McCullough v. Commissioner, 4 T.C. 109 (1944)

When a life beneficiary receives stock dividends from a testamentary trust, the basis of the stock in the beneficiary's hands is a proportionate part of the original stock's basis, not zero or the fair market value when received.

Summary

The taxpayer, McCullough, sought to determine the basis of Standard Oil Co. of California stock he sold in 1940, which he had received as a gift from his mother. The mother had received the stock as a distribution from her deceased husband's estate's testamentary trust. The core issue was the stock's basis in the mother's hands when she gifted it to her son. The Tax Court held that the basis was a proportionate part of the original stock's basis in the hands of the executors, allocated between the shares distributed to the mother and those retained by the estate, rejecting the taxpayer's claim for fair market value and the Commissioner's argument for a zero basis. This decision clarifies the treatment of stock dividends distributed from testamentary trusts.

Facts

Eliza Hall McCullough was the life beneficiary of a testamentary trust established by her deceased husband's will.
The trust held Standard Oil Co. of California stock. The corporation issued stock dividends which the executors distributed to Eliza as the income beneficiary, following Vermont law regarding apportionment of stock dividends between principal and income.
In 1929, Eliza gifted 1,551 shares of the stock to her son, the petitioner.
The petitioner then sold the stock in 1940, leading to the dispute over the stock's basis for calculating capital gains or losses.

Procedural History

The Commissioner determined a deficiency in McCullough's income tax for 1940, arguing he realized a gain on the stock sale.
McCullough petitioned the Tax Court to contest the deficiency, arguing he sustained a loss.
The Tax Court reviewed the case to determine the correct basis of the stock.

Issue(s)

Whether the basis of stock dividends received by a life beneficiary from a testamentary trust should be: (1) the fair market value of the stock when received, (2) zero, or (3) a proportionate part of the original stock's basis in the hands of the testamentary trust.

Holding

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The basis of the stock is a proportionate part of the original stock's basis in the hands of the executors because the stock dividends represented a proliferation of capital within the trust, and the basis should be allocated accordingly.

Court's Reasoning

The court rejected the Commissioner's argument for a zero basis, distinguishing cases like Koshland v. Helvering, which involved situations where stock dividends were erroneously excluded from income.
The court emphasized that the Commissioner's regulations generally provide a uniform basis rule for property passing from a decedent, applicable to all beneficiaries and interests.
The court also rejected the petitioner's argument that the basis should be the fair market value when received, noting that administrative rulings (unlike regulations or Treasury decisions) do not have the force of law.
The court relied on the principle that stock dividends represent a mere proliferation of capital within the estate. It quoted the Committee on Ways and Means, stating the goal of the Revenue Act of 1939 was to afford "a clear and unequivocal statutory basis, with respect to both past and future years, for the rule of allocation upon which taxpayers, the Treasury Department, and Congress have alike relied."
Referencing Theodore W. Case et al., Trustees, 26 B. T. A. 1044, the court applied the established principle of allocating the original basis between the old and new stock, reducing the total basis by amounts allocable to shares distributed to the life beneficiary.

Practical Implications

This case provides clarity on how to determine the basis of stock dividends received from testamentary trusts, ensuring that a proportionate allocation of the original basis is generally the correct approach.
It reinforces the principle that the source of property matters for basis determination and that distributions from an estate or trust do not automatically result in a step-up in basis to fair market value.
Legal practitioners should refer to this case when dealing with trust distributions involving stock dividends to ensure accurate calculation of capital gains or losses upon subsequent sale. This case illustrates that stock dividends, even when distributed as income, retain a basis tied to the original stock's cost or value within the estate.

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