

## THE ACCRUAL OF CORPORATE DIVIDENDS UNDER THE FEDERAL ESTATE TAX

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The distinction between capital and income, which is always difficult, presents some special problems under the federal estate tax when a decedent dies possessed of a right to income. One of these problems, about which there is considerable uncertainty, is whether a dividend which was declared upon stock owned by a decedent before his death is taxable as part of the decedent's gross estate, where the dividend was payable to stockholders of record and the decedent died before the record date. For example, suppose that the decedent owned a share of X corporation stock upon which a \$10 dividend was declared on September 1, payable on September 30, to stockholders of record on September 15, and the decedent died on September 14; must the dividend, as well as the stock, be included in his gross estate for purposes of the federal estate tax?

Any income which has accrued at the decedent's death must be included in his gross estate as property which he owned at his death, even though it may subsequently be taxed as income of his estate.<sup>1</sup> Thus, if A dies owning a bond any interest upon the bond accrued at the date of A's death must be included in his gross estate. The same thing is true of other types of income such as rents and dividends. On the other hand, income accruing after the decedent's death is not taxed as part of his estate, even though the estate is valued as of a year from his death under the optional valuation date.<sup>2</sup>

Although it is clear that dividends accrued at a deceased stockholder's death must be included in his gross estate, there is some uncertainty as to when dividends accrue for purposes of the estate tax. The regulations are a masterpiece of ambiguity. According to the regulations:<sup>3</sup> "Interest and rents accrued at the date of the decedent's death and dividends declared to stockholders of record on or before the date of the decedent's death and not collected at such date constitute part of the gross estate."

It is clear from the regulations that dividends accrue under the estate tax at least as early as the record date. But do they provide for accrual at the declaration date of a dividend payable to stockholders of record at a later date? Do the regulations mean that a dividend payable to stockholders of record at a subsequent date are taxable as part of the stockholder's estate if the stockholder dies after the declaration date but before the record date? Or, do they

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1. Merritt J. Corbett, 12 T.C. 163 (1949). U.S. Treas. Reg. 105, § 81.13 (1937). A deduction is allowed under the income tax for the estate tax paid upon income taxed under the estate tax. INT. REV. CODE § 126(c).

2. *Maass v. Higgins*, 312 U.S. 443 (1941).

3. U.S. Treas. Reg. 105, § 81.13 (1937).

mean that not only the declaration date but also the record date must precede the stockholder's death? Obviously, the literal language of the regulations is susceptible of either interpretation. It would appear, however, that what they mean is that a dividend does not accrue before the record date. If the regulations intended to say that dividends accrue at the declaration date, there is no apparent reason why this should be limited to dividends payable at a record date, nor any reason why the regulations should refer to the record date at all. This is the interpretation which has been accepted by the Tax Court.<sup>4</sup> Assuming, however, that it is the proper interpretation of the regulations and that dividends accrue for estate tax purposes at the record date, this still leaves some unsolved problems.

In several lower court cases it has been held that dividends do not accrue for purposes of the income tax until they are received, actually or constructively, by the stockholders.<sup>5</sup> These decisions cast doubt upon the validity of the estate tax regulations which treat dividends as accruing at the record date. It is quite possible, however, that a dividend may accrue at different times under the income tax and the estate tax. The cases which have held that a dividend does not accrue under the income tax until the dividend is actually received were not decided upon general principles of accrual. They went upon the narrow ground that dividends should be treated as received as income at the same time by accrual basis and cash basis taxpayers, because the existence of corporate earnings at the time a dividend is distributed determines its character as taxable income, and any rule which treated an accrual basis taxpayer as receiving a dividend at a different time than a cash basis taxpayer might lead to the absurd result of holding that the same distribution constituted income to one class of taxpayers but not to the other.

So far the Supreme Court has not committed itself as to when a dividend accrues. In *Estate of Putnam v. Commissioner*,<sup>6</sup> an income tax case, the Court said that a dividend did not accrue before the record date, because until that time it could not be determined who was entitled to the dividend. The decision in the *Putnam* case did not hold that a dividend accrues at the record date, but only that it did not accrue before that date. It is not, therefore, necessarily in conflict with the lower court cases holding that a dividend does not accrue under the income tax until it is received. Nor is the *Putnam* case necessarily inconsistent with the position that a dividend accrues for estate tax purposes at the record date. The Court in that case seemed to feel that upon general principles of accounting a dividend might accrue at the record date, although it left the door open to decide that in view of the special problem presented by the income tax, dividends do not accrue for income tax purposes until they are received. In other words, without doing any violence to the decision in the *Putnam* case, it

4. George M. Lockie, CCH TAX CT. REP. ¶ 19,937 (1953).

5. Cf. *Commissioner v. American Light & Traction Co.*, 156 F.2d 398 (7th Cir. 1946); *Tar Products Co. v. Commissioner*, 130 F.2d 866 (3rd Cir. 1942).

6. 324 U.S. 393 (1945).

would be perfectly possible to hold that dividends accrue at different times under the income and estate taxes, and to hold further that as far as the estate tax is concerned a dividend accrues at the record date.

Even though a dividend does not accrue under the estate tax before the record date, this does not mean that it may not be included in the gross estate of a stockholder who dies before that date but after the dividend has been declared. It is true that in *Sharp v. Commissioner*<sup>7</sup> the circuit court held that a dividend does not accrue for estate tax purposes at the declaration date, and that where a stockholder dies after the declaration date but before the record date, the dividend should not be included in his gross estate. Although the *Sharp* case was reversed by the Supreme Court, it was not reversed upon this point.<sup>8</sup> However, in *Estate of Putnam v. Commissioner*,<sup>9</sup> the Supreme Court pointed out that ordinarily the valuation of stock after a dividend has been declared but before the record date will include the amount of the dividend. Normally, therefore, it would appear that where a stockholder dies after a dividend has been declared the dividend will be included in his taxable estate. If he dies before the stock is quoted ex dividend, the dividend will be included in the stock quotation at which the stock is valued to his estate. If he dies after the record date and after the stock is quoted ex dividend, the dividend will be listed separately to his estate because it accrued before his death. This still leaves a puzzling situation, however, where stock is quoted ex dividend before the record date and the stockholder dies after the stock is quoted ex dividend but before the record date. In this case it might appear that the dividend would not be included in the stockholder's estate, since it would not be included in the valuation used for the stock, nor would it be listed as a separate asset of the estate because it had not accrued at the date of the stockholder's death. The result is, of course, absurd. There is no reason to include the dividend in the estate of a stockholder who dies before the stock is quoted ex dividend and in the estate of a stockholder who dies after the record date and to exclude the dividend from the estate of a stockholder who dies between those dates. When the Tax Court was faced with this problem recently,<sup>10</sup> it ruled that the dividend was not taxable to the deceased stockholder's estate as such, but intimated that the stock should *not* be valued at its quoted price, excluding the dividend, but at a value which would include the dividend.

Suppose, however, that a stockholder dies between the dates when the stock is quoted ex dividend and the record date and his estate is valued under the optional valuation date? If the stock is valued as of a year from the date of the stockholder's death it is difficult to visualize any method of valuing the stock which would include the amount of the dividend. On the other hand, the dividend itself cannot be taxed to the stockholder's estate, if it did not accrue before the record date, because he died before the record date. Obviously, there is no

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7. 91 F.2d 802 (3rd Cir. 1937).

8. 303 U.S. 624 (1938).

9. See note 6 *supra*.

10. George M. Lockie, CCH TAX CT. REP. ¶ 19,937 (1953).

sensible reason to include the dividend in the deceased stockholder's estate where his estate is valued at the date of his death, and to exclude it where the estate is valued as of a year from the date of his death. It seems clear that in providing for the optional valuation date, Congress intended that the same property should be included in the gross estate under either method of valuation. It is difficult to see, however, any basis for including a dividend in the estate of a stockholder who dies after the stock is quoted ex dividend and before the record date, where the optional valuation date is used, if the position is taken that a dividend does not accrue under the estate tax before the record date.

The difficulty which arises in including a dividend in a deceased stockholder's estate where the stockholder dies after the stock is quoted ex dividend and before the record date suggests that the rule that dividends do not accrue until the record date for purposes of the estate tax may be unsound and that dividends should be treated as accruing at the declaration date. In *Estate of Putnam v. Commissioner*,<sup>11</sup> the Supreme Court seemed to feel that dividends could not accrue before the record date because the person to whom the dividend is payable is not ascertained before this date. Mr. Justice Reed said:<sup>12</sup> "The declaration of the dividends here in question fixes their amount but does not determine the distributee. He cannot be known with certainty until the record date." The reasoning is not appealing. The owner of the stock at the declaration date is entitled to the dividend unless he parts with the stock. For all practical purposes the declaration date does "determine the distributee," because the distributee will be the owner of the stock at the declaration date, or the person whom he designates as the distributee by transferring the stock to him. It would appear, therefore, that the distributee is sufficiently ascertained to say that a dividend accrues at the declaration date. After all, a dividend will accrue when the Supreme Court says that it accrues. If the declaration date is the date which will achieve just and sensible results, then that should be the date when dividends accrue for purposes of the estate tax.

If the declaration date is accepted as the date when dividends accrue under the estate tax, this will mean that any dividends declared before the stockholder's death will be taxed to his gross estate, regardless of whether he dies before or after the record date and regardless of whether the estate is valued at the date of his death or one year after his death. It does not mean, however, that the dividend will necessarily be listed separately as part of the gross estate. If the quotation used for the stock itself includes the amount of the dividend, the dividend will be reflected in the value used for the stock and it will not be listed separately in the gross estate. The dividend will only be included separately in the gross estate where the quotation used for the stock is ex dividend.

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11. 324 U.S. 393 (1945).

12. *Id.* at 399.