie at the heart of most assignment of income controversies. Either the taxpayer seeks to pass income and the resulting income tax liability to a transferee, frequently by gratuitous assignment, or the taxpayer attempts to convert future ordinary income into present capital gain, frequently by a taxable disposition. . . . [However], neither of the traditional assignment of income issues is normally present in the § 691 controversies. First, the statute specifically provides for assumption of tax liability by the transferee of the right to income, and the transferor is no longer around to be taxed. Secondly, the passing of the interest from the decedent to others at death is not a taxable disposition and cannot give rise to the classic capital gains versus ordinary income dispute. Furthermore, while assignment of income cases often deal with future earnings, § 691 concerns only income the decedent has already substantially earned before passing rights to that income to others at death.³¹³

They conclude, consequently, that assignment of income cases have little applicability in identifying income in respect of a decedent.³¹⁴

If applicability depends on the existence of one of the two basic issues identified, assignment of income cases are clearly not relevant in the identification of income in respect of a decedent. The first, identification of the proper person to be taxed, is never an issue because Congress mandated that the decedents' successors were the proper taxpayers in section 691. The second, the attempt to convert ordinary income into capital gains, is never an issue under section 691 because income in respect of a decedent retains its original character. However, what the commentators characterize as assignment of income issues are merely two of the contexts in which the assignment of income doctrine developed.³¹⁵ The fact that assignment of income and income in respect of a decedent cases arise in different contexts, however, is immaterial to the question of whether the cases are related and should be decided by reference to each other.

312. FERGUSON ET AL., *supra* note 16, at 3:4.

313. *Id.* at 3:4-3:5 (footnotes omitted).

314. *Id.* at 3:4.

315. See Michael Asimow, *The Assault on Tax-Free Divorce: Carryover Basis and Assignment of Income*, 44 TAX L. REV. 65, 84 (1988). The author noted:

Over many decades, the courts have developed a two-branch doctrine generally referred to as assignment of income. The first branch, called donative assignment of income, establishes which of several possible taxpayers should pay tax on an item of income. The second branch, capital gains assignment of income, holds that certain assets do not qualify for the capital gains preference.

Donative assignment of income cases are relevant in income in respect of a decedent cases because both involve a common inquiry. In donative assignment of income cases, there is never a question as to whether an item is income; the issue is who is the proper taxpayer to be taxed on the income. That question is answered by examining the character or status of the item at the time it was assigned to determine if it was "earned" income or property.³¹⁶ In income in respect of a decedent cases, on the other hand, there is never a question as to who the proper taxpayer is that should be taxed (the statute provides the answer); the issue is whether the post-death receipt constitutes IRD. That question is answered by examining the character or status of the item at the time it was assigned³¹⁷ to determine if it was "earned" income or property.³¹⁸ The common inquiry in both settings is the question the leading commentators identify under section 691—whether the item transferred was income the transferor had "substantially earned."³¹⁹

The relationship between assignment of income and income in respect of a decedent is further evidenced by the fact that income in respect of a decedent fills a gap in the assignment of income doctrine. The general rule is that assignment of income does not accelerate taxation and the assignor is taxed when the income is received by the assignee. Who is to be taxed, however, if income is assigned during life, but payment is not received until after the assignor's death?

The assignor cannot be taxed at the time of receipt because his final tax year closed at death. If section 691 had not been enacted, whether the assignee would be taxed on the income would depend on whether the item was included in the decedent's gross estate for estate tax purposes. Items included in the gross estate would receive a new basis

316. *Friedman v. Commissioner*, 41 T.C. 428, 435 (1963), *aff'd*, 346 F.2d 506 (6th Cir. 1965). The court stated:

The theory of the cases dealing with anticipatory assignment of income by gift has not been concerned with when the income was accrued in a legal sense of accrual but rather with whether the income had been earned so that the right to the payment at a future date existed when the gift was made.

Id. (citation omitted).

317. *Estate of Peterson v. Commissioner*, 667 F.2d 675, 679 (8th Cir. 1981); *Estate of Sidles v. Commissioner*, 65 T.C. 873, 880 (1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977).

318. See *Estate of Peterson v. Commissioner*, 74 T.C. 630, 646 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981). The court noted:

Although the legislative history of section 691 indicates that it is not necessary for an item to have been *earned* by the decedent in any tax reporting sense or in any technical accounting sense, we believe the use of the term "earned" is appropriate insofar as it connotes the practical completion of a transaction.

Id.

319. FERGUSON ET AL., *supra* note 16, at 3:5.

under section 1014 and the income would escape taxation forever. Items not included in the decedent's gross estate would have a carry-over basis under section 1015 in the assignee's hands and the assignee would be taxed under section 61 when payment was received. Such disparate results, however, would be inconsistent with the assignment of income doctrine and the congressional objectives in enacting section 691. Section 691 fills this gap in the assignment of income doctrine and preserves the item for income taxation under its special rules.³²⁰

Utilization of assignment of income cases to identify income in respect of a decedent is justified on policy grounds. Congress enacted section 691 "to accomplish the general purpose of the internal revenue code that all income should pay a tax"³²¹ and to "reduce[] the importance of death" in income taxation.³²² If an item could not have been transferred during life without triggering the assignment of income doctrine, its transfer at death should not permit it to escape taxation. Conversely, if an item could have been transferred before death without implicating assignment principles, taxation of the item after death is unwarranted. The fact that death is rarely voluntary or tax-motivated, moreover, should not permit "earned" income, which would have triggered assignment of income principles had it been transferred during life, to escape taxation at death.³²³

When income in respect of a decedent is considered in the context of donative assignment of income cases, lack of a statutory definition of the term makes sense. The determination of whether a particular item is "earned" income at the time of its transfer, in the assignment of income or income in respect of a decedent context, is a factual determination to be made on a case-by-case basis.³²⁴ Congress, except in a few areas, has not attempted to codify the factual circumstances that trigger the assignment of income doctrine; rather, Congress has deferred to the courts. By using the undefined term "gross income in

320. *Estate of Carr v. Commissioner*, 37 T.C. 1173, 1179-80 (1962); see FERGUSON ET AL., *supra* note 16, at 3:21 ("[I]f prior to death the decedent gratuitously assigns a right to income, the donee who receives the income after the decedent's death must treat it as income in respect of a decedent under § 691(a)(1)(B). This is true even though the assignment has been ineffective to relieve the transferor of income tax liability during life.").

321. *Commissioner v. Linde*, 213 F.2d 1, 5 (9th Cir. 1954).

322. *Estate of Davison v. United States*, 292 F.2d 937, 941 (Ct. Cl. 1961).

323. See Joseph M. Dodge, *Further Thoughts on Realizing Gains and Losses at Death*, 47 VAND. L. REV. 1827, 1838 (1994) ("That death normally is considered to be involuntary is irrelevant. There is no general tax principle that involuntariness yields an exemption or other tax benefit beyond those that Congress chooses to confer.").

324. See, e.g., *Trust Co. of Ga. v. Ross*, 392 F.2d 694, 695 (5th Cir. 1967) (per curiam); *Estate of Peterson v. Commissioner*, 74 T.C. 613, 638 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981).

respect of a decedent," Congress implicitly relied upon the courts to give meaning to the phrase on a case-by-case basis in a manner consistent with fundamental principles of federal income taxation.

V. RESULTS IN SELECTED CASES COMPARED

Assignment of income and income in respect of a decedent issues can arise in a multitude of settings and involve almost any item of gross income under section 61.³²⁵ Since the inquiry in both settings is essentially the same, two separate, but substantially consistent, lines of case law should exist. Courts in both lines of cases, moreover, should have utilized similar criteria in determining whether an item was "earned" income or property at the time of its transfer, regardless of whether the question arose as a result of a lifetime or death transfer. The following discussion compares results in selected cases under both bodies of law.

Although the assignment of income doctrine and the income in respect of a decedent concept apply equally to accrual and cash method taxpayers, cases involving accrual taxpayers are rare. Two factors account for the lack of cases involving such taxpayers. First, relatively few individuals use the accrual method of accounting. Second, the "all events test" requires accrual taxpayers to report amounts they have a fixed right to receive, the amount of which can be determined with reasonable accuracy. Many items that could trigger assignment of income problems or constitute income in respect of a decedent for cash method decedents would have been properly includible in accrual taxpayers' returns before the transfer. In the discussion that follows, consequently, it is assumed that the assignors and decedents were cash method taxpayers unless expressly indicated to the contrary.

A. *Accrued Interest*

1. *Interest-Bearing Obligations*

Assignment of Income

In its landmark decision in *Helvering v. Horst*,³²⁶ the Supreme Court held that taxpayers cannot retain ownership of property (the tree) and make an effective anticipatory assignment of its income (the fruit) for federal income tax purposes.³²⁷ Horst detached negotiable

325. See *Linde*, 213 F.2d at 7 ("The language of section 126(a)(3) . . . discloses that it cannot be confined to any particular type or kind of income. . . . [I]ncome from all sources was contemplated, including capital gains, business income, interest, dividends, and the like.").

326. 311 U.S. 112 (1940).

327. *Id.* at 120.

interest coupons from bonds he owned and gave them to his son before their due dates but retained ownership of the bonds.³²⁸ The Court found “[t]he dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefits of it when paid.”³²⁹ It distinguished gifts of income-producing property from gifts of income from property. Horst, who had retained ownership of the property, fell in the second category and remained taxable upon the property’s income.³³⁰ The Court concluded that Horst was to be taxed “as if he had collected the income and paid it over to the object of his bounty.”³³¹

Seven years after *Horst*, the Sixth Circuit in *Austin v. Commissioner*³³² held *Horst* applied to accrued interest gratuitously transferred with a debt instrument.³³³ *Austin* assigned all of her right, title, and interest in a promissory note to her children in 1940.³³⁴ At the time of the gift, accrued interest on the note totalled \$43,320.04.³³⁵ The Sixth Circuit found the tree (the promissory note) had ripened (accrued) fruit (interest) attached at the time of the transfer.³³⁶ The donor was taxable on the accrued interest in the year paid to her assignees because she enjoyed the income’s benefit through the exercise of her power to command the income.³³⁷

The I.R.S. updated its position regarding the transfer of debt instruments with accrued interest in Revenue Ruling 72-312.³³⁸ A taxpayer transferred corporate bonds to a non-grantor trust. Interest had accrued prior to the transfer. After reviewing assignment of income principles, the Service ruled that the interest that had accrued on the bonds prior to their transfer was includible in the donor’s gross income for his taxable year during which the interest was actually or constructively received by the trust.³³⁹

328. *Id.* at 112.

329. *Id.* at 119.

330. *Id.* at 118-19.

331. *Harrison v. Schaffner*, 312 U.S. 579, 580 (1941).

332. 161 F.2d 666 (6th Cir. 1947).

333. *Id.* at 667.

334. *Id.*

335. *Id.*

336. *Id.* at 668.

337. *Id.* at 669.

338. Rev. Rul. 72-312, 1972-1 C.B. 22.

339. *Id.*

Income in Respect of a Decedent

In 1961, the Sixth Circuit upheld taxation of accrued interest as income in respect of a decedent in *Richardson v. United States*.³⁴⁰ The taxpayers argued that accrued interest transferred at death was not income but principal of the decedent's estate that could not be constitutionally taxed.³⁴¹ The court rejected that argument on the grounds that accrued interest was gain derived from capital and constituted income that Congress could constitutionally tax under section 691.³⁴²

The I.R.S. has issued a number of rulings indicating that accrued interest is income in respect of a decedent. In Revenue Ruling 64-104,³⁴³ the I.R.S. ruled that accrued interest on Series H United States savings bonds that had not been received by cash method taxpayers is income in respect of a decedent.³⁴⁴ In Revenue Ruling 76-153,³⁴⁵ the Service ruled that accrued interest on United States Treasury bonds known as "flower bonds" that had not been received by the decedent constituted IRD.³⁴⁶ In addition, in Revenue Ruling 79-340,³⁴⁷ the I.R.S. ruled that accrued interest on certificates of deposit issued by Federal Reserve System banks constituted IRD even though the decedent would have forfeited a portion of the interest had he redeemed the certificate before death.³⁴⁸

2. *Non-Interest-Bearing Obligations Issued at a Discount*

Certain debt instruments, including Series E U.S. savings bonds, do not expressly provide for the payment of interest but are issued at a discount and are redeemable for fixed amounts which increase at stated intervals.³⁴⁹ Nonetheless, the increases in redemption value constitute interest for income tax purposes.³⁵⁰

Congress provided special rules for the taxation of the increase in value of such non-interest-bearing obligations. If the increase in the redemption price during a taxable year does not, under the owner's method of accounting, constitute income, the owner may elect under

340. *Richardson v. United States*, 294 F.2d 593, 597-98 (6th Cir. 1961).

341. *Id.* at 596-97.

342. *Id.* at 597-98.

343. Rev. Rul. 64-104, 1964-1 C.B. 223.

344. *Id.*

345. Rev. Rul. 76-153, 1976-1 C.B. 180.

346. *Id.*

347. Rev. Rul. 79-340, 1979-2 C.B. 320.

348. *Id.* at 321.

349. See Rev. Rul. 58-435, 1958-2 C.B. 370, 371; Rev. Rul. 54-143, 1954-1 C.B. 12, 13.

350. See Rev. Rul. 58-435, 1958-2 C.B. 370; Rev. Rul. 54-143, 1954-1 C.B. 12.

section 454(a) to treat the increase as income in that year.³⁵¹ If the election is made, it applies to all such obligations owned by the taxpayer and applies to subsequent tax years.³⁵² Under section 454(c), which is limited to matured U.S. savings bonds,³⁵³ the owner of Series E bonds who did not make the section 454(a) election is taxed on the increased value upon the earlier of their redemption, disposition, or maturity.³⁵⁴

Assignment of Income

The I.R.S. has issued a number of rulings indicating that the increase in value (accrued interest) of non-interest-bearing obligations is taxable to the owner at the time of a gratuitous transfer. In Revenue Ruling 54-143,³⁵⁵ the I.R.S. ruled that the entire increase in value of Series E savings bonds issued in the names of two individuals was taxable to the co-owner who provided the entire consideration for their purchase where the non-contributing owner was permitted to redeem the bonds and retain the proceeds.

The very next year, in Revenue Ruling 55-278,³⁵⁶ the I.R.S. addressed the question of when the increased value (accrued interest) of Series E savings bonds was taxable where such bonds were transferred by gift and not redeemed. The Service ruled that a father, who had purchased the bonds entirely with his own funds and had them issued in his name and his son's name as co-owners, was taxable on the increase in value when he gratuitously had them issued solely in his son's name.³⁵⁷ It concluded that the father "realized the benefit of such interest when he made the gift thereof, since it was then already earned and he could have realized its benefit in cash payment by obtaining redemption of the bonds but chose instead to realize its benefit in a gift thereof to [his son]."³⁵⁸

In Revenue Ruling 87-112,³⁵⁹ the I.R.S. ruled that the recognition on disposition rule applies to transfers made as part of divorce property settlements.³⁶⁰ A cash method taxpayer owned Series E savings bonds registered solely in his name that had been purchased entirely

351. I.R.C. § 454(a).

352. *Id.*

353. *Estate of Noel v. Commissioner*, 50 T.C. 702, 708 (1968).

354. Treas. Reg. § 1.454-1(c)(1) (as amended in 1971); Rev. Rul. 64-104, 1964-1 C.B. 223.

355. Rev. Rul. 54-143, 1954-1 C.B. 12.

356. Rev. Rul. 55-278, 1955-1 C.B. 471.

357. *Id.* at 473.

358. *Id.*

359. Rev. Rul. 87-112, 1987-2 C.B. 207.

360. *Id.* at 208.

with his own funds.³⁶¹ The taxpayer transferred the bonds to his former spouse as part of a divorce property settlement.³⁶² The I.R.S. ruled that, although section 1041(a) "shields from recognition gain that would ordinarily be recognized on a sale or exchange of property, it does not shield from recognition income that is ordinarily recognized upon the assignment of that income to another taxpayer."³⁶³ The increased value of the bonds was determined to be "accrued but unrecognized interest," which the transferor was required to include in income for the taxable year in which the transfer was made pursuant to the recognition on disposition rule in the regulations.³⁶⁴

Income in Respect of a Decedent

Income in respect of a decedent does not include amounts that were properly includible in the decedent's return for his final year or a prior year.³⁶⁵ If the decedent made the section 454(a) election during his life, the increase in value (accrued interest) that occurred during his life would have been includible in the decedent's returns.³⁶⁶ If the decedent did not make the election, the executor of his estate can make the election for the decedent on his final return and the pre-death increase in value will be included in the decedent's final income tax return.³⁶⁷ Consequently, the increased value (accrued interest) of non-interest-bearing obligations constitutes income in respect of a decedent only where neither the decedent nor his executor acting on his behalf made the section 454(a) election.

In 1957, the Treasury issued regulations specifically providing that interest accrued during the life of an owner of Series E U.S. savings bonds is income in respect of a decedent.³⁶⁸ The following year, in Revenue Ruling 58-435,³⁶⁹ the I.R.S. similarly ruled that the pre-death increase in value (accrued interest) of Series E bonds purchased by a cash basis decedent entirely with her own funds was gross income in respect of a decedent where the section 454(a) election had not been

361. *Id.*

362. *Id.*

363. *Id.*

364. *Id.* Revenue Ruling 87-112 and application of assignment of income principles in the divorce context attracted substantial criticism. See, e.g., Asimow, *supra* note 315, at 84; Nunnallee, *supra* note 311, at 616.

365. I.R.C. § 691(a).

366. *Id.* § 454(a).

367. *Id.* § 6903 (providing that a person acting as a fiduciary for another "shall assume the powers, rights, duties, and privileges of such other person in respect of a tax" except as otherwise provided); Rev. Rul. 79-409, 1979-2 C.B. 208; Rev. Rul. 68-145, 1968-1 C.B. 203.

368. Treas. Reg. § 1.691(a)-2(b) ex. (3) (1957).

369. Rev. Rul. 58-435, 1958-2 C.B. 370.

made by or for the decedent. Whether the bonds had been issued in the decedent's name alone or in the decedent's name and that of another as co-owners did not matter.³⁷⁰ The Service reached the same conclusion a few years later in Revenue Ruling 64-104.³⁷¹ And, in 1986, the Tax Court cited the Service's 1964 ruling and summarily held that accrued interest on Series E bonds is income in respect of a decedent unless it was properly includible in the decedent's returns.³⁷²

B. Compensation for Services

1. Bonuses, Fees, Salaries, and Wages

Assignment of Income

In *Lucas v. Earl*,³⁷³ the Supreme Court had to decide whether taxpayers could make anticipatory assignments of compensation income that would be effective for federal income tax purposes. Earl and his wife, by a contract executed before the federal income tax became effective, agreed that all of their earnings would be received by them as joint tenants with right of survivorship.³⁷⁴ The issue was whether Earl was to be taxed on one-half or all of his salary and attorney's fees that he had earned for the years in question.³⁷⁵ The taxpayer contended he was taxable only on one-half of those amounts—the sum to which he was entitled and in fact received as a result of the contract.³⁷⁶

In its landmark decision, the Court found that the applicable code sections imposed a tax on the net income of every individual including "income derived from salaries, wages, or compensation for personal service."³⁷⁷ It decided the case on the basis of the statute:

There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.³⁷⁸

370. *Id.*

371. Rev. Rul. 64-104, 1964-1 C.B. 223, 225.

372. *Apkin v. Commissioner*, 86 T.C. 692, 694 (1986).

373. 281 U.S. 111 (1930).

374. *Id.* at 113-14.

375. *Id.* at 113.

376. *Id.* at 114.

377. *Id.*

378. *Id.* at 114-15.

Earl was taxed on the compensation income attributable solely to his efforts (economic activities).³⁷⁹

In 1973, the Supreme Court reaffirmed the assignment of income doctrine in the compensation context. In *United States v. Basye*,³⁸⁰ the Court held that payment of compensation income into a retirement trust for the benefit of partners triggered "familiar and long-settled principles of income and partnership taxation," requiring the income to be taxed to the partners at the time of payment.³⁸¹ It relied on two principles of taxation:

[F]irst, that income is taxed to the party who earns it and that liability may not be avoided through an anticipatory assignment of that income, and second, that partners are taxable on their distributive or proportionate shares of current partnership income irrespective of whether that income is actually distributed to them.³⁸²

Since the partnership had received a definite amount of income, the partners were taxable on their distributive shares even though none knew with certainty how much, if any, he would ultimately receive.³⁸³

These cases, however, do not establish an absolute rule that a provider of services is always taxed on things of value attributable to his services. Exceptions have been recognized where the provider was an agent, fiduciary, or a person of similar status.³⁸⁴

Income in Respect of a Decedent

Courts have concluded that post-death payments attributable to a decedent's employment constitute income in respect of a decedent.³⁸⁵ This is the case even if the decedent had no legally enforceable right to receive the payment at the time of his death³⁸⁶ or could never have received the amount in question.³⁸⁷ Only if the taxpayer can establish that the amount was a gift excludable under section 102(a) will such amounts escape taxation as income in respect of a decedent.³⁸⁸

379. *Id.* at 114.

380. 410 U.S. 441 (1973).

381. *Id.* at 457.

382. *Id.* at 447-48.

383. *Id.* at 455-56.

384. *Teschner v. Commissioner*, 38 T.C. 1003, 1007 (1962); Rev. Rul. 74-581, 1974-2 C.B. 25; Rev. Rul. 69-274, 1969-1 C.B. 36; Rev. Rul. 58-515, 1958-2 C.B. 28; Rev. Rul. 58-220, 1958-1 C.B. 26.

385. *See, e.g., Rollert Residuary Trust v. Commissioner*, 752 F.2d 1128 (6th Cir. 1985); *Bausch's Estate v. Commissioner*, 186 F.2d 313 (2d Cir. 1951); *O'Daniel's Estate v. Commissioner*, 173 F.2d 966 (2d Cir. 1949).

386. *Rollert Residuary Trust*, 752 F.2d at 1128; *Bausch's Estate*, 186 F.2d at 313; *O'Daniel's Estate*, 173 F.2d at 966.

387. *See infra* Part V.B.3.

388. *See* I.R.C. § 102(a); Rev.Rul. 68-124, 1968-1 C.B. 44.

Courts initially used the economic activity test to conclude that payments attributable to a decedent's services were income in respect of a decedent.³⁸⁹ Those early opinions represented a logical extension of *Lucas v. Earl* to earned income transferred at death under section 691's statutory scheme. Later, after the economic activities test had been displaced by the right to income test, courts found the necessary right existed to cause such amounts to be IRD. In *Rollert Residuary Trust v. Commissioner*,³⁹⁰ "a case factually identical" to *O'Daniel's Estate v. Commissioner* which had been decided under the economic activities test, the court held an employee bonus was income in respect of a decedent because there was a substantial certainty that the decedent would have received the bonus had he lived.³⁹¹ The court held "[t]he key test for determining whether decedent had a 'right' or was 'entitled' to the post-mortem bonus should be based on the likelihood, at the time of his death, that he would receive the bonus, *not* on his legal rights to it."³⁹²

Post-death taxation of employment-related amounts solely attributable to a decedent's activities as income in respect of a decedent, however, should not depend on an assessment of the likelihood that a decedent would have received the amounts had he lived. While such a determination is relevant in valuing the item for estate tax purposes, it should not be a factor in determining whether "earned" income was transferred at death.³⁹³ Lifetime assignments of compensatory ("earned") income have been ineffective for income tax purposes since the 1930 decision in *Lucas v. Earl*. If such "earned" income is received by a decedent's successor after his death, it should be taxed as income in respect of a decedent under section 691 by analogy.³⁹⁴

2. Insurance Renewal Commissions

Assignment of Income

Assignment of the right to receive compensation income triggers the assignment of income doctrine, regardless of whether the assign-

389. See, e.g., *Bausch's Estate*, 186 F.2d at 313; *O'Daniel's Estate*, 173 F.2d at 966.

390. *Rollert Residuary Trust*, 752 F.2d at 1128.

391. *Id.* at 1132.

392. *Id.*

393. See Eustice, *supra* note 26, at 43 (suggesting in the assignment of income context that the uncertain nature of a particular income right at the time of its transfer should not obscure the "question of whom is the proper person to pay the tax on such income when it does eventually become reportable").

394. See Freyburger, *supra* note 97, at 967 ("If the object of [the] . . . Revenue Act of 1942 was to tax all income to somebody, then it might well be argued that all payments which represent compensation for services rendered by an employee . . . are taxable under section 126.").

ment occurs before or after performance.³⁹⁵ In the personal service context, the fruit-tree metaphor "regards the performer of the services as the tree and his compensation as the fruit."³⁹⁶

In 1924 and 1928, Gerald A. Eubank gratuitously assigned insurance renewal commissions that would become payable to him for services he had rendered in writing insurance policies.³⁹⁷ In *Helvering v. Eubank*,³⁹⁸ a companion case to *Helvering v. Horst*, the Supreme Court summarily held Eubank taxable in 1933 on commissions paid in that year to his assignees "[f]or the reasons stated at length in the opinion in the *Horst* case."³⁹⁹

Income in Respect of a Decedent

In 1957, in *Latendresse v. Commissioner*, the Seventh Circuit held that insurance renewal commissions that had been earned by a decedent while acting as an agent were income in respect of a decedent.⁴⁰⁰ The fact that the commissions were contingent on future premium payments was irrelevant.⁴⁰¹ Six months after the decision in *Latendresse*, the Treasury issued regulations which provided that insurance renewal commissions paid after death on policies sold by decedents are income in respect of a decedent.⁴⁰²

Two subsequent decisions involving renewal commissions illustrate the unnecessary complexity introduced by the judicially developed IRD tests and why IRD should be identified by reference to assignment of income cases. In 1964, the Second Circuit utilized the economic activities test and held renewal commissions paid pursuant to a contract negotiated by the decedent were income in respect of a decedent because they were clearly attributable to the decedent's business activities.⁴⁰³ The court's determination was consistent with *Helvering v. Eubank* and taxation of the decedent's successors on "earned" income transferred at death under section 691.⁴⁰⁴ Shortly thereafter, the Fifth Circuit rejected the economic activities test and adopted the right to income test.⁴⁰⁵ *Halliday v. United States*⁴⁰⁶ required the Fifth

395. Lyon & Eustice, *supra* note 26, at 388-89.

396. *Id.* at 389; see *Kochansky v. Commissioner*, 92 F.3d 957, 959 (9th Cir. 1996)

397. *Helvering v. Eubank*, 311 U.S. 122, 124 (1940).

398. *Id.*

399. *Id.* at 125.

400. 243 F.2d 577, 580 (7th Cir. 1957).

401. *Latendresse v. Commissioner*, 26 T.C. 318, 325 (1956), *aff'd*, 243 F.2d 577 (7th Cir. 1957).

402. Treas. Reg. § 1.691(a)-2(b) ex. (2) (1957).

403. *Findlay v. Commissioner*, 332 F.2d 620, 622 (2d Cir. 1964).

404. *Id.*

405. *Trust Co. of Ga. v. Ross*, 392 F.2d 694, 696 (5th Cir. 1967) (per curiam).

406. 655 F.2d 68, 72 (5th Cir. 1981).

Circuit to determine whether renewal commissions paid pursuant to company policy, rather than contract, were IRD. The trial court had concluded the commissions were not IRD under the right to income test because the decedent had no legally enforceable right to receive the commissions.⁴⁰⁷ On appeal, the Fifth Circuit rejected the legally enforceable right requirement and held that “a right to income arises where the evidence shows a substantial certainty that benefits directly related to decedent’s past economic activities will be paid” upon his death.⁴⁰⁸ It concluded the decedent possessed such a right and held the commissions were IRD.⁴⁰⁹

The issue under section 691 is whether “earned” income or property was transferred at death. Insurance renewal commissions solely attributable to the economic efforts of the decedent are no less “earned” income than other employment-related amounts. The contingent nature of the commissions is immaterial in the determination of their character.⁴¹⁰ Courts should not determine whether compensation-related amounts are IRD by assessing the likelihood of payment. If a court were to determine, as of the date of death, that there was no substantial certainty that such an item would be received, items that should be taxed as IRD would escape taxation. Regardless of the probability of payment at death, amounts attributable solely to a decedent’s personal services should be income in respect of a decedent and taxed if and when received.

3. Amounts Never Payable to the Earner

Assignment of Income

The assignment of income doctrine applies equally to assignments of compensation income already earned and compensation income to be earned in the future. Courts, since *Lucas v. Earl*, have long held that the earner of personal service income cannot avoid its taxation by arranging for payment to a third party by anticipatory assignment, even if the assignment entitles the third party to the amounts under local law.

Under this principle, for example, courts have held that amounts paid by employers to employees’ children under employer-funded educational benefit plans constitute compensation for services to the em-

407. *Id.* at 70.

408. *Id.* at 72.

409. *Id.*

410. See Treas. Reg. § 1.691(a)-1(b)(3) (as amended in 1965) (providing that income in respect of a decedent includes “[i]ncome to which the decedent had a contingent claim at the time of his death”).

ployees under section 61.⁴¹¹ The tax result in such cases does not depend on whether the employer bargained directly with the employees for the benefits under the plans,⁴¹² whether the employees had a right to receive the funds or control their disposition,⁴¹³ or whether the payments satisfied a legal obligation of the employees to their children.⁴¹⁴ The educational benefits were considered to represent a part of the benefit package provided to the employees, and to confer an economic benefit upon them and were taxable to the employees under the principle that income is to be taxed to the one who earns it.⁴¹⁵

Income in Respect of a Decedent

Courts have similarly held that compensation-related amounts paid after death are income in respect of a decedent even though the decedent did not have a right to receive the amounts at death.⁴¹⁶ A contrary conclusion would provide an unintended loophole in the code by encouraging employees to negotiate for payment of part of their compensation after their deaths.⁴¹⁷ If such amounts were not IRD, not only would the earner of the income have avoided taxation on the income during life, but his surrogate under section 691 would escape taxation at death.

In 1927, Francis C. Carr released his employer from all claims for commissions then due him in return for the employer's promise to make payments to designated beneficiaries after his death.⁴¹⁸ In *Estate of Carr v. Commissioner*,⁴¹⁹ the Tax Court held payments made in 1953-57 pursuant to the 1927 contract were income in respect of a

411. See, e.g., *Wheeler v. United States*, 768 F.2d 1333, 1335 (Fed. Cir. 1985) (concluding that college fund created for employee's children constituted income under section 61); *Saunders v. Commissioner*, 720 F.2d 871, 873 (5th Cir. 1983) (concluding that college scholarship and loan program for employee's children constituted income under section 61); *Armantrout v. Commissioner*, 570 F.2d 210, 212 (7th Cir. 1978) (concluding that college fund created for employee's children constituted income under section 61).

412. *Wheeler*, 768 F.2d at 1335.

413. *Id.* at 1334.

414. *Id.* at 1335.

415. *Id.*; *Armantrout*, 570 F.2d at 213.

416. See, e.g., *Miller v. United States*, 389 F.2d 656 (5th Cir. 1968) (per curiam); *Estate of Nilssen v. United States*, 322 F. Supp. 382 (D. Minn. 1971); *Collins v. United States*, 318 F. Supp. 382 (C.D. Cal. 1970), *aff'd*, 448 F.2d 787 (9th Cir. 1971) (per curiam); *Bernard v. United States*, 215 F. Supp. 256 (S.D.N.Y. 1963); *Estate of Carr v. Commissioner*, 37 T.C. 1173 (1962); see also *FERGUSON ET AL.*, *supra* note 16, at 3:32 ("If before death the decedent assigns rights to deferred personal service income, application of § 691 is unaffected. . . . In such a situation, the decedent has deliberately chosen to forgo current income, to which he or she had a sort of entitlement, in favor of a survivor. Taxation of such income to the survivor seems entirely appropriate.").

417. *Freyburger*, *supra* note 97, at 967.

418. *Estate of Carr*, 37 T.C. at 1175.

419. *Id.*

decident.⁴²⁰ A district court reached the same conclusion regarding similar payments in *Bernard v. United States*.⁴²¹ The decedent had entered into contracts under which his employers agreed to pay his wife certain amounts upon his death in recognition of services he had rendered.⁴²² The court held it was not necessary that the decedent would have been entitled to receive the amounts had he lived in order for the amounts to be IRD, “[o]therwise all payments that commenced upon death would escape income tax.”⁴²³ The payments were held to be income in respect of a decedent under the economic activities test.⁴²⁴

Courts have reached the same conclusion under the right to income test. In *Collins v. United States*,⁴²⁵ the district court concluded that payments made pursuant to an employment contract were IRD even though the decedent could never have received the amounts in question.⁴²⁶ The court suggested that a decedent’s entitlement to post-death payments attributable to his personal services was “simply not relevant.”⁴²⁷ If the “decedent’s entitlement is a *sine qua non* of income in respect of a decedent,” however, the court held the decedent had been entitled to the income by virtue of his bargaining and control over who would receive payment.⁴²⁸ The very next year, a district court reached the same conclusion in *Estate of Nilssen v. United States*.⁴²⁹ It concluded that “[t]he courts have uniformly held that post-death payments to an employee’s widow are to be treated as ‘income in respect of a decedent’ despite the fact that under the terms of the employment contract, the employee would never be entitled to actual receipt of the income.”⁴³⁰

C. Corporate Liquidation Distributions

Assignment of Income

A number of cases have arisen where shareholders, after commencement of actions to liquidate corporations, transferred stock and their assignees subsequently received liquidating distributions. The

420. *Id.* at 1179.

421. *Bernard*, 215 F. Supp. at 256.

422. *Id.* at 258.

423. *Id.* at 260.

424. *Id.*

425. 318 F. Supp. 382 (C.D. Cal. 1970), *aff’d*, 448 F.2d 787 (9th Cir. 1971) (per curiam).

426. *Id.* at 389.

427. *Id.*

428. *Id.*

429. 322 F. Supp. 260 (D. Minn. 1971).

430. *Id.* at 265.

cases generally involved the transfer of stock to family members⁴³¹ or to charitable entities.⁴³² The issue was whether a right to income (liquidation proceeds) or property (stock) had been transferred.⁴³³

In October 1941, Midland Printing Company commenced negotiations to sell its printing and binding business.⁴³⁴ Assets the company had devoted to those businesses were sold before December 15, 1941.⁴³⁵ At a special meeting held December 15, 1941, the shareholders approved the earlier sales, agreed to sell the company's remaining assets, and voted to liquidate the corporation before December 31, 1941.⁴³⁶ On December 23, 1941, Howard Cook, a shareholder, gave sixty of his shares of stock to each of his two sons.⁴³⁷ Cook's sons subsequently received cash in liquidation of their shares.⁴³⁸

In *Cook v. Commissioner*,⁴³⁹ the Tax Court held Cook taxable on the gain upon liquidation of the shares.⁴⁴⁰ "[L]ooking to realities rather than formalities," the court concluded that Cook had intended to, and did, make gifts of liquidation distributions rather than of stock.⁴⁴¹ At the time of the transfer, most corporate assets had been sold, the sale of the remainder had been authorized, the shareholders had voted to liquidate the corporation, and the corporation was in the process of liquidation.⁴⁴² The court rejected Cook's contention that he should not be taxed because the liquidation was not complete when the gifts were made and the resolution to liquidate could have been rescinded.⁴⁴³ Although the court conceded the correctness of Cook's arguments "as a matter of corporate formalities," the court was concerned with the "actualities" which indicated the liquidation would be completed.⁴⁴⁴

431. See, e.g., *Cook v. Commissioner*, 5 T.C. 908 (1945).

432. See, e.g., *Jones v. United States*, 531 F.2d 1343, 1344 (6th Cir. 1976); *Kinsey v. Commissioner*, 477 F.2d 1058, 1060 (2d Cir. 1973); *Hudspeth v. United States*, 471 F.2d 275, 276 (8th Cir. 1972).

433. See *Hudspeth*, 471 F.2d at 278 ("What has the taxpayer given—stock or liquidation proceeds?").

434. *Cook*, 5 T.C. at 909.

435. *Id.*

436. *Id.*

437. *Id.* at 909-10.

438. *Id.* at 910.

439. *Id.*

440. *Id.* at 912.

441. *Id.* at 911.

442. *Id.*

443. *Id.*

444. *Id.* at 911-12.

Twenty-one years later, in 1966, the district court in *Jacobs v. United States*⁴⁴⁵ reached a contrary conclusion on facts similar to those in *Cook*. Edward A. Jacobs transferred stock to a charitable foundation after shareholder adoption of a plan of liquidation and corporate filing of a statement of intent to dissolve.⁴⁴⁶ The foundation received liquidating distributions approximately three months after the transfer.⁴⁴⁷ The court rejected *Cook*, finding the difference between the facts “so readily apparent that discussion of them is not warranted.”⁴⁴⁸ It held Jacobs was not to be taxed on the liquidating distribution because he had no absolute and infeasible right to the liquidation distributions.⁴⁴⁹ It rejected a “likelihood” analysis, noting that “[i]n spite of the arguments concerning the unlikelihood of a repudiation of the dissolution proceedings prior to their finality, the fact remains that such abandonment was entirely possible.”⁴⁵⁰ The Sixth Circuit affirmed for the reasons set forth in the district court’s opinion.⁴⁵¹

In *Rushing v. Commissioner*,⁴⁵² the Tax Court distinguished *Cook* and relied upon *Jacobs* in a case that did not involve a gift, but installment sales of stock after adoption of liquidation plans.⁴⁵³ *Rushing*, consequently, did not involve an attempt to assign income or to change the character of the gain from ordinary income to capital gain.⁴⁵⁴ Nonetheless, the I.R.S. contended that the former shareholders should be taxed when the liquidating distributions were made, rather than when payments were received under the installment method.⁴⁵⁵ The Tax Court found control over the liquidation after the transfer determinative.⁴⁵⁶ *Cook* was distinguished on that basis.⁴⁵⁷ The minority shareholder-donees in *Cook* lacked control; the only shareholder-purchasers in *Rushing* possessed control and could have voted to rescind the liquidation resolutions.⁴⁵⁸ *Jacobs*, a case in which the Tax Court found the transferors continued to exercise control over the liquidation in a fiduciary capacity, was cited in support of the

445. 280 F. Supp. 437 (S.D. Ohio 1966), *aff'd*, 390 F.2d 877 (6th Cir. 1968).

446. *Id.* at 438.

447. *Id.*

448. *Id.* at 439.

449. *Id.*

450. *Id.*

451. *Jacobs v. United States*, 390 F.2d 877, 878 (6th Cir. 1968).

452. 52 T.C. 888 (1969), *aff'd*, 441 F.2d 593 (5th Cir. 1971).

453. *Id.* at 896.

454. *Rushing v. Commissioner*, 441 F.2d 593, 597 (5th Cir. 1971).

455. *Rushing*, 52 T.C. at 897.

456. *Id.* at 897-98.

457. *Id.* at 897.

458. *Id.*

Rushing court's holding that the taxpayers were not to be taxed upon the liquidation.⁴⁵⁹ The Fifth Circuit affirmed, finding control determinative⁴⁶⁰ and holding the sale had deprived the taxpayers of the right to the liquidation distributions.⁴⁶¹

In 1971, a district court used the *Jacobs* entitlement test and held a taxpayer was not taxable on the liquidation of shares he had gratuitously transferred in *Hudspeth v. United States*.⁴⁶² The court found existence of the right to liquidation proceeds dependent on whether the liquidation plan was reversible under local law.⁴⁶³ The Eighth Circuit reversed for two reasons. First, it held the liquidation was irreversible under local law.⁴⁶⁴ Secondly, the court, citing *Cook*, rejected the *Jacobs* test, holding "that the realities and substance of the events must govern our determination, rather than the formalities and remote hypothetical possibilities."⁴⁶⁵ The court then considered the factors to be used to determine whether the transfer was of stock or liquidation proceeds.

The Eighth Circuit found early cases had held the shareholders' affirmative vote to liquidate was the critical legal step necessary to effect a "realization" of stock gain.⁴⁶⁶ *Rushing*, however, had added "a new dimension" to the analysis by holding that the shareholders' vote was not sufficient to constitute realization.⁴⁶⁷ The court read *Rushing*:

[A]s evincing the proposition that if the donor or vendor transfers a controlling interest in a corporation, such that the transferee will have the legal capacity to suspend or rescind the liquidation and thereby have the power to supersede the donor's initial intent to provide the donee only with the otherwise imminent liquidation proceeds, then the gains are not taxable to the transferor. But, in the case where the taxpayer retains control of the corporation and the transferee will be unable to vitiate the taxpayer's intent to liquidate, the shareholders' vote remains sufficient to constitute the necessary severance of gain.⁴⁶⁸

459. *Id.* at 897-98.

460. *Rushing*, 441 F.2d at 598 ("As we understand the test, in order to receive the installment sale benefits the seller may not directly or indirectly have control over the proceeds or possess the economic benefit therefrom.").

461. *Id.*

462. 335 F. Supp. 1401, 1404 (1971), *rev'd*, 471 F.2d 275 (8th Cir. 1972).

463. *Hudspeth v. United States*, 471 F.2d 275, 277 (8th Cir. 1972).

464. *Id.*

465. *Id.*

466. *Id.* at 278.

467. *Id.*

468. *Id.* at 278-79.

The taxpayer in *Hudspeth* was found to have retained control of the liquidation through retention of a majority of the corporation's stock and was held taxable on the liquidation distribution to his donees.⁴⁶⁹

The Second Circuit adopted the Eighth Circuit's approach in *Kinsey v. Commissioner*.⁴⁷⁰ It examined the "realities and substance of the events" and concluded the taxpayer's transfer of stock was an anticipatory assignment of liquidation proceeds.⁴⁷¹ It based its holding on the fact that the decision to liquidate could only have been reversed by a two-thirds vote; the donee did not own the necessary two-thirds; and, if other shareholders had joined with the donee to satisfy the two-thirds requirement, previous distributions might have been taxed as ordinary, rather than capital, gain income.⁴⁷²

Three years later, in 1976, the Sixth Circuit followed *Hudspeth* and *Kinsey* and overruled its decision in *Jacobs*. In *Jones v. United States*,⁴⁷³ the Sixth Circuit concluded that the realities and substance of events, not hypothetical possibilities, should govern the determination of whether an anticipatory assignment of income had occurred.⁴⁷⁴ The court held the taxpayer-donor taxable on liquidation distributions because the facts indicated completion of the liquidation was a practical certainty at the time of her stock transfers.⁴⁷⁵ It based its conclusion on the fact that the liquidation was being conducted under section 337 of the Internal Revenue Code; if the liquidation was not completed, the corporation would be taxed on gain from assets that had been sold; and the shareholders voted overwhelmingly in favor of liquidation (968,605 to 175).⁴⁷⁶ Donor or donee control over the liquidation was not regarded as determinative but was only one factor to be considered in deciding whether the liquidation was practically certain to be completed.⁴⁷⁷

Income in Respect of a Decedent

In 1969, the year after it had affirmed the district court's opinion in *Jacobs*, the Sixth Circuit decided *Keck v. Commissioner*.⁴⁷⁸ Decedent

469. *Id.* at 279.

470. 477 F.2d 1058 (2d Cir. 1973).

471. *Id.* at 1063.

472. *Id.*

473. *Jones v. United States*, 531 F.2d 1343, 1344-45 (6th Cir. 1976).

474. *Id.* at 1345.

475. *Id.*

476. *Id.*

477. *Id.* at 1346 & n.3.

478. 415 F.2d 531 (6th Cir. 1969).

Shaw owned minority interests in three affiliated corporations.⁴⁷⁹ In 1956, the corporations entered an agreement to sell their assets that was contingent upon approval of the Interstate Commerce Commission (I.C.C.).⁴⁸⁰ Liquidation of the corporations was contemplated and a private ruling was obtained from the Service which indicated section 337 would apply.⁴⁸¹ Decedent died November 27, 1958, before I.C.C. approval had been obtained.⁴⁸² That approval was received May 5, 1960, and, shortly thereafter, the sale was completed and liquidation distributions were made to the decedent's successors.⁴⁸³ The issue in *Keck* was whether the post-death distributions were income in respect of a decedent.⁴⁸⁴

Since two of the three judges who decided *Jacobs* and *Keck* were the same, it is not surprising that the district court opinion affirmed in *Jacobs* and the Sixth Circuit opinion in *Keck* reveal a similar analysis or that the government lost both cases. *Jacobs*⁴⁸⁵ and *Keck*⁴⁸⁶ both used the right to income test. *Jacobs* held a transferor of stock was not taxable on liquidation proceeds because the fact that the liquidation could have been abandoned meant he had no right to the proceeds.⁴⁸⁷ *Keck* held post-death liquidation proceeds were not income in respect of a decedent because contingencies at death meant the decedent had no right to the proceeds.⁴⁸⁸ *Jacobs* rejected a likelihood of completion analysis.⁴⁸⁹ *Keck* did not even mention such an analysis. It is interesting to note that, in spite of the similarity between the cases, the court in *Keck* never cited *Jacobs*.

The Tax Court's 1976 decision in *Estate of Sidles v. Commissioner*⁴⁹⁰ preceded *Jones* but followed in the wake of *Hudspeth* and *Kinsey*. The court had to decide whether a liquidation distribution received by an estate constituted income in respect of a decedent where the transfer at death followed adoption of a plan of complete liquidation.⁴⁹¹ On February 28, 1968, the board of directors of a corporation adopted

479. *Id.* at 532.

480. *Id.*

481. *Id.*

482. *Id.*

483. *Id.*

484. *Id.* at 533.

485. *Jacobs v. United States*, 280 F. Supp. 437, 439 (S.D. Ohio 1966), *aff'd*, 390 F.2d 877 (6th Cir. 1968).

486. *Keck v. Commissioner*, 415 F.2d 531, 535 (6th Cir. 1969).

487. *Jacobs*, 280 F. Supp. at 439.

488. *Keck*, 415 F.2d at 534-35.

489. *Jacobs*, 280 F. Supp. at 439.

490. 65 T.C. 873 (1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977).

491. *Id.* at 873.

a plan of complete liquidation.⁴⁹² Sidles, the sole shareholder, approved the liquidation on the same day.⁴⁹³ On February 29, 1968, the corporation filed a statement of intent to dissolve with the secretary of state.⁴⁹⁴ Sidles died four months later.⁴⁹⁵ The liquidation was completed five months after the decedent's death with distribution to the decedent's estate.⁴⁹⁶

The Tax Court held the decedent must have possessed a right to income at the time of his death in order for the post-death payment to constitute income in respect of a decedent.⁴⁹⁷ Whether the decedent possessed such a right was a question of fact to be determined by examination of relevant factors.⁴⁹⁸ The court indicated that one of those factors was whether the amounts received after death resulted from the decedent's economic activities and efforts.⁴⁹⁹ The Tax Court concluded that the right to income test required the court to determine "whether the transaction had sufficiently matured as of decedent's death so as to create in him a right to receive the income when it was subsequently realized."⁵⁰⁰

After examining the facts, the court concluded the decedent had the necessary right to the liquidating distribution at the time of his death.⁵⁰¹ The court noted that the decedent's actions were the source of the distribution, his vote for liquidation had created the right to receive the distribution, and the estate's right to the proceeds resulted solely from the decedent's death and not from its own efforts.⁵⁰² The fact that Sidles, as sole shareholder, could have rescinded the transaction was unimportant since he had not done so.⁵⁰³ The court, citing *Hudspeth* and *Kinsey* for comparison, concluded that Sidles "had performed enough substantive acts within his control to perfect his right to receive the liquidating distribution for purposes of section 691."⁵⁰⁴ The Eighth Circuit, which had decided *Hudspeth*, affirmed without a published opinion.⁵⁰⁵

492. *Id.* at 875.

493. *Id.*

494. *Id.*

495. *Id.*

496. *Id.*

497. *Id.* at 880.

498. *Id.*

499. *Id.*

500. *Id.*

501. *Id.* at 881 n.6.

502. *Id.* at 881.

503. *Id.*

504. *Id.*

505. *Estate of Sidles v. Commissioner*, 553 F.2d 102 (8th Cir. 1977).

The Tax Court's decision in *Sidles*, however, was not unanimous. Two judges concurred in the conclusion that the amounts were IRD in large part because of the control the decedent possessed over the liquidation as sole shareholder.⁵⁰⁶ These judges found the facts closely akin to those in *Hudspeth* and would have applied the rationale in that case even though it had arisen in the assignment of income context.⁵⁰⁷ Three judges dissented on the grounds that the liquidation had not proceeded to a point beyond the control of the sole shareholder.⁵⁰⁸ They, too, relied upon the assignment of income cases but concluded the sole shareholder's right to rescind the liquidation "eviscerated any claim to a 'right' to the liquidation proceeds."⁵⁰⁹

In 1985, the Tax Court again held post-death liquidation proceeds to be income in respect of a decedent. In *Estate of Bickmeyer v. Commissioner*,⁵¹⁰ the decedent had owned practically all of the shares in one corporation and one-fourth of the shares in another.⁵¹¹ During his life, a county initiated condemnation proceedings to acquire the assets of both corporations.⁵¹² After the application for condemnation was granted, the county had taken possession and paid the corporations the appraised value of the property.⁵¹³ Bickmeyer died after the corporations had voted to liquidate and after partial liquidating distributions had been made.⁵¹⁴ Litigation regarding the value of the assets was not concluded until after the decedent's death and final liquidation distributions were made to his estate.⁵¹⁵

The court, citing *Sidles*, held that the tax result depended on "whether the transaction had sufficiently matured as of decedent's death so as to create in him a right to receive the income when it was subsequently realized."⁵¹⁶ On the facts, the court held that the liquidation had progressed to the point where the decedent was entitled to receive the liquidation proceeds.⁵¹⁷ It relied, in part, on *Hudspeth*, noting that, while abandonment of the "impending dissolution may have been technically or theoretically possible, 'the realities and sub-

506. *Estate of Sidles*, 65 T.C. at 887 (Hall, J., concurring).

507. *Id.* at 890.

508. *Id.* at 896 (Featherston, J., dissenting).

509. *Id.*

510. *Estate of Bickmeyer v. Commissioner*, 84 T.C. 170 (1985).

511. *Id.* at 171.

512. *Id.*

513. *Id.* at 172.

514. *Id.*

515. *Id.*

516. *Id.* at 175 (quoting *Estate of Sidles v. Commissioner*, 65 T.C. 873, 880 (1976)).

517. *Id.* at 176.

stance of the events must govern our determination, rather than formalities and remote hypothetical possibilities.”⁵¹⁸

D. Farm Products

1. Crops and Livestock Received as Rent

Assignment of Income

In Revenue Ruling 63-66,⁵¹⁹ the I.R.S. addressed the income tax consequences of a gift of crops that had been received as rent under a cropshare lease. The taxpayer gave the crops to his children prior to their sale. The Service, before dealing with the assignment of income question, noted the special rule in the regulations that cropshares received as rent are to be included in gross income when reduced to money or its equivalent,⁵²⁰ rather than when received. Finding *Helvering v. Horst* analogous,⁵²¹ the Service ruled that the taxpayer had made a gift of rental income, not unrealized asset appreciation, and was taxable on the rent when the crops were reduced to money or its equivalent by his children.

The Fifth Circuit was required to determine the correctness of the revenue ruling in *Tatum v. Commissioner*.⁵²² The Tatums donated crops which they had received as rent under cropshare leases to charities.⁵²³ The charities sold the crops during the year in which they had been transferred.⁵²⁴ The court distinguished crops held by operating farmers from crops held by landlords that had been received as rent.⁵²⁵ Raised crops held by operating farmers were appreciated property not includible in income until the occurrence of a taxable event.⁵²⁶ Crops held by landlords that had been received as rent, on the other hand, were “rental income assets no less than money paid for the same purpose,”⁵²⁷ taxable when reduced to money or its equivalent under the regulations.⁵²⁸ The fact that the regulations deferred reporting of the rental income did not change their character as potential income assets rather than appreciated property.⁵²⁹ As such,

518. *Id.* at 179 (quoting *Hudspeth v. United States*, 471 F.2d 277 (8th Cir. 1972)).

519. Rev. Rul. 63-66, 1963-1 C.B. 13, *modified*, Rev. Rul. 75-11, 1975-1 C.B. 1.

520. *Id.* (citing Treas. Reg. § 1.61-4).

521. *Id.* at 14.

522. 400 F.2d 242 (5th Cir. 1968).

523. *Id.* at 243.

524. *Id.*

525. *Id.* at 245-46.

526. *Id.* at 246.

527. *Id.* at 247.

528. *Id.* at 246.

529. *Id.* at 247-48.

the assignment of income principles of *Helvering v. Horst* applied.⁵³⁰ Because the gift and the donee's sale occurred during the same tax year in *Tatum*, the court did not have to decide when the income would have been taxable if the gift and sale had taken place in different years.⁵³¹

In Revenue Ruling 75-11,⁵³² the I.R.S. addressed the timing issue left unresolved in *Tatum*. The I.R.S. ruled that the donor of crops that had been received as rent recognizes gross income at the time they are transferred by gift, not when the donee later reduces the crops to money or its equivalent.⁵³³ It based this departure from the usual assignment of income rule, under which the donor is taxed when the income is realized (received) by the donee, on the grounds that cropshares are realized income whose taxation is deferred under the regulations until reduced to cash.⁵³⁴ The Service ruled that "[w]hen crop shares are given away, the continuation of this deferral privilege does not serve the purpose of providing cash with which to pay the farmer-landlord's tax, since it is the donee, not the farmer-landlord, who eventually will convert the crops to cash."⁵³⁵

Income in Respect of a Decedent

In Revenue Ruling 58-436,⁵³⁶ the I.R.S. discussed the character of unsold crops received by a decedent as rent that were transferred at death. Relying on *Estate of Burnett v. Commissioner*,⁵³⁷ a case decided under section 42 of pre-1943 law, the I.R.S. ruled that the crops constituted property, not income in respect of a decedent.⁵³⁸ The crops did not represent a right to receive income but were held to be assets which the decedent could have converted into money or its equivalent.⁵³⁹

The Court of Claims considered the character of cropshares held by a decedent in *Estate of Davison v. United States*.⁵⁴⁰ Davison died in 1952. In 1953, her estate was paid for crops received as rent that were sold after the decedent's death.⁵⁴¹ The court concluded that Congress,

530. *Id.* at 248.

531. *Id.*

532. Rev. Rul. 75-11, 1975-1 C.B. 27.

533. *Id.* at 28.

534. *Id.*

535. *Id.*

536. Rev. Rul. 58-436, 1958-2 C.B. 366, 369.

537. 2 T.C. 897 (1943).

538. Rev. Rul. 58-436, 1958-2 C.B. 366, 368.

539. *Id.*

540. 292 F.2d 937 (Ct. Cl. 1961).

541. *Id.* at 938.

by enacting section 691, had intended to tax income earned, but not reported, by a decedent during his life.⁵⁴² It held that “[c]rops received as rent exist in the hands of the lessor as a unique kind of property which can be described, like a right to receive future income, as a potential income asset.”⁵⁴³ If a decedent died while possessing such crops, the essential income nature of the crops would follow them and they would be income in respect of a decedent.⁵⁴⁴ Revenue Ruling 58-436 was rejected as an improper extension of *Burnett*, a case in which no rents had been involved.⁵⁴⁵

Not surprisingly, within in a few years, the I.R.S. modified Revenue Ruling 58-436 in light of *Davison*.⁵⁴⁶ In Revenue Ruling 64-289, the I.R.S. deleted the portion of the earlier ruling holding that crops and livestock received as rent transferred at death do not constitute income in respect of a decedent.⁵⁴⁷ If the decedent died during a rental period, the I.R.S. indicated that only the portion of the net share proceeds attributable to the period ending with the death were IRD; the portion attributable to the post-death period were section 61 gross income. The Service excepted from the ruling, however, “items received in a sharing arrangement in which the landowner, as well as the tenant, participates materially in the farming operation.”⁵⁴⁸

2. *Raised Crops and Livestock*

Assignment of Income

In 1948, the I.R.S. issued two rulings involving raised crops and livestock and assignment of income principles.⁵⁴⁹ In I.T. 3910, the I.R.S. ruled that the fair market value of raised wheat contributed by a farmer to a charitable organization was includible in the farmer’s gross income.⁵⁵⁰ The raised crops were held to be “in the nature of income” and the satisfaction derived from their contribution to a charitable organization resulted in the enjoyment of income within the rule established in *Helvering v. Horst*.⁵⁵¹ The I.R.S. extended its ruling to noncharitable gifts of raised cattle held primarily for resale in

542. *Id.* at 941.

543. *Id.* at 942.

544. *Id.*

545. *Id.* at 942-43.

546. Rev. Rul. 64-289, 1964-2 C.B. 173.

547. *Id.*

548. *Id.* at 179.

549. I.T. 3910, 1948-1 C.B. 15, *revoked*, Rev. Rul. 55-138, 1955-1 C.B. 223, 226; I.T. 3932, 1948-2 C.B. 7, *revoked*, Rev. Rul. 55-531, 1955-2 C.B. 520, 522.

550. I.T. 3910, 1948-1 C.B. 15, 16, *revoked*, Rev. Rul. 55-138, 1955-1 C.B. 223, 226.

551. *Id.*

I.T. 3932.⁵⁵² According to the I.R.S., the fair market value of the cattle was includible in the donor's gross income in the year the gift was made.⁵⁵³ "Both rulings rested on the proposition that appreciation in an income item, the growing crop or livestock, was realized when the farmer assigned his interest to another."⁵⁵⁴

The Fifth Circuit considered the correctness of the Service's rulings in *Campbell v. Prothro*.⁵⁵⁵ Prothro gave one hundred raised calves to a charitable association by written instrument.⁵⁵⁶ The calves, however, were never physically segregated from others owned by the taxpayer and were sold along with the others as a single lot five months later.⁵⁵⁷ The I.R.S. relied on assignment of income principles and its 1948 rulings in attempting to include the fair market value of the gift in Prothro's gross income.⁵⁵⁸ The Fifth Circuit, however, rejected the contention that assignment of income principles applied.⁵⁵⁹ It held the transfer of appreciated property did not trigger assignment of income principles because mere appreciation does not constitute taxable income.⁵⁶⁰ A sale or exchange was necessary to convert appreciated property into income.⁵⁶¹

Other courts similarly rejected the I.R.S. characterization of raised crops and livestock as income items⁵⁶² and the I.R.S. subsequently revoked its 1948 rulings.⁵⁶³

Income in Respect of a Decedent

Estate of Burnett v. Commissioner,⁵⁶⁴ a case decided under section 42 of pre-1943 law, must be considered before the IRD issue is ad-

552. I.T. 3932, 1948-1 C.B. 7, 8, *revoked*, Rev. Rul. 55-531, 1955-2 C.B. 520, 522.

553. *Id.*

554. *Tatum v. Commissioner*, 400 F.2d 242, 245 (5th Cir. 1968).

555. 209 F.2d 331 (5th Cir. 1954).

556. *Id.* at 332 n.2.

557. *Id.*

558. *Id.* at 333-34.

559. *Id.* at 335.

560. *Id.* at 335-36.

561. *Id.*; see Lyons & Eustice, *supra* note 26, at 381 (noting that a contrary holding would have meant that taxable income would have resulted from gifts of appreciated property and that "[t]he language of section 1015 of the Code, which gives the donee the donor's carryover basis for the gift property without increase for any gain recognized on the gift, seemed clearly to militate against such a conclusion in the view of the courts").

562. See *Tatum v. Commissioner*, 400 F.2d 242, 245 (5th Cir. 1968) (citing *White v. Brodrick*, 104 F. Supp. 213 (D. Kan. 1952); *Estate of W.G. Farrier*, 15 T.C. 277 (1950); and *Elsie SoRelle*, 22 T.C. 459 (1954)).

563. Rev. Rul. 55-138, 1955-1 C.B. 223, 226, *modified*, Rev. Rul. 68-69, 1968-1 C.B. 80; Rev. Rul. 55-531, 1955-2 C.B. 520, 522.

564. 2 T.C. 897 (1943).

dressed because it played an important role in the development of the law. Tom Burnett, a taxpayer whose principal business was cattle ranching, died December 26, 1938.⁵⁶⁵ At the time of his death, Burnett owned raised livestock and feedstuffs.⁵⁶⁶ The I.R.S. contended that the value of both were gross income that had "accrued" and were includible in Burnett's final return under section 42.⁵⁶⁷ The Tax Court disagreed, holding that it did "not think the mere ownership of this property by decedent at the time of his death, even though it had been produced on his ranches during his lifetime, caused it to be gross income accrued to him up to the date of his death" absent a sale or exchange.⁵⁶⁸

In Revenue Ruling 58-436,⁵⁶⁹ the I.R.S. announced that the principles in *Burnett* were equally applicable in determining what constitutes income in respect of a decedent. It ruled that livestock and farm crops (harvested or unharvested) raised by a cash basis decedent, regardless of whether held for sale or feeding purposes, constituted items of property and not IRD where the decedent had engaged in no realization event prior to death.⁵⁷⁰ However, the proceeds would be IRD if the decedent had:

disposed of his livestock and farm crops, whether by sale or by some other arrangement which technically did not amount to a sale but which had put his property beyond his dominion and control, so that at the date of his death he was entitled only to receive the agreed proceeds from such property.⁵⁷¹

E. Sales Proceeds

A sale, exchange, or other disposition of property is generally held to occur upon the earlier of the transfer of title or the transfer of the burdens and benefits of ownership.⁵⁷² If the general rule were an absolute rule, however, gain from the taxable disposition of property could easily be shifted by the property's transfer before a sale closed in violation of assignment of income principles. Not surprisingly, courts have sought to prevent such actions.

565. *Id.* at 898.

566. *Id.*

567. *Id.* at 900.

568. *Id.* at 903.

569. Rev. Rul. 58-436, 1958-2 C.B. 366, 367, *modified*, Rev. Rul. 64-289, 1964-2 C.B. 173.

570. *Id.* at 369.

571. *Id.* at 368.

572. See Rev. Rul. 82-1, 1982-1 C.B. 26; Rev. Rul. 71-265, 1971-1 C.B. 223; Rev. Rul. 69-93, 1969-1 C.B. 139.

Discussion of sales proceeds and the assignment of income doctrine begins with the Supreme Court's 1945 decision in *Commissioner v. Court Holding Co.*⁵⁷³ In *Court Holding*, a corporation had engaged in negotiations for the sale of an apartment building and had reached an oral agreement for its sale.⁵⁷⁴ When the corporate officers and purchaser met to reduce the agreement to writing, they were advised by the corporation's lawyer of the large income tax that would result to the corporation if it sold the property as planned.⁵⁷⁵ No contract was executed at the meeting and the property was distributed to the corporation's two shareholders the next day.⁵⁷⁶ The shareholders subsequently sold the property to the purchaser on substantially the same terms as had been negotiated by the corporation.⁵⁷⁷

The Supreme Court used assignment of income principles⁵⁷⁸ in affirming the Tax Court's decision that the sale, in substance, had been made by the corporation:

The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the later as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.⁵⁷⁹

The fact that oral contracts for land were unenforceable under local law and that the corporation had never executed a written contract did not change the tax result.⁵⁸⁰

Court Holding raised difficult questions for taxpayers, the Service, and lower courts. The Supreme Court sought to provide guidance five years later in *United States v. Cumberland Public Service Co.*,⁵⁸¹ a case in which it granted certiorari "to clear up doubts arising out of the

573. 324 U.S. 331 (1945).

574. *Id.* at 333.

575. *Id.*

576. *Id.*

577. *Id.*

578. See Lyon & Eustice, *supra* note 26, at 298 ("The question of who in substance is the seller of property may seem outside the field of assignment of income, but, if so, it is close by and must be referred to frequently.")

579. *Court Holding*, 324 U.S. at 334 (footnote omitted).

580. *Id.*

581. 338 U.S. 451 (1950).

Court Holding Co. case.”⁵⁸² In *Cumberland*, shareholders of a corporation had offered to sell corporate stock that they owned.⁵⁸³ An interested party refused to buy the stock but offered to purchase some of the corporation’s assets.⁵⁸⁴ That offer was rejected by the corporation because of the high capital gain tax that would have resulted had it made the sale.⁵⁸⁵ The corporation subsequently distributed the assets to its shareholders who sold the assets to the buyer.⁵⁸⁶ The issue was whether the corporation should be taxed on the gain.⁵⁸⁷

The Supreme Court summarized its decision in *Court Holding* as follows:

Our *Court Holding Co.* decision rested on findings of fact by the Tax Court that a sale had been made and gains realized by the taxpayer corporation. There the corporation had negotiated for sale of its assets and had reached an oral agreement of sale. When the tax consequences of the corporate sale were belatedly recognized, the corporation purported to ‘call off’ the sale at the last minute and distributed the physical properties in kind to the shareholders. They promptly conveyed these properties to the same persons who had negotiated with the corporation.⁵⁸⁸

The Court cautioned that *Court Holding* did not mean that a corporation would be taxed where a sale was made by shareholders following a genuine liquidation and dissolution.⁵⁸⁹ Whether a liquidation was genuine or a sham is a question of fact⁵⁹⁰ and “in resolving such questions as who made a sale, fact-finding tribunals in tax cases can consider motives, intent, and conduct in addition to what appears in the written instruments used by the parties to control rights as among themselves.”⁵⁹¹ The fact that sales followed tax-motivated liquidations would not cause the corporation to be taxed as long as the subsequent sales were in fact made by the shareholders.⁵⁹²

Congress enacted section 337 in 1954 to permit corporations to avoid the *Court Holding* problem in the case of certain complete corporate liquidations.⁵⁹³ Section 337 permitted shareholders to avoid

582. *Id.* at 453.

583. *Id.* at 452.

584. *Id.*

585. *Id.*

586. *Id.* at 453.

587. *Id.* at 452.

588. *Id.* at 453-54.

589. *Id.* at 454.

590. *Id.*

591. *Id.* at 454 n.3.

592. *Id.* at 455.

593. See Lyon & Eustice, *supra* note 26, at 399.

taxation at the corporate level and be taxed on liquidations at capital gains rates.⁵⁹⁴ Congress repealed section 337 in 1986.⁵⁹⁵

The *Court Holding* doctrine can arise in a multitude of factual settings. The issue in such cases is whether negotiations or arrangements made for the sale of property had reached the point after which the transfer of legal title was, in substance, not a transfer of property, but of a right to receive sale proceeds.⁵⁹⁶ As the Supreme Court held in *Court Holding*, “[a] sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title.”⁵⁹⁷

1. Negotiations—No Contract

Assignment of Income

In *Court Holding*, the Court held that “each step, from the commencement of negotiations to the consummation of the sale, is relevant” in determining who made a particular sale.⁵⁹⁸ It did not hold, however, that mere commencement of negotiations always causes a subsequent sale to be treated as a sale by the owner who initiated the negotiations. Factors relevant to identifying the seller have been said to include “previous ‘arrangements’ or ‘negotiations’ for the sale conducted by the donor, close proximity of the sale to the gift, and the presence of a binding obligation, express or implied, on the part of the donee to complete the sale.”⁵⁹⁹ However, two cases illustrate that courts are unlikely to find a *Court Holding* problem if no understanding or agreement to sell existed at the time of transfer.

In *Indiana Limestone Co. v. Smith*,⁶⁰⁰ the district court rejected the I.R.S.’s contention that a sale of real property by a corporation should have been taxed as a sale by a prior owner.⁶⁰¹ Although the prior owner had conducted negotiations for sale of the property to its eventual purchaser, the court found that, at the time of the conveyance, the “negotiations had not reached a point where the sale . . . was assured

594. *Id.* at 388. Courts continued to confront assignment of income issues in connection with corporate liquidations after the enactment of section 337. The question, however, was not whether the corporation recognized gain, but whether shareholders who transferred stock after adoption of liquidation plans would be taxed when the liquidation was completed. See *supra* Part V.C.

595. See Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2269.

596. See FERGUSON ET AL., *supra* note 16, at 3:50.

597. 324 U.S. at 334.

598. *Id.*

599. Eustice, *supra* note 26, at 37.

600. 85 F. Supp. 652 (S.D. Ind. 1949).

601. *Id.* at 655.

or even substantially assured; that on that date there was no sale contract, nor was there any understanding . . . that the [property] would subsequently be conveyed.”⁶⁰²

Another court made a similar factual determination in *Martin v. Machiz*.⁶⁰³ A husband and wife, who had been negotiating to sell certain stock, conveyed 1,000 of 1,440 shares to trustees of a charitable trust.⁶⁰⁴ Two days later, the taxpayers, individually, and the trustees executed a contract to sell all 1,440 shares.⁶⁰⁵ The I.R.S. sought to tax the couple on the capital gains realized on the sale of all shares on the grounds that “the trust was a mere conduit through which taxpayers consummated an agreement of sale arrived at before the trust as a legal entity came into being.”⁶⁰⁶ The court disagreed.⁶⁰⁷ It found that “at the time the deed of trust was executed no mutual understanding or meeting of the minds or contract existed between the parties.”⁶⁰⁸ The charitable trust, consequently, made the sale of the shares that had been transferred to it in substance as well as in form.⁶⁰⁹

Income in Respect of a Decedent

Not surprisingly, no case or ruling has been found which holds that the proceeds of a sale completed after a decedent’s death were income in respect of a decedent because of a decedent’s negotiations absent either a contract negotiated by the decedent or a delivery by which property was placed beyond the decedent’s control and entitled him to receive sales proceeds.⁶¹⁰ Persons who acquire legal title to property in such cases no doubt claim a section 1014 basis in the property when reporting a post-death sale. Even if the successor’s return is audited, it is unlikely that the I.R.S. would contend the proceeds were IRD in such circumstances without evidence that the successor had merely completed a sale which had been negotiated and agreed to by the decedent.

An example in the regulations supports that conclusion. In the example, a decedent commenced negotiations to sell apples to *Y* before

602. *Id.*

603. 251 F. Supp. 381 (D. Md. 1966).

604. *Id.* at 383.

605. *Id.*

606. *Id.* at 386.

607. *Id.* at 390.

608. *Id.*

609. *Id.*

610. See *Estate of Peterson v. Commissioner*, 667 F.2d 675, 681 n.12 (8th Cir. 1981) (“If the decedent neither enters into a sales contract nor delivers the property before death, the post-death disposition of the property by the executor does not produce income in respect of a decedent.”).

his death, "but did not complete the sale before his death."⁶¹¹ The decedent's executor completed the sale and transferred the apples to Y.⁶¹² Although the facts are sparse, it appears that the decedent had not reached an understanding or agreement of the type found to exist in *Court Holding*. Consistent with the results in assignment of income cases, the regulation provides that none of the post-death proceeds of the sale to Y were income in respect of a decedent.⁶¹³

2. *Executory Contracts*

Assignment of Income

Four cases illustrate application of assignment of income principles where property is gratuitously transferred after execution of a binding contract and the transferee completes the sale.

On August 6, 1960, two individuals executed a written contract to sell real property.⁶¹⁴ Two days later, one of them deeded the real property to a corporation wholly owned by the taxpayers.⁶¹⁵ The corporation completed the sale under the contract on October 10, 1960.⁶¹⁶ In *Palmer v. Commissioner*,⁶¹⁷ the Tax Court found the facts before it presented a stronger case for the I.R.S. than those in *Court Holding*.⁶¹⁸ Viewing the transaction as a whole, the court held the individual taxpayer had made the sale.⁶¹⁹ The First Circuit affirmed, holding the evidence permitted the Tax Court to reasonably find that the taxpayer had made the sale before the transfer.⁶²⁰

In *Usher v. Commissioner*,⁶²¹ stock was transferred to an irrevocable trust after the shareholder had entered into a "Memorandum of Understanding" in which she agreed to sell the stock.⁶²² The trust completed the sale pursuant to the memorandum several weeks after the transfer.⁶²³ The Tax Court held the transferor taxable on the proceeds.⁶²⁴ It found she had been bound to sell her stock under the memorandum, the trust was not free to dispose of the stock, and the

611. Treas. Reg. § 1.691(a)-2(b) ex. (5)(i) (1957).

612. *Id.*

613. *Id.*

614. *Palmer v. Commissioner*, 44 T.C. 92, 93, *aff'd*, 354 F.2d 974 (1st Cir. 1965) (per curiam).

615. *Id.*

616. *Id.* at 94.

617. *Id.* at 92.

618. *Id.* at 95.

619. *Id.*

620. *Palmer v. Commissioner*, 354 F.2d 974, 975 (1st Cir. 1965).

621. 45 T.C. 205 (1965).

622. *Id.* at 206.

623. *Id.* at 212.

624. *Id.* at 215.

trust was a mere conduit to carry out the taxpayer's previously contracted-for sale.⁶²⁵ The fact that the contract was subject to confirmation of the financial condition and net worth of the corporation did not change that result.⁶²⁶ The taxpayer was held to have enjoyed the benefits of the proceeds "as completely as she would have had she in form collected the proceeds of the sale and transferred them to the trust."⁶²⁷

On July 24, 1963, Susie Salvatore accepted an offer from Texaco, Inc. to purchase property that she owned.⁶²⁸ By warranty deed dated August 28, 1963, she conveyed a one-half interest in the property to her five children.⁶²⁹ Salvatore and her children conveyed title to Texaco by warranty deeds dated August 28 and 30, 1963.⁶³⁰ In *Salvatore v. Commissioner*,⁶³¹ the Tax Court concluded that Salvatore, notwithstanding the intermediate conveyance, was taxable on the entire gain from the sale because "[i]n substance, petitioner made an anticipatory assignment to her children of one-half of the income from the sale of the property."⁶³² Her transfer of the one-half interest, although a completed gift for gift tax purposes, was merely an intermediate step in the transfer of title to Texaco pursuant to the contract.⁶³³ The Second Circuit affirmed, finding substantial support existed for the Tax Court's conclusion.⁶³⁴

The 1986 case of *Peterson v. Commissioner*⁶³⁵ required the Tax Court to determine whether a donor, who had given stock to his children, should be taxed on the gain from the stock's sale under a contract he had made three months earlier.⁶³⁶ The court extensively reviewed applicable principles.⁶³⁷ Citing corporate liquidating distribution cases (*Hudspeth, Kinsey, and Jones*),⁶³⁸ the court concluded:

Whether a taxpayer possesses a right to receive income or gain is, of course, a question of fact, each case turning on its own particular facts. The realities and substance of the events, rather than formalities and the technical possibility that the sale might be abandoned,

625. *Id.* at 215-16.

626. *Id.* at 215.

627. *Id.* at 216.

628. *Salvatore v. Commissioner*, 29 T.C.M. (CCH) 89, 90, *aff'd*, 434 F.2d 600 (2d Cir. 1970).

629. *Id.*

630. *Id.*

631. 29 T.C.M. (CCH) 89, *aff'd*, 434 F.2d 600 (2d Cir. 1970).

632. *Id.* at 91.

633. *Id.*

634. *Salvatore v. Commissioner*, 434 F.2d 600, 601 (2d Cir. 1970).

635. 51 T.C.M. (CCH) 1300 (1986), *aff'd*, 822 F.2d 1093 (8th Cir. 1987).

636. *Id.* at 1314.

637. *Id.* at 1314-16.

638. *See supra* Part V.C (discussing these cases in full).

must govern our determination of whether an anticipatory assignment of income occurred. We must determine whether by the time of the gifts, the sale was practically certain to be completed despite the remote and hypothetical possibility of abandonment.⁶³⁹

The court then carefully considered several contingencies relied upon by the taxpayers as negating the transferor's right to the proceeds at the time of the gift.⁶⁴⁰ It found none of them sufficient to negate the transferor's right.⁶⁴¹ Finding the sale "practically certain to be completed" at the time of the stock transfer, the gain was taxable to the taxpayer who had made the contract because his right to the proceeds "had sufficiently matured or ripened so that the gifts were in substance gifts of the sale proceeds rather than the stock itself."⁶⁴²

Income in Respect of a Decedent

*Commissioner v. Linde*⁶⁴³ did not involve post-death completion of a sale under an executory contract made by a decedent. It did, however, require the court to characterize post-death sales proceeds. The decedent had delivered grapes to several cooperative marketing associations during his life.⁶⁴⁴ The cooperatives were to process the grapes into wine, sell the products, and distribute the net proceeds to their members.⁶⁴⁵ Wine made from the grapes delivered by the decedent had not been sold at the time of his death.⁶⁴⁶ The Ninth Circuit held, nonetheless, that the post-death sale proceeds constituted income in respect of a decedent.⁶⁴⁷ The decedent's delivery (activity) had converted his property into a right to receive sale proceeds—"all he had remaining was a right to collect sums of money."⁶⁴⁸ The decedent's successors did not receive section 1014 property but the right to receive sale proceeds that eventually would be realized.⁶⁴⁹

In *Trust Co. of Georgia v. Ross*,⁶⁵⁰ the Fifth Circuit used the "right to income" test to characterize proceeds of a sale completed after death pursuant to a contract made by the decedent.⁶⁵¹ By contract

639. *Peterson*, 51 T.C.M. (CCH) at 1316 (citations omitted).

640. *Id.* at 1316-19.

641. *Id.* at 1319.

642. *Id.*

643. 213 F.2d 1 (9th Cir. 1954).

644. *Id.* at 2.

645. *Id.*

646. *Id.* at 3.

647. *Id.*

648. *Id.* at 7.

649. *Id.*

650. 392 F.2d 694 (5th Cir. 1967) (per curiam).

651. *Id.* at 696.

dated August 4, 1960, the decedent and others had agreed to sell stock or assets of certain corporations.⁶⁵² The transaction was to close January 3, 1961, but the closing was extended to March 1, 1961, pursuant to a right granted to the buyer in the contract.⁶⁵³ The decedent died January 30, 1961.⁶⁵⁴ The transaction closed February 23, 1961, with the decedent's successor receiving the sale proceeds.⁶⁵⁵

The Fifth Circuit held the proceeds were income in respect of a decedent because the decedent had possessed a right to the sale proceeds at the time of his death.⁶⁵⁶ Although the decedent's executor had to do certain things to perform the contract, the court held that they "were not of such scope as would negate the right which was his under the contract."⁶⁵⁷ The Fifth Circuit, thus, seemed to agree with the trial court's finding that unfulfilled conditions of the contract were of "no material affect" and that the estate's acts were "perfunctory and of no material significance."⁶⁵⁸ A contrary holding that post-death ministerial acts preclude characterization of proceeds as IRD would have meant that decedents must possess an unqualified right to the income at death in order for the proceeds to be IRD.⁶⁵⁹

In Revenue Ruling 78-32,⁶⁶⁰ the I.R.S. considered whether proceeds of a sale completed after death pursuant to a contract entered by the decedent were income in respect of a decedent.⁶⁶¹ On January 1, 1976, the decedent had executed a real estate contract that was to close on March 15, 1976.⁶⁶² The decedent died on February 5, 1976, after substantial fulfillment of the prerequisites to the sale.⁶⁶³ Remaining obligations of the seller were characterized as ministerial.⁶⁶⁴ The executor completed the transaction and transferred title and possession on March 15, 1976.⁶⁶⁵ On these facts, the I.R.S. ruled that the decedent was "unconditionally entitled to the proceeds of the sale at

652. *Trust Co. of Ga. v. Ross*, 262 F. Supp. 900, 901 (N.D. Ga. 1966), *aff'd on other grounds*, 392 F.2d 694 (5th Cir. 1967) (per curiam).

653. *Id.* at 902-03.

654. *Id.* at 903.

655. *Id.* at 904.

656. *Trust Co. of Ga. v. Ross*, 392 F.2d 694, 696 (5th Cir. 1967) (per curiam).

657. *Id.*

658. *Trust Co. of Ga.*, 262 F. Supp. at 909.

659. See *Brown*, *supra* note 13, at 226-27.

660. Rev. Rul. 78-32, 1978-1 C.B. 198.

661. *Id.*

662. *Id.*

663. *Id.*

664. *Id.*

665. *Id.*

the time of death" and the gain realized was income in respect of a decedent.⁶⁶⁶

In *Estate of Peterson v. Commissioner*,⁶⁶⁷ the court had to determine whether proceeds of a sale completed after a decedent's death were income in respect of a decedent.⁶⁶⁸ Peterson entered a contract on July 11, 1972, agreeing to sell approximately 3,300 calves.⁶⁶⁹ Peterson died November 9, 1972, without having completed the transaction.⁶⁷⁰ His estate raised and fed the cattle and made delivery in December of 1972.⁶⁷¹

The Tax Court articulated a four-factor test for determining whether the decedent possessed a right to income at death.⁶⁷² The second requirement of that test was that the "decedent has performed the substantive (nonministerial) acts required of him as preconditions to the sale, i.e., the subject matter of the sale was in a deliverable state on the date of the decedent's death."⁶⁷³ It held that the nature of the decedent's activities depends on the subject matter of the sale.⁶⁷⁴ One indicator of whether the decedent had performed the substantive acts was whether he had delivered or otherwise placed the subject of the sale beyond his control.⁶⁷⁵ The court cautioned, however, that the absence of delivery does not preclude a finding that sales proceeds are IRD.⁶⁷⁶ The court held the second requirement had not been satisfied in *Estate of Peterson*—only two-thirds of the calves were deliverable at the decedent's death.⁶⁷⁷ The acts of the estate in raising and feeding the calves "were not perfunctory or ministerial but substantive and essential acts not performed by the decedent prior to his death."⁶⁷⁸

The Eighth Circuit affirmed the Tax Court's decision in *Estate of Peterson*.⁶⁷⁹ It agreed with the Tax Court that the estate's performance of the contract, which it held involved the care, feeding, and delivery of the calves, could not be characterized as ministerial.⁶⁸⁰ The

666. *Id.* at 199.

667. 74 T.C. 630 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981).

668. *Id.* at 635.

669. *Id.* at 631.

670. *Id.* at 634.

671. *Id.*

672. *Id.* at 639; *see supra* Part III.C.2.b.

673. *Estate of Peterson*, 74 T.C. at 640.

674. *Id.*

675. *Id.*

676. *Id.* at 641.

677. *Id.* at 644.

678. *Id.*

679. *Estate of Peterson v. Commissioner*, 667 F.2d 675 (8th Cir. 1981).

680. *Id.* at 681.

Eighth Circuit disagreed, however, with the Tax Court's conclusion that characterization of the tasks depends on the nature of the property.⁶⁸¹ It suggested that delivery may be a substantive and, therefore, determinative act in all cases involving sales of property.⁶⁸² However, if the character of sales proceeds depends on whether the subject of the sale had been delivered during the decedent's life, rather than on whether it was deliverable, only completed sales for which the decedent had not received payment would give rise to income in respect of a decedent.

The I.R.S. published Revenue Ruling 82-1⁶⁸³ eighteen days after the Eighth Circuit's decision in *Estate of Peterson*. It addressed facts similar to those in Revenue Ruling 78-32.⁶⁸⁴ A taxpayer had entered into a binding executory contract to sell his residence but died before the sale was completed.⁶⁸⁵ Prior to the taxpayer's death, contractual conditions had been substantially fulfilled and only ministerial obligations remained to be performed.⁶⁸⁶ The decedent's executor completed the sale and delivered possession.⁶⁸⁷ The I.R.S. ruled the sale proceeds were income in respect of a decedent to the extent not excluded from income by section 121.⁶⁸⁸ The ruling evidences the Service's belief that delivery is ministerial, rather than substantive, as suggested by the Eighth Circuit in *Estate of Peterson*.⁶⁸⁹

Private Letter Ruling 90-23-012⁶⁹⁰ sheds light on what the I.R.S. considers to be a material contingency. A taxpayer had entered into a contract to sell real estate that provided either party could cancel the contract if the buyer did not obtain a mortgage within forty-five days.⁶⁹¹ The taxpayer died during the forty-five day period, and the buyer did not obtain a mortgage commitment during this forty-five day period.⁶⁹² Nonetheless, the executor of the decedent's estate and the buyer closed the transaction without a written contract extension.⁶⁹³ The I.R.S. ruled that the post-death proceeds were IRD, noting that Treasury Regulations provide that income in respect of a

681. *Id.*

682. *Id.*

683. Rev. Rul. 82-1, 1982-1 C.B. 26.

684. Rev. Rul. 78-32, 1978-1 C.B. 198.

685. Rev. Rul. 82-1, 1982-1 C.B. 26.

686. *Id.*

687. *Id.*

688. *Id.*

689. See Blattmachr, *supra* note 16, at 49.

690. Priv. Ltr. Rul. 90-23-012 (Mar. 6, 1990).

691. *Id.*

692. *Id.*

693. *Id.*

decendent includes income "to which the decedent had a contingent claim at the time of his death."⁶⁹⁴

In 1992, the Tax Court used the first two factors of its four-factor test to classify post-death sales proceeds in *Estate of Napolitano v. Commissioner*.⁶⁹⁵ Napolitano had entered into a contract to sell property for \$100,000, on April 8, 1985.⁶⁹⁶ The contract required that the property be conveyed free of any violations of local law.⁶⁹⁷ At the time of Napolitano's death, three violations existed that had not been resolved.⁶⁹⁸ After Napolitano's death, the attorney for the purchaser indicated that title would not be taken subject to the violations.⁶⁹⁹ Post-death negotiations, however, resulted in a \$2,250 price reduction and the transfer of the property subject to the violations on July 30, 1985.⁷⁰⁰

The Tax Court held the post-death proceeds were not income in respect of a decedent because the second prong of its four-factor right to income test had not been satisfied.⁷⁰¹ The decedent had not performed all the substantive (nonministerial) acts required as preconditions to the sale; consequently, the property was not in a deliverable state on the date of death because of the uncorrected violations.⁷⁰² Although the Tax Court noted that not all acts required of a seller must be completed at death in order for post-death payments to constitute IRD, the court held that remaining acts must be ministerial rather than substantive.⁷⁰³ It concluded that the post-death negotiations that resolved the violation problem "demanded judgment and discretion, and cannot be considered 'ministerial,' perfunctory, routine, or insubstantial."⁷⁰⁴ Since substantive acts remained to be completed at the decedent's death, the court held he had no right to income at death.⁷⁰⁵

If donative assignment of income cases were referenced in deciding whether proceeds of sales completed after death are income in respect of a decedent, the "practical certainty of receipt" test would be

694. *Id.* (citing Treas. Reg. § 1.691(a)-1(b)).

695. 61 T.C.M. (RIA) 1633 (1992).

696. *Id.*

697. *Id.*

698. *Id.* at 1634.

699. *Id.*

700. *Id.*

701. *Id.* at 1636.

702. *Id.*

703. *Id.*

704. *Id.*

705. *Id.*

used.⁷⁰⁶ For example, in Private Letter Ruling 90-23-012,⁷⁰⁷ at the decedent's death, was it practically certain that the buyer would obtain the required financing? The trier of fact would consider factors relevant to that question in deciding whether the decedent had a right to income under section 691. Similarly, in *Napolitano*, at the decedent's death, was it practically certain that the sale would be consummated notwithstanding the uncorrected violations? The relatively small price-reduction made after his death to complete the transaction suggests he may have had the necessary right to income. A likelihood of receipt analysis should be used to determine whether "earned" income (sale proceeds) or property was transferred in both the assignment of income and income in respect of a decedent settings when property is transferred after execution of a contract.

3. *Installment Sales*

The amount of gain realized on the sale or disposition of property includes money and the fair market value of other property received.⁷⁰⁸ Generally, the entire amount of gain realized is recognized for income tax purposes.⁷⁰⁹ However, Congress permits taxpayers to report income from installment sales under the installment method provided in section 453.⁷¹⁰ Section 453, nonetheless, defers only taxation of gain, not its realization.⁷¹¹

Assignment of Income

Congress has specifically addressed the income tax consequences of transferring installment obligations. Section 453B generally provides that if an installment obligation is "distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and . . . the fair market value of the obligation at the time of distribution, transmission, or disposition" in cases not involving a sale or exchange.⁷¹² A gratuitous assignment of an installment obligation is a disposition which triggers taxation.⁷¹³

706. See *Peterson v. Commissioner*, 51 T.C.M. (CCH) 1300, 1316 (1986), *aff'd*, 822 F.2d 1093 (8th Cir. 1987).

707. Priv. Ltr. Rul. 90-23-012 (Mar. 6, 1990).

708. I.R.C. § 1001(b).

709. *Id.* § 1001(c).

710. *Id.* § 453.

711. *Sun First Nat'l Bank v. United States*, 607 F.2d 1347, 1353 (Ct. Cl. 1979).

712. I.R.C. § 453B(a).

713. See *id.*

Income in Respect of a Decedent

Section 691(a)(4) provides that installment obligations acquired by reason of a decedent's death constitute income in respect of a decedent in an amount equal to the excess of the face amount over decedent's basis.⁷¹⁴ The transfer of installment obligations at death, however, does not usually cause immediate recognition of gain because Congress excepted the transmission of installment obligations at death from the disposition rules, except as provided in section 691.⁷¹⁵

Section 691 provides for treating two events as transfers causing recognition of income. First, section 691(a)(5)(A)(i) provides that the transfer of an installment obligation to its obligor will be a transfer under section 691(a)(2).⁷¹⁶ Second, section 691(a)(5)(A)(ii) provides that any cancellation of an installment obligation is treated as a transfer.⁷¹⁷ Additionally, any cancellation occurring at a decedent's death is to be treated as a transfer by the decedent's estate.⁷¹⁸

In *Frane v. Commissioner*,⁷¹⁹ the Eighth Circuit held the automatic self-cancellation of an installment obligation at death pursuant to the terms of the note is a "cancellation" covered by sections 453B and 691(a)(5).⁷²⁰ The court also addressed the question of whether the income triggered by the cancellation is taxable to the decedent or his estate.⁷²¹ It held that the unambiguous language of section 691(a)(5)(A)(iii) provided that a cancellation occurring at death is to be treated as a transfer by the estate taxable under section 691(a)(2).⁷²² Consequently, the decedent's estate, not the decedent, was taxable upon the income triggered by the cancellation.⁷²³

4. Sales that Can Close Only After Transfer

Assignment of Income

In Revenue Ruling 60-370,⁷²⁴ the I.R.S. extended *Court Holding* to a situation where the transferor had not even commenced negotiations to sell property.⁷²⁵ An individual transferred appreciated prop-

714. *Id.* § 691(a)(4).

715. *Id.* § 453B(c).

716. *Id.* § 691(a)(5)(A)(i).

717. *Id.* § 691(a)(5)(A)(ii).

718. *Id.* § 691(a)(5)(A)(iii).

719. 998 F.2d 567 (8th Cir. 1993).

720. *Id.* at 572.

721. *Id.*

722. *Id.*

723. *Id.*

724. Rev. Rul. 60-370, 1960-2 C.B. 203.

725. *Id.* at 205.

erty to a university, as trustee, of a charitable remainder trust.⁷²⁶ Net income was payable to the donor for life and, after his death, to a secondary income beneficiary for life.⁷²⁷ The remainder would pass to the university after the death of both beneficiaries.⁷²⁸ The trustee, as expressly required by the terms of the trust instrument, either sold the appreciated property and invested the proceeds in tax-exempt securities or exchanged the property for tax-exempt securities.⁷²⁹

The I.R.S. ruled that the gain from the disposition of the property was includible in the gross income of the donor in the year of the sale or exchange.⁷³⁰ Because of the obligation imposed on the trustee, the I.R.S. concluded that "the transferor did not give the trustee appreciated property to hold in trust, but, rather, gave the trustee the proceeds of the sale or exchange of the property which the trustee was required to consummate."⁷³¹ Although the trust instrument addressed in the ruling expressly required the disposition of the property, the Service ruled an obligation to dispose of contributed property can also arise by implication.⁷³²

Thirty-four years later, the I.R.S., in Notice 94-78,⁷³³ stated it may rely on assignment of income principles and Revenue Ruling 60-370 to challenge the use of certain short-term charitable remainder unitrusts.⁷³⁴ It gave an example of the type of transaction it considered abusive.⁷³⁵ Appreciated, nonproductive property having a value of \$1,000,000 and a zero basis is contributed to a two-year charitable remainder unitrust on January 1.⁷³⁶ The unitrust amount under the instrument is "80% of the fair market value of the trust assets valued annually."⁷³⁷ No distribution is made in the first year.⁷³⁸

All assets are sold at the beginning of the second year for \$1,000,000.⁷³⁹ The trustee, thereafter, pays the donor \$800,000 (80% x \$1,000,000), the unitrust amount for the first year, \$160,000 (80% x

726. *Id.* at 204.

727. *Id.*

728. *Id.*

729. *Id.*

730. *Id.* at 205.

731. *Id.*

732. *Id.*

733. I.R.S. Notice 94-78, 1994-2 C.B. 555.

734. *Id.* at 556.

735. *Id.*

736. *Id.*

737. *Id.*

738. *Id.*

739. *Id.*

\$200,000), the unitrust amount for the second year, and distributes the \$40,000 balance to the charitable organization.⁷⁴⁰

Noting that proponents of such planning contend the \$800,000 distribution to the donor is tax-free, the Service indicated it would challenge such transactions using one or more legal doctrines.⁷⁴¹ One of those doctrines is the assignment of income doctrine under which "the income of one person cannot be assigned to another for tax purposes."⁷⁴² Since the trustee of the short-term trust was required to dispose of the appreciated property in a taxable transaction to comply with the terms of the trust (either through a sale or distribution in kind to the donor), the Service gave notice that the gain realized upon the trust's sale of the assets may be attributed to the donor as in Revenue Ruling 60-370.⁷⁴³

Revenue Ruling 60-370 and Notice 94-78 both involved the required sale of appreciated property in circumstances where the donor retained rights to receive distributions. However, the importance of the donor's retained interests is unclear. The Service may not consider it very important. The assignment of income doctrine seeks to determine the nature of the item transferred. Did the donor transfer "earned" income (sale proceeds) or appreciated property? In Revenue Ruling 60-370, the Service ruled that a donor-imposed obligation to sell meant the transferor did not give the trustee appreciated property but merely the proceeds of a sale that the donee was required to make.⁷⁴⁴ The Service's theory is that the donee, after the mandated sale is completed, is in the same position he would have been had the donor sold the property and gifted the proceeds.⁷⁴⁵ Since the donor did not give his donee control over the decision of whether to retain or sell the property, the Service determined it was appropriate to tax the donor on the gain realized.⁷⁴⁶

Income in Respect of a Decedent

The legislative history of section 691 contains an example which suggests that the proceeds of sales negotiated by decedents that will close only after death would be income in respect of a decedent:

Another example [of the application of this provision] is the case of a partner who contracts in the partnership agreement that his inter-

740. *Id.*

741. *Id.*

742. *Id.*

743. *Id.*

744. Rev. Rul. 60-370, 1960-2 C.B. 205.

745. *Id.*

746. *Id.*

est in certain partnership assets shall pass to the surviving partners in exchange for payments to be made by them to his widow. On his death, the payments by the surviving partners shall be included in the widow's income to the extent they represent the gain on such sale.⁷⁴⁷

The critical factor not addressed in the example, however, was how the "gain" was to be computed. Was the decedent's basis or a section 1014 basis to be used? Congress must have had the decedent's basis in mind, however, otherwise there would have been no gain upon the sale at death.

The Treasury included this example in the first regulations issued to deal with income in respect of a decedent.⁷⁴⁸ Depending on one's view, however, the Treasury either clarified or expanded upon the example by providing that the payments "must be included in the widow's income to the extent they exceeded the adjusted basis of such assets in the hands of the decedent immediately prior to his death."⁷⁴⁹ Two years later, however, the Treasury did an about-face. It deleted the quoted language and provided that the payments were to be included "in the widow's income to the extent they are attributable to the earnings of the partnership accrued only by reason of his death."⁷⁵⁰

Current regulations provide that proceeds of a mandatory post-death sale of stock pursuant to an agreement made by a decedent are not income in respect of a decedent:

A, prior to his death, acquired 10,000 shares of the capital stock of the X Corporation at a cost of \$100 per share. During his lifetime, A had entered into an agreement with X Corporation whereby X Corporation agreed to purchase and the decedent agreed that his executor would sell the 10,000 shares of X Corporation stock owned by him at the book value of the stock at the date of A's death. Upon A's death, the shares are sold by A's executor for \$500 a share pursuant to the agreement. Since the sale of stock is consummated after A's death, there is no income in respect of a decedent with respect to the appreciation in value of A's stock to the date of his death. If, in this example, A had in fact sold the stock during his lifetime but payment had not been received before his death, any gain on the sale would constitute income in respect of a decedent when the proceeds were received.⁷⁵¹

747. H.R. REP. NO. 77-2333 (1942), *reprinted in* 1942-2 C.B. 372, 436; S. REP. NO. 77-1631 (1942), *reprinted in* 1942-2 C.B. 504, 580.

748. Treas. Reg. 103, § 19.126-1, T.D. 5233, 1943-1 C.B. 198, 205.

749. *Id.*

750. Treas. Reg. 111, § 29.126-1, T.D. 5459, 1945-1 C.B. 193.

751. Treas. Reg. § 1.691(a)-2(b), ex. (4) (1957).

Mandatory buy-sell agreements, so frequently used in closely held corporations, consequently, do not create income in respect of a decedent problems.

But why are not the proceeds of mandatory post-death sales income in respect of a decedent?⁷⁵²

Should the fact that the decedent could never have received the proceeds mean they are not income in respect of a decedent? As previously discussed,⁷⁵³ the fact that compensation-related payments could never have been received by the decedent does not affect their status as income in respect of a decedent. The decedent's economic activities were held to have created the necessary right to income for purposes of section 691. The proceeds of a mandatory sale at death, similarly, are solely attributable to the decedent's economic activities in negotiating the contract.

Is a different tax result in the sales context warranted because a realization event (transfer of title or delivery) is generally required before a right to sales proceeds will be found to exist? *Trust Co. of Georgia*, however, makes it clear that a sale need not be completed at death in order for sale proceeds to be income in respect of a decedent as long as remaining acts are ministerial. The actions of the decedent's estate in completing the sale of stock under a mandatory buy-sell agreement would clearly be ministerial, unless delivery is always a substantive act as suggested by the Eighth Circuit in *Estate of Peterson*.

If Revenue Ruling 60-370 is correct, consistent taxation of items transferred during life and at death would require the conclusion that the decedent did not transfer appreciated property, but the proceeds of a sale the executor was required to complete. If income in respect of a decedent is determined on the basis of the nature of the item transferred at death, it would appear the decedent merely transferred the right to receive the proceeds of a sale he had arranged. Viewed from the estate's perspective, although it received legal title to property, it merely had a right to the proceeds under the binding contract.

752. Commentators have disagreed as to the correctness of the Treasury's position. See, e.g., FERGUSON ET AL., *supra* note 16, at 3:52-53 (suggesting the proceeds are not income in respect of a decedent because the decedent possessed the benefits and burdens of ownership at death); Brown, *supra* note 13, at 230 (questioning the Treasury position and suggesting the decedent possessed a conditional right to the income during his life); Note, *Sales Transactions and Income in Respect of a Decedent*, *supra* note 311, at 620 (suggesting "it may prove impossible or undesirable for the Commissioner to attempt to rationalize" the result in the regulations).

753. See *supra* Part V.B.3.

5. *Transferee Breach or Rescission*

What tax consequences should result if a transferee of property breaches or participates in the rescission of an executory contract made by the transferor and later sells the property? Assume for purposes of this discussion that all that remains to be done under the contract at the time of the transfer are ministerial acts (transfer of title and delivery of possession) and that no material economic contingencies exist.

Assignment of Income

The issue presented by the assumed facts in the assignment of income context is not whether the gain will be taxed, but who is the proper taxpayer to be taxed when the sale is made. The *Court Holding* doctrine prevents the sale of property by one taxpayer from being converted into a sale by another for tax purposes. If that doctrine does not apply, the transferee will be taxed on the sale and will determine gain by reference to the donor's adjusted basis by virtue of section 1015's carryover basis rules.

No donative assignment of income cases have been found in which this issue has arisen. The tax consequences, however, should depend on the substance, not the form, of the transaction. If the transferee and the buyer rescind the contract at the prompting of the donor and, within a relatively short period of time, engage in a sales transaction on substantially the same terms as those under the original contract, the donor should be taxed on the gain from the sale. However, if the contract is rescinded and the transferee sells the property five years later to a different buyer upon substantially different terms, the donor should not be taxed on the gain. Between these extremes courts should consider all relevant facts in determining who should be taxed on the gain.

Income in Respect of a Decedent

The issue presented by the assumed facts in the income in respect of a decedent context is not who will be taxed, but whether any income exists to be taxed after breach or rescission. Consequently, the stakes are much higher in this context than in the assignment of income setting.

It has long been recognized that income in respect of a decedent that would result from completion of sales under executory contracts might be avoided if the decedent's successor breaches or participates

in rescission of the contract.⁷⁵⁴ If such were the case, however, the law would merely be a trap for the unwary. Well-advised successors who breached or rescinded the original contract and renegotiated the sale would report no gain. Ill-advised successors would complete the sale under the original contract and be taxed on income in respect of a decedent. While well-advised taxpayers no doubt pay less tax than ill-advised taxpayers as a general rule, it would be poor tax policy to permit that result in this context. Notwithstanding the fact that taxpayers have the right to arrange their affairs to reduce or minimize taxes, they should not be permitted to do so by retroactively recharacterizing items acquired at death.

Although a successor's actions in breaching or participating in a rescission should not be considered a taxable event,⁷⁵⁵ the important question after such an action concerns the successor's basis. The leading commentators conclude that if the decedent's successor rescinds a contract, holds the property free of any obligation to sell and later sells to an unrelated party, "[s]ection 1014(c) does not apply in such a case, and the successor computes gain or loss by reference to his or her basis in the property under § 1014(a)."⁷⁵⁶

Income in respect of a decedent, however, is determined as of the moment of death based upon the facts existing at that time.⁷⁵⁷ No actions on the part of the decedent's successor can change the nature of the item transferred at death.⁷⁵⁸ If an item constitutes income in respect of a decedent, it does not receive a section 1014(a) basis because of section 1014(c). If a successor breaches or rescinds a contract, section 1014(c) is not thereby suspended and section 1014(a) is

754. See, e.g., FERGUSON ET AL., *supra* note 16, at 3:61; Gordon, *supra* note 311, at 37-38; Verbit, *supra* note 238, at 435; Note, *Income in Respect of Decedents: The Scope of Section 126*, *supra* note 31, at 1030; Note, *Tax Effect of Executor's Rescission and Renegotiation of Decedent's Contracts*, 51 MINN. L. REV. 251, 254 (1966). Commentators have also suggested that the problem can be avoided by including in the contract a provision nullifying the contract in the event of the death of the seller prior to closing. See, e.g., Brown, *supra* note 13, at 243; Verbit, *supra* note 238, at 439.

755. FERGUSON ET AL., *supra* note 16, at 3:61 ("[I]t seems doubtful that gain or loss occurs on a rescission that simply abnegates a previous arrangement that itself has not ripened into a taxable event."); Note, *Tax Effect of Executor's Rescission and Renegotiation of Decedent's Contracts*, *supra* note 754, at 254 ("Where this right to receive income is canceled, rather than donated or sold, the estate has received no benefit from its mere possession of the right; therefore, rescission of the contract should not be considered a 'transfer.'").

756. FERGUSON ET AL., *supra* note 16, at 3:61.

757. Estate of Sidles v. Commissioner, 65 T.C. 873, 880 n. 4 (1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977); see Estate of Peterson v. Commissioner, 667 F.2d 675, 676-78 (8th Cir. 1981); Keck v. Commissioner, 415 F.2d 531, 534 (6th Cir. 1969); Trust Co. of Ga. v. Ross, 392 F.2d 694, 696 (5th Cir. 1967) (per curiam).

758. Estate of Sidles, 65 T.C. at 880 n.4 ("Whatever actions the estate or Bi-State's board of directors could have taken after decedent's death are not material here.").

not applied retroactively. The successor's basis in the property is equal to the decedent's adjusted basis on date of death—the amount of the sale proceeds that would not have been income in respect of a decedent.

Taxation of a successor who breaches or rescinds a contract and later sells the property would depend on the particular facts and the substance of the transaction. If the successor and the buyer rescind the contract and, within a relatively short period of time, engage in a sales transaction on substantially the same terms as those under the original contract, the proceeds should be taxed as income in respect of a decedent and the post-death actions should be disregarded. However, if the contract is rescinded and the transferee sells the property five years later to a different buyer upon substantially different terms, the donor should be taxed on gain under section 61 and the gain determined by reference to the decedent's adjusted basis on the date of death. Between these extremes courts should consider all relevant facts in determining how the gain should be taxed. The important point, however, is that the successor acquired an item of income in respect of a decedent and nothing the successor can do after death will serve to obtain a section 1014(a) basis for the successor.

The suggested result is consistent with taxation of the hypothetical breach or rescission in the assignment of income context. On the assumed facts, the transfer, whether during life or at death, was of a right to income, not of property. Consequently, nothing the donee (assignment of income) or successor (income in respect of a decedent) can do should permit the transferee to avoid taxation of the income upon a subsequent sale.

VI. CONCLUSION

Courts have struggled for more than fifty years to develop tests and articulate factors to be used to identify income in respect of a decedent under section 691. Although the courts, in large part, have correctly classified post-death receipts, application of the various tests has challenged taxpayers, the I.R.S., and the courts.

Income in respect of a decedent should be identified by using factors employed in donative assignment of income cases and in a manner consistent with the results in those cases. Both involve the same inquiry—was “earned” income or property transferred? If a decedent, immediately before death, could not have transferred an item without triggering the assignment of income doctrine, the item is income in respect of a decedent if transferred at death. If a decedent could have transferred an item free of the assignment doctrine during

life, the item is property entitled to a section 1014 basis if transferred at death.

Use of donative assignment of income precedents to identify income in respect of a decedent will not always provide clear and unfailing guidance. Application of assignment of income principles is not always easy or consistent.⁷⁵⁹ However, reference to that body of law to identify income in respect of a decedent will result in comparable treatment of earned income transferred during life and at death. Consistent use of such an approach will achieve the congressional objective of reducing the importance of death in federal income taxation.

759. Eustice, *supra* note 26, at 1.