Ethel M. HATCH, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent, 19 T.C. 237 (1952)

r
r

Payments received under a contract inherited from a decedent are taxable income to the extent they exceed the fair market value of the contract at the time of inheritance, and such payments are not considered capital gains unless realized from a sale or exchange of the contract.

r
r

Summary

r

Ethel M. Hatch inherited a contract from her deceased husband that entitled her to certain annual payments plus a percentage of company earnings. The contract was valued at $243,326.70 for estate tax purposes. The Commissioner of Internal Revenue determined that payments received by Hatch exceeding this valuation were taxable income. Hatch argued that the payments were bequests and thus excluded from gross income, or alternatively, should be allocated over the life of the agreement or treated as capital gains. The Tax Court held that the excess payments were taxable income because they exceeded the basis of the inherited contract, and were not capital gains because there was no sale or exchange of the contract.

r
r

Facts

r

r
Frederic H. Hatch entered into a contract with Frederic H. Hatch & Co., which was acquired by Ethel M. Hatch as legatee under her husband’s will.r
The contract entitled Ethel Hatch to $30,000 per year for ten years, plus 10% of the company’s net earnings available for common stock dividends exceeding $270,000 per year.r
For federal estate tax purposes, the contract was valued at $243,326.70.r
Ethel Hatch received $7,923.30 in 1941 and $12,000 in each of the years 1942 and 1943 under the contract in excess of the contract’s valuation.r

r
r

© 2025 SCOTUSreports.com. All rights reserved.

Procedural History

r

r
The Commissioner of Internal Revenue determined that the amounts received by Ethel Hatch in excess of the contract's estate tax valuation were taxable income.r
Ethel Hatch petitioned the Tax Court, contesting the Commissioner's determination.r

r
r

Issue(s)

r

r
Whether payments received by the petitioner under an inherited contract, exceeding the contract's fair market value at the time of inheritance, constitute taxable income.r
Whether, if the payments are taxable income, such income should be allocated over the life of the agreement.r
Whether, if taxable income was realized, it was capital gain within the meaning of section 111 of the Internal Revenue Code.r
Whether the determination of the deficiency for the year 1941 was timely made within the meaning of section 275(a) of the code.r

r
r

Holding

r

r
Yes, because the payments received exceeded the fair market value of the contract at the time of inheritance and thus constitute taxable income under section 22(a) of the Internal Revenue Code.r
No, because there is no statutory basis for allocating the gain in the manner desired by the petitioner.r
No, because the gain was not realized from a sale or exchange of a capital asset, but rather from the discharge or liquidation of the contract.r
No, because the petitioner omitted from gross income for 1941 an amount in excess of 25 per cent of the gross income stated on her return for that year. Therefore, a period of five years from March 6, 1942, the date the return was filed, was allowed for making assessment of the tax for 1941. Prior to the expiration of the five-year

© 2025 SCOTUSreports.com. All rights reserved.

period the petitioner and the respondent entered into an agreement extending the period for assessment to June 30, 1948. Since the notice of deficiency was mailed to the petitioner on February 3, 1948, it was timely.r

r
r

Court’s Reasoning

r

r
The court reasoned that the petitioner received a contract, not money, as her inheritance. The contract had a fair market value of $243,326.70 at the time of acquisition. Payments exceeding this basis constituted gain under section 22(a) of the Internal Revenue Code, which includes “gains, … of whatever kind.”r
The court distinguished the case from Commissioner v. Winslow, 113 Fed. (2d) 418, because that case involved payments made under an insurance policy, which are specifically excluded from gross income under section 22(b)(1) of the code.r
The court rejected the petitioner’s argument for allocating the income over the life of the agreement, stating that there was no statutory basis for doing so, and that this wasn’t an installment sale under section 44 or an annuity under section 22(b)(2).r
The court held that the gain was not a capital gain because it did not result from a sale or exchange of a capital asset, but rather from the discharge or liquidation of the contract. The court cited Fairbanks v. United States, 306 U. S. 436, and other cases in support of this holding. The court emphasized that the contract was merely being discharged or liquidated, and there was no sale or exchange.r
Regarding the statute of limitations, the court found that the petitioner omitted from gross income an amount in excess of 25 per cent of the gross income stated on her return for that year, and she and the respondent entered into an agreement extending the period for assessment to June 30, 1948. Since the notice of deficiency was mailed to the petitioner on February 3, 1948, it was timely.r

r
r

Practical Implications

r

r
This case clarifies that when a taxpayer inherits a contract or similar asset, subsequent payments received under that contract are taxable as ordinary income to the extent they exceed the asset’s fair market value at the time of inheritance. It highlights the importance of establishing a basis for inherited assets to accurately

© 2025 SCOTUSreports.com. All rights reserved.

determine taxable income.r
The case emphasizes that merely receiving payments under a contract is not a

© 2025 SCOTUSreports.com. All rights reserved.