3 T.C. 875 (1944)

When property is transferred from an estate to a corporation in a tax-free exchange, the basis of the property in the hands of the corporation is the same as it was in the hands of the transferor, typically the fair market value at the time of distribution from the estate or trust.

Summary

Pierce Estates, Inc. sought to establish the basis of cattle sold between 1938-1940. The cattle were initially held in the estate of A.H. Pierce and transferred to the corporation in 1929 in exchange for stock. The central issue was determining the cattle's basis when transferred to the corporation. The Tax Court held that the basis was the same as in the hands of the transferors (the estate beneficiaries). Because the estate had already deducted the costs of raising the cattle and no cattle were on hand on March 1, 1913, the basis was zero. The court also addressed deductions for salaries, legal expenses, and charitable contributions, allowing some and disallowing others.

Facts

Abel H. Pierce died testate in 1900, directing his property be held in trust. The will was probated in 1901. Pierce's will stipulated that his estate be managed independently of the probate court. Upon the youngest grandchild reaching 30 in 1929, the trustees distributed the assets to Pierce's four grandchildren. These grandchildren then conveyed the assets to Pierce Estates, Inc. in exchange for stock. The estate filed its federal income tax returns on a cash receipts and disbursements basis, deducting the costs of raising the cattle as expenses.

Procedural History

Pierce Estates, Inc. petitioned the Tax Court contesting deficiencies assessed by the Commissioner of Internal Revenue for the years 1938, 1939, and 1940. The Commissioner disallowed the basis claimed for livestock sold or that died during those years, resulting in the deficiencies. The case was consolidated with similar petitions from individual taxpayers related to other deductions.

Issue(s)

1. What is the basis, if any, to petitioner Pierce Estates, Inc., for cattle which were sold or which died in the years 1938, 1939, and 1940?
2. Did the Commissioner err in disallowing salaries paid by petitioner Pierce Estates, Inc., to two of its women vice presidents for the years 1938, 1939, and 1940?
3. Did the Commissioner err in refusing to allow certain amounts expended by petitioners for attorney fees, court costs, and other legal expenses in connection with litigation involving certain oil and gas leases?

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4. Did the Commissioner err in refusing to allow petitioner Louise K. Hutchins to deduct from her gross income for the year 1940 as a charitable contribution the cost of certain radium which she gave to two physicians who were building a hospital with the understanding that they were to use the radium only for treating the poor and needy and without compensation to themselves?

Holding

1. No, because the basis of the cattle in the hands of Pierce Estates, Inc. is the same as it was in the hands of the transferors (the grandchildren), which was zero, since the estate had already deducted the costs of raising the cattle.
2. Yes, in part. A reasonable allowance for salaries for services actually rendered Pierce Estates, Inc., during the taxable years in question by Mrs. Runnells and Mrs. Armour was $ 2,000 each per annum.
3. Yes, because the expenditures were made for the sole purpose of collecting income due petitioners under the assignment.
4. Yes, because an oral trust was created and it was organized and operated exclusively for charitable purposes.

Court's Reasoning

The court determined that the cattle's basis transferred to Pierce Estates, Inc. was the same as in the hands of the transferors under Sections 113(a)(8) and 112(b)(5). Referring to *Helvering v. Cement Investors, Inc., 316 U.S. 527*, the court noted that if a transaction meets the requirements of section 112(b)(5), the basis of the property in the hands of the acquiring corporation is the same as it would be in the hands of the transferor, per Section 113(a)(8). Since the estate had deducted the costs of raising the cattle and the cattle were not on hand on March 1, 1913, the basis was zero. The court cited *Maguire v. Commissioner, 313 U.S. 1*, stating that "Distribution to the taxpayer is not necessarily restricted to situations where property is delivered to the taxpayer. It also aptly describes the case where property is delivered by the executors to trustees in trust for the taxpayer." As to the salaries, the court found that the vice presidents did render valuable services but reduced the deductible amount to $2,000 each per annum. The court reasoned that the legal expenses were deductible because they were incurred to collect income, not to defend or perfect title. Finally, the court held that the donation of radium to doctors for treating the poor constituted a charitable contribution.

Practical Implications

This case clarifies how to determine the basis of property transferred from an estate or trust to a corporation in a tax-free exchange. It highlights that the basis in the hands of the transferor is critical and that prior deductions taken by the estate can impact the corporation's basis. It also demonstrates the importance of establishing that expenses claimed as deductions are ordinary and necessary and directly related to the business, and not capital expenditures. *Pierce Estates* serves as a reminder

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that for charitable deductions, an oral trust can suffice if it is clear that the funds or property will be used exclusively for charitable purposes. Legal practitioners can use this ruling to properly advise clients on how the characterization of expenses can drastically impact tax liabilities.

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