17 T.C. 728 (1951)

The basis of stock acquired as a gift is not increased by the amount of federal estate tax paid by the donee in a subsequent year, even if the gift was made in contemplation of death and included in the donor's estate.

Summary

Hetty B. Levy received stock as a gift from her husband, Leon Levy, who later died. After Leon's death, the IRS determined that the stock gifts were made in contemplation of death, including the stock's value in Leon's estate, which increased the estate tax liability. Hetty sold the stock in 1945 and paid a portion of Leon's estate tax in 1946. She then sought to increase her basis in the stock sold in 1945 by the amount of estate tax she paid in 1946. The Tax Court held that the basis could not be adjusted retroactively for estate tax payments made after the sale, as this would contradict annual accounting principles.

Facts

- Hetty B. Levy received 128,650 shares of Stern & Company stock as gifts from her husband, Leon Levy, in 1939 and 1941.
- Leon Levy died in 1942. His will directed that all estate taxes be paid out of the residuary estate.
- In 1945, Hetty sold 96,487 shares of the Stern & Company stock for $136,151.24. The stock had a cost basis to Leon of $30,909.79.
- In 1946, the IRS determined a deficiency in Leon's estate tax, including the stock gifted to Hetty, determining that the gifts were made in contemplation of death.
- Hetty paid $54,311.50, representing her share of the estate tax attributable to the gifted stock, to the IRS.
- Hetty sought to increase the basis of the stock she sold in 1945 by the amount of estate tax she paid in 1946.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Hetty Levy's 1945 income tax, disallowing the increase in the basis of the stock. Levy petitioned the Tax Court, contesting the Commissioner's decision. A refund claim was previously filed and denied.

Issue(s)

1. Whether the basis of stock acquired by gift can be increased by the amount of federal estate tax paid by the donee in a year subsequent to the sale of the stock, when the stock was included in the donor's estate as a gift in contemplation of death.

Holding

1. No, because adjusting the basis for events occurring after the sale of the property would violate the principle of determining income taxes on the net results of annual accounting periods.

Court's Reasoning

The court reasoned that under Section 113(b)(1)(A) of the Internal Revenue Code, adjustments to the basis of property are allowed for expenditures properly chargeable to the capital account. However, it held that the estate tax payment in 1946 was not an expenditure of this nature. The court emphasized that because Hetty sold the stock in 1945, no lien attached to the stock in 1946 when she paid the estate tax. Further, the court stated that allowing adjustments to the basis of property for events occurring after the year of a completed transaction would keep the transaction open indefinitely, which is contrary to annual accounting principles. Citing *Burnet v. Sanford & Brooks Co., 282 U.S. 359* and *Security Flour Mills Co. v. Commissioner, 321 U.S. 281*, the court held that income taxes are determined on the net results of annual accounting periods and that the gain realized on a sale is determined by the transactions in that year and cannot be affected by events in a subsequent year.

Practical Implications

This case establishes that taxpayers cannot retroactively adjust the basis of property sold to account for subsequent payments of estate tax. This ruling reinforces the importance of determining tax liabilities on a yearly basis. The decision prevents taxpayers from attempting to keep a gain or loss transaction open indefinitely. It aligns with the principle that tax consequences are generally determined at the time of the sale or disposition of property, not by subsequent events. Later cases would cite this case to disallow similar post-sale adjustments.

