6 T.C. 1119 (1946)

For estate tax purposes, property can be identified as having been acquired in exchange for previously taxed property even if the proceeds from the prior estate were used to pay off a loan incurred to purchase the asset.

Summary

The Tax Court addressed whether an estate could deduct the value of stock as previously taxed property. The decedent borrowed money to purchase stock, then used a legacy from his father-in-law's estate to partially repay the loan. The court held that the stock was acquired in exchange for previously taxed property, allowing the deduction because the legacy was directly traceable to the stock purchase, even though it was used to pay off a loan incurred for that purpose. The key is that the intent was always to use the legacy for the stock purchase.

Facts

Devereux Milburn, the decedent, was a legatee of $50,000 under the will of his father-in-law, Charles Steele. Before receiving the legacy, Milburn purchased 500 shares of J.P. Morgan & Co., Inc. stock for $100,000. He borrowed the money from his wife to make the purchase. Approximately two weeks after receiving the $50,000 legacy, Milburn used it to partially repay the loan from his wife.

Procedural History

The executor of Milburn's estate claimed a deduction for the value of 250 shares of J.P. Morgan & Co., Inc. stock as property previously taxed, arguing they were purchased with the $50,000 legacy from Steele's estate. The Commissioner of Internal Revenue disallowed the deduction. The Tax Court reviewed the Commissioner's decision.

Issue(s)

Whether the estate is entitled to a deduction from the gross estate for the value of 250 shares of J.P. Morgan & Co., Inc. stock, claiming it was purchased with a legacy from a prior decedent whose estate paid estate taxes on the legacy within five years of Milburn's death, as per Section 812(c) of the Internal Revenue Code?

Holding

Yes, because the $50,000 legacy was directly traceable to the purchase of the stock, even though the legacy was used to repay a loan incurred for the stock purchase. The court reasoned that the intent to use the legacy for the stock purchase was clear.

Court's Reasoning

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The court relied on Section 812(c) of the Internal Revenue Code, which allows a deduction for property previously taxed if it can be identified as having been received from a prior decedent or acquired in exchange for property so received. The Commissioner argued that the legacy was not used to purchase the stock because the stock was purchased before the legacy was received, and the legacy was used to reduce the loan. However, the court found that Milburn's actions indicated a clear intention to use the legacy to pay for the stock. Quoting Estate of Mary D. Gladding, 27 B.T.A. 385, the court stated the situation was "not different from a case where a second decedent takes funds from a prior decedent on which the estate tax has been paid and purchases stock." The court emphasized the importance of tracing the funds and the purpose for which they were used. Even though Milburn borrowed the money initially, the legacy was specifically intended to cover that debt related to the stock purchase. The court dismissed the Commissioner's argument that other assets could have been used to repay the loan, finding that irrelevant to the tracing analysis.

Practical Implications

This case clarifies how the "property previously taxed" deduction applies when assets are purchased with borrowed funds later repaid with inherited funds. It establishes that the deduction is allowable if the intent is to use inherited funds for the specific purchase, even if a loan is used as an intermediary step. Attorneys should focus on documenting the intent and tracing the funds to support such deductions. The case emphasizes that substance over form can prevail, and that the key inquiry is whether the assets in the second estate are economically attributable to assets that were taxed in the first estate. Subsequent cases would likely examine the taxpayer's intent and the directness of the connection between the legacy and the asset acquisition.

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