



Fall 9-1-1975

I. Valuation Of Property In The Gross Estate

Follow this and additional works at: <https://scholarlycommons.law.wlu.edu/wlulr>



Part of the [Estates and Trusts Commons](#), and the [Taxation-Federal Estate and Gift Commons](#)

Recommended Citation

I. Valuation Of Property In The Gross Estate, 32 Wash. & Lee L. Rev. 1020 (1975).

Available at: <https://scholarlycommons.law.wlu.edu/wlulr/vol32/iss4/12>

This Note is brought to you for free and open access by the Washington and Lee Law Review at Washington and Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Washington and Lee Law Review by an authorized editor of Washington and Lee University School of Law Scholarly Commons. For more information, please contact christensena@wlu.edu.

serve a worthwhile purpose by providing the general practitioner with a useful estate planning guide.

I. VALUATION OF PROPERTY IN THE GROSS ESTATE

A number of estate and gift tax sections call for the valuation of various assets and interests. However, the applicable guidelines for valuation remain uncertain. Section 2031 and its accompanying regulations set forth the methods for computing property values for estate tax purposes.¹ The basic approach of this section is that value be the equivalent of fair market value.² Despite these provisions, the entire process has remained a matter of guesswork and has been aptly characterized by one court as "an issue which should frankly be recognized as inherently imprecise and capable of resolution only by a Solomon-like pronouncement."³

Several decisions rendered in 1974 indicate the contexts in which valuation is required as well as the difficulties inherent in such a procedure.⁴ Two cases, *Continental Illinois National Bank and Trust*

under § 2012(c) should be only the amount paid by the settlor on the transfer of the property which was actually included in the decedent's estate. Therefore, *H's* estate was entitled to a credit for the full amount of the gift tax paid by *W*. *W's* estate was entitled to a gift tax credit for three-fourths of the gift tax paid by *H* because that represented the extent to which the amount of trust principal was includible in her gross estate. Rev. Rul. 74-522, 1974 INT. REV. BULL. No. 44, at 12.

¹ INT. REV. CODE OF 1954, § 2031 and Treas. Reg. §§ 20.2031-1 to 20.2031-10 (1958).

² Treas. Reg. § 20.2031-1(b) (1958), as amended, T.D. 6826, 30 F.R. 7708 (June 15, 1965).

³ Morris M. Messing, 48 T.C. 502, 512 (1967).

⁴ Two 1974 decisions involved the utilization of an often controverted valuation doctrine, the "blockage" rule. *In re* Estate of Joslyn, 500 F.2d 382 (9th Cir. 1974), concerned the IRS's use of actual sales figures as evidence of blockage in determining the value of the stock of a close corporation which was compelled to "go public" in order to pay off an estate's expenses. The government argued that § 2053 expenses were included in the blockage element and, therefore, could not be deducted. INT. REV. CODE OF 1954, § 2053. However, the Ninth Circuit ruled that the government could not deprive the taxpayer of the deductions permitted under § 2053 for administrative expenses by stating that those expenses were part of the blockage element. *Id.*

In *Estate of David Smith*, 57 T.C. 650 (1972), *acquiesced in*, 1974 INT. REV. BULL. No. 27, at 8, the issue centered around the fair market value of 425 sculptures created and owned by Smith at his death. The estate argued that the total value of the sculptures (\$4,284,000) should be discounted by 75% since the only potential buyer would be a bulk purchaser. The Commissioner, however, argued for full market value

*Company v. United States*⁵ and *Mercantile-Safe Deposit and Trust Company v. United States*,⁶ focused on the alternative techniques for valuation of a life estate under § 2013.⁷ The purpose underlying the provision is to prevent repeated estate taxation on the same property within a short period of time.⁸ Thus, a credit is provided against the estate tax where the decedent-transferee received property in a transfer liable to estate taxation within the previous ten years.⁹ A tax credit is also permitted where the transferee predeceased the transferor by no more than two years.¹⁰ The credit is essentially the amount bearing the same ratio to the total estate tax paid by the transferor as the value of the property transferred bears to the total value of the transferor's taxable estate.¹¹

Section 2013 is applicable to any beneficial interest in property,¹² thereby including life estates. The Code, however, fails to make explicit the manner in which a life estate is to be valued for purposes of § 2013. The regulations merely state that recognized valuation principles are to be utilized.¹³ Generally, actuarial tables¹⁴ are used in the computation of the values of the life estates. Courts have acknowledged that the tables do not always accurately reflect the

of each individual piece. Essentially compromising between the two contentions, the court ruled that the total value of the works was \$2,700,000. *Id.* For a detailed discussion of the principles underlying blockage, see Part VII, A of this survey, notes 19-33 and accompanying text *infra*.

Other developments in 1974 regarding valuation include: Treas. Reg. § 20.2031-8 (1958), *as amended*, T.D. 6680, 28 F.R. 10871 (Oct. 10, 1963) (valuation of shares of open-end investment company to be at "bid" or public redemption price of such shares, rather than at "asked" or public offering prices); Estate of Minnie Caplan, 33 C.C.H. Tax Ct. Mem. 189 (1974) (valuation of stock sold by decedent to son pursuant to buy-sell agreement); Estate of Lucretia Eddy Cotchett, 33 CCH Tax Ct. Mem. 138 (1974) (valuation of stock in close corporation); *Vergeer v. United States*, 74-1 U.S. Tax Cas. ¶ 12,980, at 84,366 (D. Ore. 1974); (government or "flower" bonds includible in decedent's gross estate at par, rather than at market value where market value less than par).

⁵ 504 F.2d 586 (7th Cir. 1974).

⁶ 368 F. Supp. 743 (D. Md. 1974).

⁷ INT. REV. CODE OF 1954, § 2013.

⁸ S. REP. NO. 1622, 83d Cong., 2d Sess. 122 (1954).

⁹ INT. REV. CODE OF 1954, § 2013(a).

¹⁰ *Id.*

¹¹ INT. REV. CODE OF 1954, § 2013(b).

¹² INT. REV. CODE OF 1954, § 2013(e) provides in part: "For purposes of this section, the term 'property' includes any beneficial interest in property . . ." *Id.*

¹³ Treas. Reg. § 20.2013-4(a) (1973).

¹⁴ See Treas. Reg. § 20.2031-7 (1958), *as amended*, T.D. 7077, 35 F.R. 18461 (Dec. 7, 1970).

value of a life estate in a given case.¹⁵ In the interest of more efficient administration of the tax laws, however, such potential inequities are thought to be acceptable.¹⁶ But in an "exceptional case,"¹⁷ departure from the actuarial tables is allowed.

Both *Continental Illinois National Bank and Mercantile-Safe Deposit* involved the question whether the actuarial tables should be followed. In *Continental Illinois National Bank*, the decedent-transferee Josephine Speth died on March 28, 1966, at the age of 75. She had been bequeathed a life estate in property from her sister Margaret, who had died on February 21, 1966. At the time of Margaret's death, Josephine suffered from cancer of the colon with metastasis of the liver. The executor of Josephine's estate, in computing the estate tax, claimed a credit under § 2013 for the amount of federal estate tax paid by Margaret's estate on the life estate transferred to Josephine. The amount of the credit was based on the actuarial value of Josephine's life estate (approximately six years). The Commissioner disallowed the extent of the credit and instead determined the value of the interest on the basis of Josephine's actual life expectancy. The district court held that the actuarial tables should be followed and therefore the executor's computation was correct.

On appeal before the Seventh Circuit, the government argued that departure from the tables was authorized by a revenue ruling allowing nonadherence to the tables in situations where the life tenant is afflicted with an incurable disease and can survive for only a brief period of time.¹⁸ The government argued that in the ruling, "brief" was used in a relative sense rather than in an absolute one. Thus, departure from the tables would be justified, for example, where a person with a fatal disease had an actuarial life expectancy

¹⁵ See, e.g., *Ithaca Trust Co. v. United States*, 279 U.S. 151, 155 (1929); *McMurtry v. Commissioner*, 203 F.2d 659 (1st Cir. 1953).

¹⁶ See, e.g., *Miami Beach First Nat'l Bank v. United States*, 443 F.2d 116 (5th Cir. 1971).

¹⁷ *Estate of Lion v. Commissioner*, 438 F.2d 56, 62 (4th Cir.), cert. denied, 404 U.S. 870 (1971).

¹⁸ Rev. Rul. 307, 1966-2 CUM. BULL. 429, provides in part:

[I]f it is known on the valuation date that a life tenant is afflicted with a fatal and incurable disease in its advanced stages, and that he cannot survive for more than a brief period of time, the value of the life or remainder interest should be determined by reference to such known facts

In defense of the district court's ruling, the taxpayer contended that the revenue ruling was invalid. The court, however, found it unnecessary to reach this issue as it concluded that, even if valid, the ruling was not applicable to the instant case. 504 F.2d at 590.

of 25 years and, therefore, by comparison a brief actual life expectancy.¹⁹

The court concluded that brief was an absolute, rather than a relative term, thereby rejecting the government's argument. However, it noted that medical testimony as to Josephine's actual life expectancy was inconclusive. It was possible, although not likely, that she could live for an additional two years. Also, Josephine had none of the clinical signs associated with liver metastasis which would indicate imminent death. The Seventh Circuit acknowledged that a series of cases allowed departure from the tables but pointed out that they generally involved life tenants with maximum life expectancies of one year or less.²⁰ Given the presumption of applicability accorded to the tables and the uncertainties concerning Josephine's life expectancy, the court determined that the case was not sufficiently exceptional to justify valuation based on actual rather than actuarial expectancies.

Similarly, the court in *Mercantile-Safe Deposit* held that the actuarial tables should be followed. Norma J. Bremmer was given a life estate in a residuary trust created by her husband. Mrs. Bremmer died at the age of 67 on October 29, 1965, 26 days after the death of her husband. Again, the government argued that the tables should not be utilized in determining the tax credit allowable under § 2013. The court initially rejected the taxpayer's motion for summary judgment, concluding that the tables were not to be applied automatically. The tables, however, were more than merely evidentiary materials and were to be utilized unless a party could show the case to be an "exceptional" one.²¹

¹⁹ *Id.*

²⁰ *See, e.g.*, Estate of John P. Hoelzel, 28 T.C. 384 (1957); Estate of James W. Douglas, 12 CCH Tax Ct. Mem. 347 (1953); Estate of T. G. Hendrick, 9 CCH Tax Ct. Mem. 581 (1950); Huntington Nat'l Bank, 13 T.C. 760, 765 (1949); Estate of Nellie H. Jennings, 10 T.C. 323 (1948). *See also* Estate of Lion v. Commissioner, 438 F.2d 56 (4th Cir.), *cert. denied*, 404 U.S. 870 (1971) (departure from tables allowed in valuing life interest of wife who had died simultaneously with husband in airplane crash). *But see* Estate of Chauncey Stillman, 24 CCH Tax Ct. Mem. 478 (1965) (departure not allowed where life tenant had incurable disease of myeloma but experts disagreed as to her actual life expectancy).

The Seventh Circuit appeared to suggest a one-year cut-off in permitting non-adherence to the tables. It pointed out that the revenue ruling was predicated on a factual situation wherein the life tenant, at the death of the transferor, was known to be unable to survive for more than one year. Conversely, one reason offered by the court to support its determination that the present case was not an "exceptional" one was that the medical testimony showed the possibility of Josephine surviving for more than one year. 504 F.2d at 592-93.

²¹ 368 F. Supp. at 746.

The court found that the facts in the present case were not adequate to justify departure from the tables. During the trial, Mrs. Bremmer's personal physician testified that he was unable to make a specific estimate as to her actual life expectancy. The evidence did suggest that she had a drinking problem which had resulted in her poor health for a long period of time and in several hospitalizations. However, the actual cause of her death was a stroke, unrelated to her alcoholic tendencies. The court determined that the evidence was inadequate to obviate the necessity of utilization of the actuarial tables.²² As the Seventh Circuit had done in *Continental Illinois National Bank*, the federal district court in *Mercantile-Safe Deposit* held that the revenue ruling²³ permitting deviation from the tables was inapplicable to the case at bar. There was no convincing proof that Mrs. Bremmer could be anticipated to have a drastically shorter life than predicted in the actuarial tables.

Use of the actuarial tables was examined with respect to another valuation problem in 1974. In *Karlson v. Commission*,²⁴ the court considered the valuation of a decedent's remainder interest in the computation of her estate tax liability. The decedent, Vivian G. O'Donnell, died in 1968. Under the will of her father, the decedent and her brother were given remainders following a life estate bequeathed to their mother, Nancy S. Karlson. At the time of decedent's death, Mrs. Karlson was 77 years old.

After the IRS's determination that the decedent's remainder should be assessed at a value of \$68,041.81, the executor of the estate moved for summary judgment to disallow inclusion of the interest in her estate. First, the estate offered the equitable argument that an estate should not be required to pay a tax based on a remainder interest if such a tax exceeded the liquid assets available to the estate. The court, however, dismissed this contention as simply "irrelevant."²⁵

In addition, and more fundamentally, the estate claimed that the value of the remainder was unascertainable since the holder of the life estate had been given an unlimited power of invasion over the corpus. Therefore, since valuation was impossible, the remainder should be excluded from the decedent's estate. The plaintiff relied on a series

²² *Id.* at 743.

²³ See note 18 *supra*.

²⁴ 74-2 U.S. Tax Cas. ¶ 13,014, at 85,799 (E.D.N.Y. 1974).

²⁵ *Id.* at 85,800.

of cases²⁶ holding that a charitable deduction for the present value of a charitable remainder was not allowable when the life tenant's power of invasion was not limited by an objective standard.

The government, however, argued that the estate was attempting to utilize an erroneous standard, the standard used for deductions from a gross estate rather than for valuation of inclusions in the gross estate. The court agreed that the ascertainable standard test used in conjunction with charitable remainders was inapplicable to the present case. Nevertheless, the court indicated a willingness to consider the effect of the life tenant's power to diminish the value of the remainder interest. It rejected the Commissioner's use of the actuarial tables²⁷ since such tables considered only the life expectancy of the life tenant and not her right to invade the corpus. Instead, the court determined that the more general standard of the fair market value²⁸ of the remainder interest should be utilized. Valuation, the court ruled, "must be made with reference to all relevant facts, including those which bear on the likelihood, that the life beneficiary will actually invade the corpus."²⁹ The court acknowledged that the value of the remainder interest was likely to be small. However, such insubstantiality did not demonstrate that the remainder was presently unascertainable. Accordingly, plaintiff's motion for summary judgment was denied.

As a general matter, therefore, the courts in 1974 have done little to help clarify the status of the actuarial tables provided by the regulations under § 20.2031-7. The *Continental Illinois National Bank* decision has apparently made it more difficult to establish the "exceptional" case that warrants departure from the tables. On the other hand, in the *Karlson* case, a district court has ruled that the valuation of a remainder interest for the purpose of federal estate taxation should not be governed by the tables where discretionary power to decrease that interest for the benefit of a life tenant exists.

²⁶ See, e.g., *Merchants Nat'l Bank v. Commissioner*, 320 U.S. 256 (1943); *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929).

²⁷ *Treas. Reg. § 20.2031-7* (1958), as amended, T.D. 7077, 35 F.R. 18461 (Dec. 4, 1970).

²⁸ *Treas. Reg. § 20.2031-1(b)* (1958), as amended, T.D. 6826, 30 F.R. 7708 (June 15, 1965).

²⁹ 74-2 U.S. Tax Cas. ¶ 13,014, at 85,801 (E.D.N.Y. 1974).