3 T.C. 1180 (1944)

When claiming a deduction for property previously taxed under Section 812(c) of the Internal Revenue Code, the taxpayer must sufficiently identify that the property in the present estate was derived from property taxed in a prior estate, but explicit tracing is not always required if intent and circumstances support the conclusion.

Summary

The estate of James Miller sought a deduction for property previously taxed under Section 812(c) of the Internal Revenue Code, arguing that securities and a cash balance were derived from a bequest Miller received from his sister's estate within five years of his death. The IRS contested the deduction, arguing that the funds were commingled, and the securities were not directly traceable to the bequest. The Tax Court held that the estate could take the deduction because Miller demonstrated a clear intent to use the inherited funds for specific investments, sufficiently identifying the assets as derived from previously taxed property.

Facts

James Miller received a $50,000 bequest from his sister, Annie Miller's estate, which was subject to estate tax. Miller deposited the bequest into his existing bank account containing personal funds. He subsequently made additional deposits of personal funds and withdrew money from the account to purchase securities and for personal expenditures. Miller was 73 years old, in poor health, not engaged in business, and lived modestly on investment income. He consulted with his attorney and banker, informing them that the source of funds for the securities' purchase was the legacy from his sister.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in James Miller's estate tax. The estate filed a petition with the Tax Court contesting the Commissioner's disallowance of a portion of the deduction claimed for previously taxed property under Section 812(c) of the Internal Revenue Code.

Issue(s)

1. Whether the estate sufficiently identified that the securities purchased by the decedent were acquired in exchange for the cash legacy received from his sister's estate to qualify for the previously taxed property deduction under Section 812(c) of the Internal Revenue Code?
2. Whether the cash balance in the decedent's bank account at the time of his death can be identified as part of the unexpended portion of the legacy, thereby qualifying for the previously taxed property deduction?

Holding

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1. Yes, because the decedent demonstrated a clear intent to use the inherited funds specifically for purchasing securities, which he communicated to his attorney and banker, sufficiently identifying the source of the funds despite commingling.
2. Yes, because based on the decedent's intent and financial practices, the cash balance was considered the unexpended portion of the inherited funds.

Court's Reasoning

The court emphasized that the burden of proving the identity of property under Section 812(c) rests on the taxpayer. While commingling funds does not automatically preclude identification, the estate must present evidence to show the source of the funds used to acquire the assets in question. The court distinguished this case from *Rodenbough v. United States*, where the taxpayer failed to adequately trace the source of funds. In this case, the court found that the decedent's expressed intent to invest the legacy, coupled with his consultations with his attorney and banker, provided sufficient evidence to identify the securities as having been purchased with the inherited funds. The court noted that the decedent "stated frequently that the fund received as a legacy was to be invested, and his expressions serve to distinguish the source from which the decedent purchased the securities in question." The court concluded that the cash balance in the account was also derived from the legacy, given the decedent's consistent intent and the pattern of deposits and withdrawals.

Practical Implications

This case provides valuable guidance on establishing the identity of property for the previously taxed property deduction. It clarifies that while direct tracing of funds is ideal, demonstrating a clear intent to use inherited funds for specific investments can be sufficient, especially when supported by corroborating evidence such as consultations with financial advisors. Attorneys should advise clients to document their intent regarding the use of inherited funds, as this can be critical in substantiating a deduction for previously taxed property. This case highlights the importance of demonstrating a consistent plan and segregating, even if only mentally, inherited funds for specific purposes. Later cases may distinguish *Estate of Miller* if there is a lack of documented intent or inconsistent financial practices.

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