Neuhoff v. Commissioner, 75 T. C. 36 (1980)

The basis of a surviving spouse's community property interest in U. S. Treasury bonds (flower bonds) is their fair market value at the decedent's death, not their par value, even if the decedent's estate used similar bonds to pay estate taxes at par.

Summary

Ann F. Neuhoff contested the IRS's determination of her income tax deficiencies for 1971 and 1972, stemming from her sale of community property flower bonds after her husband's death. The key issues were the validity of her consent to extend the statute of limitations and the basis of her community interest in the bonds. The Tax Court ruled that her consent was valid and that her basis in the bonds was their fair market value at her husband's death, not their par value, despite the estate's use of similar bonds at par for estate tax payment. This decision was based on the application of section 1014(b)(6) of the Internal Revenue Code and the principle that the bonds she received could not be redeemed at par by her husband's estate.

Facts

Ann F. Neuhoff and her husband acquired U. S. Treasury bonds (flower bonds) during their marriage, which were eligible for redemption at par to pay federal estate taxes. Upon her husband's death in 1970, Neuhoff received half of the bonds as her community property interest under Texas law. She sold her half for $335,089. 94. The estate included the other half in the gross estate, using some at par to pay estate taxes. Neuhoff initially reported a gain but later amended her return claiming a loss, using the value of the bonds in the estate as her basis.

Procedural History

Neuhoff filed a petition with the U. S. Tax Court challenging the IRS's notice of deficiency for her 1971 and 1972 tax years. The IRS argued that the consent to extend the statute of limitations was valid and that Neuhoff's basis in the bonds was their fair market value at her husband's death. The Tax Court agreed with the IRS on both issues, affirming the deficiencies.

Issue(s)

1. Whether the consent to extend the statute of limitations was valid, despite the IRS not notifying Neuhoff's representative.
2. Whether Neuhoff's basis in her community interest in the flower bonds was their fair market value or par value at the time of her husband's death.

Holding

1. Yes, because the consent was valid on its face, and Neuhoff understood its effect, despite the IRS's failure to notify her representative.

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2. Yes, because Neuhoff's basis in the bonds was their fair market value at her husband's death, as her community interest in the bonds could not be used by the estate to pay estate taxes at par.

Court's Reasoning

The court found that the consent to extend the statute of limitations was valid under section 6501(c)(4) of the Internal Revenue Code, as it was signed by Neuhoff without deception and she understood its effect. The court noted that the IRS's failure to notify her representative, while a procedural error, did not invalidate the consent. On the issue of basis, the court applied section 1014(b)(6), which considers the surviving spouse's community property interest as having passed from the decedent. The court rejected Neuhoff's argument that her basis should be the par value of the bonds used by the estate for tax payment, citing *Bankers Trust Co. v. Commissioner* and emphasizing that her bonds were not eligible for redemption at par by the estate.

Practical Implications

This decision clarifies that the basis of community property flower bonds for the surviving spouse is their fair market value at the time of the decedent's death, even if the estate uses similar bonds at par to pay estate taxes. Practitioners should advise clients to consider the fair market value of such assets when calculating basis for income tax purposes, regardless of their potential use in estate tax payments. The ruling also reinforces that consents to extend the statute of limitations, signed by taxpayers without deception, are valid even if the IRS fails to notify the taxpayer's representative. This case has been cited in subsequent rulings, such as *Rev. Rul. 76-68*, which further clarifies the treatment of flower bonds in estate planning and tax calculations.

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