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TAXATION - INCOME TAX - SETTLEMENT OF WILL CONTEST AS TAXABLE

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**TAXATION — INCOME TAX — SETTLEMENT OF WILL CONTEST AS TAXABLE** — Taxpayer commenced suit to contest the probate of his grandmother’s will, by which she had made nominal bequests to her grandchildren, and had created a charitable trust with the large residue. The parties agreed upon a settlement, as a result of which taxpayer received $141,404.03, all of which the tax commissioner claimed was taxable income. **Held,** the amount received by taxpayer came to him because he was an heir and did not constitute taxable income. *Lyeth v. Hoey,* (U. S. 1938) 6 U. S. Law Week 421 (Dec. 6, 1938).¹

This decision settled an issue on which the federal courts have been divided. In the principal case, the Circuit Court of Appeals for the Second Circuit had held that the problem was one of contract arising from the right to contest, and that since it had no measurable cost basis, all of it was taxable income.² In a similar case, *Magruder v. Segebade,*³ the Circuit Court of Appeals for the Fourth Circuit said that the settlement differed so slightly from an inheritance that it should be tax free under section 22 (b) (3) of the Revenue Act of 1932.⁴ But it based the exemption squarely upon the theory that the settlement did not fall within the definition of income under section 22 (a) and as defined in *Eisner v. Macomber*⁵ and later cases. The Board of Tax Appeals, in a decision by one member, held to the view of the second circuit.⁶ The two circuits differ radically on the scope of section 22 (a) of the Revenue Act defining income. The fourth circuit, adhering strictly to the *Macomber* case, limited income to gain or profit or income derived from labor, capital or both. The second circuit, in the principal case, laid stress upon the clause of section 22 (a) reading “gains or profits and income derived from any source whatever,” interpreting it to include more than gain or profit from labor or capital.⁷ Admittedly, the Supreme Court in later cases has shown a tendency to expand the definition

¹ Reversing *Lyeth v. Hoey,* (C. C. A. 2d, 1938) 96 F. (2d) 141. The district court, (D. C. N. Y. 1937) 20 F. Supp. 619, had found the amount non-taxable, on the taxpayer’s suit for refund upon payment of the assessment of the Commissioner of Internal Revenue.
³ (C. C. A. 4th, 1938) 94 F. (2d) 177, citing *Lyeth v. Hoey* as decided in the district court.
⁵ 252 U. S. 189, 40 S. Ct. 189 (1920), in which Justice Pitney defined income as gain derived from capital or labor or both, including gains from the sale of assets.
⁶ Kearney v. Commissioner, 31 B. T. A. 935 (1934), which held that the taxpayer had a right to contest “which cost him nothing” and was “given up” in exchange for $23,333.34. Reasoning attacked by District Judge Coxe in *Lyeth v. Hoey,* (D. C. N. Y. 1937) 20 F. Supp. 619.
⁷ Circuit Judge Chase said, “it must not be forgotten that the statutory definition of gross income includes gains and profits growing out of an interest in property and . . . derived from any source whatever.” 96 F. (2d) 141 at 143.
of income as stated in the Macomber case. While not absolutely necessary, the Supreme Court could have considered this question of income and removed much doubt as to its meaning. It does not necessarily follow that because an heir has the right to contest a will his settlement acquires the characteristic of an inheritance. Nor is it consistent to rationalize to the effect that it is an exchange of a right in the nature of property for a cash amount which is all taxable. Neither the circuit courts nor the Supreme Court considered the possibility that the problem could be sui generis and non-taxable because not covered by the act. It is submitted that the fourth circuit in the Magruder case more properly decided in favor of the taxpayer on the theory that the settlements did not constitute taxable income under section 22 (a) as defined and interpreted in the cases. Moreover, the result of the decision is very desirable from the taxpayer’s point of view. It prevents double taxation in the form of an estate tax and income tax on the same property at the same time.

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8 Burnett v. Sanford & Brooks Co., 282 U. S. 359, 51 S. Ct. 150 (1931) (reimbursement for loss held taxable gain although no gain resulted from the transaction); United States v. Kirby Lumber Co., 284 U. S. 1, 52 S. Ct. 4 (1931) (taxing “negative income” as taxable gain resulting from purchase of its own bonds at less than par).


9 See 44 YALE L. J. 1267 (1935), presenting a contrary view.