Estate of Marshal L. Noel, Ruth M. Noel, Executrix, and William H. Frantz, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent, 50 T. C. 702 (1968)

The original issue discount on non-interest-bearing corporate debentures is taxable as income in respect of a decedent when the estate uses the debentures to satisfy a debt, not when the debentures mature.

Summary

Marshal L. Noel owned debenture bonds issued at a discount by Equipment Investors, Inc. , which matured in January 1956. Noel died in June 1956 without receiving payment. In 1957, his estate transferred the bonds to a creditor at face value. The court held that the discount was taxable as income in respect of a decedent under IRC section 691 in 1957 when the estate used the bonds, not in 1956 when they matured, because Noel, a cash basis taxpayer, did not receive the discount before his death.

Facts

Marshal L. Noel owned 20 non-interest-bearing debenture bonds issued by Equipment Investors, Inc. , purchased in December 1950 at a discount. The bonds matured on January 1, 1956, but Noel received no payment before his death on June 20, 1956. In 1957, Noel's estate transferred the bonds to Frantz Tractor Co. , Inc. , to satisfy a $170,000 debt, receiving credit for the full face value plus accrued interest. The IRS determined that the discount and interest were taxable as income in respect of a decedent in 1957.

Procedural History

The IRS determined a deficiency in the estate's 1957 income tax, asserting that the discount and interest on the debentures were income in respect of a decedent. The estate filed a petition with the U. S. Tax Court to contest the deficiency. The Tax Court upheld the IRS's determination.

Issue(s)

1. Whether the earned discount on non-interest-bearing debenture bonds, which matured in 1956, was taxable as income in respect of a decedent under IRC section 691 to the estate in 1957 when the bonds were used to satisfy a debt.

Holding

1. Yes, because the discount was not taxable to Noel in 1956 as he was a cash basis taxpayer who did not receive the discount before his death, and under IRC section 691, the discount became taxable to the estate in 1957 when the bonds were used.

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Court’s Reasoning

The Tax Court reasoned that since Noel was a cash basis taxpayer, the discount was not taxable in 1956 when the bonds matured because he did not receive payment. The court rejected the estate’s argument that the discount was automatically taxable upon maturity, noting that IRC section 454(a) allows for an election to treat periodic increases as income but does not mandate taxation upon maturity for corporate obligations. The court found that the discount became taxable as income in respect of a decedent under IRC section 691 when the estate used the bonds in 1957. The court also determined that accrued interest post-maturity was taxable as interest under IRC section 61(a)(4), with the portion accrued before Noel’s death taxable as income in respect of a decedent. The court cited cases like *Levin v. United States* to support the principle that income is not constructively received if not available to the taxpayer.

Practical Implications

This decision clarifies that original issue discount on non-interest-bearing corporate debentures held by a cash basis taxpayer is not taxable upon maturity if not received, but becomes taxable as income in respect of a decedent when the estate uses the debentures to satisfy a debt. Practitioners should advise estates to consider the tax implications of using such debentures to settle debts. The ruling distinguishes between the tax treatment of corporate and U. S. government obligations, as IRC section 454(c) explicitly mandates taxation upon maturity for the latter. Subsequent cases have applied this principle, reinforcing the importance of understanding when income is deemed received for tax purposes.

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