Ewing v. Commissioner, 40 B. T. A. 912 (1939)

A life estate acquired through a property exchange can be amortized over the life expectancy of the holder.

Summary

In Ewing v. Commissioner, the court determined that petitioners could amortize the cost of a life estate acquired through an arm's-length settlement with an estate, rather than by gift, bequest, or inheritance. The petitioners exchanged their claim to El Paso stock for a life estate in the estate's trust, which was deemed a taxable exchange. The court ruled that the life estate's cost, including legal fees, could be amortized over the petitioners' life expectancy, as it was property held for the production of income. The decision clarified the tax treatment of life estates obtained through property exchanges, distinguishing them from those received by inheritance or gift.

Facts

Petitioners held 70,000 shares of El Paso stock endorsed to them by Rose, who later died. The stock was not part of Rose's probate estate, but certain heirs threatened legal action to include it. In an arm's-length settlement, petitioners exchanged their claim to the stock for a life estate in the estate's trust. The settlement was not based on claims as heirs or donees of lifetime gifts from Rose, except for specific bequests. The life estate was valued at the actuarial value of the trust assets, and petitioners added $20,000 in legal fees to this value to determine the cost of the life estate.

Procedural History

The case was initially brought before the Board of Tax Appeals (now the Tax Court). The respondent argued that the life estate was acquired by gift, bequest, or inheritance under Lyeth v. Hoey, precluding amortization. Petitioners contended that the settlement was a taxable exchange, allowing amortization. The Board ruled in favor of the petitioners, allowing amortization of the life estate's cost over their life expectancy.

Issue(s)

1. Whether the life estate acquired by petitioners through the settlement with the estate was acquired by gift, bequest, or inheritance, thus precluding amortization under section 273 of the Internal Revenue Code.
2. Whether the cost of the life estate, including legal fees, could be amortized over the petitioners' life expectancy under section 167(a)(2) of the Internal Revenue Code.

Holding

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1. No, because the life estate was acquired through a taxable exchange of property, not by gift, bequest, or inheritance, making section 273 inapplicable.
2. Yes, because the life estate was property held for the production of income, and its cost could be amortized over the petitioners' life expectancy under section 167(a)(2), unaffected by section 265.

Court's Reasoning

The court distinguished the petitioners' acquisition of the life estate from the situation in Lyeth v. Hoey, where property was acquired by inheritance. In Ewing, the life estate was obtained through an arm's-length settlement in exchange for a bona fide claim to stock, which the court deemed a taxable exchange. The court applied the legal rule that property acquired through purchase or exchange is not subject to the same tax treatment as property acquired by gift, bequest, or inheritance. The court noted that the life estate was dissimilar in nature to the claimed stock, further distinguishing it from Lyeth v. Hoey. The court also considered that the respondent did not argue that the exchange resulted in a gain, effectively conceding that the exchanged properties were of equal value. The court applied section 167(a)(2) to allow amortization of the life estate's cost over the petitioners' life expectancy, as it was property held for the production of income. The court rejected the applicability of section 265, which disallows deductions allocable to tax-exempt income, because it only applied to deductions under section 212, not 167(a)(2). The court emphasized the plain language of the statutes and declined to speculate on legislative intent beyond the text.

Practical Implications

This decision provides guidance on the tax treatment of life estates acquired through property exchanges. Attorneys should analyze similar cases by determining whether the life estate was acquired through a taxable exchange rather than by gift, bequest, or inheritance. The ruling suggests that practitioners should include legal fees in calculating the cost of a life estate for amortization purposes. The decision may encourage settlements involving property exchanges, as it allows for the amortization of the acquired asset's cost. Businesses and individuals may be more willing to engage in such exchanges, knowing the tax benefits. Later cases, such as Bell v. Harrison and William N. Fry, Jr. , have followed this ruling in allowing amortization of life estates acquired through purchase or exchange.

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