Rollert Residuary Trust v. Commissioner, 80 T. C. 619 (1983)

Rights to income in respect of a decedent do not acquire a basis when distributed by an estate, and the full amount of such income must be included in the recipient's gross income when received.

Summary

The case involved the Edward D. Rollert Residuary Trust and the taxation of bonus payments from General Motors (GM) awarded to the decedent, Edward D. Rollert, both before and after his death. The key issue was whether the trust could claim a basis in the rights to these bonuses distributed by the estate, thereby reducing the taxable income upon receipt. The Tax Court held that these rights, classified as income in respect of a decedent (IRD), do not acquire a basis when distributed. The court reasoned that allowing a basis would undermine the purpose of IRC Section 691, which mandates that IRD be taxed to the recipient when received, in the same manner as it would have been taxed to the decedent. This ruling ensures that all income earned by the decedent but not yet received is taxed appropriately, preventing any escape from taxation.

Facts

Edward D. Rollert was an executive vice president at GM who died on November 27, 1969. He had received significant bonuses annually from 1964 to 1968, payable in installments over several years. On March 2, 1970, GM awarded a posthumous bonus for 1969, despite Rollert's death. His estate distributed rights to these bonus installments to the residuary trust. The estate treated these distributions as distributions of its distributable net income, and the trust claimed a basis in these rights equal to their fair market value at the time of distribution. The trust then reported only the excess of the bonus payments over this basis as income.

Procedural History

The Commissioner of Internal Revenue challenged the trust's tax treatment of the bonus payments for the years 1973, 1974, and 1975, asserting deficiencies. The trust filed a petition with the U. S. Tax Court, which heard the case and issued its opinion on March 31, 1983.

Issue(s)

1. Whether the bonus payments awarded to Rollert after his death constituted income in respect of a decedent under IRC Section 691.
2. Whether the distribution of rights to receive bonus payments by the estate to the trust gave the trust a basis in these rights, allowing it to reduce the taxable income upon receipt of the bonus payments.

Holding

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1. Yes, because as of the date of his death, Rollert had a right or entitlement to the bonus payments, making them income in respect of a decedent.
2. No, because the distribution of rights to income in respect of a decedent by an estate does not give the recipient a basis in those rights, and the full amount of such income must be included in the recipient's gross income when received.

Court's Reasoning

The court applied the "right-to-income" or "entitlement" test to determine that the posthumous bonus was income in respect of a decedent. Despite the bonus not being formally awarded until after Rollert's death, the court found that there was a substantial certainty of payment based on GM's consistent practice and the tentative decisions made before Rollert's death. Regarding the second issue, the court held that IRC Section 691 overrides the distribution rules of Sections 661 and 662. Allowing a basis in rights to IRD would defeat the purpose of Section 691, which is to ensure that all income earned but not yet received by a decedent is taxed to the recipient. The court emphasized that the legislative history and regulations under Section 691 support this interpretation, and that the trust's approach would allow significant income to escape taxation.

Practical Implications

This decision clarifies that rights to income in respect of a decedent do not acquire a basis when distributed by an estate, ensuring that such income is fully taxable to the recipient upon receipt. This ruling impacts estate planning and tax strategies involving IRD, requiring estates and beneficiaries to account for the full amount of such income in their tax calculations. It also affects how similar cases involving deferred compensation plans should be analyzed, emphasizing the importance of considering the decedent's entitlement to income at the time of death. The decision has been cited in subsequent cases and has influenced IRS guidance on the taxation of IRD, reinforcing the principle that income earned by a decedent must be taxed to the recipient in the same manner as if the decedent had lived to receive it.

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