2 T.C. 840 (1943)

Property received as a bequest is excluded from gross income under Section 22(b)(3) of the Internal Revenue Code, even if the bequest is made in appreciation of services rendered, provided the property was not explicitly left as compensation for services performed.

Summary

Mildred McDonald, a registered nurse, received securities and other property from the estate of her deceased employer, Charles Roy, who named her as the residuary legatee in his will. The Commissioner of Internal Revenue argued that the property was taxable income because it was compensation for services McDonald rendered to Roy. The Tax Court held that the property constituted a bequest and was therefore excluded from McDonald's gross income under Section 22(b)(3) of the Internal Revenue Code because the will did not explicitly state the property was compensation for services.

Facts

Mildred McDonald worked as a nurse, secretary, dietitian, and driver for Charles L. Roy from 1933 until his death in 1940. Roy transferred securities into McDonald's name, but continued to control the assets and their income during his life. Roy's will and codicil named McDonald as the residuary legatee. Roy's children contested the will, claiming lack of testamentary capacity and undue influence. McDonald settled the will contest, receiving the securities. The IRS argued the securities were compensation for services.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in McDonald's income tax for 1940, arguing that the value of the securities she received from Roy's estate should be included in her gross income as compensation for services. McDonald petitioned the Tax Court for a redetermination of the deficiency. The Tax Court ruled in favor of McDonald, finding that the securities constituted a bequest and were excludable from gross income.

Issue(s)

Whether securities and property received by a registered nurse from the estate of her deceased employer, who named her as residuary legatee in his will, constitute taxable income as compensation for services, or a tax-exempt bequest under Section 22(b)(3) of the Internal Revenue Code.

Holding

No, because the securities and property passed to McDonald as a bequest under

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Roy's will and codicil, and the will did not explicitly state that the transfer was compensation for her services, the property is excluded from her gross income under Section 22(b)(3) of the Internal Revenue Code.

Court's Reasoning

The court reasoned that while Section 22(a) of the Internal Revenue Code defines gross income as including compensation for personal services, Section 22(b)(3) specifically excludes the value of property acquired by gift, bequest, devise, or inheritance. The court referenced *United States v. Merriam, 263 U.S. 179 (1923)*, which held that a bequest is a gift of personal property by will and not necessarily confined to a gratuity. The court emphasized that the will's language stating the bequest was made "in appreciation of the many years of loyal service and faithful care" did not transform it into compensation. Quoting *Bogardus v. Commissioner, 302 U.S. 34 (1937)*, the court stated, "A gift is none the less a gift because inspired by gratitude for the past faithful service of the recipient." The court found that Roy's continued control over the assets during his lifetime did not negate the testamentary nature of the transfer. The settlement agreement merely reduced the value of the bequest but did not change its character. Since the will and codicil were admitted to probate, the securities passed to McDonald as a bequest. The court distinguished *Hilda Kay, 45 B.T.A. 98, and Cole L. Blease, 16 B.T.A. 972*, noting that the recipients of the money in those cases were not legatees.

Practical Implications

This case clarifies the distinction between a bequest and compensation for services in tax law. Attorneys should carefully examine the language of a will to determine whether a transfer of property is explicitly intended as compensation. The mere expression of gratitude for past services does not automatically convert a bequest into taxable income. The key factor is the intent of the testator and whether the transfer was intended as a gift or as payment for an obligation. Later cases may distinguish this ruling if the language of the will or the circumstances surrounding the transfer clearly indicate an intent to compensate for services. Tax advisors should counsel clients to clearly document the intent behind property transfers to minimize potential tax disputes.

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