Catherine S. Moore v. Commissioner, 4 T.C. 493 (1944)

When a farmer using the cash method of accounting gifts farm chattels to a donee, the donee must use the donor's zero basis for those chattels in their opening inventory.

Summary

Catherine Moore received a gift of farm land and chattels from her mother. Her mother had used the cash method of accounting, meaning she expensed the costs of raising the chattels. Moore, reporting on an accrual basis, attempted to include the fair market value of the gifted chattels in her opening inventory. The Commissioner argued that because the donor had a zero basis in the chattels, Moore also had to use a zero basis. The Tax Court agreed with the Commissioner, holding that Section 113(a)(2) of the Internal Revenue Code requires the donee to use the donor's basis, preventing tax-free realization of the increment in value.

Facts

On December 25, 1939, Moore's mother gifted farm land and chattels to her four children, with Moore receiving a one-fourth interest.
The mother filed a gift tax return, reporting the chattels at their fair market value of $45,632.
Of this amount, $22,624.73 represented chattels purchased by the donor, and $23,007.27 represented chattels raised or produced on the donor's farm.
Moore reported her share of the net farm income, computing her income on an accrual basis.
In her opening inventory, Moore valued the farm chattels at $45,632, the same amount used by her mother in computing the gift tax.

Procedural History

The Commissioner determined a deficiency in Moore's income tax for 1940.
The Commissioner decreased the inventory at the end of the year (an adjustment Moore did not contest) and eliminated the value of the home-raised chattels from Moore's opening inventory, resulting in an increased net profit.
Moore petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether a donee of farm chattels, who uses the accrual method of accounting, must use the donor's zero basis in those chattels (which were raised on the farm and the donor used the cash method) when calculating the opening inventory.

Holding

Yes, because Section 113(a)(2) of the Internal Revenue Code requires the donee to

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use the same basis as the donor, and the donor had a zero basis in the chattels due to expensing the costs of raising them under the cash method of accounting.

Court's Reasoning

The court relied on Section 113(a)(2) of the Internal Revenue Code, which states that the donee's basis for property acquired by gift is the same as it would be in the hands of the donor.
Since the donor used the cash basis of accounting, she had already deducted the expenses of raising the chattels. Therefore, the chattels had a zero basis in her hands.
The court cited *Taft v. Bowers*, 278 U.S. 470, and *Wilson Bros. & Co. v. Commissioner*, 124 F.2d 606, emphasizing that Section 113(a)(2) aims to prevent increments in value from escaping taxation.
The court reasoned that by including the chattels in the inventory at an amount greater than zero, Moore was attempting to avoid tax on the appreciation in value.
The court acknowledged that while Moore was permitted to choose her accounting method (accrual), she was still bound by the requirement to use the donor's basis. This effectively simulates the adjustment that would be required if the donor had changed from the cash to the accrual method.

Practical Implications

This case reinforces the principle that a donee's basis in gifted property is generally the same as the donor's basis, even if the donee uses a different accounting method.
It clarifies that farmers receiving gifted farm products from cash-basis farmers must recognize the donor's zero basis when calculating their cost of goods sold, preventing a double benefit.
Tax practitioners should advise clients receiving gifted property to ascertain the donor's basis, as this will directly impact the donee's tax liability upon disposition of the property. This is especially relevant in agricultural contexts where the cash method is common.
This ruling impacts estate planning strategies for farmers, as it highlights the importance of understanding the tax implications of gifting farm assets versus selling them.

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